



WEBINAR TRANSFER PRICING

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Transfer Pricing (Sec.92 to 92F)

Meaning

- It is the value of goods or services transferred between related parties.
- It is the price which is paid for goods or services transferred from one unit of an organization to its other units situated in different countries.
- Also in India – Domestic Companies
 - By undervaluing the sales to MNC in other countries, the profit of the Indian AE is diverted to other countries.
 - By Overvaluation of purchases by Foreign AE when it is supplied to Indian Company, the income of the Indian Company is under determined resulting lower tax revenue to the India.



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- "transfer pricing" generally refers to prices of transactions between *associated enterprises* which may take place under conditions differing from those taking place between independent enterprises
 - Also refers to the value attached to transfers of goods, services and technology between related entities

Example:

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- Suppose a company A purchases goods for 100 rupees and sells it to its associated company B in another country for 200 rupees, who in turn sells in the open market for 400 rupees.
 - Had A sold it direct, it would have made a profit of 300 rupees. But by routing it through B, it restricted it to 100 rupees, permitting B to appropriate the balance.
 - The transaction between A and B is arranged and not governed by market forces.
 - The profit of 200 rupees is, thereby, shifted to the country of B. The goods is transferred on a price (transfer price) which is arbitrary or dictated (200 hundred rupees), but not on the market price (400 rupees).



Transactions

- Sale of finished goods;
- Purchase of raw material;
- Purchase of fixed assets;
- Sale or purchase of machinery etc.
- Sale or purchase of Intangibles.
- Reimbursement of expenses paid/received;
- IT Enabled services;
- Support services;
- Software Development services;
- Technical Service fees;
- Management fees;
- Royalty fee;
- Corporate Guarantee fees;
- Loan received or paid.



Conditions-International transaction

- Condition 1
 - International Transaction between two entities called “ASSOCIATE ENTERPRISES”

 - Purchase or Sale of Intangible Property
 - Provision of services
 - Lending and borrowing
- Condition 2
 - Enterprises should be ‘ASSOCIATE ENTERPRISES’ Impact on profit, income, loss, assets
 - How to treat it as AE
 - a) Participates directly or indirectly in its management or control
 - b) Control of Two Entities by the same persons
- Condition 3
 - The International Transaction be between two or more AE s
 - Allocation of Expenses, cost between two AE s – Mutual Agreement

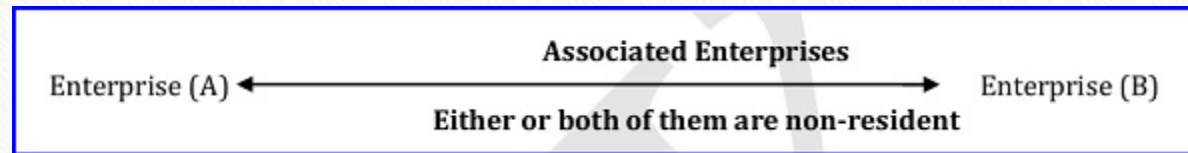
Categories – Two Entities deemed AEs

- Holding shares not less than 26% of the voting power
- Advancing Loan for more than 51% of the value of assets
- Giving guarantee for the borrowings for more than 10% of the total borrowings
- More than 50% of the directors are appointed by the other entity
- One company use the know-how, patents, copy rights, trade marks of other company.
- More 90% of the raw material is supplied
- The prices of the goods are influenced by the other company
- If one enterprises Is controlled by HUF, the other is controlled by a member of such HUF.
- Both the enterprises has mutual interest.



Meaning of International Transaction(Sec.92F)

- Prior Agreement between two AEs
- AEs : one of them or both are non residents



- Specified Domestic Transactions

transactions with certain related domestic parties, if the aggregate value of such transactions exceeds Rs.20 crores during the financial year.



