From President Desk...........................

Dear Professional Colleagues and Readers,

Indian Economy

India’s economy grew at 7.1% in quarter one of 2016-17, at its slowest pace in last five quarters, falling below expectations. It grew at 7.9% in January – March quarter of 2015-16. The slow growth is due to sluggish investment and low farm output.

However, first quarter direct and indirect collections are robust. We can expect it to be robust in rest of the year. Bountiful rains all over the country, increased pays on account of revisions in salary of the Government employees along with various structural reforms could still take growth closer to 8% for the full financial year.

Opportunities for Professionals

Practicing professionals are busy in hectic September for finalization of tax audit, which is bread and butter practice of Chartered Accountants. Many opportunities are devolving to professionals and it is expected that due to continue high growth of Indian economy many newer areas will be opened up for the professionals like GST, Start Ups, Technology etc. The professionals be it practice, in industry or as an entrepreneur, need to upgrade his/her knowledge and skills to match it with changes in fiscal laws, businesses, technology etc.

At CVOCA we are always try to make aware the members about new opportunity, newer avenues to grow and update them with new developments taking place regularly through innovative programs and articles. We at CVO CA always encourage and motivate members to take newer challenges for enhancement their professional skills.

High growth, structural reforms and liberal FDI norms have made India as attractive destination to do business. Further, due to globalization Indian Corporate are investing in the businesses abroad and becoming MNCs. So, there is tremendous increase in cross border transactions. Simultaneously there are many pending disputes on arm's length pricing in cross border transactions and amount involved in such disputes are very high.

There lies opportunity for our professionals in International taxation and transfer pricing. This issue of News and Views is special issue on transfer pricing, which covers overview of transfer pricing, Tools of transfer pricing study, assessment procedures, recent case laws and domestic transfer pricing, which will be useful to the members.

Programs at CVO CA

During the month of August we have organized various programs for the members like study circles on Opportunities in Information technology and Recent developments in TDS, Capital Market meet and career guidance for newly passed CAs, the detailed reports have been appeared in Events in retrospect column.

At CVO CA, two courses, one on CVO Certified Accountants Course (CCA) is conducted and is done half way and other we have recently started course on Kaizen for entrepreneurs of manufacturing companies jointly with KCF.

GST study group has been formed. We professionals have to unlearn the VAT and learn and relearn GST. Many of our members have enrolled. Those who are interested and still have not enrolled are requested to enrol. Enrolment is opened on first come first served basis. The details modality of GST Study group is given elsewhere in the News and Views.

In this study group we will invite our members and other eminent faculties who specialise in indirect tax practice to guide the group plus solve tricky issues in GST law.

Representation

In the month of August we have made representation to the Chairman, CBDT about draft rules in respect of buy back of shares taxable u/s 115QA. The representation letter is reproduced in the News & Views.

Michchhami Dukkadam

There is no revenge as complete as forgiveness – Josh Billings

To forgive and to seek forgiveness is the essence of Paryushan Parva and in fact is one of the fundamental of Jainism. Forgiveness breaks a bond of negativity. Upon forgiveness, energy is immediately released to bring you highest goodness in oneself. Breaking negative bond affects others as well and their heart also get soften.

To forgive or to seek forgiveness means one is forever giving up his hated feelings towards the person to whom he is forgiving or seeking forgiveness.

On the occasion of Paryushan Parva I seek forgiveness from bottom of my heart for all my feelings, words, deeds and non deeds which may in any way have hurt you. Michchhami Dukkadam

I request all to take active participation in the activities of the association.

Thank you all ..... Always in Gratitude

Date: September 01, 2016

Enhance Excel Empower

Follow us on ‪#‎CA‬, LinkedIn @cvocain ⬬ Join Yahoo group : cvoca@yahoogroups.co.in
Let's try to transform ourselves and move towards self-purification, self-enlightenment and self-achievement

Dear Members,

Parvadhiraj "Paryushan Parva" brings the importance of some of our religious rituals, Dharma Aaradhna and Satsang with our Saints and Gurus and detach us from our busy, monetary world.

All of us - young and old, men and women happily participate with full vigour and zeal in various religious rituals and other events. Pravachans and Talks by Saints and learned Gurus are organised during these days to drive out evils from our hearts, transform our mind and body and lead us to self-purification and enlightenment, and ultimately leading to our true destination, salvation.

In the present time, however, perhaps, what is required the most is to be a good human being first. The Paryushan Parva guides us to honour our humanly responsibilities religiously and to use our strength and power for the betterment of all. We all are committed; we are responsible to our family members, relatives, the people associated with us, other associates, the society and the whole world. And while we perform all the religious rituals and Kriyas, we need to take care of these responsibilities too. One would appreciate that if each one of us thinks on these lines, perhaps, we will have greater happiness and peace around us.

Our Saints and Gurus, while explaining us the life history of all our Tirthankaras and Aacharyas, have time and again warned us to stay away from negative usage of our strength and power. As we have always, then to offset the same with vigorous punishment by the all mighty in future.

Our religion has given us a very strong virtue - forgiveness. To seek pardon and to forgive, both are the traits of brave and strong men. By repenting from the bottom of our heart for a wrong deed and seeking forgiveness for all such wrong deeds by leaving aside our Ego may lead us to get some respite from the rigors of those wrong deeds.

So on the eve of Paryushan Parva, incorporating whatever said above I also seek your all pardon for any of my past wrong doings. Michchhami Dukkaddam!

By walking on this path, let us all purify traits of our soul, get rid of worldly discords and get fully absorbed in the eternal truth by experiencing and realising the true nature of the soul. And by doing so also put an end to all evils present in us.

Then only the days of Parvadhiraj Paryushan Parva will transform us to self-enlightened and self-achieved, which ultimately will lead us to liberation or salvation.

Warm regards,

CA Mulesh Savla

From the desk of Chairman
The provisions relating to Transfer Pricing have not only been a source of major litigation but also affected the manner in which it complicated some issues of foreign investments within the country. Infact, the amount of litigation that has been generated in India on account of transfer pricing provisions has been unprecedented in volume terms also as compared to the overall litigation world over on this aspect.

While it may be fashionable at times to criticise the tax policy of the country, the issues relating to profit shifting and base erosion has been a subject matter of heartburn even amongst the developed nations. The levy of around USD 14.5 billion tax by EU on Apple in regards to its operations from Ireland is case in the point. With globalisation and increase in cross border trade every jurisdiction trying to extract its rightful share of revenue is quite legitimate. It is estimated that world-wide more than half the transaction take amongst the related parties. Infact, BEPS initiative of OECD is one of the important developments in this regards. While BEPS has much wider implication as it also covers the aspects of base erosion within its ambit, transfer pricing generally affects profit shifting between two entities who are associated in a manner that there exists a possibility of arranging or influencing the transactions to enable reduction of tax liability.

Originally the provisions of transfer pricing were introduced in Chapter X relating to Avoidance of Tax, w.e.f. 1/4/2002 to bring within its ambit International Transaction. The observations of Supreme Court in Glaxo Smithkline’s case resulted in expansion of the scope to certain specified domestic transactions w.e.f. 1/4/2013. Earlier, most of the transactions were governed largely by section 40A(2)(b) and certain limited cases by deduction provisions where transaction arising on account of close connection got covered for eg. 80IA(10).

As per section 92 following transactions are required to be computed having regards to arm’s length price—

(a) Income arising from international transaction, including allowable expenditure and interest;
(b) International transactions or specified domestic transactions of shared services between associated enterprises;
(c) Specified domestic transactions relating to allowance of expenses or interest or allocation of any cost or expenses or any income.

The above are subject to further conditions of sub-section (3) which makes applicability of provisions redundant if they result in reduction of income or enhancement of loss otherwise computed.

Thus, it will be seen that the purpose of the provisions of section 92 is only to help in computation of incomes or expenses on arm’s length pricing and it does not create any additional charge. The provisions relating to transfer pricing are an aid to computation of income or expenses and by themselves cannot bring to tax anything which is otherwise not chargeable by virtue of section 5 r.w.s. 2(24). In short these are provisions relating to computation only.

