TRANSFER PRICING DEVELOPMENTS IN INDIA

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Introduction

In India, with the rise in the intra-group cross-border transactions in the present globalisation era, transfer pricing has emerged as one of the most considerable tax issues facing multinational enterprises (MNE's). The ability of MNEs to manipulate price in related party transactions, thereby, allocating profits from jurisdiction with high tax to those with favourable jurisdictions or low tax jurisdiction, is a matter of serious consideration for the tax authorities worldwide.

The application of the most appropriate transfer pricing method may yield a range of reliable arm's length price. Transfer pricing, being subjective in nature because of nature of transaction & selection of methods prescribed, had plethora of disputes among the determination of most appropriate method, comparability -inter and intra industry, adjustments, etc.

To reduce the disputes arising from ambiguous provisions, CBDT has carried out several amendments to the regulations and has also issued clarifications/circulars during the calendar year 2016 (including vide Finance Act, 2016). Few of such amendments have been summarised below. This note provides bird's eye view on few recent developments in India on the subject of Transfer Pricing regulations. The same can be broadly classified under three categories:

- Regulatory developments
- Progress of Advance Pricing Agreements programme
- Recent Judgements

Mumbai 23rd January, 2017

A. Regulatory developments

Few amendments have been carried out by the government vide Finance Act, 2016 as well as through circulars/notifications. The underlying theme was to provide the clarity and certainty on few controversial issues related to some Transfer Pricing regulations.

A.1. Amendment to existing Rule 10Bdealing with Use of Multiple Year Data

Rule 10B has been amended vide notification dated 19th October, 2015, issued by CBDT. This notification is indispensible to clarify the challenges and issues faced on use of multiple year data at the time of determining Arm's Length Price.

The amendment to Rule 10B aims to provide necessary assistance and guidance on the use of multiple year data by the tax payers. Synopses of amendments are as follows:

- Government has introduced new rule called as Rule 10B(5), and it would be applicable only in cases where Resale Price Method (RPM), Cost Plus Method (CPM) or Transactional Net Margin Method (TNMM) has been selected as the Most Appropriate Method (MAM).
- For each comparable, the data shall relate to the current year. In case such 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.
- If a comparable is selected on the basis of preceding year data, but is not found to be comparable for the current year for qualitative or quantitative reasons, then such comparable would need to be rejected from the data set.
- When using multiple year data, data for each comparable shall be the weighted average of the selected years.

A.2. Insertion of new Rule 10 CA dealing with situations where more than one ALP has been determined

For providing clarity and simplification in a scenario where more than one ALP is determined by the tax payer, the provisions of Rule 10CA shall provide adequate guidance to the tax payer by following ways:

Use of the weighted average to compute the ALP

The price in respect of comparable uncontrolled transactions shall be determined using the weighted average of the prices/data for;

- The current year and preceding two financial years; or
- Two financial years immediately preceding the current year (but not including the current year as the same may not have been available)

Where an enterprise has undertaken comparable uncontrolled transactions in more than one financial year, then for the purposes of this rule, the weighted average of the prices of such transactions shall be computed in the following manner, namely:—

- Where the prices have been determined using Resale Price Method, the weighted average of the prices shall be computed with weights being assigned to the quantum of sales.
- Where the prices have been determined using Cost Plus method, the weighted average of the prices shall be computed with weights being assigned to the quantum of costs.
- Where the prices have been determined using Transactional Net Margin Method, 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 to be employed, or as the case may be.

Range Concept

- The 'range concept' shall be applicable when:
 - (a) The MAM is Comparable Uncontrolled Price (CUP) Method, RPM, CPM, or TNMM; and
 - (b) There are at least 6 comparables

Where these conditions are not fulfilled, 'arithmetic mean' shall continue to apply, as before, along with the tolerance range benefit as notified by CBDT.

- Once the values in a data set are arranged in ascending order, the arm's length range would be data points lying between the 35th and 65th percentile of the data set.
- If the transaction price falls within the range, then the same shall be deemed to be the ALP. If the transaction price falls outside the range, the ALP shall be taken to be the Median of the data set.

A.3. Amendments arising from OECD BEPS Action Plan 13:

In line with the recommendations contained in the OECD report on Action Plan 13 of the BEPS Action Plan, the three-tiered transfer pricing documentation structure consisting of the following is introduced:

- amaster file containing standardized information relevant for all multinational enterprises (MNE) group members;
- a **local file** referring specifically to material transactions of the local taxpayer; and
- A Country-by-Country (Cubic) 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.