TP occurs

- multinational companies (MNCs) have some amount of discretion while defining how to distribute the profits and expenses to the subsidiaries located in various countries.
- profitability of a subsidiary depends on prices at which the inter-company transactions occur
- business having cross-border intercompany transactions should understand transfer pricing concept
- Management of enterprise is likely to avoid tax in a particular country by manipulating the transfer prices.



Compliances as per IT Act 1961

- **1. Report-3CEB:** Every person who has entered into an “international transaction” or “specified domestic transaction” during the year, shall obtain a report in Form 3CEB and furnish on or before the filing of income tax return (i.e. 30th November).
- **2. Documentation:** Every person who has entered into an “international transaction (aggregate value > Rs.1 crore)” or “specified domestic transaction” during the year, shall maintain prescribed information and documents (i.e. TP documentation)]
- **3. Penalties for non-compliance:** The penal provisions for non-compliance with TP provisions severe.



TP Background

- “Transfer Price” – In general, refers to price agreed between two parties for transfer of goods or services and technology.
- “Transfer Pricing” – In general, refers to price agreed between related parties for transfer of goods, services and technology. It also refers to price agreed between unrelated parties for transfers which are controlled by a common entity.
- Price in the case of a transaction between unrelated parties is determined by market forces. However, between related parties (i.e. associated enterprises), price may be determined by internal factors.
- There is a general belief that multi-national corporations have employed creative transfer pricing approaches for transfer of goods, services, funds, intangibles, etc to minimize their global tax outflows.
- Thus, the effect of transfer pricing is that lower profit or excessive loss in high tax rate countries and higher profit or minimal loss in low tax rate countries. The result is revenue loss to the country and also a drain on foreign exchange services.



Arm's Length Price

- OECD (The Organization for Economic Co-operation and Development) Guidelines discusses the transfer pricing methods which could be used for examining the arms-length price of the controlled transactions.
- Here, arms-length price refers to
 - price which is applied or proposed to be applied
 - or charged when unrelated parties enter into similar transactions
 - in an uncontrolled condition.



Income

- Section 92 cannot override section 5 and 9
- Sec.5
 - a. Income received or deemed to be received
 - b. Accrue or arises outside India but received in India
 - c. Received outside India – but accrue or deemed to accrue or arise in India

Sec.9

Deemed to accrue or arise in India



Reference to TPO (Sec.92CA)

- The AO considers necessary with the approval of the Commissioner refer the computation of Arm's length Price (ALP)
- TPO will serve notice to the assessee
- Orders within 60 days



Six Methods of TP

- Transaction Based Methods (Price Based)
 - i. Comparable Uncontrolled Price (CUP) Method
 - ii. Resale Price Method (RPM)
 - iii. Cost Plus Method (CPM)
- Profit Based Methods
 - iv. Profit Split Method (PSM)
 - v. Transactional Net Margin Method (TNMM)
- Any Other Method Prescribed by the Board (CBDT)

1. CUP – comparable uncontrolled price

- Uncontrolled Transaction
 - A transaction between enterprises other than A E s
 - Such Price is adjusted to account for the difference
 - The Adjusted Price is ALP
- This method applied
 - Transfer to goods
 - Provision of service
 - Intangibles
 - Interest on Loans



Procedure for CUP

- Compare the prices charged for property or services for controlled transactions vs. uncontrolled transactions.
- The basic tenet is to compare close similarity in products, property or services that are involved
- Timing of the transactions are relevant where prices of the product fluctuate regularly



2. RPM

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- CPM determines ALP by adding Gross Profit Margin (mark-up) earned in comparable transaction(s) / by comparable companies to the cost incurred by Tested Party under controlled transaction
 - Price of goods purchased from AE and resold to an Unrelated Enterprise
 - Profit margin is reduced
 - Expenses are also reduced
 - If any other differences
 - The adjusted price is ALP
 - RPM is typically useful to determine ALP of purchases made by the distributor (trader) from related party

3. CPM

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- CPM determines ALP by adding Gross Profit Margin (mark-up) earned in comparable transaction(s) / by comparable companies to the cost incurred by Tested Party under controlled transaction
 - Considerations
 - Direct and indirect costs
 - Normal profit
 - Other costs
 - The total of all is ALP

4. PSM

- Applied mostly for Intangibles
- Combined NP of AE is split from the international transaction
- Apportioned Profit to the assessee is considered for ALP

TNMM

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- The NP margin realized by the enterprise from an international transaction with AE is computed in relation to costs incurred or sales effected or assets employed.
 - The n.p. arising in comparable uncontrolled transactions is adjusted
 - The np margin is taken into account to arrive ALP



6. Most Appropriate Method

- Selected based on
 - Nature and class of international transaction
 - Class of Assets Employed is considered and risk assumed
 - Availability of data
 - Degree of comparability
 - Reliable and accurate adjustments can be made
 - Reliable assumptions required to be made

Advance Pricing Agreement

- An advance pricing agreement (APA) is an agreement between a taxpayer and at least one tax authority. The agreement is on the transfer pricing methodology to be used to determine taxpayer's international transactions with its associated groups (AGs) for future years.
- APAs can be one-sided, two-sided/bilateral, or multilateral:
 - **An independent APA** is an agreement between a taxpayer and the tax authority of the country where the taxpayer is located;
 - **Two-sided or bilateral APA** involves the taxpayer, AG of the taxpayer in the foreign country, the tax authority of the country where the taxpayer is located, and the foreign tax authority; and
 - **Multilateral APAs** concern the taxpayer, two or more AGs of the taxpayer located in different foreign countries, the tax authority of the country where the taxpayer is located, and the tax authorities of the AGs.



TP Documentation

- Taxpayers are required to maintain information related to international transactions undertaken with AEs.
- The rules prescribe detailed information and documentation that must be maintained by the taxpayer.
- Requirements can broadly be divided into two parts.
 - first part includes information on the ownership structure of the taxpayer, a group profile, and a business overview of the taxpayer and AEs,
 - second part of the rules requires that adequate documentation maintained to substantiate the information, analysis, and studies documented under the first part of the rule.



Audit Report

- A report from an accountant has to be furnished by persons who are entering into an international transaction or a specified domestic transaction.
- A report from an accountant in a prescribed form, duly signed and verified by the accountant must be obtained before the specified date by any person entering into an international transaction or specified domestic transaction in the previous year.
- The audit is applicable to both international and specified domestic transactions.
- Form 3CEB must be filed.



Penalties

Nature of default	Relevant Section of the Act	Nature of penalty
Under Reporting of income arising in the cases other than the case referred in sub section (9)	270A(2) read with sub-section (6)	50% of the tax payable on under reported income
Under reporting of income in consequence of misreporting of income – this includes failure to report any international transaction(s) or SDT(s) to which the provisions of Chapter X apply	<u>270A sub-sections (8) & (9)</u>	200% of the tax payable on the under reported income
Failure to maintain TP documentation as prescribed in Section 92D of the Act read with Rule 10D of the Rules or report any international transaction(s) or maintains or furnishes incorrect information or documents	271AA	2% of the value of the international transaction(s) [or SDTs] for which documentation is not maintained or transaction is not reported
Failure to furnish TP documentation to the TP Officer, during the course of TP audit	271G	2% of the value of the international transaction [or SDTs] for which documentation is not furnished
Failure to furnish accountant's report (Form 3CEB)	271BA	INR 100,000



TP - SDTs

- As per the section 92BA of the IT Act,
- “**Specified Domestic Transaction**” in case of an assessee means any of the following transactions (the aggregate of which exceeds INR 20 crore in previous year and which is not an international transaction),
- namely:—
 - (1) *any transaction referred to in section 80A;*
 - (2) *any transfer of goods or services referred to in section 80-LA(8);*
 - (3) *any business transacted between the assessee and other person as referred to in section 80-LA(10);*
 - (4) *any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which section 80-LA(8) or section 80-LA(10) are applicable; or*
 - (5) *any other transaction as may be prescribed,*
- If a transaction is an International Transaction, then the same will not be a Specified Domestic Transaction.



Sec. 80A

- Section 80A (6) refers to internal transactions between various units / undertakings of the assessee in respect of goods or services and the transaction value does not correspond to the market value of such goods or services.
- This clause covers any transactions of goods or services and hence this transaction will be applicable to income as well as expenditure.



Sec.80-IA (8)

- Section 80IA-(8) internal transactions with more than one undertaking / units of the assessee,
- one or more undertaking is exempted from tax.
- The units enjoying tax holiday, charge more than the market value for goods or services used by non-eligible units.
- Due to this practice, there is no effect on the health of the tax holiday unit as there are no taxes at all and the non-eligible unit gets higher deduction from taxable income.
- As per Section 80IA-(8), if the internal transfer of goods or services at high value than market value, the profits of transacting units shall be computed, the taxpayer require to prove that the internal transfer is at ALP (Arm's Length Price)



Sec.80-IA (10)

- when relationship between assessee and ‘any other person’, the eligible business of the assessee produces ‘more than the ordinary profit’, then for the purpose of deduction under this section, profit of the eligible business shall be determined by taking ALP of the transaction.
- Primary liability is on the taxpayer to prove that the internal transfer is at ALP.
- The burden of proof is on the the department that ALP is not applied.



Sec.10AA

- profits of the units located in SEZ, engaged in the manufacturing of any article or thing or providing any services, is exempt subject to conditions.
- indirect expenses / head office expenses / administrative expenses is not been charged to the undertaking in SEZ resulting in higher profits.
- This profit gets exempted.



Problem

- Sony, Japan and Y Ltd., Indian Co. are A Es. Y manufactures mobile phones and sels to Sony, Japan.
 - Y also sells to L.G. Korea
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- Details of price
 - FOB Sales to Sony 1,20,000 phones = Rs.2,000 per phone
 - CIF Sales to LG 20,000 = Rs.3,200 per phone
 - Other Details
 - Sony pays freight and insurance = Rs.300 per phone
 - LG = 1 year Warranty.
 - No warranty to Sony (Such warranty costs = Rs.350 per phone)
 - Quantity Discount to Sony Rs.50 per phone



Computation of ALP

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- Sales to LG = Uncontrolled Unrelated Transaction
 - Comparable Uncontrolled Price = Rs.3,200
 - Less: Adjustments
 - Freight and Insurance 300
 - Warranty Costs 350
 - Quantity Discount 50 Rs. 700
 - ALP of sales to Sony Rs.2,500
 - Selling Price to Sony Rs.2,000
 - ALP Rs.2,500
 - Difference Rs. 500
 - Quantity sold to Sony $1,20,000 \times 500 = \text{Rs.}60,00,000$ Increase in Sales
 - The income of Y should be increased by Rs.60,00,000 in the assessment



- A Ltd., an Indian Company sells computer monitor to its 100 subsidiary X Ltd., US at \$50 per piece. A Ltd. , also sells the same product to Y Ltd., US at \$80 per piece. Total Income of A Ltd., for the assessment year 2020-21 is Rs.12,00,000 which includes sales made for 100 computer @\$50 to X Ltd. Exchange Rate 1\$=Rs.69.

• ALP	\$80 x 100 x 69	Rs.5,52,000
• Income of A Ltd.		Rs.12,00,000
• Less: Sale consideration of 100 monitors(-)		Rs.3,45,000
• Sold to X Ltd.		
• Add: Sale consideration at ALP		(+) Rs.5,52,000
Taxable Income of A Ltd.		<u>Rs.14,07,000</u>



- Thank You

Behind Every Successful Business Decision, There Is Always A CMA