

INDIA

TRANSFER PRICING LANDSCAPE

2001: A separate code on transfer pricing under sections 92 to 92F of the Indian Income Tax, 1961 (the Act) and its corresponding Rules were introduced. These regulations covered the intra-group cross-border transactions.

2012: Specified domestic transactions were introduced under the Indian transfer pricing regulations with effect from 1 April, 2012. Also, provisions for the Advance Pricing Agreement were introduced.

2016: Country-by-Country (CbC) reporting, master file and local file requirements on the lines of the recommendations of Action Plan 13 of the OECD BEPS Project were introduced.



Introduction

In India, detailed provisions on transfer pricing were introduced by the Finance Act, 2001. These generally follow the OECD guidelines to keep the Indian provisions in line with the global practices.

The transfer pricing provisions derive its subsistence from section 92 of the Act which provides that the price of any transaction between associated enterprises, either or both of which are non-residents for tax purposes (international transactions), shall be computed having regard to the arm's length principle. The Finance Act, 2012 brought 'specified domestic transactions' and the Finance Act, 2014 (No.2) widened the scope of 'deemed international transactions' under the purview of transfer pricing.

Associated enterprise

Two enterprises are considered associated enterprises (AE) if there is direct/indirect participation in the management or control or capital of an enterprise by another enterprise or by the same persons in both the enterprises. The provisions also include certain conditions wherein two enterprises are deemed as AEs.

Transactions covered

The regulations cover international transactions as well as certain specified domestic transactions (which may result into tax arbitrage) in case the value exceeds INR 200 million. International transactions would include, apart from routine transactions relating to the purchase and sale of goods and services, transactions involving business restructuring, intangibles, goodwill, corporate guarantee, over due debts, etc.

Furthermore, deemed international transactions cover certain cases where a taxpayer deals with a third party, which could also be deemed to be a transaction between the taxpayer and its AE. If there exists a prior agreement in relation to such a transaction between the third party and the AE or if the terms of such transactions are determined in substance between the third party and the AE. Therefore, even transactions between two resident and independent enterprises may be covered under transfer pricing regulations.

Arm's length price and methods

An arm's length price according to the regulations is a price, which is applied or proposed to be applied in a transaction between a person other than the AE in an uncontrolled transaction. The arm's length price has to be determined using any of the following six methods:

- i. comparable uncontrolled price method;
- ii. resale price method;
- iii. cost plus method;
- iv. profit split method;
- v. transactional net margin method; and
- vi. other methods as may be prescribed by the Board (the authority monitoring the direct taxes in India)

The regulations do not give preference to any specific method or methods and the taxpayers are independent to choose the most appropriate method out of the six transfer pricing methods.

Usage of multiple year data and range

To enhance the reliability of the comparability analysis, taxpayers need to examine multiple year data as opposed to single year data in order to evaluate factors that influence transfer prices, such as long-term arrangements, business/product life cycles, etc. Furthermore, taxpayers can use inter-quartile range (35th to 65th percentile) if the dataset contains more than six comparability data points.

Transfer pricing documentation

Exemption and thresholds

Preparation of a documentation report is compulsory if the value of:

- the international transaction exceeds INR 10 million
- the specified domestic transaction exceed INR 200 million

The above threshold applies to the aggregated value of the transactions.

Extent of documentation

There is no specific format prescribed for documentation, but it should include the following information:

- Detailed description of the company (organisation structure, operational aspects, competitors, description of business environment ownership structure etc.);
- A profile of the multinational or group of which the company is a part of, along with certain details (such name, address, business etc.);
- Transaction details such as nature and terms, quantum and value of each such transactions;
- A description of functions performed, risks assumed and assets employed by the company and by the associated undertaking involved in the transaction;
- Comparability analysis - selection of comparables; and
- Application of transfer pricing methods selected by taxpayers along with reasoning for rejection of other methods.

A taxpayer (falling within the thresholds above) is required to keep contemporaneous documentation in the English language for demonstrating arm's length nature of the international transactions and specified domestic transactions (collectively referred to as a related party transactions). The record keeping i.e. retention of the documentation should be for a period of eight years from the end of the relevant year of assessment.

For comparability analysis, the taxpayer can use publicly available databases to arrive at an arm's length price and appropriate adjustments need to be made if necessary.

The databases widely used are PROWESS, CAPITALINE and ACETP online, all maintained by private companies, while the corporate filings of companies are available on the public portal, namely, the Ministry of Company Affairs (MCA).