As per **Section** 286 of the Income Tax Act, the Cubic report has to be submitted by parent entity of an international group to the prescribed authority in its country of residence. The said report should be submitted with specified the documents the Act.



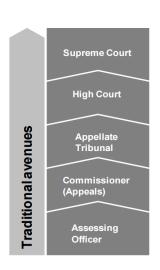
B. Progress of Advance Pricing Agreements Programme

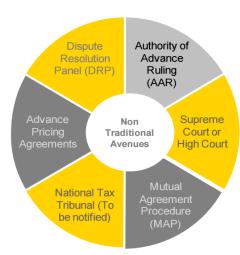
In order to reduce the litigation, the Advance Pricing Agreement(APA) Scheme have been notified by the Central Board of Direct Taxes (CBDT) by way of insertion of Rule 10F to Rule 10T and Rule 44GA in the Income-tax Rules, 1962 (Rules). It is also called 'covered transactions'.

The APA Scheme was introduced in the Income-tax Act in 2012 and the "Rollback" provisions were introduced in 2014

APA is a contract, usually for multiple years, between a taxpayer and at least one tax authority specifying the pricing method that the taxpayer will apply to its related-company transactions.

Difference between situations, pre introduction of APA (Traditional avenues) and post introduction of APA (Non Traditional avenues).





Source:Deloitte

These programmes are designed to help taxpayers voluntarily resolve actual or potential transfer pricing disputes in a proactive, cooperative manner, as an alternative to the traditional examination process.

The progress of the APA Scheme strengthens the Government's resolve of fostering a non-adversarial tax regime. The Indian APA programme has been appreciated nationally and internationally for being able to address complex transfer pricing issues in a fair and transparent manner. The approach and functioning of the officers in the APA teams have been appreciated and acknowledged by the industry in India and abroad.

The said agreement helps to provide:

- Certainty with respect to tax outcome of the tax payer's international transactions, by agreeing in advance the arm's length pricing or pricing methodology (ies) to be applied to the tax payer's international transactions covered by the APA;
- Removal of an audit threat (minimize rigours of audit), and deliverance of a particular tax outcome based on the terms of the agreement;

- Substantial reduction of compliance costs over the term of the APA; and
- For tax authorities, an APA reduces cost of administration and also frees scarce resources
- Certainty to taxpayers in the domain of transfer pricing by specifying the methods of pricing and setting the prices of international transactions in advance.

Due to these benefits many MNCs undertaking transactions which fall in Transfer Pricing provisions have started taking the said benefit which has increased number of applications filed by Taxpayer to Tax Authorities. Details of applications for unilateral and bilateral APAs received are as under:

Financial Year	Number of Applications Filed	Number of applications withdrawn	Number of Applications for which agreement is signed	Number of Applications Pending
2012-13	146	4	22#	120
2013-14	232	4	10	219
2014-15	205	-	-	204
2015-16*	7	-	-	7
Total	590	8	32	550

^{*} Till 31st December, 2015

Out of 5 APAs signed in FY 2013-14, one APA has been revised and signed in FY 2015-16 [Source: Annual report of Ministry of Finance – 2015-16]

Subsequent to December 2015, additionally over 100 new applications (both unilateral & bilateral) have been filed as per CBDT press release dated 4th January, 2017. The number of total applications filed in last four years is more than 700.

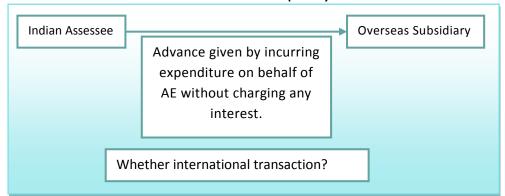
The said circular also confirms that total number of APA entered into by CBDT was 120 (including 113 unilateral 7 bilateral) APAs. A total of 56 APAs (4 bilateral APAs and 52 unilateral APAs) have been entered into in the calendar year 2016

C. Recent Judgements

A quick review of the reported judgements reveals that during the calendar year 2016, close to 600 reported cases dealt with the transfer pricing disputes. The subject of disputes were far reaching and numerous. Few of the reported judgements are summarised below by classifying them under broad subject of the dispute.

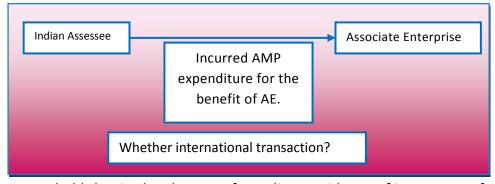
C.1. International Transactions / Associated Enterprise

Strides Shasun Ltd v ITO - TS-277-ITAT-2016 (Mum) – TP



It was held that the interest free advances given by the assessee to its overseas subsidiary by incurring expenditure on behalf of the AEs without charging interest or without recovering the said amount, was to be considered as an international transaction under clause (c) of Explanation (i) to section 92B of the Act.

