GUIDE
TO
TRANSFER PRICING

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IN PURSUIT OF PROFESSIONAL EXCELLENCE
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PREFACE

The era of globalization has witnessed a significant increase in the foreign institutional investments along with the huge opening of the production, sale, distribution and exchange of goods and services beyond borders. This has resultant to the multiplicity of international transactions. The amplification in Cross Border transactions, especially among the Associated Enterprises, has enforced the substantial value of the applicability and enforcement of the provisions related to transfer pricing under the Income Tax Act, 1961 and other specified statutes in India.

It is noteworthy that owing to proportional relation with the transactions at global market, the law relating to transfer pricing is dynamic and smooth with trending changes in the cross border transactions. Company Secretaries as the qualified professionals in ensuring compliances to sanction the authenticity and legitimacy of the cross border transactions plays pivotal role in implementing the provisions of Transfer Pricing. In short, they ensure the practical implications of the law and the rules relating to transfer pricing.

With a view to guide the businesses for cross border transactions and to act and operate as Principal Officer for governance and compliance, it is imperative for professionals to advance expertise on various dimensions of Transfer Pricing.

With the substantial amendments in Transfer Pricing Regulation over a period of time, this "Guide to Transfer Pricing" will help the professionals to augment their skills and expertise in Transfer Pricing Regulation. The Guide deals with concept of Transfer Pricing, Methods of Computing Arm's Length Price, Applicability of Transfer Pricing Provision to Domestic Transaction, Documentation, Consequences of non compliances, Advance Pricing Agreement 'APA', Safe Harbour Rules etc.

I appreciate the efforts of Mr. Govind Krishna Agarwal, Assistant Director in bringing out this publication under the guidance of Ms. Sonia Baijal, Director (Professional Development, Perspective Planning &

Studies). I am also thankful to Mr.Vishwanath Kane, Deloitte Haskins & Sells for his value addition made to the publication.

I am sure this Guide will be of immense practical value to professionals and corporate executives.

I would personally be grateful to users and readers for offering their suggestions for further improvement of this Guide.

CS Mamta Binani
President
The Institute of Company Secretaries of India

Place : New Delhi

Date : November 04, 2016

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Introduction

The globalization of the Indian economy has resulted in considerable increase in foreign institutional investments, a huge expansion in the production and service base and also a multiplicity of international transactions across the globe between related parties. In cases, wherein the transactions are entered into between independent enterprises, the price therefore is determined by market forces. However, when a transaction is entered into between the associated enterprises, the commercial and financial aspects of the transactions may not be influenced by external market forces but may be determined based on internal factors. In such cases, the transfer price agreed between the associated enterprises does not reflect arm's length price and therefore the income arising from such transactions and the consequent tax liabilities of the associated enterprises could be distorted.

The existence of different tax rates and rules in different countries offers a potential incentive to multinational enterprises to manipulate their transfer prices to recognise lower profit in countries with higher tax rates and vice versa. This can reduce the aggregate tax payable by the multinational groups / companies and increase the after tax returns available for distribution to shareholders.

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

Transfer pricing is the setting of the price for goods and services sold between controlled (or related) entities within an enterprise. For example, if a subsidiary company sells goods to a parent company, the cost of those goods paid by the parent to the subsidiary is the transfer price.

Need for Transfer Pricing Regulation

In an economy where multinational enterprises/big diversified business groups play a prominent role in the development of the country, the governments need to ensure that the taxable profits are not artificially shifted out of their jurisdiction and that the tax base reported in their country reflects the economic activity undertaken therein. To ensure the fair valuation of economic activity (Production of goods/services, other transactions) in their jurisdiction, about 70 countries such as US, China, Brazil, Indonesia, Germany, England have issued transfer pricing guidelines and rules.

Transfer Pricing Regulation in India

Increasing participation of multi-national groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same group. Hence, there was a need to introduce a uniform and internationally accepted mechanism of determining reasonable, fair and equitable profits and taxes in India. Accordingly, the Finance Act, 2001 ushered in India the law of transfer pricing by virtue of introduction of Sections 92 to 92F of the Income Tax Act, 1961 (the Act) which guides the computation of transfer price and suggests detailed documentation procedures. Year 2012 brought a big change in transfer pricing regulations in India whereby government extended the scope of transfer pricing regulation to specified domestic transactions which are enumerated in Section 92BA of the Income Tax Act, 1961. This would help in curbing the practice of transferring profit from a taxable domestic zone to tax free domestic zone or shifting the profits from profit making entity to loss making entity within the group in order to defer the tax payments.

As stated earlier, the fundamental of transfer pricing regulation is that transfer price should represent the arm's length price of goods transferred and services rendered / provided from one unit to another unit within a group.

Applicability of the Transfer Pricing Regulation

The transfer pricing regulation would apply based upon certain criteria. Firstly, there must be an international transaction. Secondly, such international transaction must be between two or more associated enterprises either or both of whom are non-residents. Further, a specified domestic transaction, not being an international transaction has to fulfill the conditions outlined in section 92BA of the Act in order to attract the transfer pricing provisions.

The international transactions should involve incurring of any cost or expenses or interest or it should involve in purchase, sale or lease of tangible or intangible property or in the lending or borrowing of money or any other transaction having a bearing on the profits and income, losses or assets of such enterprises.

Further, as per section 92B(2) even if a transaction entered into between an enterprise with a person other than an associated enterprise, it shall be deemed to be a transaction between associated enterprises if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise. Consequently the provisions of this chapter shall apply even in such cases.

Further also, as per section 92(3), these transfer pricing regulation are not intended to be applied in cases where the effect of application of these provisions reduces income chargeable to tax in India or increases the loss as applicable.

What is Arm's Length Price?

In general, an arm's length price is the price at which independent enterprises deal with each other, where the conditions of their commercial and financial relations ordinarily are determined by market forces. In other words, the transfer price should represent the price which could be charged from an independent party in uncontrolled conditions. Determining the arm's length price is very important for an entity. In case the transfer price is not at arm's length, it may have following consequences:

A. Incorrect evaluation of the performance of an entity.

B. Incorrect pricing of the final product (In case where the goods/ services are used in the manufacturing of final product)

C. Non-compliance with applicable laws / regulations and consequent attraction of penalty provisions.

The same may be explained with the following examples

Company X and Company Y is working under the common umbrella of Mohan & Company. Company X manufactures a product which is raw material for Company Y.

Case	*Criteria X*	*Effect on Company X*	*Effect on Company Y*
1	Company X charges price more than the Arm's length price from Company Y	The revenue of company X will increase.	The total cost of the product in case of Company Y will increase. This will result into incorrect pricing of its product which may further lead to the product becoming incompetitive.
2	Company X charges price less than the Arm's length price from Company Y	The revenue of company X will decrease. The parent company may close the company X treating it as loss making entity.	The total cost of company Y will decrease. Therefore, the company Y may charge lower price which may lead to loss at an entity level.
3	Company X charges at Arm's length price from Company Y	The revenue of Company X will be representing true and fair view of its operation.	Company Y will be paying the price as equivalent to market price of Company's X product and its cost will be correct. On the basis of the cost arrived after considering the arm's

Case	*Criteria X*	*Effect on Company X*	*Effect on Company Y*
			length price of company's X product, company Y will be able to take correct pricing decision.

Conclusion

Transfer pricing has a direct bearing on the company's profitability/ revenue. Importance of transfer pricing may be understood by the fact that in financial year 2014-2015, the tax authorities in India have made an adjustment of exceeding Rs. 46,000 crores in the taxable income of companies on account of alleged non-adherence to the arm's length price in case of covered transactions. Since Company Secretary is the principal officer of the company, he / she must guide the transfer pricing practices in his / her company. He / she should ensure that the transfer price declared for the product/services or other transactions of the company has been calculated as per the Transfer Pricing regulation and the transfer price represent the arm's length price.

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Transfer Pricing - Concepts

The Finance Act, 2001 introduced the transfer pricing concept in India vide insertion of Section 92 to Section 92F of the Act, which can also be called the Transfer Pricing Code of India. Subsequently, the Finance Act, 2012, has made many changes in Transfer Pricing Regulation to broaden the tax base and accordingly expanded the scope of the transfer pricing provisions to cover certain "specified domestic transactions" (not being an international transaction) entered into within or between two domestic entities within India.

Objective of Transfer Pricing Regulation

1. To regulate the International transaction or SDT between two associated enterprises.
2. To ensure that transaction entered between two associated enterprises or specified domestic transaction is carried out at an arm's length price.
3. Transfer Pricing Codeis enacted to curb the arrangement which is mainly entered into between the entities to shift the profit from higher tax jurisdiction to lower tax jurisdiction. The shifting of profit is often done with an overall objective of lowering the tax base of the group entities.
4. To prevent the misuse of incentive given by Indian Government for developing some specific areas/sectors.

"The concept of associated enterprises and International transaction are very important for applying the transfer pricing regulation. Section 92A and Section 92B deal with these two important concepts of chapter X of Income Tax Act, 1961."

Associated Enterprises (AE)

Associated Enterprises has been defined in Section 92A of the Act.

It prescribes that "associated enterprise", in relation to another enterprise, means an enterprise—

(a) Which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

(b) In respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

The basic criterion to determine an AE is the participation in management, control or capital (ownership) of one enterprise by another enterprise whereby the participation may be direct or indirect or through one or more intermediaries, control may be direct or indirect.

Deemed Associated Enterprises

The Finance Act, 2002 has amended sub-section (2) of section 92A to the effect that for the purposes of sub-section (1), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year any of the conditions mentioned in clauses (a) to (m) are satisfied. For the purposes of these clauses, two enterprises would be deemed to be an associated enterprise if the conditions stipulated therein are fulfilled at any time during the previous year. Further, the words 'directly' or 'indirectly' have not been used in clauses (c) to (m), and therefore, direct relationship between two enterprises is relevant for the purposes of clauses (c) to (m) in order to determine whether they are associated enterprises.

As per Section 92A(2), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year,—

(a) one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise; or

(b) any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises; or

(c) a loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one per cent of the book value of the total assets of the other enterprise; or

(d) one enterprise guarantees not less than ten per cent of the total borrowings of the other enterprise; or

(e) more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or

(f) more than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons; or

(g) the manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights; or

(h) ninety per cent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise; or

(i) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; or

(j) where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; or

(k) where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family or by a relative of a member of such Hindu undivided family or jointly by such member and his relative; or

(l) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than ten per cent interest in such firm, association of persons or body of individuals; or

(m) there exists between the two enterprises, any relationship of mutual interest, as may be prescribed

In summary, two enterprises will be deemed as Associated Enterprises if

Quantum of Interest	*Criteria applied for Associated Enterprises*
26% or more	Shareholding with voting power – either direct or indirect
51% or more	Advancement of loan by one entity to other constituting 51% or more of the book value of the total assets of the other entity
51% or more	Based on the board of directors appointed by the governing board of the entity in the other
90% or more	Based on the quantum of supply of raw materials and consumables by one entity to the other
10% or more	Total Borrowing Guarantee by one enterprises for other
10% or more	Interest by a firm or association of Person (AOP) or by a body of Individual (BOI) in other firm AOP or firm or BOI

Meaning of International Transaction

International Transaction have been defined vide Section 92B of Income Tax Act. It provides that "International Transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

Deemed International Transaction

As per Section 92B(2) of Income Tax Act, A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be an international transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise.