The terms which repeatedly arise and need consideration while dealing with the subject of transfer pricing are associated enterprise, international transaction and specified domestic transactions. All these terms have been elaborately defined and need due consideration to understand whether the transaction will get covered by any of the limbs of the definitions of each term.

The most important machinery provision of the transfer pricing is section 92C which is being separately dealt in the other article. But it would be worthwhile to note that the whole computation mechanism arises from the said section which provides for following methods of computation—

(i) Comparable uncontrolled price method;
(ii) Resale price method;
(iii) Cost plus method;
(iv) Profit split method;
(v) Transactional net margin method and
(vi) Such other method as may be prescribed.

It may be noted that above are not options to be used for determination of arm’s length price but preferences to be decided upon and eliminated before jumping to the next appropriate method in sequential order. Rule 10B provides elaborate guidance on choice of most appropriate method.

The choice of appropriate method, as discussed elsewhere in this issue, require elaborate study of the transactions involved and thus the study report assumes great significance in determination of most appropriate method based on FAR (Function, Assets and Risk) analysis of the entities involved in the transaction. Rules 10A to 10C are very important provisions in this regards and rule 10D provides for documents that are required to be contemposously maintained for purpose of determination of ALP.

In last few years there have been further important development in the subject of transfer pricing and these relate to—

(1) Dispute resolution panel providing for mechanism of determination of ALP by a panel of three Commissioners.

(2) Safe harbour rules which provide for the acceptable margins within which certain types of transactions may fall.

(3) Advance pricing Agreement is a measure which has been recently announced whereby an entity enters into agreement with the Board for determination of ALP or manner of computing ALP.

The subject of transactions between related parties and their impact has also assumed greater significance in accounting sphere as well and is not confined only to disclosure but also serious discussions in boards and audit committees.

However, as a parting though I would like to end by pointing out that is this craze to put things in straight jacket formulae somewhere leading to putting restrictions on business process innovations? Can there ever be one size fits all apparel?

One may have varying opinions on pros and cons but one thing is definite that the current issue of Newsletter has important articles on latest development on the subject and I am sure practitioners of transfer pricing shall find this very useful in upcoming audit and assessment season.

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1. Introduction

1.1. Taxation based on transfer pricing and related compliances are becoming an important issue for many companies, both foreign and domestic. India has introduced detailed Transfer Pricing Regulations in 2001 and since then the Transfer Pricing compliances has become one of the biggest compliance activity for many MNCs. Some of the companies have implemented a full blown comprehensive approach to transfer pricing whereby creating and developing a team of decision makers and other resource people, both within and outside the company to comply with the inland transfer pricing regulations.

1.2. India has adopted detailed transfer pricing documentation rules which has resulted in dramatic increase in the volume and complexity of international intra-group trade and the heightened scrutiny of transfer pricing issues by tax administrations and in turn has resulted in a significant increase in compliance costs for taxpayers. Nevertheless, tax administrations often find transfer pricing documentation to be less than fully informative and not adequate for their tax enforcement and risk assessment needs.

1.3. OECD in its BEPS report has listed down three important objectives which every transfer pricing study should take care of:

- to ensure that taxpayers give appropriate consideration to transfer pricing requirements in establishing prices and other conditions for transactions between associated enterprises (‘AEs’) and in reporting the income derived from such transactions in their tax returns;

- to provide tax administrations with the information necessary to conduct an informed transfer pricing risk assessment; and

- to provide tax administrations with useful information to employ in conducting an appropriately thorough audit of the transfer pricing practices of entities subject to tax in their jurisdiction, although it may be necessary to supplement the documentation with additional information as the audit progresses.

2. Approach to Transfer Pricing Study

2.1. The approach of “one size fits all” does not appear viable for the facets of Transfer Pricing study. Instead, Transfer pricing study should be based on the facts and transaction pattern of each Assessee.

2.2. In India, prevalent practise of Transfer Pricing study is more based on compliance requirement rather than on business requirements. Therefore, to understand the approach for carrying on transfer pricing study, it is important to understand the compliance requirements for transfer pricing.

2.3. Rule 10D of the Income-tax Rules prescribes various information and documents which are required to be prepared and maintained. Such information and documents can be divided into two parts viz. (i) Primary Information and Documents and (ii) Supporting Documents.

2.4. The Primary Information and Documents required to be maintained can further be classified into three categories:

**Enterprise-wise Documentation**

These sets of documents describes relationship of the assessee with AE and the nature of business. This information is largely descriptive. An illustrative list of information / documents to be maintained under this classification is provided below.

- Ownership / shareholding pattern of the Assessee;

- Business profile of the multinational group;

- Details of AE(s) with whom international transactions are entered into;

- Business of the Assessee and the AE(s); and

- Broad industry profile in which the Assessee operates.
The above documentation would provide the tax authorities with the preliminary information of Assessee’s group profile, Assessee’s function in the group and the industry in which it operates. The broad industry profile, if well documented, will provide the tax authorities with an overview of the demand and the business drivers within the industry as well as the Assessee’s position in the industry. The documentation can also provide an overview of the Assessee’s growth objectives, given the evaluation of the industry sector and the competitive dynamics within industry in which the Assessee operates.

**Transaction specific documents**

These documents explain each international transaction in detail e.g. nature and terms of contract, description of the functions performed, assets employed and risks assumed by each party to the transaction, economic and market analyses, etc. An illustrative list of information/documents to be maintained under this classification is provided below.

- Details of each international transaction e.g. name of the AE(s), product transferred / service provided, quantity, price; shipment and credit terms, etc.;
- Functional analysis of the Assessee and AE(s) listing the functions performed, assets employed and risks assumed for undertaking the international transaction;
- Pricing policy adopted for the international transaction;
- Budget / forecasts for the Assessee’s business;
- Reports of market research studies carried out and technical publications brought out by institutions of national or international repute;
- Record of uncontrolled transactions (internal and external comparables) for each international transaction including nature and terms of the uncontrolled transactions; and
- Economic analysis to provide details of data used and data rejected with reasons thereof.

The above information would capture the relevant information about the Assessee and the concerned AE(s). The documentation of the precise functions performed by the parties (Assessee and AE(s)) and the economic characterisation (eg: integrated manufacturer, contract manufacturer, indenting agent, support service provider, etc) of the respective parties would be relevant here. The economic characterisation of parties would assist the Assessee to determine the tested party.

Tested party means the AE from whose perspective the international transaction is tested for the determination of the ALP.

In case of an international transaction between two AEs, in order to conduct an economic analysis, one has to select one of the two AEs as the tested party. The parameters for selection of the tested party could, inter alia, include:

- The tested party should be the least complex (functionally) of the transacting parties.
- There should be availability of reliable data that requires fewest and most reliable adjustments
- The tested party should ideally not own intangibles / or own fewer intangibles

The reasons for selection of one of the two AEs as the tested party, based on above parameters, should be adequately documented.

In case the foreign AE is considered as the tested party for a particular international transaction, the relevant documents regarding the foreign AE should be maintained. It may be pertinent to note that the Tribunal in the case of Ranbaxy Laboratories Ltd. observed that if taxpayer wishes to take foreign AE as the tested party it must ensure that the relevant data for comparison is available in public domain or is furnished to tax administration.

**Computation related documents**

These documents detail the methods considered, actual working assumptions, adjustments made to the transfer prices and any other relevant information / data relied for determining the ALP. An illustrative list of information / documents to be maintained under this classification is provided below.

- Nature of each international transaction and the rationale for selecting the most appropriate method for each international transaction. The Assessee is required to substantiate the selection by proper
documentation and the manner in which the method was applied to each international transaction;

- Actual working / computation of the arm length’s price ('ALP') i.e. recording the calculations i.e. comparability analysis performed to determine whether or not uncontrolled transactions are comparable to the international transactions with reasons for adjustments made to make the comparability analysis more reliable.