Thomas Cook (India) Ltd v DCIT - TS-307-ITAT-2016 (Mum) – TP

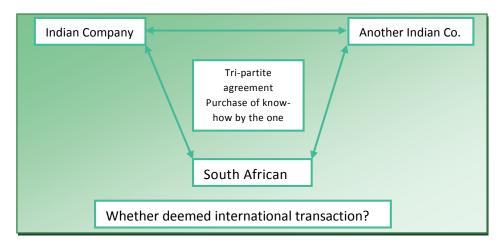


It was held that in the absence of any direct evidence of incurrence of Advertising, Marketing & Promotional (AMP) expenses by the assessee for the benefit of its AE or on behalf of its AE, the AMP expenses could not be treated as an international transaction under section 92B of the Act. It held that probable incidental benefit to the AE would not make the transaction an international transaction.

Accordingly, it deleted the addition made by the TPO arrived at by

benchmarking the AMP expenses of the assessee with the industry mean AMP expenses to total revenue.

Astrix Laboratories Ltd v ACIT - (2016) 67 taxmann.com 28 (Hyd)

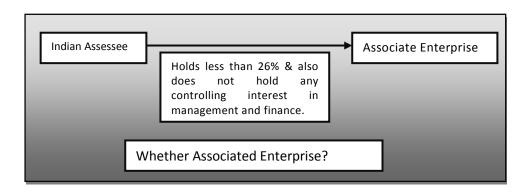


It was held that for the purpose of falling under the definition of international transaction, at least one of the parties had to be a non-resident and therefore the purchase of know-how by the assessee, a joint venture between an Indian company (Matrix) and a South African company (Aspen), from the Indian company (Matrix) pursuant to an tri-partite agreement between the aforesaid companies could not be considered as a deemed international transaction.

The contention of the TPO was that, the transaction was a deemed international transaction on the basis that Aspen being a party to the agreement dictated the terms and conditions of the transaction.

But both transacting parties were residents in India and hence contention of TPO was held invalid.

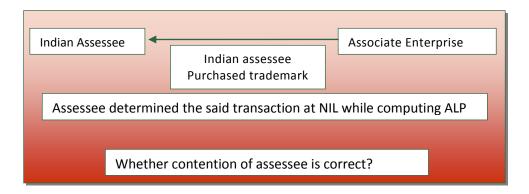
Dun & Bradstreet Technologies & Data Services Pvt Ltd v ACIT - TS-524-ITAT-2016 (Chny) - TP I.T.A.No.760/Mds/2014



Here, The Tribunal remitted the matter to the file of the AO with the direction to determine whether the non-resident with whom the assessee had entered into international transactions was an AE of the assessee since the assessee had less than 26 percent interest in the said company and was not holding any controlling interest in management and finance and the DRP had incorrectly presumed that since the assessee was pricing the sale of material, it had controlling interest over the said non-resident.

C.2. Most Appropriate Method

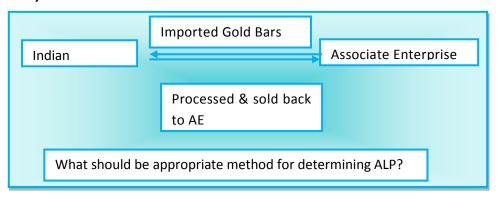
DCIT v FabIndia Overseas Pvt Ltd - TS-333-ITAT-2016 (Del) – TP



In the above case it was held that the TPO was not justified in determining the ALP of the purchase of trademark by the assessee from its AE at Nil on the ground that there was no need for the assessee to purchase such trademark.

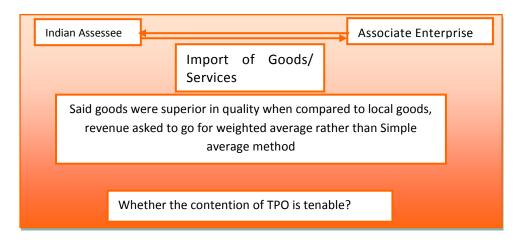
It was further held that the TPO had no role in examining the commercial rationale of decision to purchase a trademark and determine the ALP at Nil without conducting any analysis under the CUP method.

 Kailash Jewels (P) Ltd vs ITO - [2016] 68 taxmann.com 303 (Delhi-Trib)



The Tribunal held that where Assessee Company having imported gold bars from its AE, converted the same into jewellery and sold the same back to AE, since assessee was a simple job worker, CUP was to be regarded as most appropriate method for determining ALP.