Finance Act, 2012 has added an explanation for the purpose of Definition 92B and it provides that the expression "international transaction" shall include —

(a) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;

(b) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;

(c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;

(d) Provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;

(e) A transaction of business restructuring or reorganization, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date.

The term Intangible assets have also been elaborated and explanation to Section 92B provides that the expression Intangible shall include:

(a) Marketing related intangible assets, such as, trademarks, trade names, brand names, logos;

(b) Technology related intangible assets, such as, process patents, patent applications, technical documentation such as laboratory notebooks, technical know-how;

(c) Artistic related intangible assets, such as, literary works and copyrights, musical compositions, copyrights, maps, engravings;

(d) Data processing related intangible assets, such as, proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters;

(e) Engineering related intangible assets, such as, industrial design, product patents, trade secrets, engineering drawing and schematics, blueprints, proprietary documentation;

(f) Customer related intangible assets, such as, customer lists, customer contracts, customer relationship, open purchase orders;

(g) Contract related intangible assets, such as, favourable supplier, contracts, licence agreements, franchise agreements, non-compete agreements;

(h) Human capital related intangible assets, such as, trained and organized work force, employment agreements, and union contracts;

(i) Location related intangible assets, such as, leasehold interest, mineral exploitation rights, easements, air rights, water rights;

(j) Goodwill related intangible assets, such as, institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value;

(k) Methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data;

(l) Any other similar item that derives its value from its intellectual content rather than its physical attributes.'

The above explanation has added a wide range of Intangibles and other transactions and the purpose of the explanation is to extend the applicability of Transfer pricing code to all International transaction involving the exchange of Intangibles which are not expressly available for trade.

Services, finances and costs etc.

The two main issues while analysing intra-group services are:

(i) Whether an intra-group service has been provided; and

(ii) What's the consideration should be in accordance with the arm's length principle.

The test whether a service has been provided to associated enterprises is at arm's length price or not, is 'whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in-house for itself. If the activity is not one for which the independent enterprise would have been willing to pay or perform for itself, the activity ordinarily should not be considered as an intra-group service meeting the arm's length principle'. Services benefiting a group of enterprises as a whole should be allocated amongst the group in a way that matches the benefit received.

The enterprises usually enter into a capital financing including borrowing, lending, guarantee arrangements, etc. with its associated enterprises. The pricing of these arrangements will have a bearing on the profits or losses of the associated enterprises. The Finance Act, 2012 expressly covers the transactions of capital financing including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business are expressly covered as international transactions.

The cost contribution arrangements are arrangements between business enterprises to share the costs and risks of developing, producing, or obtaining assets, services or rights. When an enterprise enters into a cost contribution arrangement with its associated enterprise, the conditions of the arrangements should be in conformity with arm's length principle and accordingly, a participant's contributions must be consistent with what an independent enterprise would have agreed to contribute under comparable circumstances given the benefits it reasonably expects to derive from the arrangement.

Specified Domestic Transactions

Finance Act, 2012 has made a very important change and it has extended the scope of the applicability of Transfer Pricing Regulation to specified domestic transactions w.e.f. 1st April, 2012. As per Section 92BA of the Act, "Specified domestic transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely:

(i) Any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;

(ii) Any transaction referred to in section 80A;

(iii) Any transfer of goods or services referred to in sub-section (8) of section 80-IA;

(iv) Any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;

(v) Any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or

(vi) Any other transaction as may be prescribed,

And where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of Rs. 20 crores.' All the transactions covered under the six limbs as mentioned above will be regarded as SDT only if the aggregate value of all transactions exceeds threshold of Rs. 20 crores.

Accordingly, all of the compliance requirements relating to transfer pricing documentation, accountant's report, etc. shall equally apply to specified domestic transactions as they do for international transactions amongst associated enterprises.

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Transfer Pricing - Methods

Introduction

Transfer Pricing in India is dealt in Section 92 to 92F of Income Tax Act, 1961. As per Section 92 of the Act, any income arising from an international transaction or specified domestic transaction shall be computed having regard to the arm's length price. In computing income under sub-section (1), the allowance for any expense or interest shall also be determined having regard to the arm's length price. Where in an international transaction, two or more associated enterprises enter into a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises, the cost or expense allocated or apportioned to, or, as the case may be, contributed by, any such enterprise shall be determined having regard to the arm's length price of such benefit, service or facility, as the case may be.

However, the provision of Transfer Pricing shall not apply in a case where the computation of income or the determination of the allowance for any expenses or interest or the determination of any cost or expenses allocated or apportioned under this Section, has the effect of reducing the income chargeable to tax or increasing the loss. In such cases, the computation of income will be done on the basis of entries made in the books of accounts in respect of the previous year in which the international transaction or specified domestic transaction was entered into.

Section 92C of Income Tax Act defines the methods which are to be used in determination of Arm's Length prices for International Transaction or specified domestic transaction. The arm's length price in relation to an international transaction or specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely:--

(a) Comparable Uncontrolled Price Method (CUP)

(b) Resale Price Method (RPM)

(c) Cost Plus Method (CPM)

(d) Profit Split Method (PSM)

(e) Transactional Net Margin Method (TNMM)

(f) Other method as may be prescribed by the Board and provided in Rule 10AB.

A. Comparable Uncontrolled Price Method

Comparable Uncontrolled Price ("CUP") method compares the price charged or paid for property transferred or services provided in a controlled transaction to the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction in comparable circumstances.

An Uncontrolled price is the price agreed between the unrelated parties for the transfer of goods or providing of services. If this uncontrolled price is comparable with the price charged for transfer of goods or services between the associated enterprises, then that price is Comparable Uncontrolled Price (CUP). This is the most direct method for the determination of the Arms' length price.

The application of this method involves:

(i) Identify the price charged or paid in comparable uncontrolled transactions;

(ii) The above price should be adjusted at a transaction level for the differences on the basis of functions performed, assets employed and risks undertaken (i.e. FAR analysis) and enterprise level differences if any;

(iii) The adjusted price is the arm's length price;

Methods of CUP

CUP can be either

(a) Internal CUP or

(b) External CUP

Internal CUP is available, when the tax payer enters into a similar transaction with unrelated parties, as is done with a related party as well. This is considered a very good comparable, as the functions performed, processes involved, risks undertaken and assets employed are all easily comparable – more so, on “an apple to apple basis”.

The external CUP is available if a transaction between two independent enterprises takes place under comparable conditions involving comparable goods or services. For example an independent enterprise buys or sells a similar product, in similar quantities under similar term from / to another independent enterprise in a similar market will be termed as external CUP.

Assume that A and B are two associated company and C and D are two independent companies. The concept of Internal CUP and External CUP can be understood with the help of the following chart.

Uncontrolled Transaction

Internal	*External*
Related party to an unrelated party transaction (transaction between A & C or B & C)	Transactions between two unrelated parties (Transaction between C & D)

Provision of Income Tax Act, 1961 about CUP Method

Rule 10B(1)(a) of Income Tax Rules, 1962 prescribes that Comparable Uncontrolled Price is the price charged for property transferred or services provided in a comparable uncontrolled transaction in comparable circumstances. If there is any difference between the two prices, this may indicate that the conditions of the commercial and financial relations of the associated enterprises are not at arm's length, and that the price in the uncontrolled transaction may need to be substituted for the price in the controlled transaction.”

Such price is adjusted for any differences (on the basis of functions performed, assets used and risks undertaken i.e. FAR analysis and enterprise level differences if any between the uncontrolled transaction and the international transaction or specified domestic transaction of the enterprise. The adjusted price arrived at, is taken to be the "arm's length price" for the property transferred or services provided with respect to the international transaction or specified domestic transaction.

Applicability of the CUP Method

Comparable Uncontrolled Price method is treated as most reliable method of determining the transfer price but it is not easy to find out the controllable price easily. The CUP is believed to be the most reliable or best method, if one could identify and map it. Typical transactions in respect of which the comparable uncontrolled price method may be adopted are:

(a) Transfer of goods;

(b) Provision of services;

(c) Interest on loans;

(d) Intangibles

Resale Price Method

Rule 10B(1)(b) of Income Tax Rules, 1962 prescribes Resale Price method by which,

A. The price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise is identified;

B. Such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;

C. The price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;

D. The price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction or specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;

E. The adjusted price arrived at under sub-clause (iv) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise.

The resale price method may be adopted where the goods are purchased and then sold with little or no value addition i.e. trading of goods.

Example:

1. A sold a machine to B (Associated enterprise) and in turn B sold the same machinery to C (an independent party) at sale margin of 30% for Rs 2,10,000 but without making any additional expenses and change. Here Arm's length price would be calculated as

   Sales price to B = Rs. 2,10,000

   Gross Margin = Rs. 2,10,000 * 30% = Rs. 63,000

   Transfer price = Rs. 1,47,000

2. A sold a machine to B (Associated enterprise) and in turn B sold the same machinery to C (an independent party) at sale margin of 30% for Rs 4,00,000 but B has incurred Rs. 4000 in sending the machine to C. Here Arm's length price would be calculated as

   Sales price to B = Rs. 4, 00,000

   Gross Margin = Rs. 4,00,000*30%= Rs. 1, 20,000

   Balance = Rs. 2, 80,000

   Less : Expenses incurred by B = Rs. 4,000

   Arm's length price = Rs. 2,76,000

The formula for the transfer price in inter-company transactions of products is as follows:

TP = RSP x (1-GPM), where:

- TP = Transfer Price of a product sold between seller company and a related company;
- RSP = Resale Price at which a product is sold by seller company to unrelated customers; and
- GPM = Gross Profit Margin that a specific seller company should earn, defined as the ratio of gross profit to net sales. Gross profit is defined as Net Sales minus Cost of Goods Sold

The OECD in its Transfer Pricing Guidelines has observed that *"An appropriate resale price margin is easiest to determine where the reseller does not add substantially to the value of the product. In contrast, it may be more difficult to use the resale price method to arrive at an arm's length price where, before resale, the goods are further processed or incorporated into a more complicated product so that their identity is lost or transformed.*

A resale price margin is more accurate where it is realised within a short time of the reseller's purchase of the goods. The more time that elapses between the original purchase and resale the more likely it is that other factors – changes in the market, in rates of exchange, in costs, etc. – will need to be taken into account in any comparison."

C. Cost Plus Method

Rule 10B (1)(c) of Income tax Rules, 1962 prescribes Cost Plus Method, by which,

(i) The direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;

(ii) The amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;

(iii) The normal gross profit mark-up so determined is adjusted to take into account the functional and other differences, if any, between the international transaction or specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;

(iv) The costs referred to in sub-clause (i) are increased by the adjusted profit mark-up arrived at under sub-clause (iii);

(v) The sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise.

Under the Cost Plus Method, an arm's-length price equals the controlled party's cost of producing the tangible property plus an appropriate gross profit mark-up, defined as the ratio of gross profit to cost of goods sold (excluding operating expenses) for a comparable uncontrolled transaction.

The formulas for the transfer price in inter-company transactions of products are as follows:

TP = COGS x (1 + mark-up), where:

- TP = Transfer Price of a product sold between a manufacturing company and a related company;
- COGS = Cost of goods sold of the manufacturing company
- Cost plus mark-up = gross profit mark-up defined as the ratio of gross profit to cost of goods sold

Gross profit is defined as sales minus cost of goods sold.

