

ERNAKULAM BRANCH OF SIRC VITUAL CPE SEMINAR

TOPIC : TACKLE TRANSFER PRICING
DATE :23-09-2021

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WHAT IS TRANSFER PRICING

- “Prices at which an enterprise transfers goods and intangible property or provides services to **Associated Enterprises**” [OECD]
- It matters for government when the transactions are with **Associated Enterprise (AE)**.
- To ensure **Arms Length Price (ALP)**

WHY TRANSFER PRICING

INDIA	CYPRUS
Profit : 1,00,000	Profit : 90,000
Purchase from AE: 50,000	Sales to AE: 50,000
Profit after purchase: 50,000	Profit after Sale: 1,40,000
Tax @ 30% : 15,000	Tax @ 0% : NIL

Group Level:
1st Transaction: Profit : 1,90,000 (50,000+1,40,000) & Tax : 15,000
2nd Transaction: Profit : 1,90,000 (20,000+170,000) & Tax : 6,000

Purchase from AE: 80,000	Sales to AE: 80,000
Profit after purchase: 20,000	Profit after Sale: 1,70,000
Tax @ 30% : 6,000	Tax @ 0% : NIL

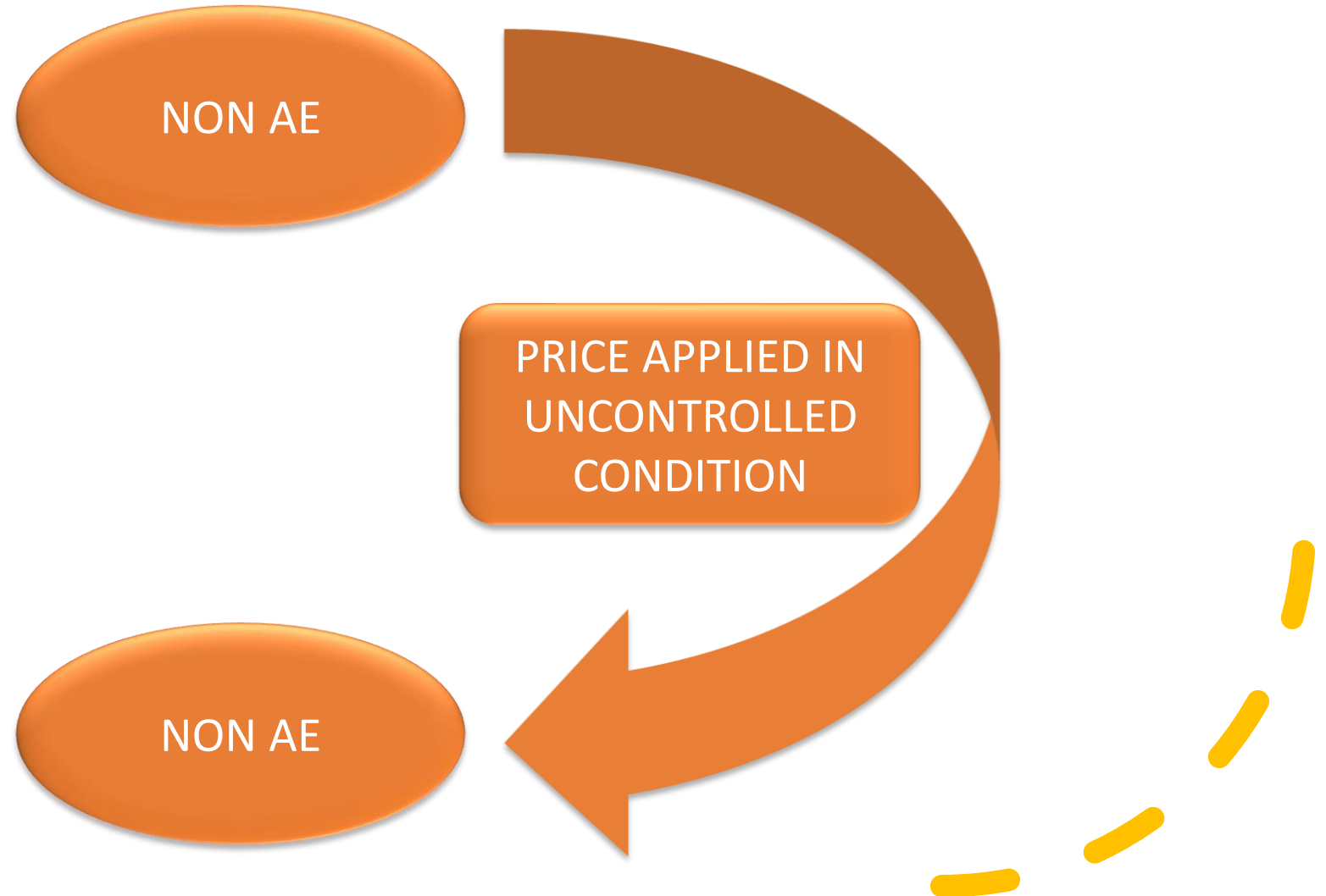
Income Tax Regulations

- Chapter X of the IT Act deals with provisions for Transfer Pricing
- Applicable to International Transaction between AE.
- Also applies for few Specific Domestic Transactions



Section 92 - Computation of income from international transaction

- Transaction should be in Arms Length Price (ALP)





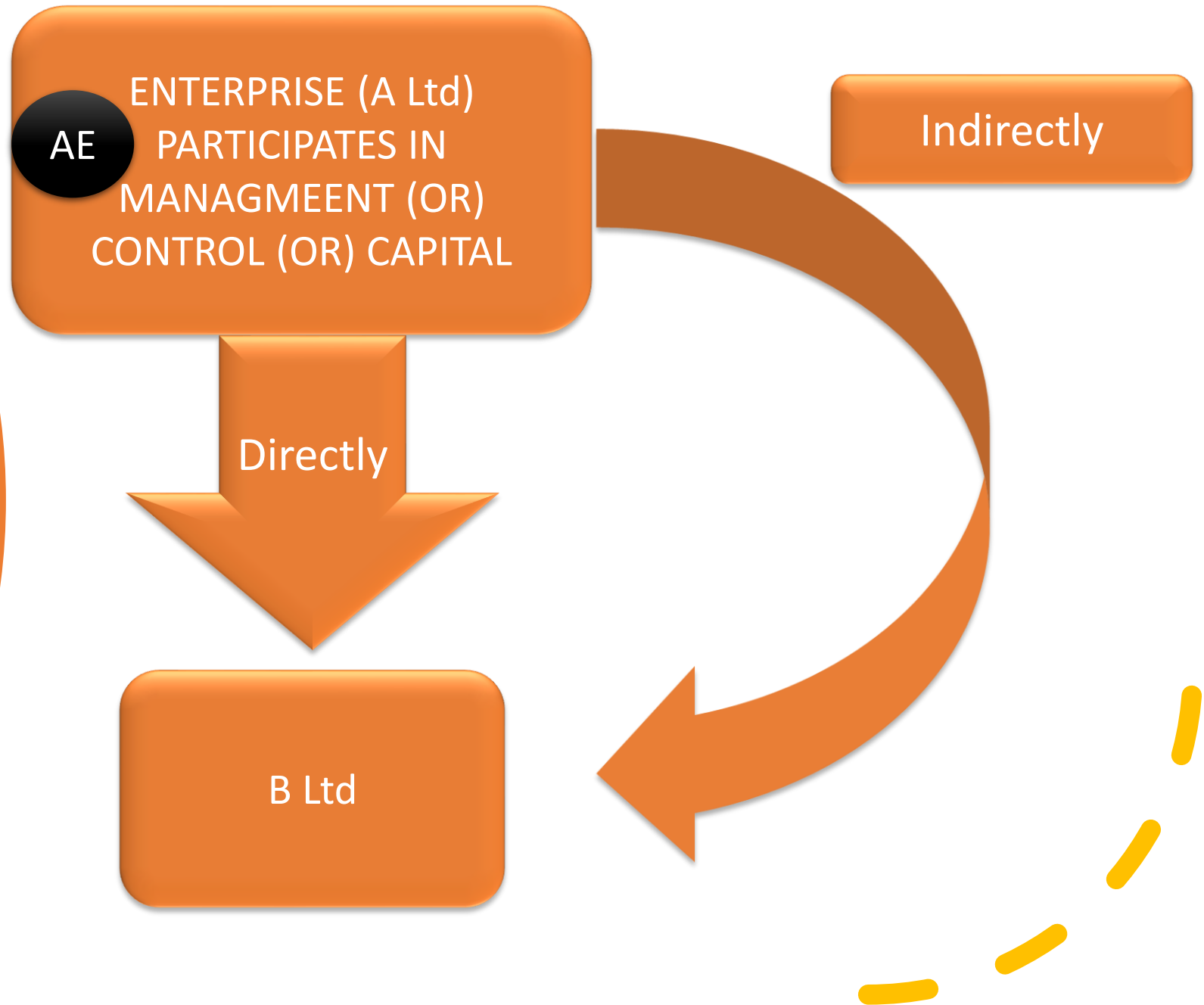
Key
takeaways
Till now

- INTERNATIONAL TRANSACTION
- ASSOCIATED ENTERPRISE
- ARMS LENGTH PRICE

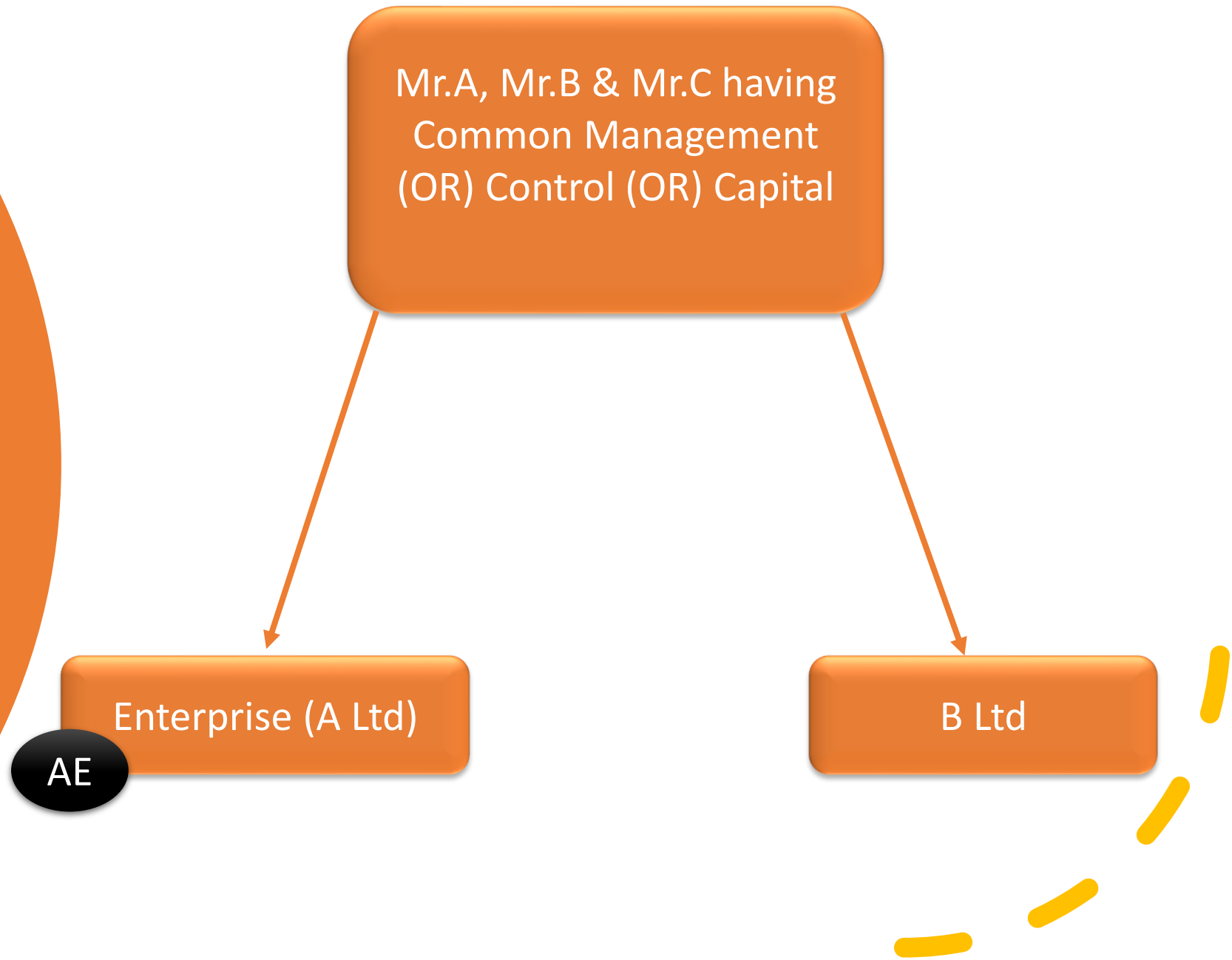


Section 92A- ASSOCIATED ENTERPRISE

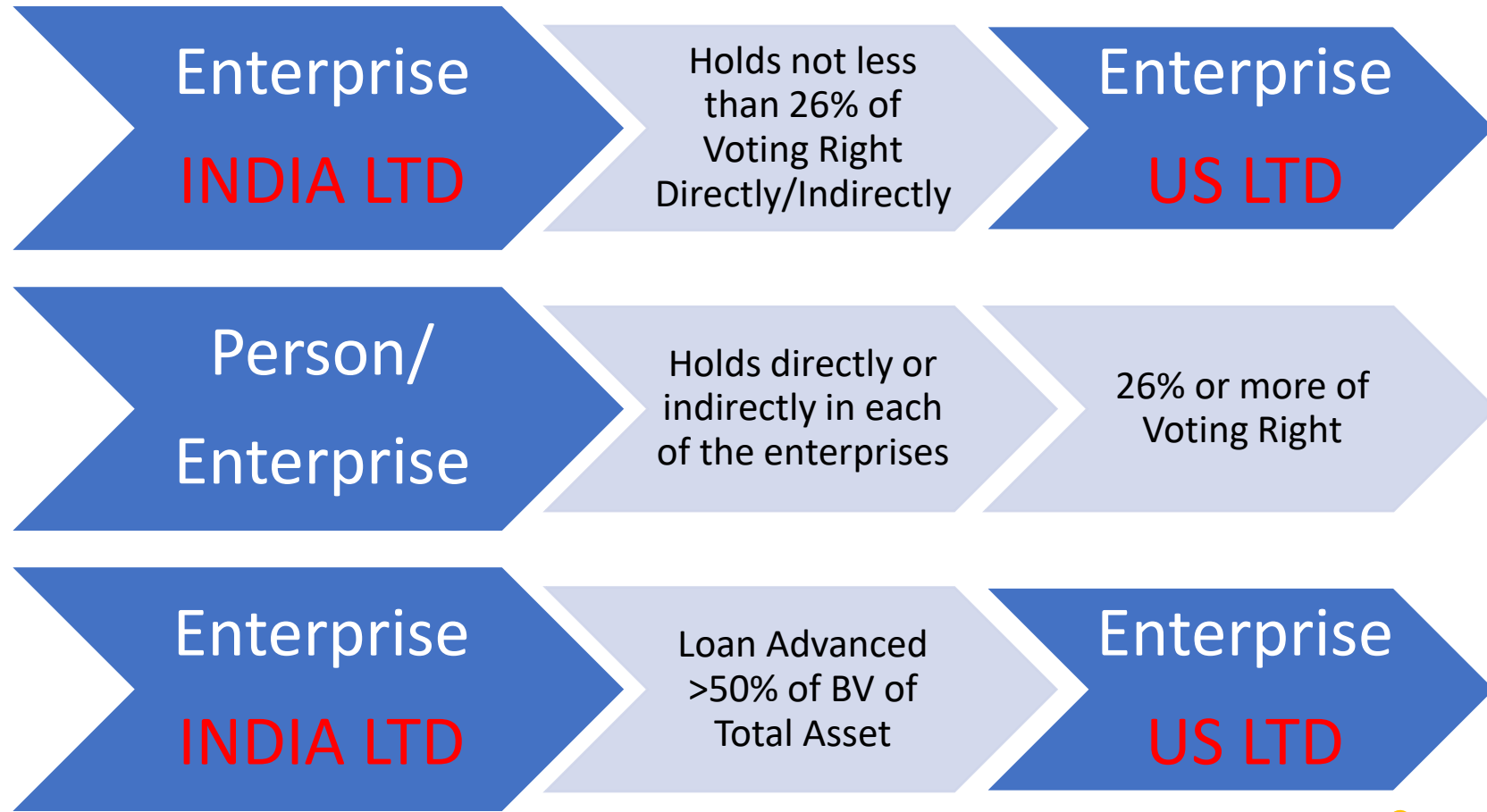
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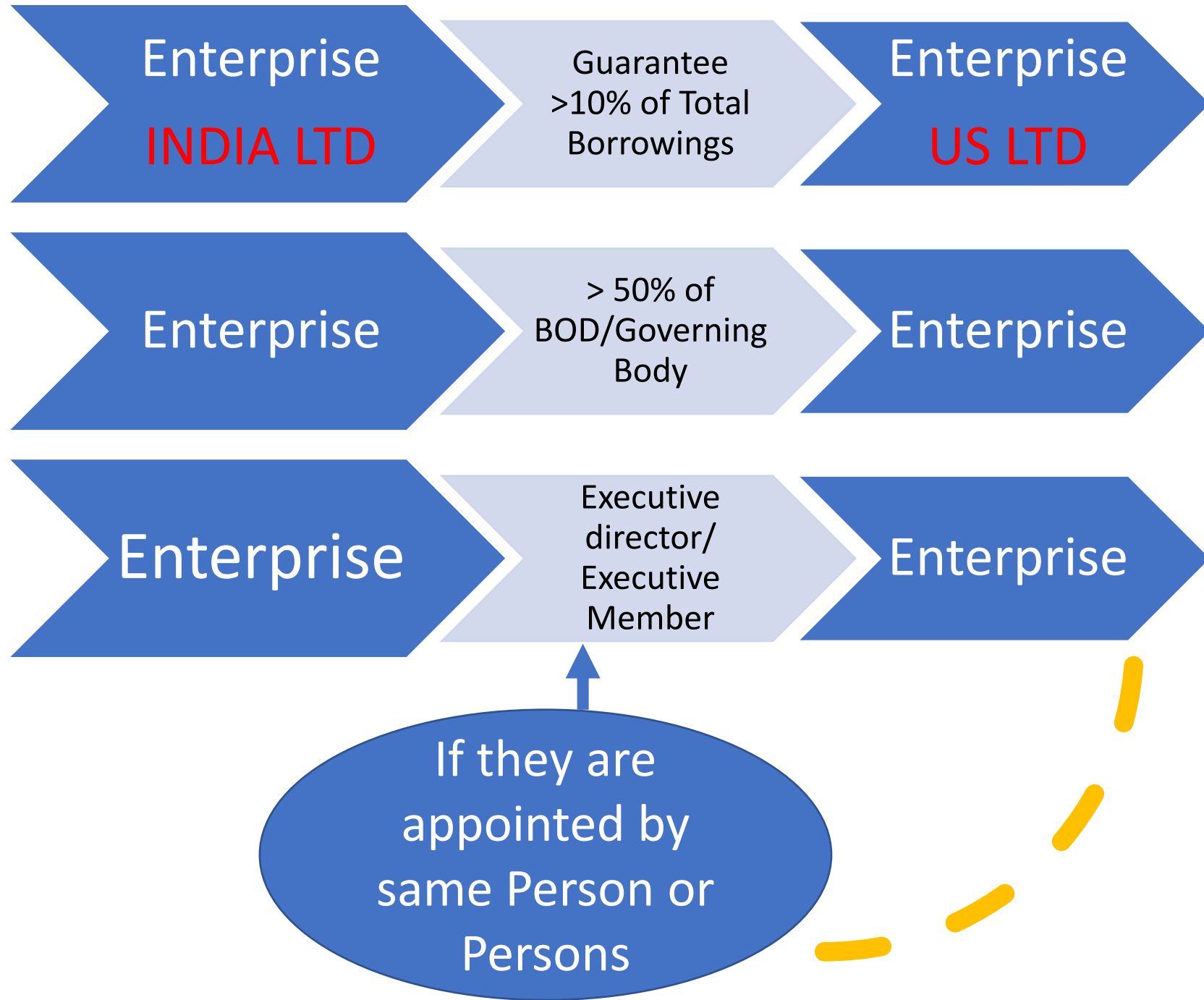
Section 92A- ASSOCIATED ENTERPRISE II



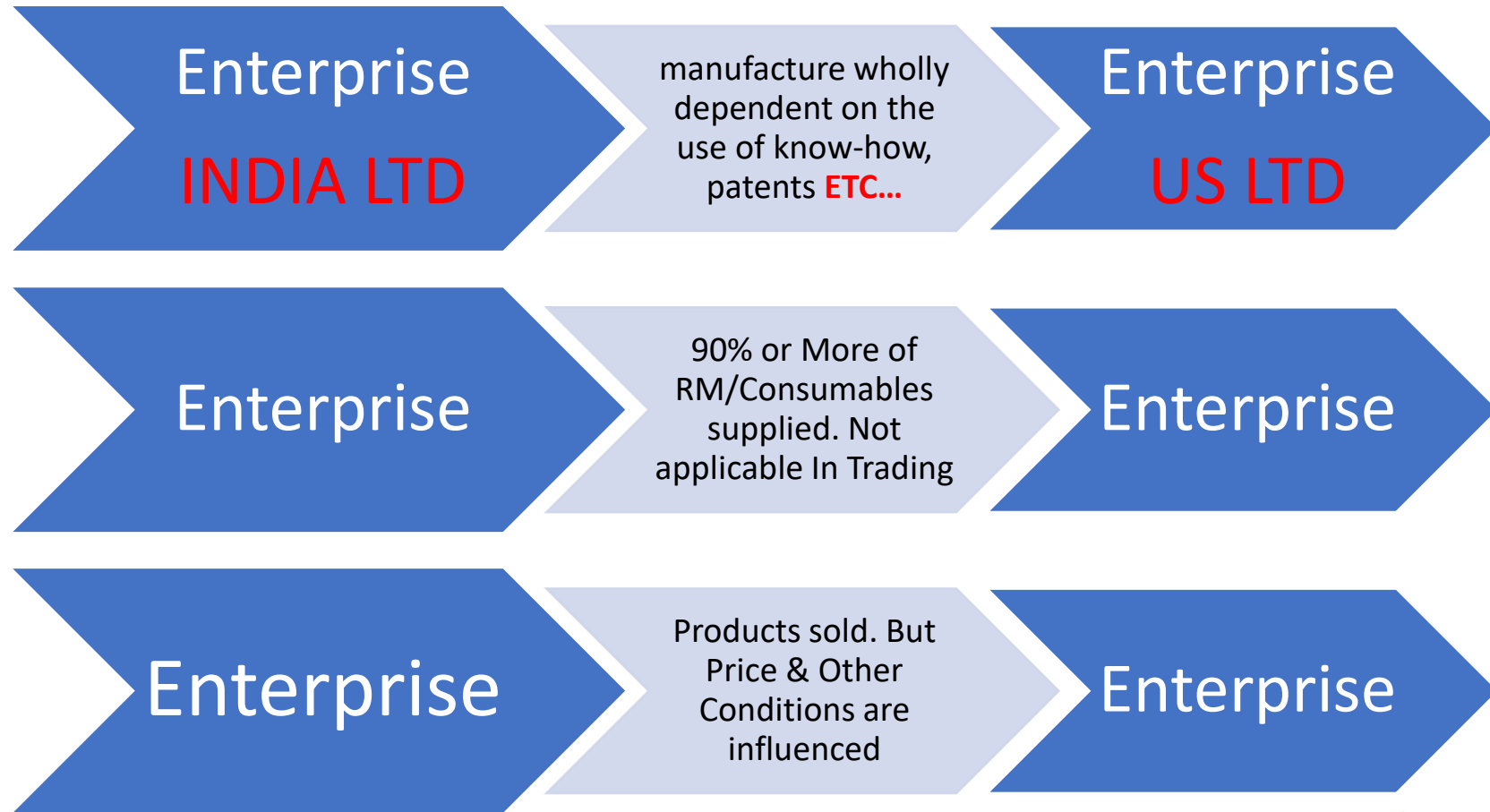
Section 92A-
DEEMED
ASSOCIATED
ENTERPRISE
III



Section 92A-
DEEMED
ASSOCIATED
ENTERPRISE
IV

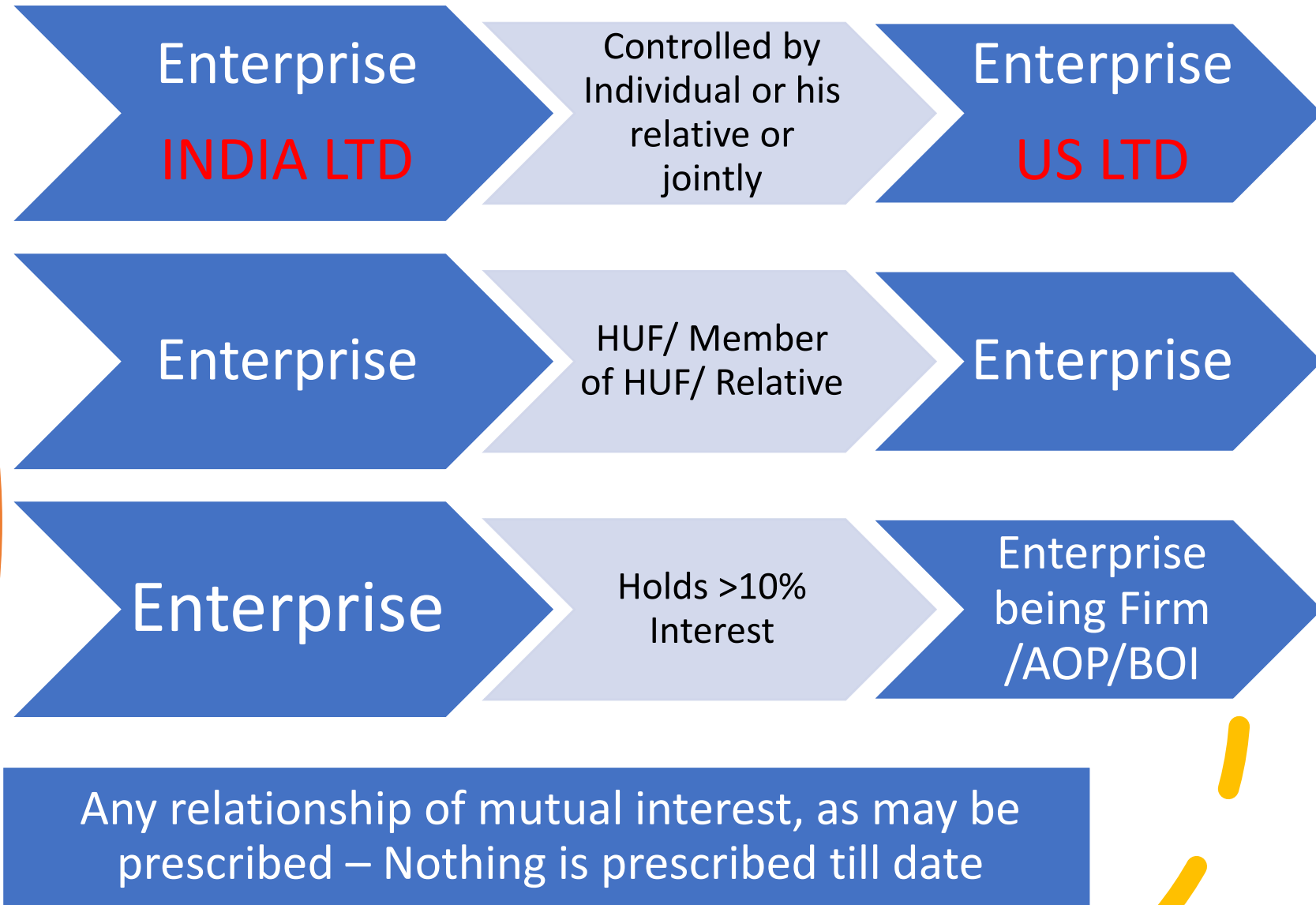


Section 92A-
DEEMED
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ENTERPRISE
V



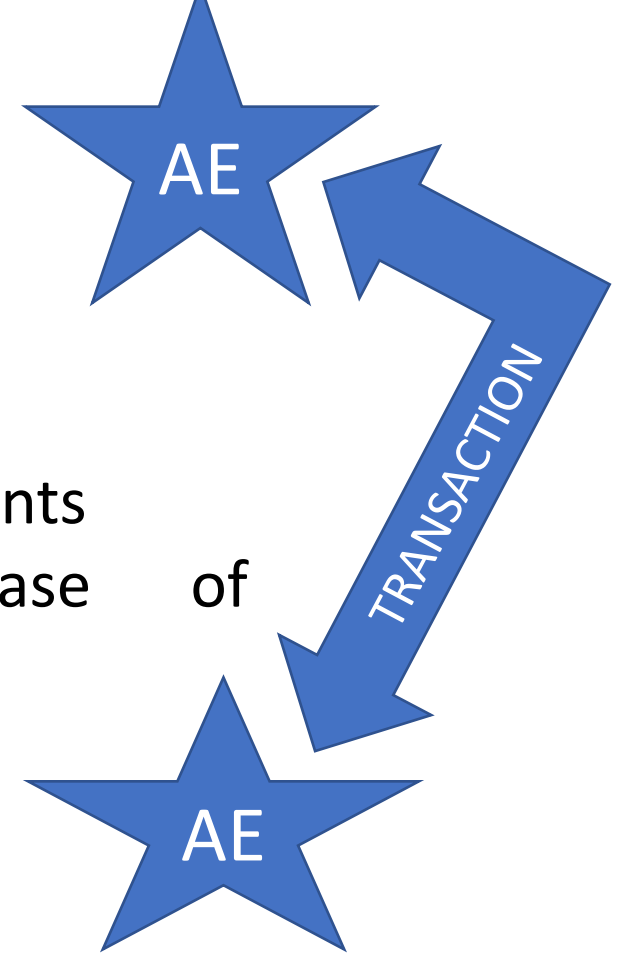
Ques : X Jewellers sell gold to UK Ltd, price is not fixed by X Jeweller. It was decided to keep the price as per London Metal Exchange rate as on the date of sale. Whether X and UK Ltd are AE as per above clause ?

Section 92A-
DEEMED
ASSOCIATED
ENTERPRISE
VI



International Transaction Section 92B

- Either or Both are Non-Residents
- Purchase, Sales or Lease of Tangible/Intangible property
- Provision of Services
- Lending or Borrowing Money
- Allocation or Apportionment
- Other Transaction having a bearing on the **profits, income, losses or assets** of such enterprises
- Note : Entire Definition is not included here



International Transaction Section 92B



- TPO Assessed FMV of Vodafone share at Rs. 53,775 and the actual issue was happened at Rs. 8,519. TPO made differential value of Rs.13.09 Billion as addition.
- At Bombay High Court it was decided that this Transaction is capital receipt and cannot be considered as “income” within the meaning of the expression as defined under the Act.
- Hence TP is not applicable for Issue of Shares.

Arms Length Price (ALP)

- Price at which a **W** - illing buyer
- illing unrelated seller

would freely agree to Transact or Trade between related parties that is conducted as if they were unrelated, so there is no conflict of interest in the transaction.

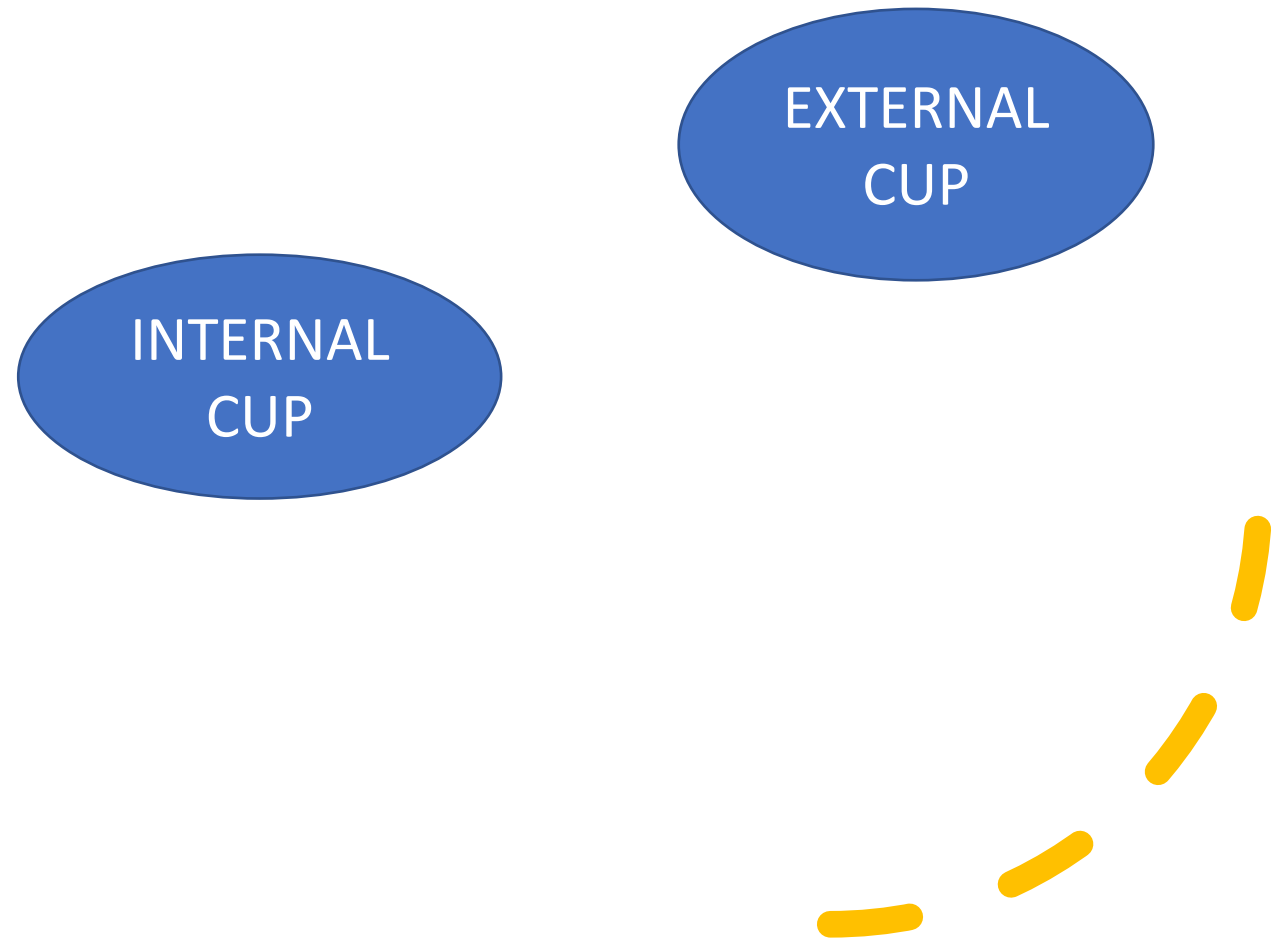


Arms Length Price (ALP) Section 92C

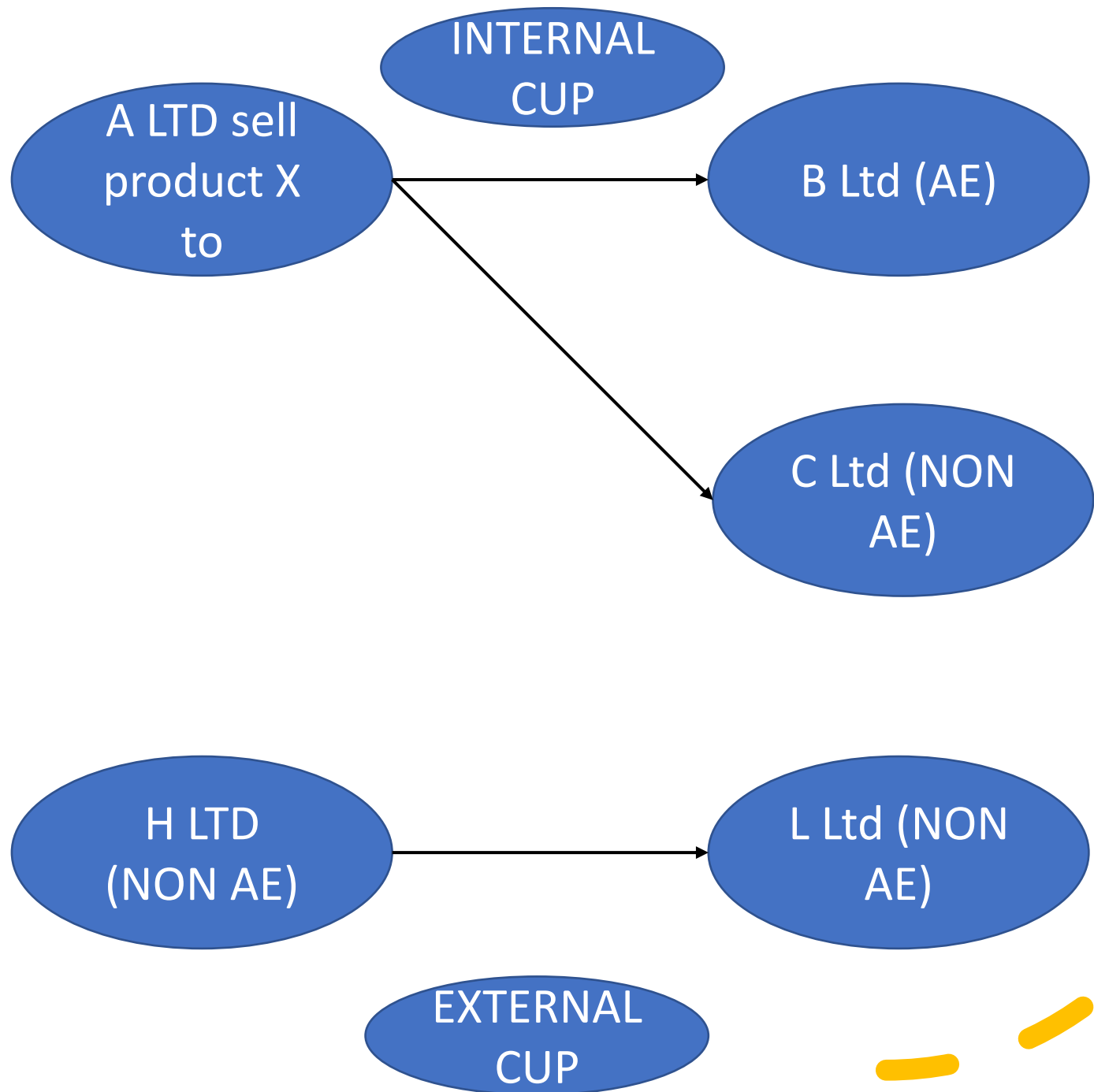
- Can be computed using any of the following method.
- It should be proved as Most Appropriate Method (MAM)
- If more than one MAM, then take Arithmetic Mean
- Methods :
 - (a) Comparable Uncontrolled Price (CUP) method;
 - (b) Resale Price Method (RPM);
 - (c) Cost Plus Method (CPM);
 - (d) Profit Split Method (PSM);
 - (e) Transactional Net Margin Method (TNMM);
 - (f) such other method.

Comparable Uncontrolled Price (CUP)

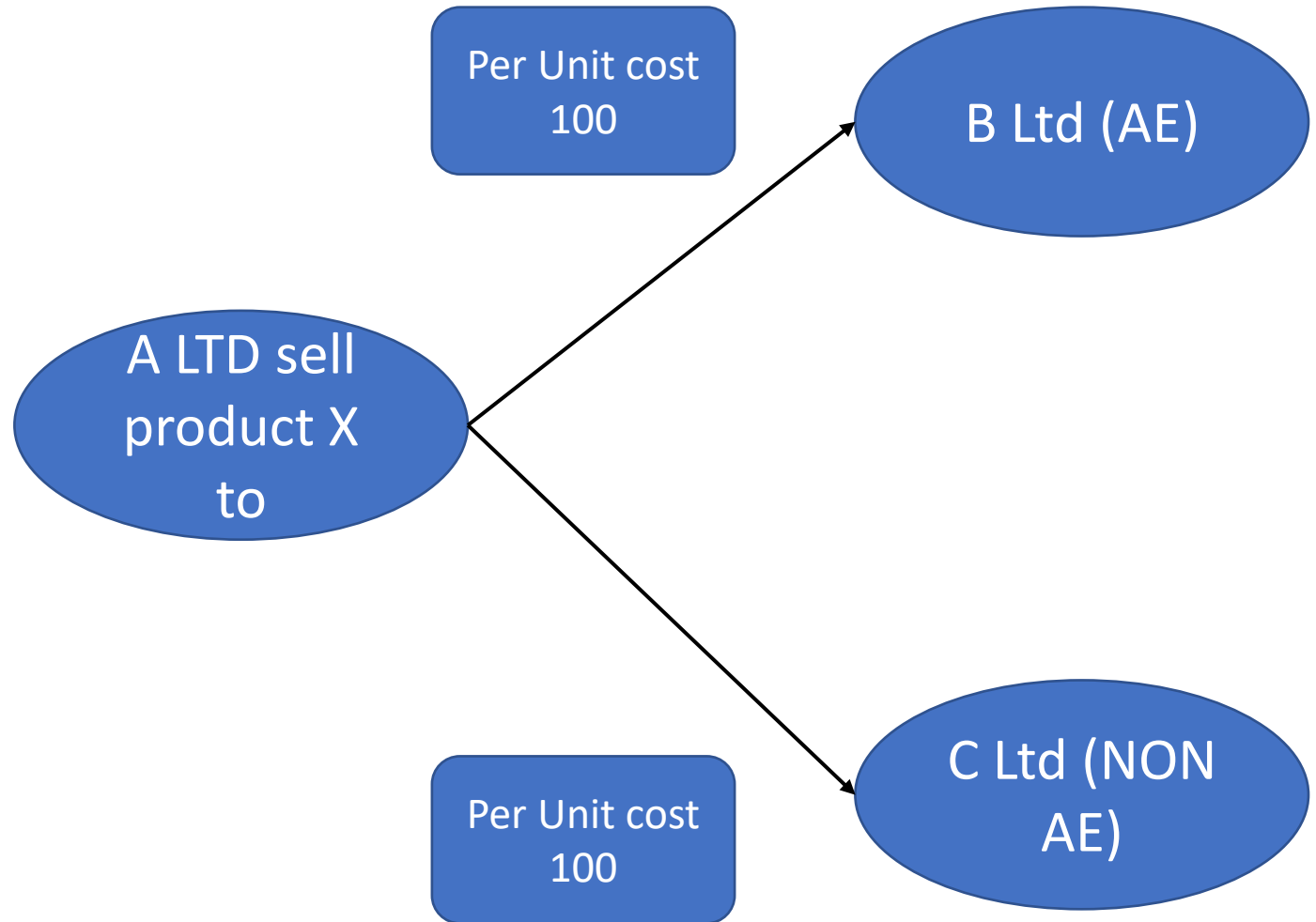
- Price Charged for Identical or nearly identical transaction with comparable uncontrolled Transactions.



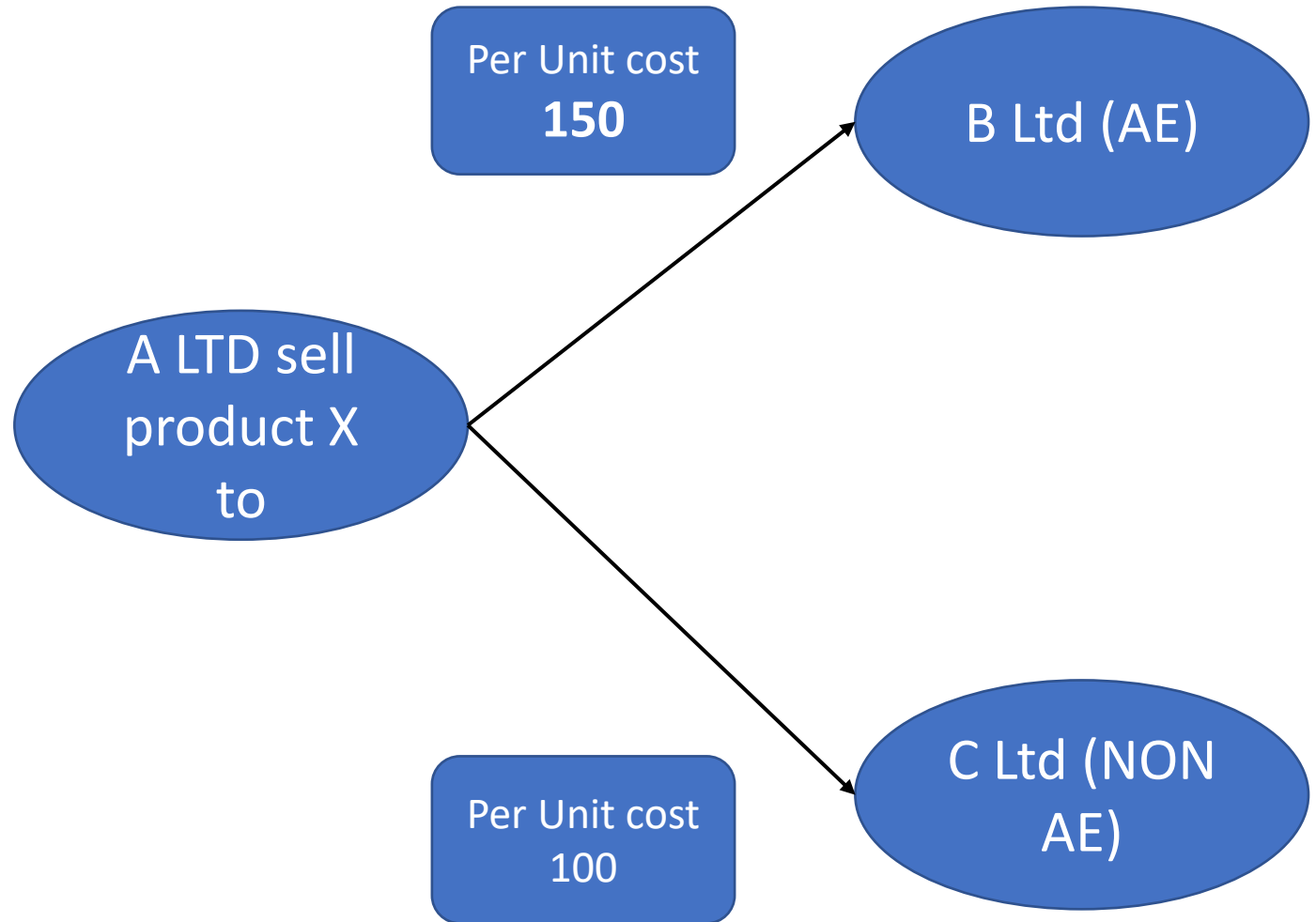
Comparable Uncontrolled Price (CUP)



Comparable Uncontrolled Price (CUP)



Comparable Uncontrolled Price (CUP)



Examples of Adjustment to CUP

- Fright Charges
- Cash & Credit Sales
- Specific Design added on Sale to Non - AE
- Trade Differences Etc..
- All these depends on the quality of Data Available. Which makes this method difficult to apply.



Resale Price Method

- Price at which a product purchased from an AE is resold to an independent enterprise.
- This price is reduced to by Gross Margin or resale price margin to arrive at ALP.
- Margin may be determined by referring to the margin may be earned by the reseller in comparable uncontrolled transactions



Resale Price Method

Sale Price to Independent Party	60,000
Less: Distribution Cost	5,000
Less: Normal Marketing Expenses	5,000
Less: Normal Distributor's Margin (10%)	6,000
Purchase Price (ALP)	44,000
Compare it with :	
Actual Purchase Price	45,000

- If the Actual Purchase price is 42,000.
Then ??

Cost Plus Method

- Begins from COST.
- MARK UP is added to the COST to arrive at ALP



Business Process Outsourcing



Cost Plus Method

- In services like BPO cost may differ between AE and NON AE. Like the requirement of experienced employee may differ from project to project, travel cost will differ etc ...
- Difficult to prove the cost, but it is possible.
- Margin or Mark up to the cost has to be derived from Market.



Cost Plus Method

Operating Income	60,000
Less: Total Cost	45,000
Profit Margin	15,000
Ratio (PM/TC)	33.33%
Compare it with :	
Ratio of Comparable	20%

- If the comparable ratio is 45%.
Then ??

Profit Split Method

- ALP is determined through a division of the Consolidated profits of the AEs.
- Commonly applied methods are Contribution Analysis and Residual Analysis
- The method is applicable in cases involving multiple transactions which are so interrelated that they cannot be evaluated separately.



Transactional Net Margin Method

- Net profit margin realised by taxpayer from a controlled transaction is determined by reference to the net margin earned in comparable uncontrolled transactions.
- Comparability is judged with reference to specific characteristics of the property or services, Functions performed, contractual terms or conditions prevailing in the market.
- Margin to be compared is operating margin – means no Extra Ordinary Items
- Improved version of Cost Plus Method
- Use Database like Prowess

Transactional Net Margin Method

Sales & Other Income	XXXXX
Less: Non – Operating Income	XXXX
Operating Income (OI)	XXXX
Total Cost	XXXXX
Less: Non- Operating Cost	XXXX
Operating Cost (OC)	XXXX
Operating Profit (OP)	XXX

- Ratio (OP/OC) or (OP/OI)
- Compare it with Industry Margin



Any Other Method

- Transactions like Reimbursement of Expenses, Purchase of Share Etc



Transfer Pricing Documentation

- As per Section 92D r.w.r 10D, it is required to maintain Transfer Pricing Documentation by the Assessee.
- This is a detailed documentation of International Transaction, AE Details, ALP computed through MAM and how the MAM is determined.
- The Rule 10D requirements in the TP Documentation are as attached in the Excel file Named "[TP Documentation](#)"

Transfer Pricing Audit & Assessment

- Sec 93E : [Form 3CEB](#) - by a CA to be filed with in 30th Nov of Every Year. (This year due date is 28.02.2022).
- AO can refer the TP cases to TPO after taking prior approval from Principal Commissioner (or) Commissioner of Income Tax.
- TPO's Responsibility is to identify the ALP.
- Final order will be passed by AO after considering the ALP computed by TPO.

OECD

- OECD - Organisation for Economic Co-operation and Development
- International Organisation with 38 member countries
- Founded in 1961
- Objectives :
 - Taxation – publish and update model tax conventions
 - Multinational corporations
 - Fighting against Bid Rigging Etc



BEPS

- BEPS - Base erosion and profit shifting
- It refers to corporate tax planning strategies used by multinationals to "shift" profits from higher-tax jurisdictions to lower-tax jurisdictions, thus "eroding" the "tax-base" of the higher-tax jurisdictions.
- Who is defining BEPS Strategies? - OECD
- BEPS Action plan 13 published in October 2015 requires country to keep master document regarding International Group.

Amendments in Indian Regulations due to BEPS 13

- To be in line with BEPS Action Plan, Indian Tax Regulations amended.
- Section 92D r.w.r 10DA amended and added requirement of filing basic details about the group if the Group T/O exceeds 500 Crores AND International Transaction exceeds 50 Crores or Transaction in Intangible property >10 Crores.
- However, for Part A of Form 3CEAA, the above limit is not applicable, Hence it has to be filed by all the designated constituent entity of the group.
- Form 3CEAA - on or before 139(1). i.e 30th Nov
- Form 3CEAB – One month before the due date of Form 3CEAA.

Amendments in Indian Regulations due to BEPS 13

- Similarly Section 286 is Introduced for Country by Country Reporting
- Rule 10DB Deals with the Reporting Requirement
- Applies only when the Group Turnover exceeds Rs. 6400 Crores (w.e.f 1.4.21) (Earlier limit was 5000 Crores)
- Forms to be filed are Form 3CEAC, 3CEAD, 3CEAE.
- 3CEAC - 2 Months prior to reporting under 3CEAD
- 3CEAD & 3CEAE – with in 12 months from the end of accounting year.
- If this Section is applicable then it has to be reported in 3CD as well.

Case Study 1

- X Ltd in Software Industry – Software Development
- Sales made only to Z Inc in USA
- Z Inc is 100% subsidiary of X Ltd
- T/o – 25 Crores. X Ltd Margin – 5%
- TNMM based on TP Study – 4.98% (with 3 comparable Companies). Analysis done using Prowis.
- Agreement with AE – 90% of the Project Sale Price to the final party will be billed by the Indian Company.
- Criteria Set by Assessee –
 - IT Companies - Selected
 - Turnover between 15-100 Crores – