

Latest Transfer Pricing Developments in India

December 2015

Agenda

- Overview of Transfer Pricing in India
- Advance Pricing Agreements (APA) –Regulatory and Practical Aspects
- Safe Harbour Rules in India
- Range concept, APA roll back & Multiple Year Data
- Key Controversial Issues:
 - *Shares Valuation*
 - *Location Saving*
 - *Intangibles*
 - *Management charges*
 - *Contract Research and Development*
- Key Measures to Mitigate Litigation

A presentation by:



Rajat Chawla, Partner, J P Chawla & Co. LLP

Rajat is a Lead Partner of J P Chawla & Co. LLP for Transfer Pricing, International Tax and Foreign Exchange Law. Rajat has been involved in managing transfer pricing documentation and tax litigation of multinationals. He has been successfully advising companies with global operations in designing their transfer pricing, international tax and foreign exchange laws policies and documentation enabling complete lifecycle support for transfer pricing process, starting from documentation to assessment to litigation.



Virender Sharma, Partner, Transfer Pricing Associates

Virender has an overall experience of 15 years working in the UK, India, the US, and the Netherlands. He has been working in transfer pricing for the last 13 years, in the areas of planning, documentation, and controversy with major organizations and multinational corporations to develop practical transfer pricing strategies. Virender has a significant exposure in dispute resolution including assisting clients before commissioner appeals and tax tribunals, Advance Pricing Agreements (APAs), and Mutual Agreement Procedures.

ABBREVIATIONS

Abbreviation	Full Form
ALP	Arms Length Price
APA	Advance Pricing Agreement
AO	Assessing Officer
CA	Competent Authority
CBDT	Central Board of Direct Taxes
CPM	Cost Plus Method
CUP	Comparable Uncontrolled Price Method
DRP	Dispute Resolution Panel
FAR	Functional Assets and Risk Analysis
IRA	Indian Revenue Authorities
IT/ITES	Information Technology. Information technology Enabled services
ITAT	Income Tax Appellate Tribunal

ABBREVIATIONS

Abbreviation	Full Form
KPO	Knowledge Process Outsourcing
MOU	Memorandum of Understanding
MAP	Mutual Agreement Procedure
MNC	Multinational Companies
PSM	Profit Split Method
RPM	Resale Price Method
R&D	Research and Development
TP	Transfer Pricing
TPO	Transfer Pricing Officer
TNMM	Transactional Net Margin Method
WOS	Wholly owned subsidiary
SBI	State Bank of India

Overview of Transfer Pricing in India

- Presence of MNC's in India- Intra-group transactions through controlled prices
- Allegation of shifting of profits from High tax jurisdiction to low tax jurisdiction -Introduction of Transfer Pricing Regulations by Finance Act 2001
- Determination of ALP -Six methods – CUP, CPM, TNMM, PSM, RPM and lately introduced any other method
- Detailed and contemporaneous documentation
- Tolerance Band of 1% percent for wholesale traders and 3% for other Tax Payers
- Range & Multiple Year concept introduced lately
- Non compliance with Indian TP provisions can lead to Stringent consequences – Penalty and Prosecution
- India not obliged to follow OECD Principles- Persuasive value

Cont:

- Positive aspects of Indian transfer pricing regulations :
 - Avoidance of Disputes:
 - Advance pricing Agreements (“APA”)
 - Safe Harbor Rules
 - Resolution of disputes:
 - Reference to Dispute Resolution Panels (“DRP”)
 - Mutual Agreement Procedures (“MAP”)
- Benchmarking Databases – Prowess and Capital line – Preferred both by IRA and taxpayer
- 54% jump in transfer pricing (TP) adjustments to \$ 1.16 Billion in FY 2013 Audit cycle , involving high profile TP litigation such as Shell, Vodafone, Microsoft and Maruti
- Transfer pricing adjustments dropped by 22% in FY 2014-15 audit cycle to \$ 714.86 million vis- a -vis FY 2013-14 audit cycle

Advance Pricing Agreements- Regulatory Aspects

- Alternative Dispute resolution and Mitigation channel
- Types of Indian APA –Unilateral, Bilateral and Multilateral
- Preference – Complex/High Volume of transactions – No specified limit
- Validity- Maximum of consecutive 5 years
- Roll back to prior periods
- Anonymous application can be filed
- Post APA – Annual compliance necessary for each year

APA Process:

- Prefiling stage
- Formal submission stage
- Negotiation stage
- Finalisation stage

Some other aspects of Indian APA programme

- APA requires agreement on following items:
 - *Selection and application of Transfer pricing method*
 - *Deciding on the years over which comparables results are analysed*
 - *Adjusting the comparables results and testing results during APA period*
 - *Critical assumptions*
- CBDT developed a model APA template
- Sensitive information- in personal custody of APA team members- but no firewall
- Indian Govt. examining scope of Bilateral APA's, even where relevant DTAA does not have Article 9(2)

Advance Pricing Agreements – Practical Aspects

- India first country to sign APA in first year of implementation
- Approximately 550 APA applications filed in the last three years, and 10 unilateral as well as 1 bilateral APA concluded by the APA Authorities till date
- Issues – Captive centres, Share valuations, Royalty, Management fees, Interest Payments, Extension of Corporate Guarantee, Contract Manufacturing

Cont:

Practical aspects during APA negotiations:

- Site visits by APA team - Interaction with Senior employees to understand functional profile of taxpayer
- Examination of role of overseas enterprise in transaction
- Validation and verification of FAR and economic analysis
- Transparency in Negotiation – Share comparable search
- Patient and Proactive approach- Inclined to complete cases

Safe Harbour Rules in India:

- CBDT announced Final Rules on September 18, 2013 - their are defined margins

Sector	Limits of international transactions	Safe harbour on operating expense
ITES	Up to INR 5 Billion	20% or more on operating profit margin
	Exceeds INR 5 Billion	22% or more on operating profit margin
KPO	No limit	25% or more on operating profit margin
Contract R&D	No limit	30% or more on operating profit margin
Contract R&D services – Pharmaceuticals drugs	No limit	29% or more on operating profit margin

Safe Harbour Rules in India Contd.:

Sector	Limits of international transactions	Safe harbour on operating expense
Intra group Loans to WOS	Up to INR 500 million	SBI Base Rate plus 150 Basis points
	Exceeds INR 500 million	SBI Base Rate plus 300 Basis points
Corporate Guarantee to WOS	Up to INR 1 Billion	Fee of 2% or more Per annum
	Exceeds INR 1 Billion	Fee of 1.75% or more Per annum
Manufacture and export of core auto components	No limit	≥ 12 %
Manufacture and export of non-core auto components	No limit	≥ 8.5 %

Cont:

- Taxpayer may opt for safe harbour regime either for one or more year subject to maximum period of 5 years by furnishing relevant compliance form
- No adjustment for comparable or allowance for range
- Mandatory Transfer pricing documentation and file of Form 3CEB
- **Practical Challenges:**
 - No relaxation in documentation requirement
 - High margins – Inconsistent with ALP in domain- May not be acceptable to foreign jurisdictions – leads to Double taxation since no MAP available – APA preferred
 - Overlapping categories between Software services and R&D in the area of software as well as between ITES and KPO services

Range, APA roll back & Multiple Year Data

- Range : Earlier arithmetic mean was used (as against the universal standard of inter quartile range) as a measure for computing arm's length price. Budget 2014 has introduced the range concept, apart from arithmetic mean.
- Multiple Year Data : Earlier regulations restricted use of multiple year data. Budget 2014 has introduced the concept of Multiple year Data.
- APA roll back : The amendment in Budget 2014 has allowed an APA entered into from April 1, 2013 to be applied to four previous years for the international transactions covered in the APA
- Rules/regulations, including the manner in which the range & multiple year concept shall be applied have been recently notified.

Key Controversial Issues

- Disputes are increasing with each transfer pricing audit cycle, due to the following factors :
 - Cross-border transactions have increased exponentially in the last decade;
 - Lack of consensus on certain Transfer Pricing Issues such as :
 - Challenges in the Comparability Analysis
 - Issue Relating to Risks
 - Arm's Length Range
 - Comparability Adjustment
 - Location Savings
 - Intangibles,
 - R&D activities
 - Financial transactions,
 - Intra-group services

Cont:

- Taxpayers in India can postpone payment of tax liability by resorting to litigation; and
- Availability of multiple channels to resolve disputes in India.

Key Controversial Issues Cont.

Issuance of share capital

- **Dispute**
 - Shares are not issued at market value
 - Deficit in the share value considered as an inter-company loan

- **Relevance**
 - Transfer pricing provisions are anti-abuse provisions
 - Income has to arise for tax purpose
 - Issuance of share is a creation of an asset and not a transfer
 - Price setting of shares in case of a wholly owned subsidiary is meaningless

Vodafone & Shell case has been decided in favour of tax payer

Key Controversial Issues

Location Saving

- **Dispute**
 - › Indian AE not compensated for generating location saving
 - › Services re-characterised on the basis incorrect FAR profile
- **Relevance**
 - › Location saving a complex issue
 - › Difficult to quantify & apportion
 - › Attribution of location saving may lead to no incentive

Key Controversial issues

Intangible

- **Dispute**

- Excessive advertising, marketing and promotional ('AMP')
- Application of the bright-line test
- The benefit test
- India should in fact receive royalty

- **Relevance**

- No specific guidance on intangibles in India
- Contracts are crucial
- Multiple year analysis is imperative
- Distinguish between routine and non-routine AMP expenditure
- Benefits received should be documented

Key controversial issues

Management charges

Dispute

- Need, benefit and evidence test
- India is strong in non-engineering areas such as IT, finance and taxation

Relevance

- The commercial expediency comes under the taxpayer's purview
- Evidencing the availing of services and the consequential benefits
- Evidencing the delivery of services

Key Controversial Issues

Contract R&D

- **Dispute**

- Providing high value adding services
- Performing core function
- Involve significant investment and highly skilled people
- Risks cannot be controlled remotely

- **Relevance**

- Clearly document who develops, enhances, maintains and protects the R&D related intangible
- Interactions between the contract R&D and the Principal
- Alignment of external communication with internal communication
- CBDT circular on R&D

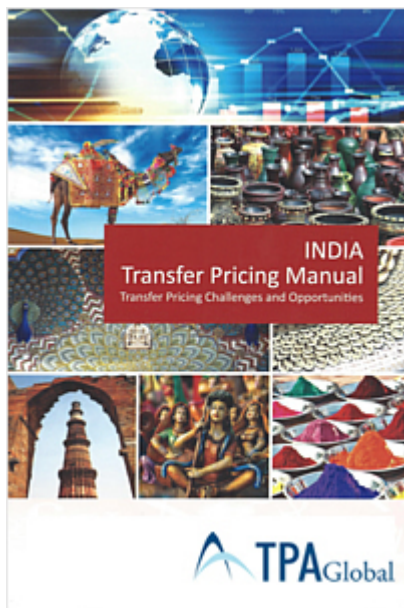
Key Measures to Mitigate Litigation

- Tax payer to have Robust documentation
- Recent guidelines indicate risk based selection approach for TP Audits.
- No adjustments are made in cases where the variation between the arm's length price determined and the price of the international transaction does not exceed 3 per cent or other notified percentage
- Range Concept & multiple year concept notified
- Significant efforts have been made to provide certainty in the application of transfer pricing laws

Key Measures to Mitigate Litigation – Cont.

- There is a time limit for disposal of objection of the taxpayer by the DRP
- Indicative time limits have been provided for various judicial forums
- Direct appeal to the tax tribunal is provided against transfer pricing orders approved by the DRP
- Dedicated and specialized appellate Commissioners and benches of tax tribunals have been put in place to deal with disputes on transfer pricing
- The process for Mutual Agreement Procedure has been put on fast track
- An Advance Pricing Agreement Scheme is put in place.

India - Transfer Pricing Manual



TPA Global, in close cooperation with its alliances and member firms in India– Accretive, J P Chawla & Co. LLP, Ashok Maheshwary & Associates, Nangia & Co – has prepared a TP manual, aimed at providing a more practical TP guidance for current and future investors in India.

This manual, published by LexisNexis, not only provides insights into existing and emerging TP developments in India, but also extends to providing an overview of Indian TP trends in a global context.

For further inquiry, please contact:

Steeff Huibregtse

Transfer Pricing Associates
CEO and Managing Partner
E: s.huibregtse@tpa-global.com
T: +31 (0)20 462 3530

Virender Sharma

Transfer Pricing Associates
Local Partner
E: v.sharma@tpa-global.com
T: +31 (0)20 217 0108

Rajat Chawla

J.P. Chawla & Co.
Alliance Partner
E: rajatchawla@jpc.co.in
T: +91 987 149 44 99

Read more at:

<http://www.tpa-global.com/news/2015/09/18/tpa-global-releases-india-transfer-pricing-manual>

THANK YOU



TPA Global provides international businesses with integrated and value-added solutions in improving financial performance, operational efficiency, strategic development and talent coaching through a cross-border and cross-discipline team of professionals which identifies the right solutions for customers and targets; efficient and streamlined advisory and implementation processes which cut through operational complexities across functions and borders; and superior customer service and support which proactively anticipate the evolving needs of the clients.

H.J.E. Wenckebachweg 210 . 1096 AS Amsterdam . The Netherlands . +31 (0)20 462 3530 . tpa-global.com

The views expressed and the information provided in this material are of general nature and is not intended to address the circumstances of any particular individual or entity. The above content should neither be regarded as comprehensive nor sufficient for making decisions. No one should act on the information or views provided in this publication without appropriate professional advice. It should be noted that no assurance is given for any loss arising from any actions taken or to be taken or not taken by anyone based on this publication.

© 2014 Transfer Pricing Associates Holding B.V. All Rights Reserved.