The OECD in its Transfer Pricing Guidelines states that "This method probably is most useful where semi finished goods are sold between associated parties, where associated parties have concluded joint facility agreements or long-term buy-and-supply arrangements, or where the controlled transaction is the provision of services."

As an example, let us assume that the COGS in a transaction between two associated enterprises is Rs. 5,000. Assume that an arm's length gross profit mark-up that Associated Enterprise 1 should earn is 50%. The resulting transfer price between Associated Enterprise 1 and Associated Enterprise 2 is Rs. 7,500 [i.e. Rs. 5,000 x (1 + 0.50)].

In this method, calculation of cost of goods sold and gross margin are the most important factor.

D. Profit Split Method

Rule 10B(1)(d) of Income tax Rules, 1962 prescribes Profit Split Method, which may be applicable mainly in international transactions or specified domestic transaction involving transfer of unique intangibles or in multiple international transactions or specified domestic transaction which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which:

(i) The combined net profit of the associated enterprises arising from the international transaction or specified domestic transaction in which they are engaged, is determined;

(ii) The relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;

(iii) The combined net profit is then split amongst the enterprises in proportion to their relative contributions, as computed above;

(iv) The profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction or the specified domestic transaction.

However, the combined net profit as determined in sub-clause (i) may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction or specified domestic transaction in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution in the manner specified under sub-clauses (ii) and (iii), and in such a case the aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction or specified domestic transaction.

Two step Approach of Profit Spilt Method

Step 1: Allocation of sufficient profit to each enterprise to provide a basic compensation for routine contributions. This basic compensation does not include a return for possible valuable intangible assets owned by the associated enterprises. The basic compensation is determined based on the returns earned by comparable independent enterprises for comparable transactions or, more frequently, functions.

Step 2 : Allocation of residual profit (i.e. profit remaining after step 1) between the associated enterprises based on the facts and circumstances. If the residual profit is attributable to intangible property, then the allocation of this profit should be based on the relative value of each enterprise's contributions of intangible property.

Example on the Profit Split Method (Residual Analysis Approach)

Company A is an Indian Company and deals in telecommunication products. It has developed a Microprocessor and it holds the patent for manufacturing of the microprocessor. Company B which is an overseas subsidiary of Company A is engaged in manufacturing of Mobile equipment at Australia. Company A supplies the microprocessor to company B for using it in Mobile equipment and company B in turn after manufacturing the mobile, sends the mobile to company "A" in India. Company A sells all the mobile in India.

Both companies contribute to the success of the mobile equipment through their design of the microprocessor and the equipment. As the nature of the products is very advanced and unique, the group is unable to locate any comparable with similar intangible assets. Therefore, neither the traditional methods i.e. CUP Method, RSP Method nor the TNMM is appropriate in this case.

Nevertheless, the group is able to obtain reliable data on hand phone contract manufacturers and equipment wholesalers without unique intangible property in the telecommunication industry. The manufacturers earn a mark-up of 10% while the wholesalers derive a 25% margin on sales.

Company A's and Company B's respective share of profit is determined in 2 steps using the profit split method (residual analysis approach).

Step 1 – Determining the basic return

The simplified accounts of Company A and Company B are shown below:

	Company B (Rs. in Lakhs)	*Company A (Rs. in Lakhs)*
Sales	100	125
Cost of Goods Sold	(60)	(100)
Gross Margin	40	25
Sales, General & Administration Expenses	(5)	(15)
Operating Margin	35	10

The total operating profit for the group is Rs. 45 Lakhs.

Company B

Particulars	*Amount (Rs. in Lakhs)*
Cost of goods sold	60
Margin @10%	6
Transfer price based on Comparable (without considering Intangibles)	66

Company A

Particulars	*Amount (Rs. in Lakhs)*
Sales to third party customers	125
Resale margin of wholesalers comparables (without intangibles) @25%	31.25
Gross Margin	31.25

	Company B (Rs. in Lakhs)	*Company A (Rs. in Lakhs)*
Sales	66	
Cost of Goods Sold	(60)	
Gross Margin	6	31.25
Sales, General & Admin		
Expenses	(5)	(15)
Routine operating margin	1	16.25

The total operating margin of the group is Rs. 17.25 Lakhs.

Step 2 : Dividing the residual profit

The residual profit of the group is = Rs. 45 Lakhs - Rs. 17.25 Lakhs = Rs. 27.75 Lakhs

On further study of the two companies, two particular expense items, R&D expenses and marketing expenses, are identified as the key intangibles critical to the success of the mobile equipment. The R&D expenses and marketing expenses incurred by each company are:

Company A 12 Lakhs (80%)

Company B 3 Lakhs (20%)

Assuming that the R&D and marketing expenses are equally significant in contributing to the residual profits, based on the proportionate expenses incurred:

Company A's share of residual profit (80% x 27.75)

= Rs. 22.20 Lakhs

Company B's share of residual profit (20% x 27.75)

= Rs. 5.55 Lakhs

Therefore, the adjusted operating profit of

Company A is = Rs. 22.20 L + Rs. 16.25 L = Rs. 38.45 Lakhs

Company B is = Rs. 5.55 + Rs. 1 = Rs. 6.55 Lakhs.

The adjusted tax accounts are as follows:

	Company B (Rs. in Lakhs)	*Company A (Rs. in Lakhs)*
Sales	71.55	125
Cost of Goods Sold	(60)	(71.55)
Gross Margin	11.55	53.45
Sales, General & Admin Expenses	(5)	(15)
Operating Margin	6.55	38.45

Hence, the transfer price determined using the profit split method (residual analysis approach) should be Rs. 71.55 Lakhs

E. Transactional Net Margin Method (TNMM)

Rule 10B (1)(e) of Income Tax Rules, 1962 prescribes, Transactional net margin method, by which,

(i) The net profit margin realized by the enterprise from an international transaction or specified domestic transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;

(ii) The net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

(iii) The net profit margin referred to in (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction or specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;

(iv) the net profit margin realized by the enterprise and referred to in (i) is established to be the same as the net profit margin referred to in (iii);

(v) The net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction or specified domestic transaction.

Example

Nikhil & Co is an India manufacturer of dishwashers. All Nikhil & Co.'s dishwashers are sold to an overseas associated enterprise, Company G, and bears Company G's brand. Company G, a household electrical appliances brand name, sells only dishwashers manufactured by Nikhil & Co.

The CUP method is not applied in this case because no reliable adjustments can be made to account for differences with similar products in the market. After the appropriate functional analysis, Nikhil & Co was able to identify an Indian manufacturer of home electrical appliances, Company H, as a suitable comparable company. However, Company H performs warranty functions for its independent wholesalers, whereas Nikhil & Co does not. Company H realizes a net mark up (i.e. operating margin) of 10%.

As the costs pertaining to the warranty functions cannot be separately identified in Company H's accounts and no reliable adjustments can be made to account for the difference in the functions, it may be more reliable to examine the net margins in this case. The transfer price for

Nikhil & Co.'s sale of dishwashers to Company G is computed using the TNMM as follows:

Nikhil & Co.'s cost of goods sold	Rs. 5,000
Nikhil & Co.'s operating expenses	Rs. 1,500
Total costs	Rs. 6,500
Add : Net mark-up @ 10% (10% x 6,500)	Rs. 650
Transfer price based on TNMM	Rs. 7,150

Applicability of TNMM

The TNMM is used to analyze transfer pricing issues involving tangible property, intangible property or services. However, it is more typically applied when one of the associated enterprises employs intangible assets, the appropriate return to which cannot be determined directly. In such a case, the arm's length compensation of the associated enterprise(s) not employing the intangible asset is determined by determining the margin realized by enterprises engaged in a like function with unrelated parties. The remaining return is consequently left to the associated enterprise controlling the intangible asset; the return to the intangible asset is, in practice, a "residual category" being the return left over after other functions have been appropriately compensated at arm's length. This implies that the TNMM is applied to the least complex of the related parties involved in the controlled transaction. The tested party should not own valuable intangible property. This approach has the added benefit of resulting in, because generally more comparable data will then in existence and fewer adjustments will required to account for differences in functions and risks between the controlled and uncontrolled transactions. In addition, the tested party should not own valuable intangible property. This is also the reason why it is recommended to select the least complex entity for the application of the cost plus method or resale price method. The application of the TNMM is similar to the application of the cost plus method or the resale price method, but the TNMM involves comparison of net profit margins.

Comparability as per Income Tax Act

As per Rule 10B(2) of Income Tax Rules, 1962, the comparability of an international transaction or specified domestic transaction with an uncontrolled transaction shall be judged with reference to the following, namely:

(a) The specific characteristics of the property transferred or services provided in either transaction;

(b) The functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;

(c) The contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

(d) Conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

An uncontrolled transaction shall be comparable to an international transaction or specified domestic transaction if

(i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or

(ii) Reasonably accurate adjustments can be made to eliminate the material effects of such differences.

"Multiple Year Data" and Range Concept (vide Amendment to Rule 10B of Income-tax Rules, 1962)

With an intent to align the Indian Transfer Pricing regulations with international best practices, the Central Board of Direct Taxes (CBDT) on October 19, 2015 has prescribed rules for applicability of range concept and multiple year data. The rules would be applicable to international transaction or specified domestic transaction entered into by taxpayers on or after April 1, 2014.

- The rules specify the use of current year data i.e. the year in which taxpayer has undertaken the international transactions or SDT as the case may be has been entered into, for the purpose of comparability analysis. However, in cases wherein current year data is not available at the time of furnishing the return of income, data pertaining to up to two preceding financial years may be used for comparability analysis.

- This would be applicable only in cases where Resale Price Method ("RPM"), Cost Plus Method ("CPLM") or Transactional Net Margin Method ("TNMM") has been used as the most appropriate method for computation of ALP.
- If at the time of audit proceedings, the data for the Current Year of the comparable transactions / enterprises becomes available, then such data for the Current Year shall be used for determining the comparability of an uncontrolled transaction(s) with the international transaction(s) or the SDT(s), even if the Current Year data was not available at the time of filing of the return of income by the taxpayer.

Determination of Arm's Length Price ("ALP") where application of the most appropriate method result in more than one price, the ALP shall be computed as follows:

- A dataset shall be constructed by placing the prices/data in an ascending order.
- If a comparable has been identified on the basis of data relating to:

  (A) Current Year, then the data for the immediately preceding two financial year can be considered, provided the comparables has undertaken the same or similar comparable uncontrolled transaction in those preceding two years.

  (B) Financial year immediately preceding the current year, then the data for the immediately preceding two financial years can be considered, provided the comparables has undertaken the same or similar comparable uncontrolled transaction in those preceding year.

- The price in respect of comparable uncontrolled transaction shall be determined using the weighted average of the prices/data for"

  1. The current year and preceding two financial years or

2. Two financial years immediately preceding the current year

- In accordance to the following:
  - (i) Where the prices have been determined using RPM, the weighted average of the prices shall be computed with weights being assigned to the quantum of sales.
  - (ii) Where the prices have been determined using CUP, the weighted average of the prices shall be computed with weights being assigned to the quantum of costs.
  - (iii) Where the prices have been determined using TNMM, the weighted average of the prices shall be computed with weights being assigned to the quantum of costs incurred or sales effected or assets employed or as the case may be.

