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SKP Wish List

Transfer Pricing

- ◆ Safe Harbour Provisions should be introduced. Despite the enabling provisions announced in the Finance Bill 2010, the rules are yet to be notified. A safe harbour mechanism would provide a measure of predictability as well as continuity for all participating organisations. It would eliminate the possibility of litigation between taxpayers and the income tax authorities. Further, it would reduce the administrative burden and ease compliance for taxpayers.

- ◆ Guidance is required on the valuation of cross-border capital transactions such as subscriptions to capital, reorganisation, restructuring and share transfers, with such transactions now falling within the realm of transfer pricing according to the Finance Act 2012.

Valuation of share transfers amongst related parties in particular has been a bone of contention between the tax authorities and taxpayers. A recent case involving Shell India, where the tax authorities proposed an adjustment of USD 2.7 billion (₹ 150 billion) with respect to shares of Shell India subscribed by the parent company, demonstrates the high-handedness and aggressive approach of the Indian tax authorities. Thus, guidance on this front would be useful.

- ◆ Guidance in terms of valuation methodologies and credit rating analysis in the case of inter-company guarantees will help bring certainty. Tax authorities have taken divergent views while making adjustments, in some cases (wrongly) applying concepts pulled from global developments to arrive at the arm's length guarantee charges of 3-8% of the guarantee amount. Similarly, guidelines to determine the arm's length interest rate with respect to inter-company loans are essential.

- ◆ Advance Pricing Agreements (APAs)
 - 'Firewall provisions' should be laid down

to protect confidentiality of information

- Terms such as 'critical assumptions' should be defined clearly
- Roll-back mechanism and a time frame for conclusion of the APA process should be prescribed
- APA program should also be extended to domestic transactions

- ◆ Specified Domestic Transactions

- Transfer pricing provisions should not be applicable to domestic entities in a tax neutral situation
- Threshold limit should be increased from the current ₹ 50 million, which is low and leads to an administrative burden on the taxpayer
- Payment to directors/partners is presently subject to compliance under company law and income tax law, respectively. Justification of such payments under transfer pricing law only increases the administrative burden on both, the taxpayer and the tax authority. Further, benchmarking for such transactions is a challenge.

- ◆ Clear guidelines with regards to transfer pricing of marketing intangibles are required. This has been one of the most complex issues raised by the Indian tax authorities and an area of focus in the past few years. Guidance with respect to what constitutes advertising, marketing and promotion (AMP) expenses, on brand development, comparables selection and the Bright Line Test is needed. We hope the Finance Bill 2013 throws light on these aspects.

- ◆ Currently, adjustments are made considering the total turnover of the taxpayer whereas many Tribunals have held that this should be restricted to transactions with associated enterprises. Clarification on this matter would be useful.



APAs & Domestic Transfer Pricing: The Way Forward

The Finance Act, 2012 introduced the Advance Pricing Agreement (APA) mechanism w.e.f. 1st July 2012 which aims to resolve transfer pricing conflicts between the taxpayers and the tax authorities. Additionally, transfer pricing provisions were also made applicable to certain Specified Domestic Transactions (SDT) resulting in widening the ambit of transfer pricing. Certain concerns have been expressed regarding these two important developments. We take a look at some of these apprehensions and the corresponding steps Government of India may consider including in the Finance Bill 2013.

(a) APA Program

An APA can be entered into by a person who has undertaken an international transaction or is contemplating one. The opportunity will allow potential applicants to seek guidance in advance regarding the appropriate transfer pricing methodology and may act as a tool to avoid prolonged audit and litigation time and cost. The potential steps that can be considered in Finance Bill 2013 to make the APA mechanism effective are as follows:

- i) There is no roll back mechanism prescribed. 'Roll-back' of an APA is wherein the negotiated position under an executed APA can be applied to the prior years. Roll back provisions will be effective where the facts are similar and would help ease out the current huge litigation backlog.
- ii) No time frame is prescribed for conclusion of the APA process. This adds uncertainty to the entire process and could render the APA mechanism ineffective. Thus provision of timelines is called for.
- iii) There are no firewall provisions with regards to the secrecy of information sought from the APA applicant. This is a serious loophole that may discourage a prospective applicant from filing an APA application.
- iv) APA provisions are not applicable to SDT. Extension of the APA program to SDT would be an added advantage for the applicants who enter/propose to enter into international as well as domestic transactions during the same period.

- v) For renewal of APAs, applicants have to follow almost all stages of the APA process making the renewal of APA time-consuming. One way-out could be commencing the renewal process well before the completion of the existing APA term.

(b) Specified Domestic Transactions

We now look at some concerns with regards to the SDT provisions and the steps that could be considered in Finance Bill 2013.

- i) The current threshold limit of ₹ 50 million prescribed for the applicability of SDT provisions is very low, creating administrative burden on the taxpayers. A significant upward revision in this regard should be considered.
- ii) SDT provisions should not be applicable for domestic entities in a tax neutral situation where there is no tax advantage accruing to either of the entities.
- iii) Payments to directors/ partners are presently subject to compliance under company law and income tax law respectively. Justification of such payments under transfer pricing law would increase the administrative burden, both the taxpayer and the tax authority. Further, benchmarking exercise for such transactions poses an enormous practical challenge.
- iv) 'Close connection' and 'any other reason' appearing in Section 80-IA (10) need clarification to avoid arbitrary interpretations of Section 92BA of the Act.

Conclusion

The APA program provided a ray of hope to the taxpayers marred with transfer pricing adjustments and litigation. If some of the above issues are addressed it would increase the effectiveness of the program and provide a great opportunity to the taxpayers to gain certainty and avoid protracted litigation.

On the other hand, SDT provisions are burdensome and onerous and the taxpayers need to be prepared with robust planning, documentation and defense strategies well in advance.

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