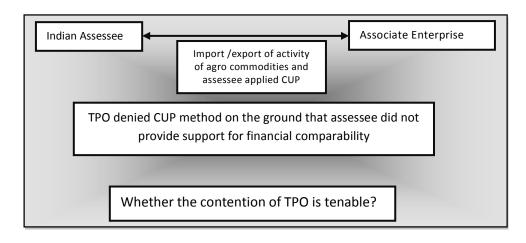
Merck Ltd. vs DCIT - TS-143-ITAT-2016(Mum)-TP



The Tribunal upheld TPO's application of CUP to benchmark assessee's import transaction following Serdia Pharmaceuticals ruling(ITAT Mumbai)and also allowed 10% quality adjustment as the quality of asseessee's products (being manufactured in a German plant where quality control requirements are much more stringent than in India) were demonstrably superior to locally manufactured products in India.

Further, The Tribunal rejected Revenue's contention that weighted average rather than simple arithmetic mean should be used to compute ALP of import prices, and held that only domestic prices of the product should have been taken into account and not the export price while benchmarking the import transaction.

DCIT v Noble Resources & Trading India Pvt Ltd - TS-269-ITAT-2016 (Del) – TP

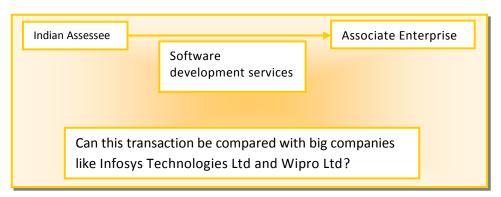


In this case, Tribunal held that the CUP method was the most appropriate method for benchmarking the international transactions of the assessee viz. export and import of agro commodities and upheld the use of third party quotations as an external CUP since the quotations furnished by the assessee were authentic and reliable.

Accordingly, it dismissed the contention of the TPO, rejecting CUP on the ground that the data provided by the assessee did not provide support for functional comparability. Reference was also made to the BEPS Action Plans 8-10 in respect to use of Quoted Prices and their authenticity for comparability under this Method.

C.3. Comparability - Inter and Intra Industry

• Avaya India Pvt Ltd v DCIT - TS-377-ITAT-2016 (Del) - TP

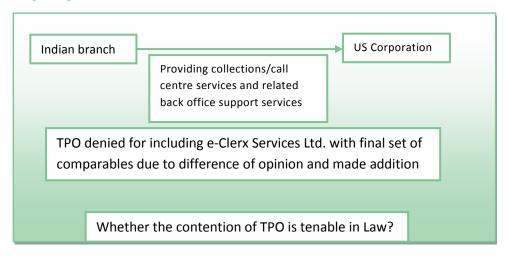


The Tribunal held that the assessee's software development services segment was not comparable to giant companies such as Infosys Technologies Ltd and Wipro Ltd in terms of risk profile, scale, nature of services, revenue, ownership of branded products and provision of both onsite and offshore services and companies having revenue from software products and training as well.

Further, with respect to the ITES Segment of the assessee, it held that companies engaged in providing high end KPO services and companies having related party to sales in excess of 15 percent could not be compared to the assessee engaged in providing low end services.

The Tribunal further held that the assessee's marketing support segment could not be compared to companies imparting technical consultancy services and companies not having a separate marketing support segment.

Genpact Services LLC Vs. ADIT, Circle 1(2), International Taxation,
 New Delhi

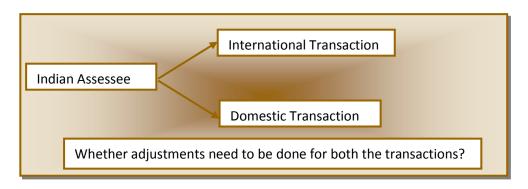


In this case the Tribunal held that e-Clerx provides sales and marketing support services to leading global manufacturing, retail, travel and leisure companies. Such services are aimed at supporting their e-commerce activities. It also provides sales and marketing support services to leading global manufacturing, retail, travel and leisure companies through its pricing and profitability services.

From the above discussed nature of business carried on by e-Clerx Services Ltd., it is patent that the same being a KPO company is quite different from the assessee, providing only IT enabled services to its AE, which fall in the realm of BPO services. Apart from that, it is further observed that this company has significant intangibles which it uses in rendering KPO services, against which the assessee does not have any intangibles. As such, e-Clerx Services Ltd. cannot be considered as comparable.