Application of the Range Concept

If the price at which the international transaction or specified domestic transaction is undertaken is within the (thirty-fifth percentile to sixty-fifth percentile of the dataset), the transaction shall be deemed to be at the ALP. However, if it is outside the range (mentioned above), the ALP of the transaction shall be taken to be the median of the dataset.

- A minimum of six comparables would be required in the dataset for applying the concept of range.
- An arm's length range beginning from the thirty-fifth percentile of the dataset (arranged in ascending order) and ending on the sixty-fifth percentile will be considered.

The range concept would not be applied in cases where the most appropriate method selected for determining the ALP is 'profit split method' or 'Other Method.' Also, where the range concept is applied, the benefit of three percent variation (one percent for wholesalers as prescribed) shall not be available.

Further, if the dataset consists of less than six comparables, or the most appropriate method selected for determining the ALP is profit split method or other method, the ALP will be determined based on the arithmetical mean of all the prices / data included in the dataset. Further, the benefits of three percent variation (one percent for wholesalers as prescribed) which was earlier permissible while adopting the arithmetic mean continues to be available.

Where during the course of any proceeding for the assessment of income, the Assessing Officer , on the basis of material or information or document in his possession, is of the opinion that—

1. The price charged or paid in an international transaction or specified domestic transaction has not been determined in accordance with Section 92C(1)/92C(2); or
2. Any information and document relating to an international transaction or specified domestic transaction have not been kept and maintained by the assessee in accordance with the provisions contained in sub-section (1) of section 92D and the rules made in this behalf; or
3. The information or data used in computation of the arm's length price is not reliable or correct; or
4. The assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of Section 92D.

In all such cases, the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction or specified domestic transaction in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him. Provided that an opportunity of being heard is to be given by assessing officer to Assessee by serving a notice calling upon him to show cause, on a date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer. Where an arm’s length price is determined by assessing Officer under this Section, the Assessing Officer may re-compute the total Income of the Assessee having regard to the arm’s length price so determined.

If Arm’s length price is determined by Assessing officer under this provision no deduction under section 10A or section 10AA or section 10B or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of Income under this Section.

In this case, the income of other associated enterprises from which tax was deducted or deductible, shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise.

Selection of Transfer Pricing Method

Rule 10C of the Indian Income Tax Rules, 1962 states that:

In selecting a most appropriate method, the following factors shall be taken into account namely,

(a) The nature and class of the international transaction or specified domestic transaction.

(b) 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 risks assumed by such enterprises.

(c) The availability, coverage and reliability of data necessary for application of the method.

(d) The degree of comparability existing between the international transaction or specified domestic transaction and the uncontrolled transaction and between the enterprises entering into such transactions.

(e) The extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction or specified domestic transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions.

(f) The nature, extent and reliability of assumptions required to be made in the application of a method.

The starting point to select the most appropriate method is the functional analysis which is necessary regardless of what transfer pricing method is selected. Each method may require a deeper analysis focusing on aspects relating to various methods. The functional analysis helps to:

- Identify and understand the intra-group transactions;
- Have a basis for comparability;
- Determine any necessary adjustments to the comparables;
- Check the accuracy of the method selected; and
- Over time, to consider adaptation of the policy if the functions, risks or assets have been modified.

Functional analysis also forms part of the documentation. The major components of a functional analysis are:

1. *Identification of Functions Performed* : for the purpose of determining comparability, functions of the entities play an important role.
2. *Identification of Risk Undertaken* : A risk-bearing party should have a chance of higher earnings than a non-risk bearing party, and will incur the expenses and perhaps related loss if and when risk materializes.
3. *Identification of Assets used or contributed* : The functional analysis must identify and distinguish tangible assets and intangible assets as this is very important for functional analysis.

The functional analysis provides answers to identify which functions risks and assets are attributable to the various related parties. In some cases one company may perform one function but the cost thereof is incurred/ paid by the other party to the transaction. The functional analysis could emphasize that situation. The functional analysis includes reference to the industry specifics, the contractual terms of the transaction, the economics circumstances and the business strategies. A checklist with columns for each related party and if needed for the comparable parties could be used to summarize the functional analysis and give a quick idea of which party performs each relevant function, uses what assets and bears which risk. But this short-cut overview should not be used by tax auditors to count the number of enumerated functions, risks and assets in order to determine the arm's length compensation. It should be used to consider the relative importance of each function, risk and asset. Once the functional analysis is performed and the functionality of the entity as regards the transactions subject to review (or the entity as a whole) has been completed, it can be determined what transfer pricing method is most suitable to determine the arm's length price for the transactions under the review (or the operating margin for the entity under review).

There is no universally accepted method or model which describes the technique for choosing a transfer pricing method. Traditionally the Comparable Uncontrolled Pricing Method, Profit Split Method, Resale Price Methods are being used in transfer pricing. Other methods such as TNMM may also be used after the analysis of the functional profile and global practices.

Reference to Transfer Pricing Officer

Section 92CA of the Income tax Act provides that the Assessing Officer with prior approval of Commissioner may refer the computation of Arm's Length Price in an International Transaction or specified domestic transaction to transfer pricing officer if he considers it necessary or expedient to do so. On reference by Assessing officer, Transfer Pricing Officer (TPO) shall serve a notice to the Assessee requiring him to produce the evidence in support of computation made by him of Arm's Length Price in relation to an International transaction or specified domestic transaction.

As per instruction no. 3/ 2016 (guidelines) issued by the Central Board of Direct Taxes ("CBDT") on 10 March 2016, it has been provided that the AO can refer the international transactions and the specified domestic transactions to the TPO only in the following circumstances:

(a) Cases where the AO notices transfer pricing transactions during the course of assessment and the taxpayer has either not filed any Form No. 3CEB or has filed Form No. 3CEB but has not reported such transactions;

(b) Where there is a transfer pricing adjustment of INR 10 crore or more in case of a taxpayer in any earlier assessment and the same has been pending in appeal or has been upheld by the judicial authority;

(c) In case search and seizure or survey operations of a taxpayer where transfer pricing issues are reported by the investigating officer or the AO.

In all the above situations, the AO must provide an opportunity of being heard to the taxpayer before recording his satisfaction or otherwise.

The CBDT has decided that the AO shall henceforth make a mandatory reference to the TPO only under the following circumstances:

1. All cases selected for scrutiny on the basis of TP risk parameters;
    - Computer assisted scrutiny selection system; or
    - Compulsory manual selection system in accordance with the CBDT's annual instruction.

2. Cases selected for scrutiny on non-TP risk parameters shall be referred to TPO's only in the following circumstances:
   - Where Accountant's report has not been filed or has not disclosed the international transaction or SDTs;
   - Where there has been a TP adjustment of more than INR 10 crore or more in an earlier assessment year and such an adjustment has been upheld by the judicial authorities or is pending appeal;
   - Where either search and seizure or survey operations have been carried out and findings regarding the issues in respect of the international transaction and SDT or both have been recorded by the Investigation wing or the AO.
   - Cases involving a TP adjustment in earlier assessment year that has been fully or partially set-aside by the ITAT, High Court or Supreme Court on the issue of the said adjustment;
   - The AO as a jurisdictional requirement record the satisfaction that there is an income or potential of an income arising and/or being effected from an international transaction and SDT, where the taxpayer has either not filed the Accountant's report or has not disclosed a transaction or has reported a transaction with a qualifying remark;
   - It is imperative for the AO to ensure that all international transactions or SDTs are explicitly mentioned in the letter through which the reference is made to the TPO;
   - It is clarified that the determination of the ALP should not be done by the office of the AO, wherein the reference is not made to the TPO at all. However, in such cases the AO must record in the body of the assessment order that due to the CBDT's instruction, the TP issue has not been examined at all.

Who is Transfer Pricing Officer (TPO)

For the purpose of Section 92CA "Transfer Pricing Officer" means a Joint Commissioner or Deputy Commissioner or Assistant Commissioner authorized by the Board to perform all or any of the functions of an Assessing Officer specified in sections 92C and 92D in respect of any person or class of persons.

Determination of Arm's Length Price by Transfer Pricing Officer

Transfer Pricing Officer after hearing the evidences, information or documents as produced by assessee and after considering such evidence as he may require on any specified points and after taking into account all relevant materials which he has gathered during the course of proceeding, shall, by order in writing, determine the arm's length price in relation to the international transaction/specified domestic transaction and send a copy of his order to the Assessing Officer and to the assessee. On receipt of the order from Transfer Pricing officer, the Assessing Officer shall proceed to compute the total income of the assessee in conformity with the arm's length price as determined by the Transfer Pricing Officer.

Rectification of Arm's Length Price Order by Transfer Pricing Officer

If any mistake is observed which is apparent from record, the Transfer Pricing Officer may as per the provisions of section 92CA(5) amend any order passed by him and the provisions of Section 154 w.r.t. rectification of mistake shall apply accordingly. Where any amendment is made by the Transfer Pricing Officer, he shall send a copy of his order to the Assessing Officer who shall thereafter proceed to amend the order of assessment in conformity with such order of the Transfer Pricing Officer.

Powers of Transfer Pricing Officer

1. *Power to call evidences/Information from Assessee*

   As per Section 92CA(2), the Transfer Pricing Officer may issue a notice to the Assessee and ask him to furnish records, evidences, information in support of the computation of Arm's Length Price relating to the International Transaction or specified domestic transaction.

2. *Power to amend the Order made in regard to computation of Arm's length price for the transaction referred to him*

   As stated earlier, if any mistake is observed which is apparent from record, the Transfer Pricing Officer may as per the provisions of section 92CA(5) amend any order passed by him and the provisions of section 154 w.r.t. rectification of mistake shall apply accordingly

3. *Power to proceed if the report under Section 92E is not furnished for some International transactions or Specified domestic transaction*

   Section 92CA(2B) has been inserted vide Finance Act which provides that w.e.f. 1st June, 2002 if the assessee has not furnished return u/s 92E and the transfer pricing officer observe International transaction or specified domestic transactions during the course of the proceedings before him, he may proceed with deeming that such transaction has been referred to him under this section 92CA provided that the provision of this section shall not empower the Assessing Officer either to assess or reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year, proceedings for which have been completed before the 1st day of July, 2012

4. *Power to proceed into the cases not referred to him*

   As per amendment made by Finance Act, 2011 the jurisdiction of the Transfer Pricing Officer shall extend to the determination of the Arm's Length Price (ALP) in respect of other international transactions or specified domestic transaction which are noticed by him subsequently, in the course of proceedings before him. These international transactions would be in addition to the international transactions referred to the TPO by the Assessing Officer

5. *Power to exercise all of the following powers specified in Sections 131(1)(a) to 131(1)(d) or 133(6) or 133A of Income Tax Act:*

   Power u/s 131(1)(a) to 131(1)(d)

   TPO have the same powers as are vested in a Court under the Code of Civil Procedure, 1908 (5 of 1908), when trying a suit in respect of the following matters, namely:—

   (a) discovery and inspection;

   (b) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;

   (c) compelling the production of books of account and other documents; and

(d) Issuing commissions.

6. *Power u/s 133(6)*

   Under Section 133(6), TPO may require any person, including a banking company or any officer thereof, to furnish information in relation to such points or matters, or to furnish statements of accounts and affairs verified in the manner specified by him giving information in relation to such points or matters as his opinion will be useful for, or relevant to, any enquiry or proceeding under this Act.