- Critical factors and assumptions influencing the determination of the ALP;

- Adjustments made (along with reasons) to the Assessee’s transfer prices so as to align it with ALPs; and

- Any other information relevant for the determination of the ALP

One of the aspects of documentation is to capture the group policies and the pricing methodology of the international transaction. For instance, pricing methodology could be either on cost plus mark-up basis, percentage on sales basis, bilateral negotiations basis, etc to appropriately substantiate the arm’s length nature of the transaction.

2.5. The Supporting Documents would primarily include the official publications, reports, studies etc. of the Government of the country of AE or other country, market research studies, reports and technical publications of reputed Institutions (National and International), price publications etc. to support the Primary Information and Documents kept and maintained by the Assessee.

In case of exceptional transactions, assessee should endeavour, as far as possible, to record all relevant information (available at the time of entering into the international transaction) that is critical for the management to determine the pricing / other factors of the international transaction. The information / documents maintained could be in the form of minutes of Board of Directors meeting, emails, faxes, agreements, quotations, independent valuations, market surveys, etc.

3. Comparability Analysis in Transfer Pricing Study

3.1. The key to any transfer pricing study is the comparability analysis. Comparability analysis is relevant not only for the determination of ALP under the method selected, but also for selection of the most appropriate method itself.

The documents required for comparability analysis under each of the prescribed methods could be different. An illustrative list of documents to be maintained by the Assessee for the determination of ALP in case of an international transaction is discussed below:

3.1.1. Comparable Uncontrolled Price ('CUP') Method:

CUP method compares the price for property transferred or services provided in a controlled transaction to a price in a comparable uncontrolled transaction.

When assessing the factors in determining comparability between controlled and uncontrolled transactions, the Rules provide that the specific characteristics of the property transferred or services provided, the functions performed, the contractual terms and the conditions prevailing in the market, would be, inter alia, some of the relevant factors.

For the transactions benchmarked using the CUP method, the documents that may be maintained by the Assessee to justify the CUP could, inter alia, include the following:

- Process of identification and listing of:
  - Internal Comparable Uncontrolled Transactions
    An internal CUP could be available where the tested party undertaking the controlled transaction also undertakes an uncontrolled transaction in respect of the same property / service, in the same financial year
  - External uncontrolled comparable transactions
    An external CUP would be available when third parties undertake transactions similar to that of a tested party

- Nature, terms and conditions of uncontrolled comparable transactions

- The supporting agreements / correspondence / minutes of meetings and any other documents exchanged between the Associated enterprises ('AE')

- Basis of selection of the CUPs considering the functions performed, assets utilized and
risks assumed by the tested party (as
documented under the functional analysis)
vis-à-vis the comparables

3.1.2. Resale Price Method (RPM):
RPM compares the gross profit margin in a
controlled transaction with the gross profit
margin in an uncontrolled transaction.

RPM is applicable to transactions involving a
purchase and subsequent sale of the same
property or services. Consequently, greater
degree of similarity is required between the
products / services (of the tested party vis-a-vis
the comparable).

For the transactions benchmarked using the
RPM, the documents that may be maintained by
the Assessee to justify the ALP could, inter alia,
include the following:
- Details of resale price charged in an
  uncontrolled transaction
- Details of
  - controlled transaction between AEs, and,
  - the transaction between AE and the third
    party
  - such as, terms of the transactions and the
    functions performed, assets utilized and
    risks assumed
- Search conducted to find the comparables
- Analysis conducted to find comparable gross
  margin data
- In case of any adjustments to gross margin
  of the comparables, further documentation
  would be required
- Documents supporting the computation of
  ALP

3.1.3. Cost Plus Method (CPM):
CPM compares the mark-up over costs in a
controlled transaction with the mark-up over
costs in an uncontrolled transaction.

CPM envisages the computation of the total cost
(direct and indirect) of production incurred by
the enterprise in respect of the property
transferred or services provided to an AE.

For the transactions benchmarked using the
CPM, the documents that may be maintained by
the Assessee to justify the ALP could, inter alia,
include the following:
- Total cost of production of the tested party.
- Search conducted to find the comparables.
- In case of any adjustments to mark-up,
  further documentation would be required.
- Documents supporting the computation of
  ALP.

3.1.4. Profit Split Method (PSM):
PSM is applicable mainly in international
transactions involving transfer of unique
intangibles or in case of multiple interrelated
international transactions.

PSM determines the combined net profit of the
AEs and the same is then split in proportion of
the relative contributions of the AEs. The
combined net profit may be partially allocated to
each AE so as to provide it with a basic return
and the balance, after such allocation, may be
split amongst the AEs in proportion to their
relative contribution which may be determined
based on intangibles, etc owned by the AEs.

For the transactions benchmarked using the
PSM, the documents that may be maintained by
the Assessee to justify the ALP could, inter alia,
include the following:
- Number and nature of transactions closely
  interlinked.
- Details of all AEs involved in the
  transaction.
- Functions performed by each AE.
- Intangibles owned by each AE.
- Search conducted to identify ordinary
  operating profits for each of the AE.
- Basis of apportionment and allocation of
  profits.

3.1.5. Transactional Net Margin Method (TNMM):
TNMM is generally appropriate for transactions
where RPM / CPM cannot be adequately applied.
TNMM is more tolerant to the functional
differences since these differences often get
reflected in the variation in the operating
expenses.

TNMM examines the net profit margin
[generally, operating profit after depreciation
but before interest] from controlled transactions
in relation to a relevant base like sales, costs,
assets, etc. Unlike RPM and CPM which compares gross margins / mark-up, TNMM involves a comparison of margins at the net profit level.

For the transactions benchmarked using the TNMM, the documents that may be maintained by the Assessee to justify the ALP could, inter alia, include the following:

- Determination of functions for choice of comparables.
- Search conducted to find the comparables.
- Calculation of net profit margin of comparables and the tested party along with assumptions made.
- Determination / use of appropriate profit level indicator (PLI).

In case of any adjustments to net profit margin, further documentation would be required.

- Computation of ALP.

3.1.6. Search process for identification of comparables using RPM, CPM, PSM and TNMM:

The Assessee needs to properly document the search process to find the comparables. The Assessee, inter alia, needs to maintain the following documents in this regard:

- Search methodology for determining comparables.
- Details of database (such as, Prowess, Capitaline Plus and ACE, and international databases, such as, Onesource, Amadeus, TP Catalyst) selected for conducting the search for comparables.
- Source documents for each of the above processes.
- Reasons for acceptance or rejection of comparables.
- Detailed accept / reject sheet. Reasons for rejection of comparables may, inter alia, include the following:
  - Sufficient financial / descriptive information is not available to so as to undertake analysis;
  - Companies have been declared sick;
  - Companies have ceased business operations
- or are currently inactive;

- Companies have experienced exceptional year of operations;
- Companies are engaged in activity other than activities carried out by the tested party;
- Companies themselves had transactions with related parties (i.e. transactions are not uncontrolled);
- Segmental information is not available / is insufficient to undertake analysis;
- Companies experience persistent operating losses.
- Short business descriptions of accepted comparables.
- Financial data of all companies forming part of the search.
- Calculation of the margins / mark-up using annual report data / database data for all accepted companies, bringing out the following:
  - Working of arithmetic mean of comparables margin / mark-up.
  - Details of adjustments made to account for differences.

Other Method

The intent of having the ‘other method’ appears to be to provide flexibility to the taxpayer to select a method other that five methods for benchmarking routine transactions (such as reimbursement of expenses, etc) and non-routine / unique transactions (such as transfer of intangibles, etc). This would also enable taxpayer to credible rely upon data referred to in commercial negotiations, data points reflecting market conditions and other persuasive evidences which would help in establishing ALP.

Broadly, this step is in line with the OECD TP guidelines and many other global jurisdictions that support use of ‘other method’ provided it satisfies the arms-length principle and is found to be more appropriate based on facts and circumstance of the case. Of course if the ‘other method’ is used, it must be supported by an explanation of why conventionally recognized methods were regarded as less appropriate and why selected ‘other method’ provides a better solution.
Other method seems to be a price based method and therefore an extensions of CUP method as it relies on the price been charged or paid or would have been charged or paid for the same or similar uncontrolled transaction, with or between non AE.