C.4. Adjustments / Computation / Calculations

 CIT v Goldstar Jewellery Design Pvt Ltd - (2016) 67 taxmann.com 86 (Bom)



The Court held that the TPO was unjustified in applying the base of capital employed under the TNM method without segregating the capital employed in respect of AE and Non-AE transactions. Further, it held that where the assessee entered into both international as well as domestic transactions, the Tribunal was justified in restricting the adjustment only to international transactions.

• Astrix Laboratories Ltd v ACIT - (2016) 67 taxmann.com 28 (Hyd)

The Tribunal held that for the purposes of making necessary adjustments as envisaged under Rule 10D, the relevant segments of the comparable companies were to be considered and only the segmental revenue and segmental costs were to be considered with allocation of common expenditure amongst the segments on a proportionate and reasonable basis.

Excellence Data Research Pvt.Ltd. & ANR. Vs. ACIT & ANR. (2016) 48 CCH 0051 (Hyd Trib)-ITA No.310/Hyd/2015

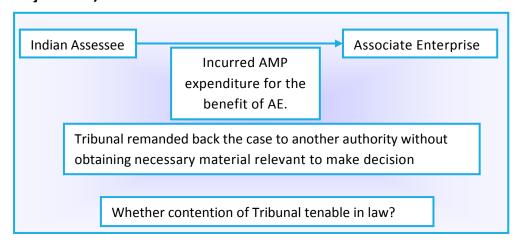
The Tribunal held that for the purpose of determining ALP, only transactions / turnover of assessee arising out of transactions with its AEs was to be considered and not the transactions undertaken by the assessee on an entity level. Accordingly, it set aside the matter to the file of the AO.

C.5. Specific Transactions

Paxar India Pvt Ltd v DCIT - TS-582-ITAT-2016 (Bang) - TP ITA No. 1788/B/2013

In this case the Tribunal held that where the assessee had paid **commission** to its US AE at 10 percent and justified the same under the CUP method on the basis of similar commission paid (@ 8 percent) by the AE to unconnected parties who acted as selling agents, no addition could be sustained since the commission paid by the assessee to its AE was for services rendered in respect of sales in the US and the scope of services rendered by the AE was much wider than the scope of services rendered by the uncontrolled companies to whom the AE was making commission payments at the rate of 8 percent.

Daikin Airconditioning India Pvt Ltd v/s ACIT [TS-533-HC-2016 (DEL)-TP] ITA 269/2016



The Court set aside the Tribunal order by holding that the Tribunal should decide the question regarding existence of international transaction involving advertisement, marketing and promotion ("AMP") expenses between assessee and its AE, instead of remanding the issue to any other authority for decision, where all the necessary material relevant to decide this issue is already on record. It further held that in case the question regarding existence of international transaction was answered by the Tribunal in the positive, the Tribunal should decide the further issues that arise in the appeal in accordance with law.

It further directed that in the eventuality that the first question is answered in the positive, it would be open to assessee to file further appeal before the High Court and raise relevant questions of law including relating to the jurisdiction and power of TPO to determine the existence of an international transaction even though it was not reported by assessee and also regarding the retrospective application of Sec 92CA (2B)

Marico Ltd v ACIT - TS-411-ITAT-2016 (Mum) - TP - I.T.A./8858/ Mum/2011 I.T.A./8713/Mum/2011

The Tribunal held that for the purpose of benchmarking the interest on **loan** given by the assessee to its US based AE, LIBOR was the safest tool since the loan was denominated in foreign currency and rejected the approach of the CIT (A) in adopting the rate of interest stipulated in the RBI Master Circular No 7 / 2006-07 dealing with External Commercial Borrowings.

UFO Movies India Ltd v ACIT - (2016) 66 taxmann.com 120 (Del)

The Tribunal held that where the assessee advanced a loan to its AE at LIBOR plus 247 basis points and Indian banks were charging LIBOR plus 250 basis points on similar loans, the addition made by the TPO / DRP was to be set aside, more so since the loans granted by the assessee were to subsidiaries under the same management and control which substantially reduced the risk factor.

Concluding Remarks

The trend of transfer pricing disputes is a matter of concern, both for tax payers as well as the government. We can expect from the government further steps in this direction of providing the adequate direction and certainty in tax policy /regulation& its implementation. Budget 2017 would offer one such opportunity for government in this regard. In the post BEPS environment, MNEs would welcome unambiguous, transparent & clear tax rules and policy from the government. Such positive steps by the government will further support its ambitious and inclusive growth oriented schemes like Make in India, Digital India, etc.