7. *Power u/s 133A - Power of Survey*

   Finance Act, 2011 has made an amendment which provides for the power of Survey to TPO through introduction of Section 133A. In course of the proceedings, a TPO may carry out the survey as per section 133A of Income Tax Act.

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Transfer Pricing - Documentation

The legal framework for maintenance of information and documentation by a taxpayer is provided in Section 92D of Income Tax Act, 1961 which lays down that every person who enters into an international transaction or specified domestic transaction during a previous years shall maintain such information and documents , prescribed by the Board, as will assist the Assessing Officer/ Transfer Pricing Officer to compute the income arising from that transaction, having regard to the arm's length price.

OECD in its transfer pricing guidelines stated that "Taxpayers should make reasonable efforts at the time the transfer pricing is established to determine whether the transfer pricing is appropriate for tax purposes in accordance with the arm's length principle. Tax administrations should have the right to obtain the documentation prepared or referred to in this process as means of verifying compliance with the arm's length principle. Moreover, the need for the documents should be balanced by the costs and the administrative burdens, particularly where this process suggests the creation of documents that would not otherwise be prepared or referred to in the absence of tax considerations.

Rule 10D(1) lays down thirteen different types of information and documents that a person has to keep and maintain. Broadly, these information and documents may be classified into three types:

(i) *Enterprise-wise documents* – These are documents that describe the enterprise, the relationships with other associated enterprise, the nature of business carried out, etc. This information is, largely, descriptive [clauses (a) to (c)].

(ii) *Transaction-specific documents* – These are documents that explain the international transaction in greater detail. It includes information with regard to each transaction (nature and terms of the contract, etc.), description of the functions performed, assets employed and risks assumed by each party to the transaction, economic and market analyses, etc. This information is both descriptive and quantitative in nature [clauses (d) to (h)].

(iii) *Computation related documents* – These are documents which describe and detail the methods considered, actual working assumptions, policies etc., adjustments made to transfer prices and any other relevant information, data, document relied for determination of arm's length price [clause (i) to (m)].

(a) A description of the ownership structure of the enterprise and details of shares or other ownership interest held therein by other enterprises;

(b) A profile of the multinational group of which the assessee enterprises i.e. taxpayer is a part and the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions have been made by the taxpayer and the ownership linkages among them;

(c) A broad description of the business of the taxpayer and the industry in which it operates and the business of the associated enterprises;

(d) The nature, terms and prices of international transaction entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;

(e) A description of the functions performed, risks assumed and assets employed or to be employed by the taxpayer and by the associated enterprise involved in the international transaction;

(f) A record of the economic and market analysis, forecasts, budgets or any other financial estimates prepared by the taxpayer for its business as a whole or separately for each division or product which may have a bearing on the international transaction entered into by the taxpayer;

(g) A record of uncontrolled transactions taken into account for analysing their comparability with the international transaction entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be relevant to the pricing of the international transactions;

(h) A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction*;

(i) A description of the methods considered for determining the arm's length price in relation to each international transaction or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case;

(j) A record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transaction;

(k) The assumptions, policies and price negotiations if any which have critically affected the determination of the arm's length price;

(l) Details of the adjustments, if any made to the transfer price to align it with arm's length price determined under these rules and consequent adjustment made to the total income for tax purposes;

(m) Any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

Rule 10D also prescribes that the above information is to be supported by authentic documents which may include the following:

(a) Official publications, reports, studies and data bases of the government of the country of residence of the associated enterprise or of any other country;

(b) Reports of market research studies carried out and technical publications of institutions of national or international repute;

(c) Publications relating to prices including stock exchange and commodity market quotations;

(d) Published accounts and financial statements relating to the business of the associated enterprises;

(e) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transaction similar to the international transactions;

(f) Letters and other correspondence documenting terms negotiated between the taxpayer and associated enterprise;

(g) Documents normally issued in connection with various transaction under the accounting practices followed.

Burden of Proof

It is noteworthy that the information and documentation requirements referred to above are linked to the burden of proof laid on the taxpayer to prove that the transfer price adopted is in accordance with the arm's length principle. One of the conditions to be fulfilled for discharging this burden by the taxpayer is maintenance of prescribed information and documents in respect of an international transaction entered into with an associated enterprise or specified domestic transaction. A default in maintaining information and documents in accordance with the rules is one of the conditions which may trigger a transfer pricing audit under Section 92C(3). Any default in respect of the documentation requirement may also attract penalty of a sum equal to two percent of the value of the international transaction or specified domestic transaction (Sec 271AA).

Submission of Documents with the Tax Authorities

There is no reference in the provisions included either in the Income Tax Act or the Income Tax Rules about any requirement to submit the prescribed information and documents at the stage of initial compliance in the form of submission of report under Section 92E. All that Section 92E requires is that the concerned taxpayer shall obtain a report from an Accountant in the prescribed form (i.e. Form 3CEB) and submit the report by the specified date.

Form 3CEB contains a certificate from the Accountant that in his opinion proper information and documents as prescribed have been maintained by the taxpayer. Rule 10D requires that the information and document maintained should be contemporaneous as far as possible and should exist latest by the specified date for filing the report under Section 92E. Section 92D also provides that information and documentation may be requisitioned by the Assessing Officer or the Appellate Commissioner on a notice of thirty days which may be extended by another period of 30 days.

Non Applicability of Documentation Requirement

As per Rule 10D(2) of the Income tax rules, 1962 waived off the requirement of maintenance of information and document in case of those person who has entered into an international transactions the aggregate value of which, as recorded in the books of account does not exceed Rs. 1 crore. However, the concerned taxpayer may be required to substantiate on the basis of available material that the income arising from the international transaction is computed in accordance with the arm's length rule. Further, there is no exemption for such assessees in obtaining and furnishing audit report under section 92E of the Act i.e. even if the aggregate value of the international transaction during the previous year is not exceeding 1 crore, the assesse is required to obtain and furnish audit report.

Retention Period of Documents kept under Rule 10D

Rule 10D of the Income tax rules, 1962 states that the prescribed information and documents are required to be maintained for a period of eight years from the end of the relevant Assessment years.

Section 92D(3) of the Act provides that the Assessing Officer or the Commissioner (Appeals) during the course of any proceeding under the Act may require a person who has entered into an international transaction or specified domestic transaction to furnish any information or document, which he was expected to maintain under section 92D (1) and the person shall furnish such information or document called for within thirty days from the date of receipt of a notice issued in this regard. However, if, for any reason, the person is unable to produce the information or documents called for within the stipulated period of thirty days, the Assessing Officer or Commissioner (Appeals) may, on an application made by the person, extend the period by a further period or periods not exceeding, in all, thirty days.

Section 92E of the Act stated that every person who has entered into an international transaction or specified domestic transaction during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date in the prescribed form duly signed and verified in the prescribed manner by such accountant and setting forth such particulars as may be prescribed.

"Specified date" shall have the same meaning as assigned to due date in Explanation 2 below subsection (1) of section 139 as per which, "In case of an assessee being a company, which is required to furnish a report referred to in section 92E, the due date means the 30th day of November of the assessment year."

As per section 92F(i) "accountant" shall have the same meaning as in the Explanation below sub-section (2) of section 288 as per which "Accountant means a chartered accountant within the meaning of Chartered Accountants Act, 1949 (38 of 1949) and includes, in relation to any State, any person, who by virtue of the provisions of sub-section (2) of section 226 of the Companies Act, 1956 (1 of 1956), is entitled to be appointed to act as an Accountant of companies registered in that State.".

Country by Country Reporting (CbCR) introduced vide the Finance Act, 2016

The OECD in its report on Base Erosion and Profit Shifting "BEPS" with respect to action plan 13 provides for revised standards for transfer pricing documentation and a template for country-by-country reporting of income, earnings, taxes paid and certain measure of economic activity and recommended that the countries should adopt a standardised approach to transfer pricing documentation. As India has been one of the active members of BEPS initiative and part of international consensus, the new provisions introduced in the Act vide the Finance Act, 2016 has prescribed a three-layered transfer pricing documentation requirement consisting of:-

(i) A master file containing standardized information relevant for all multinational enterprises (MNE) group members;

(ii) A local file referring specifically to material transactions of the local taxpayer; and

(iii) A country-by-country report containing certain information relating to the global allocation of the MNE's income and taxes paid together with certain indicators of the location of economic activity within the MNE group.

The report mentions that taken together, these three documents (country-by-country report, master file and local file) will require taxpayers to articulate consistent transfer pricing positions and will provide tax administrations with useful information to assess transfer pricing risks. It will facilitate tax administrations to make determinations about where their resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries.

The country-by-country report requires multinational enterprises (MNEs) to report annually and for each tax jurisdiction in which they do business; the amount of revenue, profit before income tax and income tax paid and accrued. It also requires MNEs to report their total employment, capital, accumulated earnings and tangible assets in each tax jurisdiction. The Country-by-Country (CbC) report has to be submitted by parent entity of an international group to the prescribed authority in its country of residence. This report is to be based on consolidated financial statement of the group.

The master file is intended to provide an overview of the MNE groups business, including the nature of its global business operations, its overall transfer pricing policies, and its global allocation of income and economic activity in order to assist tax administrations in evaluating the presence of significant transfer pricing risk. The master file shall be furnished by each entity to the tax authority of the country in which it operates.

It may be noted that detailed rules in regard to the Master File and the Local File maintenance requirements are awaited,

The prescribed authority may call for such document and information from the entity furnishing the report for the purpose of verifying the accuracy as it may specify in notice. The entity shall be required to make submission within thirty days of receipt of notice or further period if extended by the prescribed authority, but extension shall not be beyond 30 days;

Penalties for non-compliance with new documentation requirements:

- Penalty for failure to furnish Master file: INR 5,00,000
- Penalty for failure to furnish CbCR or further information (called for) in respect of CbCR: INR 5,000 – INR 50,000 per day, depending upon period of delay.
- Penalty for proving inaccurate information in CbCR: INR 500,000

The CbC reporting requirement will apply only to large taxpayers i.e. taxpayers having an annual consolidated group turnover over € 750 million (equivalent in local currency) in the preceding financial year. Further, the new documentation regime will apply for the Financial Year (FY) 2016-17 (i.e. April 1, 2016 to March 31, 2017), and the first filing will be due by November 30, 2017.

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Transfer Pricing – Penalty for Contravention

Contravention of Transfer Pricing Regulation as contained in Chapter X of the Income tax Act, 1961 may invite hefty penalties. The details of penalties under different sections of Income tax Act, 1961 are as follows:-

A. Penalty for concealment of income or for furnishing inaccurate particulars of such income under Section 271(1)(c)

If the Assessing Officer or Commissioner (Appeals) or the Commissioner in the course of any proceedings under this Act, is satisfied that any person has concealed the particulars of his income or furnished inaccurate particulars of such income, he may direct that such person shall pay by way of penalty in addition to tax, if any, payable by him, a sum which shall not be less than, but which shall not exceed three times, the amount of tax sought to be evaded by reason of the concealment of particulars of his income or the furnishing of inaccurate particulars of such income.

Explanation 7 to Section 271(1)(c) - Where in the case of an assessee who has entered into an international transaction* defined in section 92B, any amount is added or disallowed in computing the total income under sub-section (4) of section 92C, then, the amount so added or disallowed shall, for the purposes of clause (c) of this sub-section, be deemed to represent the income in respect of which particulars have been concealed or inaccurate particulars have been furnished, unless the assessee proves to the satisfaction of the Assessing Officer or the Commissioner (Appeals) or the Commissioner that the price charged or paid in such transaction was computed in accordance with the provisions contained in section 92C and in the manner prescribed under that Section, in good faith and with due diligence.