Following could be scenarios where other method can be useful:

- Use of revenue split / allocation in case of investment banking, logistics and similar complex uncontrolled transactions
- Use of tender documents, price quotations to demonstrate ALP in case of loan, guarantee transactions
- Reliance on standard rate cards
- Use of valuation methodologies for determining ALP for transfer of business/intangibles
- Technical valuation reports for determining ALP for purchase/sale of fixed assets.

It should however be kept in mind that for application of the ‘other method,’ the taxpayers would still be required to satisfy the six comparability factors prescribed by Rule 10C. Also, other method still relies on the availability of same and similar uncontrolled transaction for the purpose of benchmarking analysis. Therefore, the applicability of the other method in the scenario where no comparable uncontrolled transactions are available would still be a challenge.

3.1.7. Adjustments to price / margin / mark-up.

In case of any adjustments to price / margin / mark-up, the following needs to be documented:

- Nature of adjustments.
- Rationale of adjustments.
- Working of adjustments.
- Impact of adjustment.

Adjustments for differences may involve subjectivity in assigning quantitative data for qualitative factors. The adjustments could, inter alia, include adjustments for depreciation, credit period, working capacity, client rating, credentials, quantity, etc.

3.1.8. Use of PLI

In absence of specific guidelines on the choice of PLI (to benchmark international transactions) under the Indian transfer pricing legislation, one has the discretion to adopt either of the following PLIs:

- Gross margin or operating margin on operating cost; or
- Gross margin or operating margin on operating revenue.

The adoption of PLI in different methods is discussed hereunder:

- Under the CPM, the PLI usually adopted is gross margin (mark-up) on operating cost
- Under the RPM, the PLI usually adopted is gross margin on operating revenue
- Under the TNMM, the selection of PLI depends on the nature of transactions entered into by the tested party
- In case transactions of a tested party pertain to receipt of income, the PLI adopted is operating margin on operating cost.
- In case transactions of a tested party pertain to payment of expenses, the PLI adopted is operating margin on operating revenue.

4. Conclusion

Transfer Pricing analysis on paper looks simple but in practice it can be a laborious, difficult, time-consuming and, more often than not, expensive exercise. Seeking information, analysing all the data from various sources, documenting the analysis and substantiating adjustments, all steps cost precious time and money. It is therefore important to put the need for Transfer Pricing analyses into perspective and to keep the burden and costs that should be borne by a taxpayer to identify possible comparable and obtain detailed information thereon reasonable and proportionate to the complexity of the transaction. It is recognised that the cost of information can be a real concern, especially for small to medium sized operations, but also for those MNEs that deal with a very large number of controlled transactions in many countries. However, it should be observed that burden of cost cannot be a reason for dilution of Transfer Pricing comparability standards.
TRANSFER PRICING (‘TP’) LITIGATION – TP ASSESSMENT AND DISPUTE RESOLUTION PANEL (‘DRP’)

Contributed by:
CA Kushal Dedhia
(a member of the association)
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1. TP Litigation Process

- End of the financial year (March 31)
  - Filing of accountant’s report i.e. Form 3CEB and tax return (November 30)
  - AO issues the notice within six months from the end of the FY in which return has been filed
  
  - Based on the results of the above mentioned procedure AO passes the draft order
  - Notice to be issued by TPO calling for supporting documents and evidences
  - Reference to be made by AO to the TPO (Refer subsequent section for recent guidelines)
  
  - Receipt of draft order by taxpayer
  - Files objection with the DRP (within 30 days of receipt of draft order)
  - DRP passes direction (within 9 months from the end of the month in which the draft order is issued)
  
  - Conveys acceptance/ No objection communicated (within 30 days of receipt of the draft)
  - AO passes final order (within 1 month from the end of the month in which direction is received)
  
  - AO passes final order (within one month from the end of the month in which acceptance received)
  - Appeal before CIT(A) (within 30 days after receipt of the final order from the AO)
  - Appeal to be filed before the ITAT (within 60 days of the receipt of the final AO order / CIT(A) order
  
  - Supreme Court
  - High Court (only on substantial question of law)
2. Transfer pricing assessment – Section 92CA

A. Reference to the TPO

In order to reduce the rising volume of transfer pricing litigations and to provide clarity and procedural uniformity, the Central Board of Direct Taxes (CBDT) has recently issued Instruction No. 03/2016 on 10 March, 2016 (Instruction) replacing Instruction No. 15/2015 issued on 16 October, 2015 to give guidance to Assessing Officers (AOs) and Transfer Pricing Officers (TPOs) regarding transfer pricing assessments. The said instruction focuses on the procedure for reference to be made by AO to the TPO and outlines the respective roles of AO and TPO with reference to international transactions.

Some key aspects of the Instruction that are likely to impact the transfer pricing landscape of the country are highlighted below.

(i) Selection of cases by the AO

- Till date, any case involving an aggregate value of the international transaction exceeding INR 150 million was mandatorily selected for scrutiny and referred to the TPO.
- Under the new guidelines, the selection of the cases for TP assessments would be based on the risk parameters and not on the basis of the value of the international transaction.

(ii) Reference to the TPO

Under the following circumstances only, AO has to mandatorily refer the case to the TPO

- **Case I** - All cases selected for scrutiny on the basis of TP risk parameters either under the CASS or manual selection process.
- **Case II** - Cases selected for scrutiny on non-TP risk parameters shall be referred to TPO only in following circumstances:
  - Either has not filed accountant’s report (i.e. Form 3CEB) or has filed Form 3CEB but has not disclosed an international transaction(s) or SDT(s) or both;
  - Historical TP adjustment of INR 10 crores or more and such an adjustment has been upheld by the judicial authorities or is pending in appeal; and
  - Findings of TP issues in respect of international transactions or SDT's or both during search and seizure and survey.
- **Case III** - Cases involving a TP adjustment in earlier years which has been set-aside either fully or partially by the ITAT or High Court or Supreme Court.

Henceforth, if any case is referred by the AO to the TPO, the taxpayer can first approach AO asking for the reason for reference so as to confirm whether the same is in conformity with the above instruction.

B. Update on time limit for transfer pricing assessment – Finance Act 2016

- Based on the amendment in the Finance Act 2016, the time limit for completion of assessment where reference is made to the TPO reduced to 33 months (from 36 months) from the end of the relevant assessment year i.e. henceforth it will be 31st December.

Accordingly, the transfer pricing assessments will now have to be concluded by 31st October (i.e. any time before sixty days prior to the date on which time limit for fresh assessment us. 153 expires i.e. 31st December). Kindly note that, in technical parlance the due date for completion of transfer pricing assessment comes to 01st November, however the department has internally communicated to the TPO to consider the completion date as 31st October.

FROM: NEWS BULLETIN COMMITTEE

**Be happy with who you are and what you do, and you can do anything you want.**
In lieu of the above amendment, the due date for ongoing transfer pricing assessment for AY 2013-14 will be 31st October, 2016 instead of January, 2017.

Further, the time available for completing transfer pricing assessments excludes the time:

- for which the assessment is stayed by Court;
- or where a reference for exchange of information with other countries has been made to the Competent Authority.

Where the time available for completion of assessment excluding such period is less than 60 days, the time available to the TPO will now be extended to 60 days, maximum time period to close the assessment is 1 year from date on which the first reference for exchange of information is made.

3. **Dispute Resolution Panel (‘DRP’) – Section 144C**

DRP mechanism was introduced by Finance Act, 2009 as an alternative to first appellate authority i.e. Commissioner of Income-tax (Appeals) [CIT(A)] with the objective of speedy disposal of disputes and to encourage the growth of foreign investment in India.