Reporting and compliance

Certificate from a chartered accountant

Section 92E of the Act provides for a requirement of furnishing a certificate from a Chartered Accountant (CA/CPA) containing the details of transactions with AE (in Form 3CEB) by November 30 every year. The certificate would confirm the arm's length nature of the related party transactions and the disclosure as required to be made in the prescribed format.

Filing Form 3CEB in case of international transactions is mandatory (without any exemption). In cases of specified domestic transactions, it is necessary only if the value exceeds INR 200 million.

Submission of transfer pricing documentation

Taxpayers are not required to submit documentation along with Form 3CEB or return of income. However, it needs to be submitted to tax authorities upon request.

Transfer pricing audit/assessment

A recent Board Instruction (No. 3, 2016) lays down the process to be followed by the tax officer in cases that involve transfer pricing. According to the instruction, a reference to the special cell of officers – transfer pricing officer can be made only under certain circumstances that could be risk-based or other parameters like search or survey operations, non-filing of Form 3CEB or non-disclosure of transaction in the Form 3CEB, etc.

The risk parameters may include the following areas:

- Intra-group services/management fees transaction
- Financial transactions (especially corporate guarantee)
- Royalty/technical fees of any nature
- Captive services (back-office, R&D, investment advisory)
- Losses in the initial years of operations.

APA, MAP and safe harbour procedures

Taxpayers may apply for unilateral, bilateral or multilateral Advance Pricing Agreement (APA) for a period of five years. Moreover, taxpayers can also apply for roll-back provisions for four preceding financial years also.

Taxpayers may also apply for Mutual Agreement Procedure (MAP) within the given time limit as may be applicable according to the relevant tax treaty.

Safe harbour procedures have been notified and currently provide for circumstances in which certain transactions like Information Technology (IT)/Information Technology Enabled Services (ITES) services, contract R&D services, manufacture of automobile components and financial transactions in the nature of loans and guarantees are covered. If these are opted for, whereby the transfer prices declared (in line with the provisions) by them would automatically be accepted by the Indian tax authorities, subject to the fulfilment of certain conditions. Taxpayers can choose to opt for safe harbour for a period of one to five years.

Penalties and other consequences of non-compliance

In case of any lapses/adverse inferences drawn by the transfer pricing officers, penalties linked to the value of transactions are attracted. The penalties, circumstances under which they shall be attracted, and their quantum are mentioned below:

Nature of default	Penalty
For under-reporting of income (for assessments commencing after 1 April 2017)	50% of the amount of tax payable on under-reported income
For misreporting of income including failure to report any international transaction or deemed international transaction or specified domestic transaction (for assessments commencing after 1 April 2017)	200% of the amount of tax payable on misreported income
Addition to income on account of concealment or furnishing of inaccurate details (for assessments up to 31 March 2016)	100% to 300% of tax on addition to income
Failure to maintain documentation	2% of value of the international transaction entered into between related parties
Failure to furnish documentation to tax authorities, when called for	
Failure to disclose a transaction in the accountant's report.	2% of the value of the transaction
Failure to furnish chartered accountants' certificate (Form 3CEB)	INR 100,000

BEPS/CbC applicability

Recently, India has formally announced the implementation of Country-by-Country (CbC) reporting requirements in line with Action 13 of OECD/G20 Base Erosion and Profit Shifting (BEPS) Project. However, the final rules on implementation in this regard have not yet been notified.

The CbC reporting is proposed to be effective from fiscal year 2016-17 beginning on 1 April 2016. The first compliance for this period would be due by 30 November 2017, which is the due date for filing tax returns (in cases where transfer pricing applies).





SUMMARY OF TRANSFER PRICING REQUIREMENTS

Effective from

April 2001

Compliance requirements

- Accountant's report under section 92E of the Act to be filed by 30 November of the relevant assessment year
- Contemporaneous documentation to be maintained as referred to in section 92D of the Act

Penalties

Penalties that would be imposed are:

- It can range from 100% to 300% of the tax on an addition to the income; or
- 2% of the value of the transaction entered into between related parties.
- INR 100,000 for non-furnishing of prescribed accountant's report.

Method and preference for comparable

- Six methods
- Preference for local comparables

Peculiar features

Maintenance of contemporaneous documentation is not applicable where the aggregate of the international transactions does not exceed INR 10 million.

Exemption from filing Form 3CEB and preparation of a documentation report if the specified domestic transactions does not exceed INR 200 million.

APA, MAP and safe harbour

Available

BEPS/CbC applicability

Applicable, with effect from 1 April 2016

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