B. Penalty for failure to furnish information or document- Section 271G

As per Section 271G of Income Tax Act, If any person who has entered into an international transaction or specified domestic transaction fails to furnish any such information or document as required by sub-section (3) of section 92D, the Assessing Officer or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two per cent of the value of the international transaction for each such failure.

C. Penalty for failure to keep and maintain information and document in respect of International transaction or specified domestic transaction- Section 271AA

- Without prejudice to the provisions of Section 271 or Section 271BA, if any person in respect of an International transaction or specified domestic transaction fails to keep and maintain any such information and document as required by sub-section (1) or sub-section (2) of Section 92D,
- fails to report any international transaction or specified domestic transaction which is required to be reported; or
- maintains or furnishes any incorrect information or documents

The Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two per cent of the value of each international transaction or specified domestic transaction entered into by such person.

Further, in light of section 270A, in a case of under-reporting of income penalty shall be 50% of the tax payable. The amendment also prescribes that in cases where under-reporting of income results from misreporting of income by the assesse, the person shall be liable for penalty @ 200% of the tax payable on such misreported income.

D. Penalty for failure to furnish report under Section 92E– Section 271BA

If any person fails to furnish a report from an accountant as required by Section 92E, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of one hundred thousand rupees.

E. Penalty for failure to answer questions, sign statements, furnish information, returns or statements etc. - Section 272A

If any person,—

(a) being legally bound to state the truth of any matter touching the subject of his assessment, refuses to answer any question put to him by an income-tax authority in the exercise of its powers under this Act; or

(b) refuses to sign any statement made by him in the course of any proceedings under this Act, which an income-tax authority may legally require him to sign; or

(c) to whom a summons is issued under sub-section (1) of Section 131 either to attend to give evidence or produce books of account or other documents at a certain place and time omits to attend or produce books of account or documents at the place or time, he shall pay, by way of penalty, a sum of ten thousand rupees for each such default or failure.

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Transfer Pricing – Applicability to Domestic Transactions

Misuse of Tax Incentives by Corporates

With an objective of developing specific sectors/areas Indian government has given various tax incentives in form of Tax holiday, deduction from Income etc. The details of some of such Tax Incentives are as given below:

Tax incentive under Section 80 IA : Deductions in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development etc.

Tax incentive under Section 80 IC : Deduction in respect of profit and gains from certain undertakings or enterprises in certain special category states – notified industrial areas

Tax incentive under Section 10AA : a unit operating in an SEZ is eligible to claim 100% tax holiday for the first five years and a 50% tax holiday for the subsequent 10 years subject to some conditions.

However the drawback of above such incentives is that they are sometimes been used to avoid taxes.

Example of Misuse of Tax Incentive by Corporates

Company A is located in SEZ area where Income tax holiday for 5 years is available. Company A has got its associated company B in Delhi. Company B is producing raw material for company A. In order to avoid Income tax payment, company B sells the goods to company A at a price much lower than the market price. In this case company A's profit is enhanced by the difference of market price and price charged by B. Since company A need not require to pay any Income Tax for first five years, company A will be getting tax free profit while company B will not require to pay any tax on the difference of market price of goods supplied to A and price charged from A for supply of goods resulting into the increase in overall post tax profits and decrease the overall tax of the group

Extension of Transfer Pricing Regulation to Specified Domestic Transaction

Honourable Supreme court in the case of [CIT v. Glaxo SmithKline Asia (P) Ltd., 2010-TII-02-SC-LB-T] has advised that it needs to be considered whether the regulations should be applied to domestic transactions in cases where such transactions are not revenue-neutral. The facts and ruling of Honourable Supreme Court is following:

CIT v. *Glaxo SmithKline Asia (P) Ltd.*, 2010-TII-02-SC-LB-T

Facts

1. Glaxo SmithKline Asia (P) Ltd (GSK) entered into an agreement with Glaxo Smith Kline Consumer Healthcare Ltd ("GSKCH") whereby GSKCH would provide all administrative services relating to marketing, finance, Human Resource (HR) to GSK for cost +5% markup.
2. The AO disallowed a part of the charges reimbursed on the ground that they were excessive and not for business purposes. On appeal by GSK, CIT (Appeals) upheld the decision of AO.
3. GSK appeal to Income Tax Appellate Tribunal (ITAT) and ITAT ruled that AO has no power to disallow any expenditure as excessive or unreasonable unless the case falls within the scope of Section 40A(2). The department appeal to high court and appeal was dismissed by High court.
4. For subsequent years, the AO continued to follow the same approach and GSK continued to get relief from ITAT. Having regard to the delay on the part of department to give effect to ITAT order, GSK filled a writ petition before the High Court and High court issued direction to the department to issue refund of taxes along with applicable interest.

Supreme Court Ruling

1. The department filed a Special Leave Petition (SLP) before the Hon'ble Supreme court and Supreme court held that since the exercise is revenue neutral and both the parties are not related parties in terms of Section 40A(2) of Income tax act, no

interference is called for and the SLP filled by the department is dismissed.

2. The Hon'ble Supreme court further stated that the larger issue is whether Transfer Pricing provisions should be limited to cross-border transactions or whether the Transfer Pricing Regulations be extended to domestic transactions. In domestic transactions, the under-invoicing of sales and over-invoicing of expenses ordinarily will be revenue neutral in nature, except in two circumstances having tax arbitrage such as where one of the related entities is (i) loss making or (ii) liable to pay tax at a lower rate and the profits are shifted to such entity;
3. The Supreme court further held that the complications arise in cases where the fair market value is required to be assigned to transactions between related parties u/s 40A(2). The Central Board of Direct taxes (CBDT) should examine whether Transfer Pricing provisions can be applied to domestic transactions between related parties u/s 40A(2) by making amendments to the Act. The AO can be empowered to make adjustments to the income declared by the assessee having regard to the fair market value of the transactions between the related parties and can apply any of the generally accepted methods of determination of arm's length price, including the methods provided under Transfer Pricing provisions. The law can also be amended to make it compulsory for the taxpayer to maintain Books of Accounts and other documents on the lines prescribed in Rule 10D and obtain an audit report from his Chartered Accountant (CA) that proper documents are maintained;
4. Finally it was held that though the Court normally does not make recommendations or suggestions, in order to reduce litigation occurring in complicated matters, the question of extending Transfer Pricing regulations to domestic transactions require expeditious consideration by the Ministry of Finance and the CBDT may also consider issuing appropriate instructions in that regard.

Thereafter the Finance Act, 2012 has extends the transfer pricing provisions to specified domestic transaction as well. This requires domestic transactions involving payments to related persons to be reckoned with reference to the arm's length price. This would especially be relevant where losses are sought to be cushioned through expense allocations. The Government intends to plug these loopholes by bringing domestic transactions within the ambit of the transfer pricing legislation.

Specified Domestic Transactions

The specified domestic party transactions includes payment made by a company to a person referred to in Section 40A(2)(b) of the Act including payment to a director of the company or any person who has a substantial interest in the company (that is, has a beneficial ownership of shares carrying not less than 20 per cent of voting power); transactions referred to in Section 80A(6) of the Act (for example, transfer of goods or services from a unit/ entity claiming tax-incentives to another unit/entity that does not get any tax incentives and vice-versa); and transactions referred to in Section 80IA(8), 80IA(10) and 10AA(9) of the Act (carried out by industrial undertakings, infrastructure companies and units operating in special economic zones).

Advance Pricing Agreement

As per Section 92CC of Income Tax Act, 1961, w.e.f. 1st July, 2012, the Central Board of Direct Taxes (Board), with the approval of the Central Government, may enter into an Advance Price Agreement with any person, determining the arm's length price or specifying the manner in which arm's length price is to be determined, in relation to an international transaction to be entered into by that person.

Advance Pricing Agreement (APA) is an agreement between a taxpayer and a taxing authority (Board) on an appropriate transfer pricing methodology for fixing the arm's length price for a set of transactions over a fixed period of time in future. Importance of APA may be understood with the fact that as stated earlier, in financial year 2014-2015, addition of about Rs. 46,000 crores in income has been proposed by Transfer pricing officers.

Determination of Arm's Length Price under Advance Pricing Agreement

Arm's Length Price under Advance Pricing Agreement shall be determined as per method enumerated in section 92C(1) or any other method with such adjustment and variation as may be necessary and expedient so to do.

Section 92C(1) of Income Tax Act prescribes that the arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe (see rule 10B) namely:—

(a) Comparable uncontrolled price method;

(b) Resale price method;

(c) Cost plus method;

(d) Profit split method;

(e) Transactional net margin method;

(f) Such other method as may be prescribed by the Board.

Notwithstanding anything contained in Section 92C or Section 92CA, if the Advance Pricing Agreement has been entered between an assessee and Board in respect of an international transaction, the arm's length price will be calculated as per the provisions of Advance Pricing Agreement.

Validity of Advance Pricing Agreement

The Advance Pricing Agreement shall be valid for a period as specified in the Advance Pricing Agreement. However, this period will not be more than 5 consecutive years.

Binding nature of the Advance Pricing Agreement

Advance Pricing Agreement shall be binding on:

(a) the person in whose case, and in respect of the transaction in relation to which, the agreement has been entered into; and

(b) on the Commissioner, and the income-tax authorities subordinate to him, in respect of the said person and the said transaction

However the advance pricing agreement shall not be binding if there is a change in law or facts having bearing on the agreement so entered.

Declaring an Advance Pricing Agreement void ab initio

The Board may, with the approval of the Central Government, by an order, declare an agreement to be void ab initio, if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts.

Effect of declaring an Advance Pricing Agreement void ab initio

If an agreement is declared void ab initio -

(a) All the provisions of the Act shall apply to the person as if such agreement had never been entered into; and

(b) Notwithstanding anything contained in the Act, for the purpose of computing any period of limitation under this Act, the period beginning with the date of such agreement and ending on the date of order for declaring an Advance Pricing Agreement void ab initio shall be excluded. Provided that where immediately after the exclusion of the aforesaid period, the period of limitation, referred to in any provision of this Act, is less than sixty days, such remaining period shall be extended to sixty days and the aforesaid period of limitation shall be deemed to be extended accordingly.

Procedure and Scheme of Advance Pricing Agreement

The Board may, for the purposes of this section, prescribe a scheme specifying therein the manner, form, procedure and any other matter generally in respect of the Advance Pricing Agreement. Where an application is made by a person for entering into Advance Pricing Agreement, the proceeding shall be deemed to be pending in the case of the person for the purposes of the Act.

Filing of Modified return for any assessment year relevant to a previous year to which APA applies

As per Section 92CD of Income Tax Act, 1961, w.e.f. 1st July, 2012 notwithstanding anything to the contrary contained in Section 139, where any person has entered into an agreement and prior to the date of entering into the agreement, any return of income has been furnished under the provisions of Section 139 for any assessment year relevant to a previous year to which such agreement applies, such person shall furnish, within a period of three months from the end of the month in which the said agreement was entered into, a modified return in accordance with and limited to the agreement. Save as otherwise provided in Section 92CD, if modified return is furnished under Section 139, all other provision of the Act shall apply accordingly.

Thus, Section 92CD provides an opportunity to taxpayer to avoid the litigation even for the years for which return has already been filed.

Reassessment of Total Income in the cases where Modified return has been filed but the Assessment/Reassessment proceedings have been completed before the expiry of period allowed for furnishing of modified return

As per Section 92CD(3), if the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the agreement applies have been completed before the expiry of period allowed for furnishing of modified return under Section 92CD, the Assessing Officer shall, in a case where modified return is filed under this Section, proceed to assess or reassess or recompute the total income of the relevant assessment year having regard to and in accordance with the agreement.

Application of APA in the pending assessment or reassessment for an assessment year relevant to the previous year to which the agreement applies and modified return has been filed under Section 92 CD

Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the agreement applies are pending on the date of filing of modified return in accordance with the provisions of sub-section (1), the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the agreement taking into consideration the modified return so furnished.

Extension of Limitation Period in the cases where modified return is filed under Section 92CD

As per Section 92CD(5), notwithstanding anything contained in Section 153 or Section 153B or Section 144C—

(a) The order of assessment, reassessment or recomputation of total income under Section 92CD (3) shall be passed within a period of one year from the end of the financial year in which the modified return under sub-section (1) is furnished;

(b) The period of limitation as provided in Section 153 or Section 153B or Section 144C for completion of pending assessment or reassessment proceedings referred to Section 92CD(4) shall be extended by a period of twelve months.

This may be observed from above provision that Advance Pricing Agreement, although styled as "advance" agreements, may be a good arm in the resolution of transfer pricing issues pending from prior years—and in some cases it can provide an effective means for resolving existing transfer pricing audits or adjustments.

By virtue of Advance Pricing Agreement, the taxpayer is assured about the Tax Liability arising out of International transactions. No surprises or challenges will arise if the agreement is followed. The scope of certainty includes tax treatment of covered transactions as to amount and characterization and elimination of potential penalties for substantial tax understatement.

Roll back provision in Advance Pricing Agreements (APA)

Provisions relating to Advance Pricing Agreements (APAs) were introduced in the Indian Income-tax Act, 1961 (the Act) with effect from 1 July 2012, vide Finance Act, 2012. These provisions did not then include rollback provisions. The provision to provide for a rollback mechanism was brought into the Act vides Finance Act 2014 with effect from 1 October 2014. Thereafter, in March 2015, the Central Board of Direct Taxes (CBDT) announced detailed rules explaining the rollback provisions and the procedure for giving effect to them (the Rules).

- Roll back is available for the roll back years, and a 'roll back year' has been defined to mean any previous year falling within the period of four previous years, preceding the first previous year covered in the APA (i.e. the regular APA).

For example

If the applicant files an APA application on or before 31 March 2015 covering a period of up to 5 years from financial year (FY) 2015-16 to FY 2019-20 and applies for a roll back, the roll back years can cover the period from FY 2011- 12 to FY 2014-15. Similarly, if the applicant has filed an APA application covering a period of 5 years from FY 2013-14 to FY 2017-18 and applies for a roll back, the roll back years can cover the period from FY 2009-10 to FY 2012-13.

Power of Board to make Safe Harbour Rules (Section 92CB)

The determination of arm's length price under section 92C or section 92CA shall be subject to safe harbour rules as prescribed under section 92CB of the Act. The term "Safe Harbour" means "circumstances under which the income-tax authorities shall accept the transfer pricing declared by the assessee." The Rule provides minimum operating profit margin in relation to operating expenses a taxpayer is expected to earn for certain categories of international transactions or specified domestic transfer pricing , that will acceptable to the income tax authorities as arm's length price (ALP) . The rule also provides acceptable norms for certain categories of financial transactions such as intra-group loans made or guarantees provided to non-resident affiliates of an Indian tax payers. The safe harbor rules, optional for a taxpayer, contains the conditions and circumstances under which norms / margins would be accepted by the tax authorities and the related compliance obligations.

Safe harbours carry certain benefits which are described below

- *Compliance Simplicity* : Safe harbours tend to substitute simplified requirements in place of existing regulations, thereby reducing compliance burden and associated costs for eligible taxpayers, who would otherwise be obligated to dedicate resources and time to collect, analyze and maintain extensive data to support their inter-company transactions.
- *Certainty & Reduce Litigation* : Electing safe harbours may grant a greater sense of assurance to taxpayers regarding acceptability of their transfer price by the tax authorities without onerous audits. This conserves administrative and monetary resources for both the taxpayer and the tax administration.
- *Administrative Simplicity* : Since tax administrations would be required to carry out only a minimal examination in respect of taxpayers opting for safe harbours, they can channelize their efforts to examine more complex and high-risk transactions and taxpayers.

Filling of form 3CEFA / 3CEFB

Any taxpayer who has entered into an eligible international transaction or specified domestic transaction and who wishes to exercise the option to be governed by the safe harbour rules is required to file a specified form (Form 3CEFA for International Transaction or Form 3CEFB for SDT). Form 3CEFA / 3CEFB requires the taxpayer to declare the following:

- Transaction entered with an AE is an eligible international transaction or specified domestic transaction;
- Quantum of the international transaction specified domestic transaction;
- Whether the AEs country or territory is a no tax or low tax country or territory; and
- Operating profit margin/transfer price.

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FORM NO. 3CEB

[See rule 10E]

Report from an accountant to be furnished under Section 92E relating to international transaction(s) and specified domestic transaction

If 'yes' provide the following details in respect of each associated enterprise and each category of intangible property: If 'yes' provide the following details in respect of each associated enterprise and each category of service :

1. *I/We have examined the accounts and records of ______________ (name and address of the assessee with PAN) relating to the international transactions and specified domestic transaction entered into by the assessee during the previous year ending on 31st March, ______________.

2. In *my/our opinion proper information and documents as are prescribed have been kept by the assessee in respect of the international transaction(s) and specified domestic transaction entered into so far as appears from *my/our examination of the records of the assessee.

3. The particulars required to be furnished under section 92E are given in the Annexure to this Form. In *my/our opinion and to the best of my/our information and according to the explanations given to *me/us, the particulars given in the Annexure are true and correct.

   **Signed

   Name :

   Address :

   Membership No. :

   Place : ______________

   Date : ______________

Notes:

1. *Delete whichever is not applicable.

2. **This report has to be signed by —

   (i) a chartered accountant within the meaning of the Chartered Accountants Act, 1949 (38 of 1949); or

   (ii) any person who, in relation to any State, is, by virtue of the provisions in sub-section (2) of section 226 of the Companies Act, 1956 (1 of 1956), entitled to be appointed to act as an auditor of companies registered in that State.

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ANNEXURE TO FORM NO. 3CEB

Particulars relating to international transactions or specified domestic transaction required to be furnished under Section 92E of the Income Tax Act, 1961

PART A

1. Name of the assessee
2. Address
3. Permanent account number
4. Nature of business or activities of the assessee*
5. Status
6. Previous year ended
7. Assessment year
8. Aggregate value of international transactions as per books of accounts
9. Aggregate value of specified domestic transactions as per books of accounts

   * Code for nature of business to be filled in as per instructions for filling Form ITR 6

PART B

(International Transactions)

10. List of associated enterprises with whom the assessee has entered into international transactions, with the following details:

    (a) Name of the associated enterprise.

    (b) Nature of the relationship with the associated enterprise as referred to in section 92A(2).

    (c) Brief description of the business carried on by the associated enterprise.

11. Particulars in respect of transactions in tangible property.

    A. Has the assessee entered into any international transaction(s) in respect of purchase/sale of raw material, consumables or any other supplies for assembling/processing/manufacturing of goods/articles from/to associated enterprises ? Yes/No

If 'yes', provide the following details in respect of each associated enterprise and each transaction or class of transaction:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of transaction and quantity purchased/sold.

(c) Total amount paid/received or payable/receivable in the transaction—

(i) as per books of account.

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C (1)]

B. Has the assessee entered into any international transaction(s) in respect of purchase/sale of traded/finished goods ? **YES /NO**

If 'yes' provide the following details in respect of each associated enterprise and each transaction or class of transaction:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of transaction and quantity purchased/sold.

(c) Total amount paid/received or payable/receivable in the transaction—

(i) As per books of account.

(ii) As computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C (1)]

C. Has the assessee entered into any international transaction(s) in respect of purchase/sale, transfer, lease or use of any other tangible property including transactions specified in Explanation (i)(a) below section 92B(2)? Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each transaction or class of transaction:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of the property and nature of transaction.

(c) Number of units of each category of tangible property involved in the transaction.

(d) Amount paid/received or payable/receivable in each transaction of purchase/sale/transfer/ use, or lease rent paid/received or payable/receivable in respect of each lease provided/entered into —

(i) as per books of account.

(ii) as computed by the assessee having regard to the arm's length price.

(e) Method used for determining the arm's length price [See section 92C(1)]

12. Particulars in respect of transactions in intangible property:

Has the assessee entered into any international transaction(s) in respect of purchase/sale/lease/use of intangible property, including transactions specified in Explanation (i)(b) below section 92B(2)? Yes/No

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of intangible property and nature of transaction.

(c) Amount paid/received or payable/receivable for purchase/ sale/transfer/use of each category of intangible property—

(i) as per books of account.

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See Section 92C(1)]

13. Particulars in respect of providing of services:

Has the assessee entered into any international transaction(s) in respect of services including transactions as specified in Explanation (i)(d) below section 92B(2)? **YES /NO**

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of services provided/availed to/from the associated enterprise.

(c) Amount paid/received or payable/receivable for the services provided/taken—

(i) as per books of account.

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See Section 92C(1)]

14. Particulars in respect of lending or borrowing money:

Has the assessee entered into any international transaction(s) in respect of lending or borrowing of money including any type of advance, payments, deferred payments, receivable, non-convertible preference shares/ debentures or any other debt arising during the course of business as specified in Explanation (i)(c) below section 92B (2)? **YES /NO**

(c) Currency in which transaction has taken place.

(d) Interest rate charged/paid in respect of each lending/ borrowing.

(e) Amount paid/received or payable/receivable in the transaction —

(i) as per books of account.

(ii) as computed by the assessee having regard to the arm's length price.

(f) Method used for determining the arm's length price [See Section 92C(1)]

15. Particulars in respect of transactions in the nature of guarantee:

    Has the assessee entered into any international transaction(s) in the nature of guarantee ? **YES /NO**

    If 'yes' provide the following details in respect of each guarantee:

    (a) Name and address of the associated enterprise with whom the international transaction has been entered into.

    (b) Nature of guarantee agreement

    (c) Currency in which the guarantee transaction was undertaken

    (d) Compensation/ fees charged/ paid in respect of the transaction

    (e) Method used for determining the arm's length price [See Section 92C(1)].

16. Particulars in respect of international transactions of purchase or sale of marketable securities, issue and buyback of equity shares, optionally convertible/ partially convertible/ compulsorily convertible debentures/ preference shares:

    Has the assessee entered into any international transaction(s) in respect of purchase or sale of marketable securities or issue of equity shares including transactions specified in Explanation (i)(c) below section 92B(2)? **YES /NO**

    If yes, provide the following details:

    (a) Name and address of the associated enterprise with whom the international transaction has been entered into.

    (b) Nature of transaction

    (c) Currency in which the transaction was undertaken

    (d) Consideration charged/ paid in respect of the transaction.

    (e) Method used for determining the arm's length price [See section 92C(1)]

17. Particulars in respect of mutual agreement or arrangement :

    Has the assessee entered into any international transaction with

an associated enterprise or enterprises by way of a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises?
YES /NO

If 'yes' provide the following details in respect of each agreement/ arrangement:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of such mutual agreement or arrangement.

(c) Amount paid/received or payable/receivable in each such transaction—

(i) as per books of account;

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)].

18. Particulars in respect of international transactions arising out/ being part of business restructuring or reorganizations:

Has the assessee entered into any international transaction(s) arising out/being part of any business restructuring or reorganization entered into by it with the associated enterprise or enterprises as specified in Explanation (i) (e) below section 92B (2) and which has not been specifically referred to above?
YES / NO

If 'yes', provide the following details:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Nature of transaction

(c) Agreement in relation to such business restructuring/ reorganization.

(d) Terms of business restructuring/ reorganization.

(e) Method used for determining the arm's length price [See section 92C(1)].

19. Particulars in respect of any other transaction including the transaction having a bearing on the profits, income, losses or assets of the assessee:

Has the assessee entered into any other international transaction(s) If 'yes' provide the following details in respect of each associated enterprise and each loan/advance :

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Nature of financing agreement.

including a transaction having a bearing on the profits, income, losses or asset, but not specifically referred to above, with associated enterprise? **YES / NO**

If 'yes' provide the following details in respect of each associated enterprise and each transaction:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of the transaction.

(c) Amount paid/received or payable/receivable in the transaction—

(i) as per books of account;

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)].

20. Particulars of deemed international transactions:

Has the assessee entered into any transaction with a person other than an AE in pursuance of a prior agreement in relation to the relevant transaction between such other person and the associated enterprise? **YES / NO**

If yes, provide the following details in respect of each of such agreement

(a) Name and address of the person other than the associated enterprise with whom the deemed international transaction has been entered into.

(b) Description of the transaction.

(c) Amount paid/received or payable/receivable in the transaction—

(i) as per books of account;

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)].

PART C (Specified domestic transaction)

21. List of associated enterprises with whom the assessee has entered into specified domestic transactions, with the following details:

(a) Name, address and PAN of the associated enterprise.

(b) Nature of the relationship with the associated enterprise

(c) Brief description of the business carried on by the said associated enterprise.

22. Particulars in respect of transactions in the nature of any expenditure:

Has the assessee entered into any specified domestic transaction (s) being any expenditure in respect of which payment has been made or is to be made to any person referred to in section 40A(2)(b)? **YES/NO**

If "yes", provide the following details in respect of each of such person and each transaction or class of transaction:

(a) Name of person with whom the specified domestic transaction has been entered into.

(b) Description of transaction along with quantitative details, if any.

(c) Total amount paid or payable in the transaction—

(i) as per books of account;

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)]

23. Particulars in respect of transactions in the nature of transfer or acquisition of any goods or services:

A. Has any undertaking or unit or enterprise or eligible business of the assessee [as referred to in section 80A(6), 80IA(8) or section 10AA)] transferred any goods or services to any other business carried on by the assessee?

If yes, provide the following details in respect of each unit or enterprise or eligible business:

(a) Name and details of business to which goods or services have been transferred

(b) Description of goods or services transferred

(c) Amount received/receivable for transferring of such goods or services –

(i) as per the books of account;

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)].

B. Has any undertaking or unit or enterprise or eligible business of the assessee [as referred to in section 80A(6), 80IA(8) or section 10AA] acquired any goods or services from another business of the assessee? **YES / NO**

If yes, provide the following details in respect of each unit or enterprise or eligible business:

(a) Name and details of business from which goods or services have been acquired

(b) Description of goods or services acquired

(c) Amount paid/payable for acquiring of such goods or services–

(i) as per the books of account;

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)].

24. Particulars in respect of specified domestic transaction in the nature of any business transacted: Has the assessee entered into any specified domestic transaction(s) with any associated enterprise which has resulted in more than ordinary profits to an eligible business to which section 80IA(10) or section 10AA applies? **YES / NO**

If "yes", provide the following details:

(a) Name of the person with whom the specified domestic transaction has been entered into

(b) Description of the transaction including quantitative details, if any.

(c) Total amount received/receivable or paid/ payable in the transaction –

(i) as per books of account;

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)].

25. Particulars in respect of any other transaction:

Has the assessee entered into any other specified domestic transaction(s) not specifically referred to above, with an associated enterprise? **YES /NO**

If 'yes' provide the following details in respect of each associated enterprise and each transaction:

(a) Name and address of the associated enterprise with whom the specified domestic transaction has been entered into.

(b) Description of the transaction.

(c) Amount paid/received or payable/receivable in the transaction—

(i) as per books of account.

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See Section 92C(1)].

**Signed

Name :

Address :

Place : ______________

Date : ______________

Notes :

**This annexure has to be signed by __

(i) a chartered accountant within the meaning of the Chartered Accountants Act, 1949 (38 of 1949); or

(ii) any person who, in relation to any State, is, by virtue of the provisions in sub-section (2) of Section 226 of the Companies Act, 1956 (1 of 1956), entitled to be appointed to act as an auditor of companies registered in that State.

Abbreviations

APA	Advance Pricing Agreement
AE	Associated Enterprises
ALP	Arm's Length price
AO	Assessing Officer
CUP	Comparable Uncontrolled Price
COGS	Cost of Goods Sold
CBDT	Central Board of Direct taxes
CPM	Cost Plus Method
CIT	Commissioner of Income Tax
CbCR	Country by Country Reporting
GPM	Gross Profit Margin
HR	Human Resources
ITAT	Income Tax Appellate tribunal
MNE	Multinational Enterprises
OECD	Organisation for Economic Co-operation and Development
PE	Permanent Establishment
PSM	Profit Split Method
R&D	Research & Development
RSP	Resale Price
SEZ	Special Economic Zone
SLP	Special Leave Petition
SC	Supreme Court
SHR	Safe Harbour Rules
SDT	Specified Domestic Transaction
TNMM	Transaction Net Margin Method
TPO	Transfer Pricing officer
TP	Transfer Price

Glossary of Terms

Act

Act means Income Tax Act, 1961 unless otherwise stated.

Advance Pricing Agreements ("APA")

As per Section 92CC of Income Tax Act, 1961, the Central Board of Direct Taxes (Board), with the approval of the Central Government, may enter into an Advance Price Agreement with any person, determining the arm's length price or specifying the manner in which arm's length price is to be determined, in relation to an international transaction or specified domestic transaction to be entered into by that person. Advance pricing agreement is very useful in minimizing transfer pricing litigation. These agreements are binding to Taxpayer and tax authority for the specified period.

Arm's Length Price

Arm's Length Price has not been defined anywhere in the Act. In general, Arm's Length Price means the price which has been calculated in accordance with the method specified in Rule 10 B i.e. Comparable Unit Price Method (CUP), Resale Price Method (RSP), Profit Spilt Method (PS), Cost Plus Method (CP), Transaction Net Margin Method (TNMM) or such other method as may be prescribed by the board.

Associated/Related Enterprises, Companies, or Parties

Section 92A of Income Tax Act, 1961 provides meaning of the expression associated enterprises. The enterprises will be taken to be associated enterprises if one enterprise is controlled by the other, or both enterprises are controlled by a common third person. The concept of control adopted in the legislation extends not only to control through holding shares or voting power or the power to appoint the management of an enterprise, but also through debt, blood relationships, and control over various components of the business activity performed by the taxpayer such as control over raw materials, sales and intangibles.

Board

Board means Central Board of Direct Taxes (CBDT). The CBDT is a part of Department of Revenue in the Ministry of Finance. CBDT provides essential inputs for policy and planning of direct taxes in India and it is also responsible for administration of direct tax laws through the Income

Tax Department. The Central Board of Direct Taxes is a statutory authority functioning under the Central Board of Revenue Act, 1963.

Comparability Analysis

It refers to a comparison of a controlled transaction with an uncontrolled transaction or transactions. Controlled and uncontrolled transactions are comparable if none of the differences between the transactions could materially affect the factor being examined in the methodology (e.g. price or margin), or if reasonably accurate adjustments can be made to eliminate the material effects of any such differences.

Compensating Adjustment

An adjustment in which the taxpayer reports a transfer price for tax purposes that is, in the taxpayer's opinion, an arm's length price for a controlled transaction, even though this price differs from the amount actually charged between the associated enterprises. This adjustment would be made before the tax return is filed.

Comparable Uncontrolled Price (CUP) Method

A transfer pricing method that compares the price for property transferred or services rendered in a controlled transaction to the price charged for property transferred or services rendered in a comparable uncontrolled transaction in comparable circumstances is termed as CUP method.

Cost Plus Mark up

A mark up that is measured by reference to margins computed after the direct and indirect costs incurred by a supplier of property or services in a transaction.

Cost Plus Method

A Transfer Pricing Method which uses the cost incurred by supplier of goods or services in a controlled transaction. An appropriate cost plus mark up is added to this cost, to make an appropriate profit in light of the functions performed.

Independent Enterprises

Two enterprises are independent enterprises with respect to each other if they are not associated enterprises with respect to each other.

International Transaction

An international transaction is essentially a cross border transaction between associated enterprises in any sort of property, whether tangible or intangible, or in the provision of services, lending of money etc. At least one of the parties to the transaction must be a non-resident. The definition also covers a transaction between two non-residents where for example, one of them has a permanent establishment whose income is taxable in India.

Multinational enterprise (MNE)

A company that is part of an MNE group.

Multinational Enterprise Group (MNE Group)

A group of associated companies with business establishments in two or more countries is called as MNE.

Permanent Establishment

Section 92F of the Indian Income Tax Act, 1961 explains the term "Permanent Establishment (PE)" as a fixed place of business through which the business of the enterprise is wholly or partly carried out.

Profit Split Method

Profit Spilt Method is applicable mainly in international transaction or specified domestic transaction involving transfer of unique intangibles or in multiple international transactions or specified domestic transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length. This method identifies the combined profit to be split for the associated enterprises from a controlled transaction and then splits those profits between the associated enterprises proportion to their relative contributions. The relative contribution made by each of the associated enterprises to the earning of such combined net profit, is evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances

Resale Price Method

A transfer pricing method based on the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. The resale price is reduced by the resale price margin. What is left after subtracting the resale price margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. customs duties), as an arm's length price of the original transfer of property between the associated enterprises.

Transfer Pricing Adjustment

An adjustment to the tax liability of an enterprise when a tax jurisdiction applies the arm's length principle to transactions between associated enterprises in a transfer pricing case.

Traditional Transaction Methods

The comparable uncontrolled price method, the resale price method, and the cost plus method.

Transactional Net Margin Method

A transactional profit method that examines the net profit margin relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realizes from a controlled transaction.

Transactional Profit Method

A transfer pricing method that examines the profits that arise from particular controlled transactions of one or more of the associated enterprises participating in those transactions.

Transfer Pricing Officer (TPO)

Transfer Pricing Officer" means a Joint Commissioner or Deputy Commissioner or Assistant Commissioner authorized by the Board to perform all or any of the functions of an Assessing Officer specified in Sections 92C and 92D in respect of any person or class of persons.

Uncontrolled Transactions

A transfer pricing term for transactions between enterprises that are independent enterprises (that is, that are not "associated enterprises") with respect to each other.

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