The salient features of the DRP are as under:

- taxpayers with transfer pricing adjustments or a foreign company can only apply to the DRP;
- it has a wide powers akin to those of the court under the Code of Civil Procedure, 1908 and the directions issued by the DRP are binding on the tax officer;
- the DRP consists of three commissioners or directors of income tax appointed by the Central Board of Direct Taxes (CBDT) and the dedicated panels are located in metro cities for efficient disposal of cases;
- no payment of tax till AO issues the final order in pursuance of DRP directions;
- DRP application has to be filed in Form 35A in quadruplicate and the format for the same is explained below;
- DRP also accepts additional evidence through separate application but at their discretion as there are no rules prescribed as in the case of ITAT;
- The taxpayer can raise any matter before the DRP irrespective of the fact that such an issue was not raised before the AO. In plethora of judgments it has been upheld that though the powers of CIT(A) is co-terminus to the power of the AO, still it has no jurisdiction over the matters, which were not raised or processed before the AO;
- DRP has to complete the hearing and give its final directions within a period of nine months from the end of the month in which the draft order was forwarded to the assessee; and
- The directions issued by the DRP can be challenged by the assessee before the ITAT, however this directions cannot be challenge by the Revenue (as amended in the Finance Act 2016, earlier it was appealable by the Revenue)

**Format of Form 35A is reproduced below:**

- Grounds of Objections
- Facts as submitted to Assessing Officer
- Facts, if any, modified by the Assessing Officer
- Legal arguments submitted to Assessing Officer
- Case laws relied upon by the assessee
- Legal arguments relied upon by the Assessing Officer
- Case laws relied upon by Assessing Officer
- Grounds of Objections
- Facts as submitted to Assessing Officer
- Facts, if any, modified by the Assessing Officer
DRP vs. CIT(A): The key differentiation is produced in the table below:

<table>
<thead>
<tr>
<th>Key</th>
<th>DRP</th>
<th>CIT(A)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constitution</td>
<td>Collegium of three officers of the CIT rank.</td>
<td>Only one CIT</td>
</tr>
<tr>
<td>Application process</td>
<td>If the taxpayer chooses this route, he is required to lodge objections within 1 month from receipt of Draft Order.</td>
<td>Should file appeal within 30 days from the receipt of the Final AO Order.</td>
</tr>
<tr>
<td>Form</td>
<td>Form 35A – specific format to be followed for submission</td>
<td>Form 35 - New online format (word limits: Per Ground-100 words and Statement of Facts-1000 words)</td>
</tr>
<tr>
<td>Time limit</td>
<td>Only 9 months from the date of Draft Order to examine the case, hold hearings and pass directions</td>
<td>No time limit</td>
</tr>
<tr>
<td>Demand</td>
<td>No demand till disposal of the matter</td>
<td>Significant portion of demand is required to be paid unless stayed</td>
</tr>
<tr>
<td>Pros</td>
<td>Fast track route to the ITAT.</td>
<td>Detailed hearings may be granted to the assessee to represent their case.</td>
</tr>
<tr>
<td>Further Appeal</td>
<td>Only taxpayer can appeal to the ITAT.</td>
<td>Both taxpayer as well as AO can appeal to the ITAT.</td>
</tr>
</tbody>
</table>

4. India is showing a decline in transfer pricing litigation and creating a tax friendly environment thereby making the country preferred destination for inbound investments.

- Indian transfer pricing completed eleven rounds of transfer pricing audits in March 2016.
- India has more number of TP Rulings (over 2000 reported TP rulings) than most other countries in the world where TP law has been in existence for several decades prior to introduction of this law in India in 2001.
- The TP litigation history in India, which has occurred in the last decade consistently shows an upward trend, as evident from the table below:

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Amt. of Adj. (in crs.)*</td>
<td>1,220</td>
<td>2,287</td>
<td>3,432</td>
<td>7,754</td>
<td>10,908</td>
<td>24,111</td>
<td>44,532</td>
<td>70,016</td>
<td>59,602</td>
<td>46,466</td>
</tr>
<tr>
<td>No. of TP Audits completed*</td>
<td>1,061</td>
<td>1,501</td>
<td>1,768</td>
<td>1,945</td>
<td>1,830</td>
<td>2,368</td>
<td>2,638</td>
<td>3,171</td>
<td>3,617</td>
<td>4,290</td>
</tr>
<tr>
<td>No. of adj. cases*</td>
<td>239</td>
<td>337</td>
<td>471</td>
<td>754</td>
<td>813</td>
<td>1,207</td>
<td>1,343</td>
<td>1,686</td>
<td>1,920</td>
<td>2,353</td>
</tr>
</tbody>
</table>


"Your greatest self has been waiting your whole life; don’t make it wait any longer."
It is pertinent to note that the number of TP audits in the last five years have almost doubled.

In each of these FYs, the revenue authorities have made TP adjustments in more than 50% of the selected cases.

It is also interesting to observe that the quantum of TP adjustments during FY 2011-12 exceeded Rs. 44,000 crores, which is a whopping 85% increase when compared with the earlier FY (i.e. FY 2010-11).

The next FY (i.e. FY 2012-13) witnessed massive adjustments to the tune of Rs. 70,000 crores, and this is the highest in any year to date. One of the primary reasons for the huge surge in TP adjustments inFY 2012-13 is the TP dispute relating to valuation of shares.

However, FY 2014-15 has seen a reverse trend. In fact, there has been a reduction of 22% in the quantum of adjustments when compared with FY 2013-14. Similarly, recently concluded transfer pricing assessments in FY 2015-16 shown a dip as compared to previous years. This is primarily because the government of India wants a non-confrontational environment with a stable and taxpayer friendly environment.

The litigation in India will even more decrease in future due to the following key developments in recent years:

- Introduction of faster dispute resolution mechanisms such as Advanced Pricing Agreement (APA)’ Mutual Agreement Procedure (MAP), Safe Harbour Rules and Roll-back provisions for APA.
- Introduction of the range and multiple year data concept which will help in reducing TP litigation since the comparability analysis undertaken using the arithmetic mean and current year data has been a continuous challenge in India.
- Recently introduced guidelines on criteria for selection of the cases for TP scrutiny and the instruction to be followed by the AO for referring the case to the TPO. These guidelines prescribed selection of transfer pricing case based on risk based parameters as against the earlier criteria of monetary threshold. These guidelines has helped in reducing the overall number of cases to be picked up for scrutiny.

Although a good amount of steps have already been taken for creating taxpayer friendly environment in India but still many areas for improvement do exist. However, with the make in India concept and a radical liberalization of the Foreign Direct Investment (FDI), India’s intention is very clear, making itself a preferred destination for inbound investments and improving the ease of doing business.

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**FEMA UPDATE**

**Foreign Investment in other Financial Services Sector**

*Press Information Bureau, GOI (Press Release) dated August 10, 2016*

The Union Cabinet has given its approval to amend regulation for foreign investment in the Non-Banking Finance Companies (NBFCs).

The present regulations on NBFC stipulates that FDI would be allowed on automatic route for only 18 specified NBFC activities after fulfilling prescribed minimum capitalization norms mentioned therein.

In the proposed amendments are as under:

- **a.** FDI in “Other Financial Services” will be permitted under automatic route provided such services are regulated by any other regulator (Reserve Bank of India, Securities and Exchange Board of India, Pension Fund Regulatory and Development Authority etc.)/ Government Agencies.
- **b.** FDI in “Other Financial Services” not regulated by any regulators/government agencies will be permitted under approval route.
- **c.** Minimum capitalization norms specified for NBFCs will be eliminated as most of the regulators have already fixed minimum capitalization norms.

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“Do what you think is right. Don't let people make the decision of right or wrong for you.”
This article deals with the recent cases adjudicated in the field of transfer pricing. Accordingly, the following judgements have been hand-picked for the unique subject matter dealt by them. I have tried to cover the cases to discuss both simple and basic issues and complex issues in the field of transfer pricing.

Happy reading!

1. M/s Obulapuram Mining Company Pvt. Ltd. Vs. DCIT[TS 512 ITAT 2016 (Bang)]

Background:

The ld. Commissioner of Income Tax (Appeals) (‘CIT(A)’) passed an order U/s 263 of Income Tax Act, 1961 (‘the Act’) holding the ld. Assessing Officer (‘AO’)’s Order to be erroneous and prejudicial to the interest of the Revenue.

The ground for holding the AO’s order to be prejudicial as stated by the CIT (A) in his Order being that the AO did not make reference to the ld. Transfer Pricing Officer (‘TPO’) despite Central Board of Direct Taxes (‘CBDT’) Instruction No.3 dated 25 May 2003, which states that where the value of the international transactions exceeds INR 5 Crores, the case must be referred to TPO for determination of the Arm’s Length Price (‘ALP’).

This case deals with certain critical matters which can be broadly enlisted as under:

a. Whether is it mandatory for the AO to make a reference to the TPO as per the provisions of the Act or can he himself determine the ALP?

b. Whether the above mentioned circular overrides the provisions of the Act in authority making the reference to the TPO mandatory for the AO above a certain transaction value?

c. Is it essential for the AO to apply his own mind before making a reference to the TPO and for the CIT before granting his approval for the same?

Discussions before the Income Tax Appellate Tribunal (‘ITAT’):

The discussions in the captioned case have revolved around the fact that the CIT held the order to be erroneous and prejudicial solely for the reason that the AO did not make any reference to the TPO for determination of the ALP thereof.

The ld. AR in his representations based his contentions on the judgement of Hon’ble Bombay High Court in the case of M/s Vodafone India Services Pvt. Ltd. Vs. Union of India, wherein it was held that the said Instruction (supra) departs from the Law. Further, the Hon’ble ITAT, in the case under consideration, has placed due reliance on the order of co-ordinate Bench in the case of Tata Consultancy Services Ltd. (ITA No.7513(Mum)/2010) which followed the order of Vodafone India (supra) and went on to prove that the said Instruction (supra) as issued by the CBDT sets off from the provisions of the Act.

The ld. CIT in his order passed u/s 263, placed reliance on the Instruction (supra) in addition to the judgement of the Special Bench in the case of M/s Aztec Software & Technology Service Ltd. Vs. ACIT (294 ITR 321) which upholds the validity of the said Instruction and its precedent judgement in the case of M/s Sony India Pvt. Ltd. (288 ITR 52(Del.)). However, a later judgement passed in the case of Vodafone India (Supra) accentuated the fact that in view of the amendment in the Act effectuated by the Finance Act, 2007, the AO is required to pass the order in conformity with the TPO’s Order in contrast with the provision existent prior to the foregoing amendment in the Act which stated that the AO is required to pass his Assessment Order merely having regard to the TPO’s order.

In view of the judgement passed in the aforementioned Vodafone India case, it can be undeniably comprehended that the reliance placed by the ld. CIT(A) on the erstwhile judgements viz. Aztec Software (supra) and Sony India (Supra) is misplaced, since the Order has been passed in respect of the assessment year subsequent to amendment becoming into effect, the impugned orders shall fail to be applicable.

Further, on perusal of the relevant excerpt of the

“...
Tata Consultancy (supra), it can be apprehended that the ITAT has affirmed that the aforesaid instruction detracts from the law in view of the fact that it does away with a statutory obligation, disregarding the need to apply his mind before making a reference to the TPO. In consideration of the substance over form, we discern the fact that the ultimate authority lies with the AO to determine the ALP of a transaction which, in view of the said Instruction is supplanted as it requires a mandatory reference to be made to the TPO, if in case the value of the international transactions exceeds INR 5 Crores. Also, the Tribunal has construed that Section 92CA(1) can be inferred to be have implied that the AO has to first form an opinion in a manner indicated in Section 92CA(3) before making a reference to the TPO.

In order to underpin the above inference, the Hon’ble Tribunal in the captioned case has quoted various miscellaneous judgements in its Order which recapitulate the fact that the condition precedent to making a reference to the TPO being that the AO has to prima facie have a belief that it is necessary or expedient to make a reference to the TPO. Also, for the CIT to accord his approval to the same, he must apply his mind considering the circumstances, on a case to case basis. The primary duty of computing the income of the assessee is that of the AO and that where the AO require a specialist to look into the matter he must refer the same to the TPO.

Further, the Hon’ble Bombay High Court in Vodafone India (supra) has reiterated the fact that, it is pre-requisite to grant an opportunity to be heard to the assessee before making a reference to the TPO for determination of the ALP to avoid any undue hardship to the assessee. This leads to the conclusion that the Instruction (supra) also violates the principle of natural justice.

In view of a landmark judgement referred by the Hon’ble Tribunal in the captioned case, it was held that Section 119 of the Act permits the CBDT to specify conditions subject to which a provision can apply, but the conditions cannot have effect of curtailing the scope of the deduction granted by the section; the deduction granted by a section cannot be cut down in the guise of imposing a condition; that in effect, is not a condition but an impermissible attempt to re-write the section. Hence the CBDT may control, exercise the powers of the departmental officer in administrative matters, but not quasi-judicial.

The decision taken apropos to the captioned matter by the Hon’ble ITAT underscores that the provisions of the Act place the primary onus on the AO to determine whether it is judicious to refer the case to the TPO by application of his mind and no circular can supplant this authority to mandate such reference and before any such reference is made an opportunity must be afforded to the assessee to refute the need for such reference. Further, the CIT also has to be mindful of the facts of the case in granting his approval for a reference to be made by the AO to the TPO. Additionally, the Hon’ble ITAT has been empowered to quash any Instruction/Circular issued by the CBDT which is bad in law to the extent that it goes beyond the provisions of the Act.

2. Page Industries Ltd Vs. DCIT [TS-382-ITAT-2016(Bang)-TP]

The assessee is a company incorporated under the provisions of the Companies Act, 1956 and is engaged in the business of manufacture and sale of ready-made garments. The assessee-company is a licensee of the brand-name ‘Jockey’ for the exclusive and marketing of Jockey readymade garments under license agreement with Jockey International Inc, USA [‘JII’], a company incorporated in USA and the owner of the brand Jockey. In consideration for granting the right to use brand-name, the assessee-company paid consideration in the form of royalty at the rate of 5% of the sales.

The AO referred the matter to the TPO. While doing so, the TPO has treated expenditure incurred on advertisement and marketing and product promotion as an international transaction and attempted to determine the ALP by applying Bright Line Method.

Pursuant to the TPO’s order, draft assessment order was issued by the AO wherein the said disallowances were proposed. It was contended by the assessee-company before the Dispute Resolution Panel (‘DRP’) that the said transactions do not constitute international transaction as the assessee-company and JII do not constitute an Associated Enterprise (‘AE’) within the meaning of Section 92A of the Act. It was submitted that the conditions specified u/s 92A(1) of the Act are not existing between the assessee-company and JII. In the absence of
relationship of assessee-company and JII, the
transaction does not constitute to be an
international transaction within the meaning of
Section 92B of the Act.

Being aggrieved, assessee-company is in appeal
before ITAT.

After due consideration of the arguments of the
assessee and the Revenue, the ITAT holds that
theassessee and JII are not associated enterprises for AY 2010-11 as the parameters of
Sec 92A(1) which provides for management / control / capital of the other enterprise are not
fulfilled. The assessee was a mere licensee of the
brand-name 'Jockey' for exclusive manufacture and marketing of goods under license agreement
with JII. Further, it was observed that the
assessee owned the entire manufacturing facility
with a capital investment of INR 100 crores and
had employed 15000 without any participation of
JI either in the capital or management of the
assessee.

Thus, in the instant case, the ITAT rejected
TPO’s view that the two enterprises should be
treated as associated entities u/s 92A(2). ITAT
while arriving at this conclusion considered
the amendment to Sec 92A(2) enacted vide
Finance Act, 2002 w.e.f. April 1, 2002 wherein it
is provided that in order to constitute
relationship of an AE, the parameters laid down
in both subsections (1) and (2) should be
fulfilled; Accordingly, ITAT opines “If we were to
hold that there is a relationship of AE, once the
requirements of sub-sec (2) are fulfilled, then the
provisions of sub-sec(1) renders otiose or
superfluous”. ITAT while providing its decision
also relied on SC rulings in State of Tamil Nadu
Vs. M.K. Kandaswami and Calcutta Jute
Manufacturing Co on principles of
interpretation of statutes to state that Courts
should not adopt construction which would upset
or even impair the purpose in introducing a
particular; Thus, concludes that “since the
parameters laid down in sub-section (1) are not
fulfilled, there is no relationship of AE between
assessee-company and JII and therefore, the
provisions of chapter X of the Act have no
application”.

3. Kirloskar Toyota Textile Machinery
Private Limited vs. DCIT [TS-363-ITAT-
2016(Bang)-TP]

The assessee, Kirloskar Toyota Textile
Machinery Pvt Ltd, is engaged in manufacture
and sale of textile machinery, manufacture and
sale of auto transmission components and is also
engaged in distribution of material handling
equipment.

The assessee in the FAR analysis contended that
the capacity utilization was at 78% of total
capacity and thereby cost of overheads above the
utilised capacity was not to be considered.
Accordingly, the assessee stated that Gross Profit
('GP') margin on sales be considered for the
purpose of comparability analysis as GP was
calculated as sales less cost of raw material
consumed. Since, the assessee stated that due to
underutilization of capacity, the comparability of
Operating Profit / Operating Cost did not give
proper analysis.

ITAT noted that the TPO himself in many cases
had acknowledged the fact that in case where in
the rate of depreciation impacts the profit margin
of the company, then the company should be
allowed depreciation adjustment or can opt for
PLI as PBDIT/TC.

ITAT approves, in principle, assessee’s claim that
gross profit over sales can eliminate difference in
depreciation claim due to machinery age, rate /
method difference, directs AO/TPO to adopt
comparison of profitability ratios using gross
profit over sales to benchmark international
transaction of purchase of auto-components
from AE for AY 2010-11. The ITAT also takes a
note of DRP’s observation that details of capacity
utilization of the comparable companies and rate
of depreciation could not be analysed.

Hence, it has been opined that it would be better
if gross profit analysis is undertaken taking sales
less cost of raw material as basis (excluding cost
including depreciation, interest etc.) to
understand whether the import of material from
AE had affected the profitability of assessee. Due
reliance is placed on ITAT rulings in
SchefenackerMotherson, Market Tools
Research, Qual Core Logic and BA Continuum
India (approved by Andhra Pradesh HC).

Further, accepting assessee’s contention that AO
had not given effect to DRP directions to restrict
TP adjustment to cost of import of raw material
from AE, the ITAT opines “to that extent, AO’s
order is not in compliance with the directions of
DRP”. Accordingly, remits to file to AO/TPO
while clarifying that if any adjustment is
required, it should be restricted to cost of
material as directed by DRP.

Note:- Views, if any, expressed are personal and readers may seek specific professional advice based on their facts.
1. Introduction:
Transfer pricing regulations were first introduced in India in the year 2001 and applied only to international transactions between two associated enterprises. With advancement of business practices, more aggressive domestic tax planning and various other factors, need was felt to have a similar transfer pricing provisions for domestic transactions. The said need was felt in spite of having specific anti avoidance provisions (like section 40A(2)(b) etc.). Similar view was also expressed by the Apex Court while delivering the judgement in the case of CIT v/s. GlaxoSmithkline Asia Private Limited (2010) 195 taxmann 35. The Court held that “The larger issue is whether Transfer Pricing Regulations should be limited to cross border transactions or whether the Transfer Pricing Regulations to 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. The CBDT should examine whether Transfer Pricing Regulations can be applied to domestic transactions between related parties u/s 40A(2) by making amendments to the Act…………….”

Accepting the suggestion made by the Apex Court, the Finance Minister while presenting the Finance Bill for 2012, introduced the provisions of transfer pricing for certain “Specified Domestic Transactions” w.e.f. AY 2013-14. Transfer pricing for domestic transactions is still in its nascent stage with the law regards to the same still not developed fully.

In last couple of years of transfer pricing audits, the professional fraternity has faced lot of problems while finalising the domestic transfer pricing report. In the said article attempt has been made to identify those significant issue applicable to a larger group and provide possible solutions / views that could be adopted while finalizing the transfer pricing audit/report.

2. Specified Domestic Transactions – Section 92BA

Section 92BA of the Income Tax Act, 1961 (hereinafter referred to as “the Act”), defines the term “Specified Domestic Transactions” (hereinafter referred to as “SDTs”) as follows transactions and which are not international transactions:

(1) any expenditure incurred between related parties defined u/s 40A(2)(b);
(2) any transaction referred to in section 80A;
(3) any transfer of goods or services referred to in section 80-IA(8);
(4) any business transacted between the assessee and other person as referred to in section 80-IA(10);
(5) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which section 80-IA(8) or section 80-IA(10) are applicable; or
(6) any other transaction which may be prescribed (currently there are no other transaction which have been prescribed),

The said provisions would be applicable only where the aggregate of the above mentioned SDT’s exceed the threshold limit of INR 20 crore w.e.f. A.Y. 2016-17. Earlier, the said limit was INR 5 crore.

3. Issues
3.1 General Issues
A. In case where payment is made to a director (who is a non-resident) – whether reporting required under International TP or Domestic TP or both ?

The definition of “specified domestic transaction” as per S. 92BA is very clear and it states that “……any transactions, not being an international transaction, namely…”. Thus, if a transaction falls within the ambit of international transaction, then the same transaction need not be reported for the purpose of Domestic TP.

B. Whether provisions of DTP apply to transactions between two entities falling within the highest tax bracket:

The biggest criticism that Domestic TP has faced is that it also applies to those Asseesees who are taxed at maximum marginal rate. No exception has been made in the provision as regards its applicability to such class of Asseesees.
Ideally, the intent of legislature was always to apply the provisions to those Assessee where there was possibility of tax evasion /avoidance. In a case, where both the Assessee are taxed at highest rate, there is no possibility of tax evasion and accordingly provisions of transfer pricing should not be made applicable. The said view has also been upheld by Hon’ble Gujarat High Court1.

However, considering the fact that there are severe penal consequences for non-reporting of transactions. It would be advisable to report the same in Form 3CEB.

C. In case there is adjustment under DTP provisions, whether any corresponding adjustment required to be made while computing book profit?

If any additions are made by the Tax Officer by way of Transfer Pricing adjustments, then ideally the said additions should be restricted to normal provisions only2. No such adjustments should be made by the Tax Officer while computing profits under Section 115JB, since provisions of S. 115JB is a code3 in itself and only specified adjustments as prescribed are to be factored while computing book profits.

3.2 Issues relating computation of threshold limit

A. Value of transaction – Whether Book Value or Market Value of transactions?

Consider a case where actual transaction value with related parties is Rs. 20.2 crore but the transaction has been actually recorded in books at Rs. 19.8 crore to circumvent the provisions of domestic transfer pricing. In such a case whether provisions of DTP should be applicable?

Theoretically, it should be the book value of the transaction that needs to be considered while computing the overall threshold limit of 20 crore. However, if one goes by the intent and purpose of introducing the said section, it would have to be the fair value / actual value of the transaction. In absence of any clarity, it would always be preferable to proceed with a conservative view, to ensure that penalty provisions are not attracted at a later stage.

B. Netting off expense and income transactions with the same party?

Consider a case where Assessee has to pay a sum of Rs. 22 crore to a related party for purchase of goods and has to receive a sum of Rs. 5 crore for rendering certain services. Can the Assessee claim that the expense and income should be netted off while computing the threshold limit?

The two transactions are distinct and separate transactions. Accordingly, the option of netting off the income and expense transactions is not available. Transfer pricing provisions would be applicable in the instant case.

C. When a particular transaction gets covered within the definition of specified transaction twice – whether should be added twice?

In case of an business enterprise claiming tax holiday exemptions, there can be a situation that a particular transaction might get covered within the ambit of domestic transfer pricing twice (i.e. as per S. 40(A)(2)(b) and S. 80IA (10). Though the transaction gets covered within the definition of SDT, however perse the transaction is one and the same. Hence, in such a case the transaction ought to be considered only once while computing the threshold limit.

3.3 Issues relating to applicability of S. 40A(2)(b)

A. Applicability of provisions of Section 40A(2)(b) - Direct ownership vis-à-vis Indirect ownership?

Section 40A(2)(b) has used the term “substantial interest” in its various clauses. The term “substantial interest” is defined to include a ‘beneficial owner of shares’ carrying not less than 20% of voting power. The issue arises whether ‘beneficial ownership’ includes direct as well as indirect shareholdings.

Issue under consideration is debatable. The predominant view being that for the purpose of S. 40A(2)(b), it should always be immediate shareholding that needs to be considered and not the indirect shareholding. The said view has also been upheld by various judicial authorities4.

Further, the revised ICAI Guidance Note on transfer pricing(August 2013) also suggests that it may be appropriate to consider only direct shareholding and not indirect shareholding for purpose of determining whether provisions of S. 40A(2)(b) to a particular transactions.

B. Purchase of Capital Asset from a related party and depreciation thereon - whether covered?

The section has been introduced to disallow the excess expenditure claimed in profit and loss while making payment to related party. In case of capital expenditure, the Assessee generally claims depreciation (which is treated as allowance) and therefore for purpose of S. 40A(2)(b), expenditure

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1CIT v. Gujarat Gas Financial Services Ltd 233 Taxman 0532
2Cash Edge India Private Limited v. ITO [ITA NO. 64/Del/2015]
3Apollo Tyres Ltd v. CIT [2002] 255 ITR 273 (SC)
4“Our deepest fear is not that we are inadequate. Our deepest fear is that we are powerful beyond measure. It is our light, not our darkness that most frightens us. We ask ourselves, Who am I to be brilliant, gorgeous, talented, fabulous? Actually, who are you not to be?”
should generally be interpreted as revenue expenditure. Any capital expenditure paid to related party is generally not covered by provision of S. 40A(2)(b). Therefore purchase of capital asset from a related party and depreciation thereon should not be considered for purpose of domestic TP.

It may also be noted that as per Revised ICAI Guidance Note on TP (August 2013) states that S. 40A(2)(b) provisions are also applicable to expenditure of capital nature and being eligible for claim of 100% deduction under provisions such as section 35(2AB), 35 or 35AD of the Income-tax Act, 1961 (the Act).

Accordingly, purchase of fixed assets are excluded within the purview of 40A(2)(b), however capital expenditure for which 100% deduction is allowed in year 1 should be considered for purpose of domestic transfer pricing.

C. Whether a person is related or not as per S. 40A(2)(b) – should be checked at what point of time?
Consider a situation where A is paid a sum of Rs 1,00,000/- by the Company for availing certain services. Later on, the Company appoints Mr. B (who is relative of Mr. A) as a director of the Company on 1st December, 2015. Whether payment made by Company to Mr. A be considered for transfer pricing?

The services were availed by the Company much prior to the appointment of Mr. B as the director. On the date of availment of services the said transaction was an independent transaction. Therefore, though Mr. B is a director of the Company for a part of the year, any payment which is made prior to its appointment to its relatives should not be consider for the purpose of transfer pricing.

However, the department may always try to cover the said transactions within the purview of domestic TP.

3.4 Issue relating to S. 80IA(10)
A. Meaning of the term “Close Connection” as per Section 80-IA(10)
Provisions of S. 80IA(10) try to regulate the transfer price between parties having close connection. However, the term ‘close connection’ has been neither defined in the Act nor in Guidance Note issued by the ICAI. Accordingly, in absence of any guidance available it would be reasonable to consider all parties which are covered u/s 40A(2)(b) to consider as closely connected. In extreme circumstances and to be very conservative, all the entities covered within the definition of Associated Enterprises as per provisions of Section 92A can also be considered as closely connected parties.

3.5 Benchmarking of transaction
A. Difficulty to justify transactions like Director’s Remuneration, Commission, Salary paid to the relative of the Director, etc:
The payments like Directors Remuneration, Commission paid, Salary to relative of Director who is an employee of the company, etc is difficult to justify in absence of sufficient data in public domain. In majority of the cases, the payments are being made to the said parties based on the knowledge and skills they possess. Every person uses different skills in performing the functions allocated to him and thus, the amount paid to them for the functions so performed cannot be benchmarked with some other Director performing similar functions. This is because, the skills and knowledge possessed by them vary.

However, though difficult the same could be justified using any of the following approach:
- If overall remuneration paid is within the limits prescribed under the Companies Act, 2013
- Obtaining salary quotation from external agency for similar qualifications
- Average salary paid to key employees vis-à-vis average salary to directors
- Evaluating % increase in the salary of key employees & directors over past few years

4. Conclusion
It is very much evident that the applicability and benchmarking challenges in respect of domestic transaction is still not very settled. With introduction of the said provision, additional compliance burden has been casted on the Assessee in terms of contemporaneous documentation requirement. One really wonders, whether such a provision which does not result in any additional tax collection to the government should continue on the statute and whether it actually adds to “Ease of doing business in India.”

However, considering the fact that the law is on the statute it would be advisable for taxpayers and professionals to be aware of the intricacies of domestic transfer pricing provisions and ensure that same are applied in correct manner to ensure that they are not charged with stringent penalties for non-compliance.

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“How would your life be different if…You stopped validating your victim mentality? Let today be the day…You shake off your self-defeating drama and embrace your innate ability to recover and achieve.”
Virat Kolhi, the captain, is a metamorphosis of the person he used to be before being shouldered with the responsibility of captaining the Indian Test Team in addition to being the lynchpin of the team’s fledgling test batting line up. He has evolved into a talismanic leader, who wears his passion on his sleeve. He has gone from being the brat of Indian cricket to being a masterful batsman with a level head on his shoulders and a cold, calculative chamber of a mind. This man leads the team like a lion leads his pride.

The composure and maturity that he has come to gather has made him a more complete player than he ever was. For any team he faces, he has become essential viewing as soon as he swaggers onto the pitch, irrespective of the state of the game. Nobody wants to miss the magic that his blade wields. His twin hundreds in Australia at the very beginning of his stint as captain just go to show how he thrives under the pressure that comes with leading the side. Some men shirk responsibility. It instead makes Kohli a greater player.

His style of captaincy is more about leading by example than by delegation. He backs his players and is not scared of saying a word or two on the field. Or three if he’s playing against Australia. He believes in his ideas and is a willing learner, both evidenced first by his firm belief in playing five bowlers and six batsmen in tests and then by him tweaking the same after a loss.

In many ways, his batting in all formats has seen improvements, gradually, after being awarded the captaincy. His maturity in the last six months in limited overs cricket has been a breath of fresh air. He has been batting like a man possessed. It is almost like it is in his nature to rise to greatness when greatness is expected of him.

Indian cricket fans have labeled Kohli the natural successor to Sachin Tendulkar. However, Kohli’s style is more reminiscent of Ricky Ponting’s. Kohli, like Ponting, is an aggressive batsman. Both inherited their captaincies from cooler heads and legends in MS Dhoni and Steve Waugh respectively. Both can have a bout or two of petulance, but have inherent leadership qualities. Time will tell if Kohli goes on to match Ponting as a player or as a captain. Ponting had his best years as a test player scoring more than 6000 runs between 2001 and 2006, from ages 27-32, at an average of 73. The signs are more than positive. Kohli is 27, at the beginning of his peak, much like Ponting was in 2001.

Kohli and Ponting have been termed arrogant by fans and critics alike. However, in a lot of ways, that arrogance was a vital cog in making Ponting the player and captain he was. It galvanized Ponting’s side. The same can be said about Virat Kohli. And a certain Portuguese footballer who plies his trade at Real Madrid.

And a sprinter from Jamaica who also happens to be the fastest man in the world. That arrogance is what makes them unstoppable. That is what makes them great leaders. After all, a man who wants to lead the orchestra must turn his back on the crowd.

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