

TRANSFER PRICING

- to be **AWARE** or **BEWARE** ?

E-Venue:

The Institute of Cost Accountants of India - Webinar

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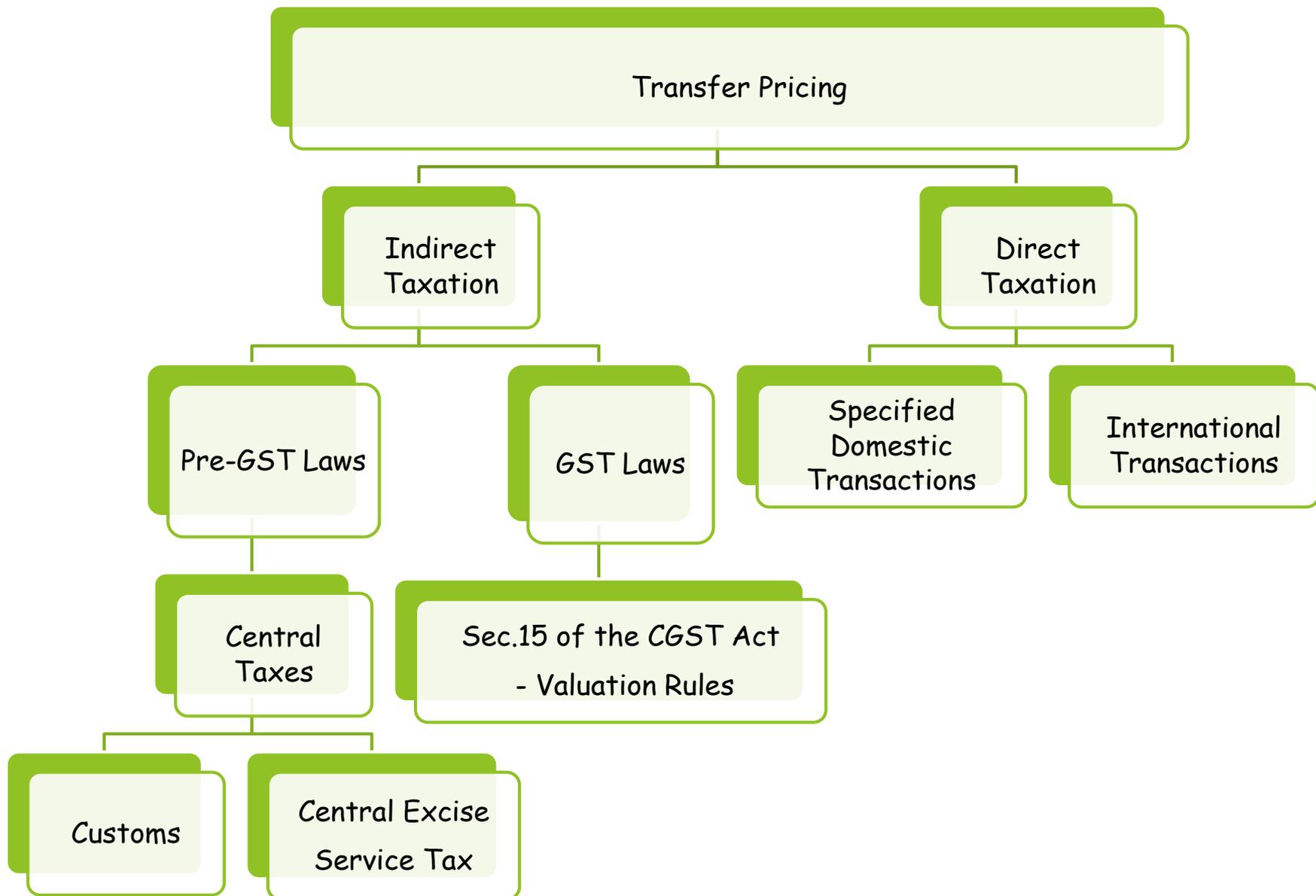
By

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Presentation Plan

- (1) Transfer Pricing - an Overview
- (2) Transfer Pricing Laws
 - (a) - Under Direct Taxation
 - (i) Specified Domestic Transactions
 - (ii) International Transactions
 - (b) - Under Indirect Taxation
 - (i) as per Customs
 - (ii) as per Pre-GST Laws
 - (iii) as per GST Laws
- (3) CMAs - role under Transfer Pricing

Transfer Pricing - at a glance



TRANSFER PRICING - under Direct Taxation

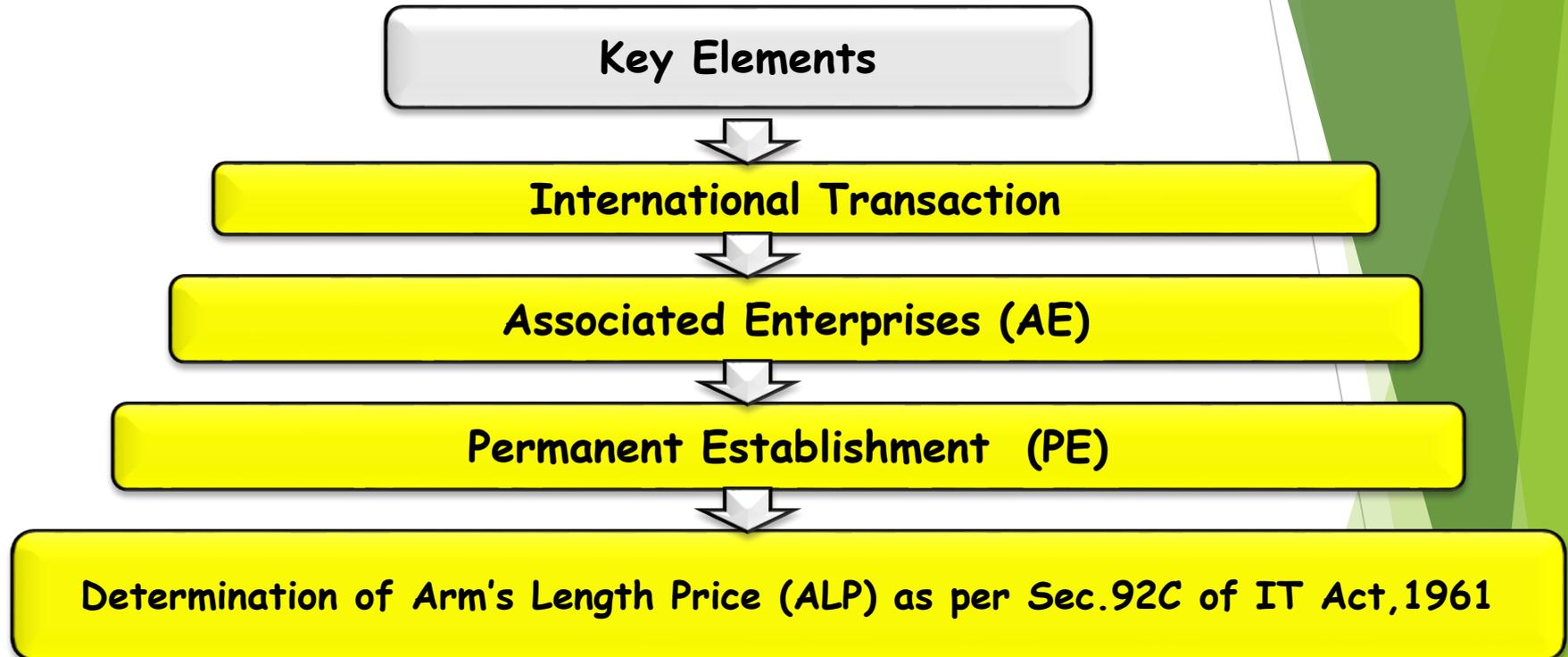
Definition:
as per OECD

"Prices at which an enterprise transfers physical goods and intangibles or provides services to associated enterprises"

Definition:
as per **Sec.92** of the Income Tax Act,1961

"Any income arising from an international transaction shall be computed having regard to the arm's length price"

TRANSFER PRICING - International Transactions



Determination of Arm's Length Price as per Sec.92C(1) of the Income Tax Act,1961
(framed as per the OECD Guidelines)

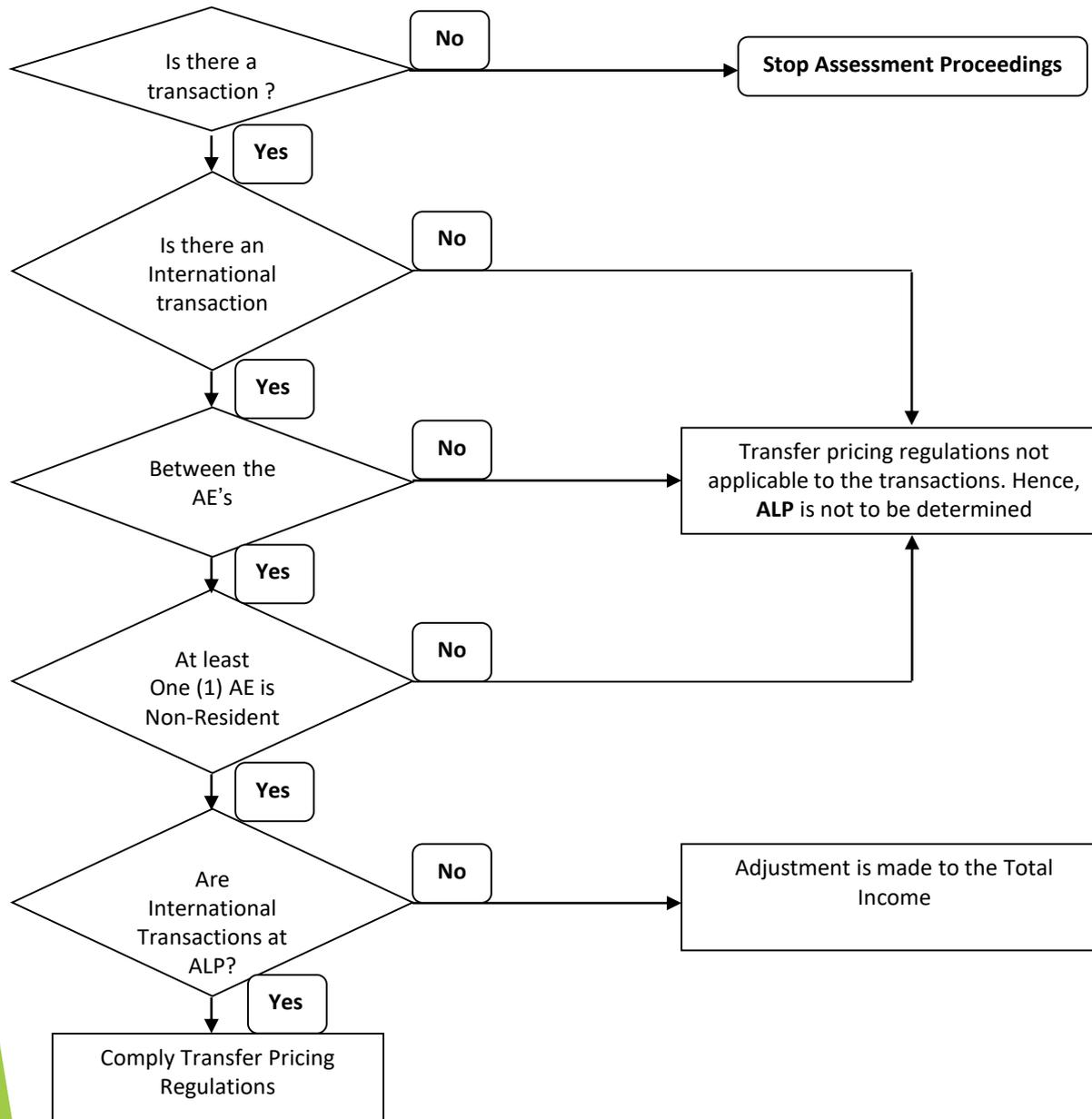
TRANSACTION BASED METHODS

- ❖ COMPARABLE UNCONTROLLED PRICE METHOD (CUP)
- ❖ RESALE PRICE METHOD (RPM)
- ❖ COST PLUS METHOD (CPM)

PROFIT BASED METHODS

- ❖ PROFIT SPLIT METHOD (PSM)
- ❖ TRANSACTION NET MARGIN METHOD (TNMM)

TRANSFER PRICING - International Transactions



Selection of Most Appropriate Method (MAM)

Relevant factors	Explanation
(a) The nature and class of international transactions	e.g., if a product is sold in controlled transactions is identified to have a close similarity to the product in uncontrolled transactions, the CUP method may be useful. Similarly, if a transaction concerns a retailer or distributor, the resale price method would be appropriate.
(b) Assets employed or risks assumed	The class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risk assumed by such enterprises.
(c) Availability, coverage and reliability of data necessary for application of the method	e.g., if the comparable data is not available in the public domain, in respect of comparable prices of uncontrolled transactions, the selection can be made from other methods.
(d) Degree of comparability	The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions.
(e) Reliability and accuracy for adjustments	The extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions.

Computation of Arm's length Price (ALP)

Availability, coverage and reliability of data

Comparability between controlled and uncontrolled transactions

Possibility to make reliable and accurate adjustments

Issues when value added services are provided

Arm's length Price (ALP)

- Comparability based on FAR Analysis

F = Functions

A = Assets

R = Risk Analysis

Why Arm's Length Pricing?

The basic object of determining Arm's Length Price is to find out whether any addition to income is warranted or not, if the following situations arises:

- Selling Price of the Goods < Arm's Length Price
- Purchase Price > Arm's Length Price

Total Income as disclosed by an Assessee	XXX
Add: Understatement of profit due to overstatement of purchase price	XXX
Add: Understatement of profit due to understatement of selling price	XXX
Total Income after Assessment	XXX

Transfer Pricing :- Compliance Regulations

Accountants Report

Sec. 93E read with Rule 10E
Form 3CEB is to be filed at the time of submission of Return of Income

Documentation

Sec.92D read with Rule 10D

- Maintain relevant prescribed documents.
- Submit with the tax authorities during the time of TP AUDIT

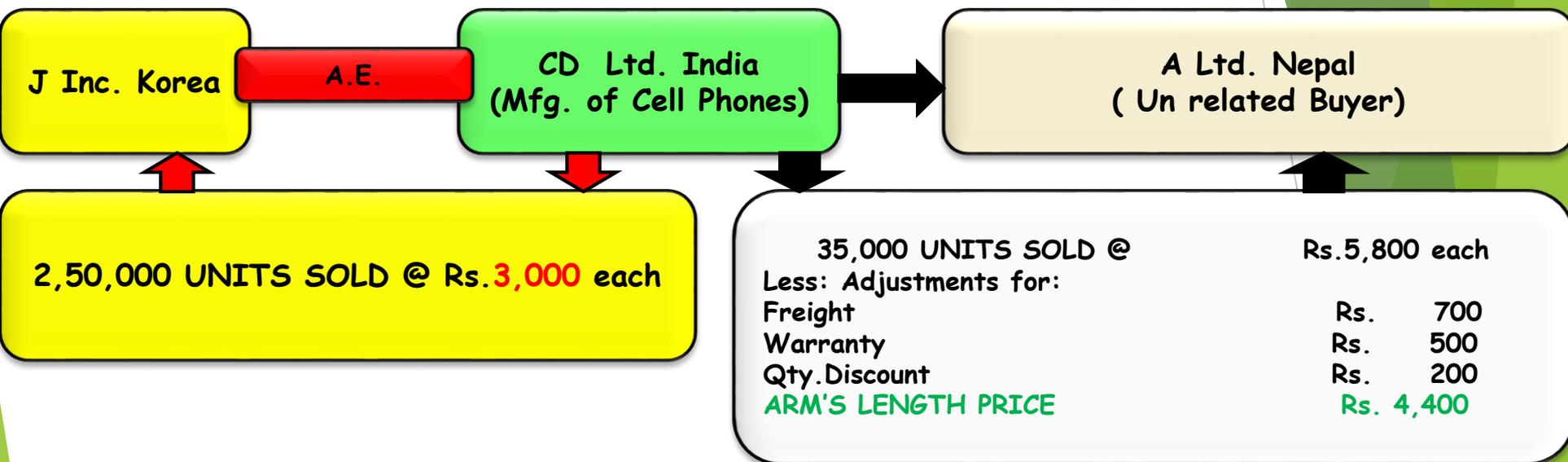
COMPARABLE UNCONTROLLED PRICE METHOD (CUP)

Case Study:

(i) J Inc.(Korea) & CD Ltd (India) are Associated Enterprises ; (ii) CD Ltd. supplied 2,50,000 cell phones to J Inc. @ Rs.3,000 per unit (on FOB basis) and 35,000 units to A Ltd. Nepal @ Rs.5,800 each (on CIF basis); (iii) Freight & Insurance paid by J Inc. @ Rs.700 per unit; (iv) Sale to A Ltd.(Nepal) under two year warranty but no such warranty to J Inc. Korea, estimated cost of each warranty Rs.500; (v) Quantity discount offered to J Inc. Rs.200 per unit

Cont...

COMPARABLE UNCONTROLLED PRICE METHOD (CUP)



Difference in Price = Excess of ALP over Sale Price to A.E. = Rs. (4,400 - 3,000) = Rs. 1,400 per unit

Undisclosed Income = Units Sold to A.E. × Difference in Price
= 2,50,000 units × Rs. 1,400 per unit = Rs. 35 crores

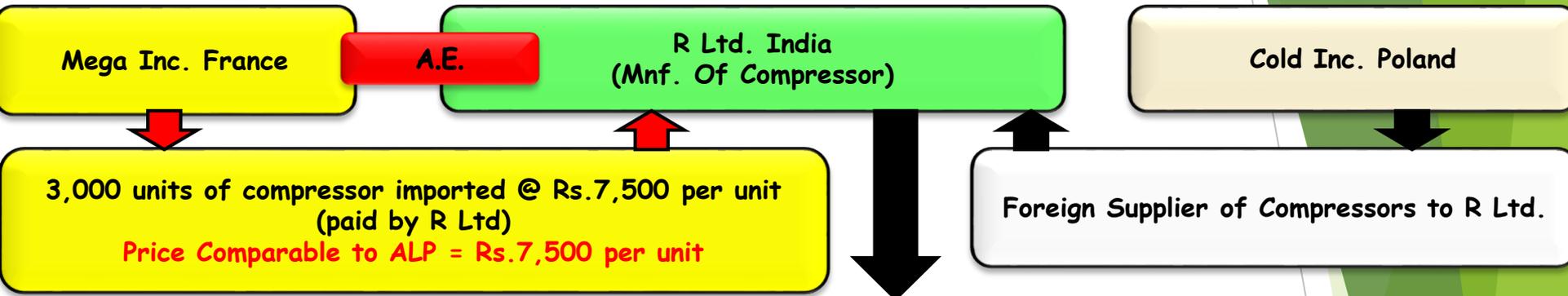
RESALE PRICE METHOD (RPM)

Case Study:

(i) Mega Inc.(France) & R Ltd (India) are AEs; (ii) R Ltd. imports 3,000 compressors from Mega Inc.@ Rs.7,500 per unit and sold to Pleasure Cooling Solutions @ Rs.11,000 p.u. (iii) R Ltd. also imported similar products from Cold Inc. Poland and sold outside @ 20% G.P. on sales. (iv) Quantity Discount : Mega Inc.(France) @ Rs.1,500 per unit; Cold Inc. @ Rs.500 p.u. (v) Freight Charges paid by R Ltd -imports from :Mega Inc. Rs. 1,200 p.u.; Cold Inc. Rs.200 p.u.

Cont...

RESALE PRICE METHOD (RPM)



3,000 units of compressor imported @ Rs.7,500 per unit
(paid by R Ltd)
Price Comparable to ALP = Rs.7,500 per unit

Foreign Supplier of Compressors to R Ltd.

Sale Price to Pleasure Cooling @
Less: Gross Profit @ 20% of Rs.11,000
Less: Savings in Freight Cost (Rs.1,200 - Rs.200)
Less: Diff.in Qty.Disc (Rs.1,500 - Rs.500)
ARM'S LENGTH PRICE

Rs.11,000
Rs. 2,200
Rs. 1,000
Rs. 1,000
Rs. 6,800

Difference in Price = Excess of Price paid to A.E. & ALP = Rs.(7,500 - 6,800) = Rs.700 per unit

Undisclosed Income = Units Purchased from A.E. x Difference in Price
= 3,000 units x Rs.700 per unit = Rs.21 lakhs

COST PLUS METHOD (CPM)

Case Study

(i) Branco Inc.(UK) & C Ltd. (India), a software development company, are AEs;
(ii) C Ltd. spent 2,400 man hours in Branco Inc. and billed @ Rs.1,300 per man-hr , actual cost incurred Rs.20 lakhs; (iii) C Ltd. also provided service to Harsha Ltd @ Rs.2,700 per man-hr and made a gross profit of 60% ; (iv) Branch Inc. provides technical support to C Ltd., valued at 8% of normal gross profit (v) Quantity Discount to Branco Inc. @ 14% of normal gross profit; (vi) C Ltd. also offered 90 days credit to Branco Inc. which is equal to 2% of normal gross profits.

Cont...

COST PLUS METHOD (CPM)

Branco Inc. (UK)

A.E.

C Ltd. India
(Software Developer)

Harsha Ltd
(Un-related Buyer)

Service provided for 2,400 man hours @ Rs.1,300
Actual Job Cost incurred by C Ltd Rs.20 lakhs

Rate per Man hr @Rs.2,700

COST TAKEN IN ACCOUNT (%) [in terms of Harsha Ltd]

- (i) Tech. Knowhow- 8% on 60%= 4.8%
- (ii) Qty. disc- 14% on 60%=8.4%
- (iii) Gain included 2% on 60%=1.2%

Gross Margin (%)	60.00
Less: <u>Cost not to be taken</u>	
Tech. Know How (i)	4.80
Qty. disc. (ii)	8.40
Add: <u>Gain to be further added back:</u>	
Credit	1.20
Adjusted Gross Profit Margin (%)	48.00

COMPUTATION OF INCREASE IN TOTAL INCOME OF CTL (for services rendered to Branco Inc. (UK))	%	Amount (Rs.)
Cost	52.00	20,00,000
Adjusted Gross Profit Margin	<u>48.00</u>	<u>18,46,154</u>
Arm's Length Price (Billed value at arms length [cost/(100-arms length mark)]= Rs.20,00,000/ (100% -48%)	100.00	38,46,154
Less : Actual Billing to Branch Inc.		31,20,000
Increase in Total Income of Branco Inc.		7,26,154

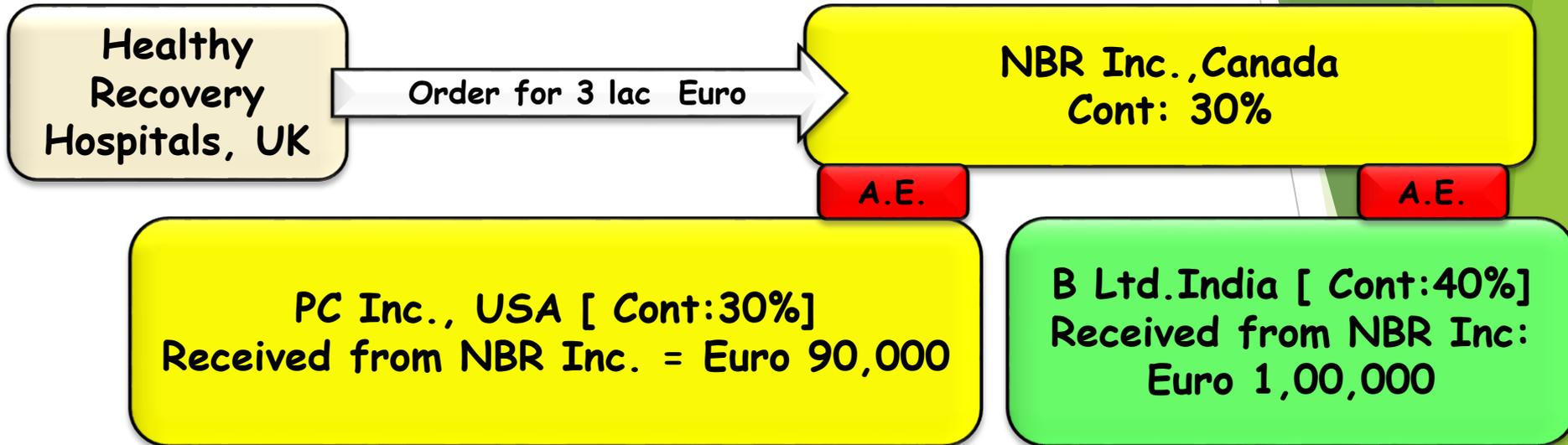
PROFIT SPLIT METHOD (PSM)

Case Study:

(i) NBR Inc.(Canada) received order from Healthy Recovery Group of Hospitals (UK) for rendering of specialised services. Order value Euro 3,00,000; (ii) NBR Inc. joined hands with its subsidiary PC Inc.(USA) and B Ltd.(India); (iii) PC Inc. holds 30% shares in B Ltd; (iv) NBR Inc. paid to: PC Inc Euro 90,000 and B Ltd. Euro 1,00,000; (v) Profit earned Euro 1,00,000 (vi) Total Cost of B Ltd for execution of its work in the above contract Euro 80,000; (vii) Relative contribution of NBR, PCI & B Ltd. are 30%, 30% and 40% respectively.

Cont...

PROFIT SPLIT METHOD (PSM)



Total Cost of B Ltd	Share of Profit from NBR Inc. Canada	Arm's Length Price	Receipt of B L td. from Canada	Undisclosed Income
80,000	40,000	1,20,000	1,00,000	20,000

TRANSACTION NET MARGIN METHOD(TNMM)

Case Study:

- (i) Fox Solutions Inc. (USA) sells laser printer cartridge drum to its Indian subsidiary "Quality Printing Ltd" @ \$ 20 per drum ; (ii) Fox Solutions has other takers in India for @ \$ 30 per drum (iii) Fox Solutions Inc. supplied 12,000 of such items to Quality Printing Ltd. (iv) Taxable Income of "Quality Printing Ltd" is Rs.45,00,000 (v) \$ = Rs. 45

Cont...

TRANSACTION NET MARGIN METHOD(TNMM)

Fox Solutions Inc. (USA) (seller of laser printer cartridge drums)

A.E.

Quality Printing Ltd (India)
Purchased from Fox Solutions Inc.
12,000 units @ \$ 40

Other Un-related Buyers in India
Purchased from Fox Solutions Inc.
@ \$ 30 per unit

Quality Printing Ltd.
Profit Reduced Due to Excess Cost charged in Profit & Loss Account in
Comparable Transaction
=Units Purchased x Difference in Price x Conversion Rate
=12,000 units x \$(40-30) x Rs.45= Rs.54 lakhs

Assessed Total Income = Income declared + Increase in income after adjustment of ALP
= Rs.(45 + 54) lakhs = Rs.99 lakhs.

TRANSFER PRICING - under Indirect Taxation

Under Pre-GST regime Vs. Transfer Pricing

Pre-GST Indirect Tax Regime Vs. Transfer Pricing (Under Income Tax)

Transaction	Customs/ Service Tax Valuation	Transfer Pricing (Income Tax)
Import of Goods	Yes	Yes
Import of Services	No	Yes
	Excise / Service Tax Valuation	
Domestic goods	Yes	Yes (restricted to profit linked transactions)
Domestic Services	No	Yes (restricted to profit linked transactions)

GST Vs. Transfer Pricing regime

GST Vs. Transfer Pricing (Under Income Tax)

Transactions	Customs Valuation (BCD)	GST Valuation (IGST)	Transfer Pricing (Income Tax)
Import of Goods	Yes	Yes	Yes
Import of Services	No	yes	Yes
Domestic Goods	Yes	Yes	Yes (restricted to profit linked transactions)
Domestic Services	No	Yes	Yes (restricted to profit linked transactions)

GST and Transfer Pricing - Expectation of Taxpayers

Section 15 of the CGST Act, 2017 - Valuation

Read with Valuation Rules

(as prescribed in Rules 27 - 35 of the CGST Rules, 2017)

Harmonisation -

GST framework governing arms' length standard would need to be aligned with the Income Tax Provisions

Methodologies to be adopted

Nature of documentation to be maintained

Process to identify comparable data

Reliance to be placed on the comparable data

APA (Advanced Pricing Agreement) & Transfer Pricing

Is the TP Study or an APA alone viewed by the Customs Authorities as sufficient to support the use of the transaction value method of customs valuation?

- APA/ TP may contain useful information for supporting the transaction value method.

Transfer Pricing - Issues & Concerns

Is it possible to get the customs and tax authorities agree on the same price
(= the price paid or payable, exclusive of freight, insurance and other additions to the price) for corporate tax and customs duties purposes ?

Transfer Pricing - Issues & Concerns

In practice, what evidence do the customs authorities require to substantiate that the related party price is acceptable from a customs perspective? Is it recommended to conduct a test and/ or analysis under the customs rules (which would be a separate test/ analysis from the transfer pricing analysis) ?

Customs Valuation - Post importation changes & its impact on Transfer Pricing

Are importers required to report to Customs Authorities on any post-importation change in the reported customs value (e.g. due to a retroactive transfer pricing adjustment) that increases the price paid / payable by the importer ?

If yes, is there an exception to report when the duty rate is zero ?

If no, is there still a risk of fines or penalties ?

Customs Valuation - Post importation changes & its impact on Transfer Pricing

Are importers required to report to Customs Authorities on any post-importation change in the reported customs value (e.g. due to a retroactive transfer pricing adjustment) that **increases/ decreases** the price paid / payable by the importer ?

If yes, is there an exception to report when the duty rate is zero ?

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Inventory Valuation & Transfer Pricing

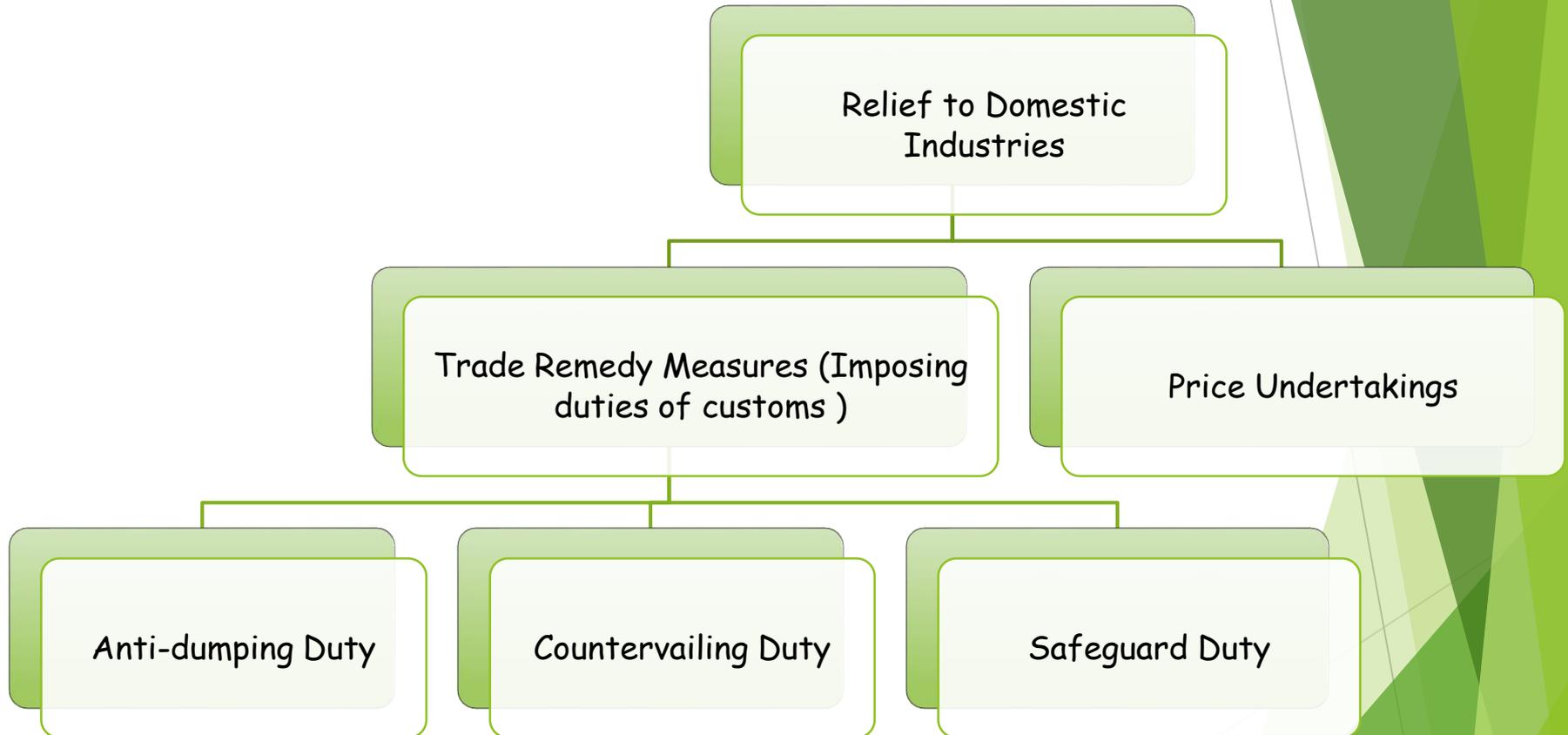
Does the income tax laws or practices in the country require (for corporate income tax purposes) consistency between a tax payer's inventory basis (cost of goods sold) and values reported for customs purposes ?

If such amounts are not consistent, what are the potential risks ?

Anti Dumping... a quick look....

- ❖ Anti Dumping takes its reference and powers from Customs Laws
- ❖ It is similar to determining the Arm's Length Price which is applied in case of both International and Specified Domestic Transactions
- ❖ With the Assessed Value/ Value as determined, the difference over the normal value is considered to be the quantum of dumping
- ❖ on the quantum of dumping - duty of customs is imposed under the title 'Anti-dumping'
- ❖ This provides a relief to the domestic industry from being affected by injury due to price of imports which are at a price lower than the normal value of identical /like goods in the domestic market

Trade Remedy Measures - Relief to Domestic Industries



Comparative Analysis - AD/CD/SD

Anti Dumping	Countervailing Duty	Safeguard Duty
<i>Product specific and Exporter Specific Duty</i>	<i>Product specific and Country specific duty</i>	<i>Product specific duty imposed against imports coming from all sources irrespective of exporter and country of origin</i>
<i>Continue forever as long as dumping continues</i>	<i>Continue forever as long as subsidy continues</i>	<i>Continue only for a temporary period not exceeding 10 years</i>
<i>There is an alleged foul play on the part of the exporter</i>	<i>There is an alleged foul play on the part of the exporting country</i>	<i>No alleged foul play on the part of exporter or exporting country in case of safeguards duty</i>

Cost Accounting Standards - relevance in AD Study

Anti-dumping Application Proforma	Reference to Para prescribed under Cost Audit Report Rules, 2011		Reference to relevant Cost Accounting Standards
Format A - Statement of Raw Materials and Packing Materials Consumption and Reconciliation	Para 5 : Abridged Cost Statement	Item No.1 & 2 Raw Material Consumption and Process Materials	CAS 6 - Material Cost
		Item No.16 and 23 - Primary Packing Cost Material and Secondary Packing Cost	CAS 9 - Packing Material Cost
Format B - Statement of Raw Material Consumption	Para 5 : Abridged Cost Statement - Item Nos.1 & 2		CAS - 6 - Material Cost
Format CI - Statement of Cost of Production <i>(to be certified by a Cost Accountant in Practice)</i>	Para 5 : Abridged Cost Statement - Item No. 21 - Cost of Production		CAS 2 - Capacity Determination CAS 6 - Material Cost CAS 7 - Employee Cost CAS 8 - Cost of Utilities CAS 9 - Packing Material Cost CAS 10 - Direct Expenses CAS 12 - Repairs & Maintenance
Format CII - Allocation and Apportionment of Expenditure	Para 2 : Cost Accounting Policy		CAS 1 - Classification of Cost CAS 2 - Capacity Determination CAS 3 - Overheads
Format D - Statement of Consumption of Utilities	Para 5: Abridged Cost Statement - Item No.3 - Utilities		CAS 8 - Cost of Utilities

Example: FORMAT "CI" - STATEMENT OF COST OF PRODUCTION - Name of the Company: XYZ Limited

Installed Capacity				1,00,000 units				
Production in Installed				65,000 units				
Capacity Utilization (%)				65%				
Production in Investigation Period				56,000 units				
Capacity Utilisation in Investigation period				56%				
Sales (quantity)				61,000 units	51,000 units			
Particulars	Previous Accounting Year				Investigating Period			
	Qty	Rate (Rs.)	Value (Rs.)	Cost per unit (Rs.)	Qty	Rate (Rs.)	Value (Rs.)	Cost per unit (Rs.)
Manufacturing Expenses:								
Raw Materials (specify the major raw materials) (MT)	10,000	100.00	10,00,000	15.38	8,000	120.00	9,60,000	17.14
Utilities			2,00,000	3.08			1,90,000	3.39
Depreciation			1,95,000	3.00			1,75,000	3.13
Others (specify nature of expenditure)								
Administrative Expenses								
Variable			1,30,000	2.00			1,12,000	2.00
Fixed			78,000	1.20			78,000	1.39
Selling & Distribution Expenses								
Variable			61,000	1.00			56,000	1.00
Fixed			40,000	0.66			40,000	0.71
Financial Expenses								
Variable			1,30,000	0.70			35,700	0.70
Fixed			21,000	0.32			21,000	0.38
Less: Miscellaneous Income (from product concerned) - Sale of Scrap raw materials			(25,000)				(20,000)	
Total Cost to make and sell			18,34,000	28.22			16,47,700	29.42
Selling Price				35.00				32.00
Profit/Loss				6.78				2.58

Role of CMAs in Goods and Services Tax (GST) in India

Role of CMAs in GST - as per Draft Report of Dr. J.P Verma Committee in 2002, CMAs were recommended & recognised to conduct Transfer Pricing Audits

Towards Taxable Persons / Business Entities

- Advising in maintenance of Proper Records & documents leading to support TP adjudications
- Determination of Price/ Value for the purpose of Transfer between related parties
 - Preventing Litigation
 - Defending Litigation

Government

Advisory in Advance Pricing/ Valuation / Anti-Profiteering

Facilitating in TP Adjudication & TP Audits - to serve the National Interest

Valuation : Anti-Profiteering under GST & Transfer Pricing

- Nexus between Anti-profiteering under GST & Valuations involving Transfer Pricing



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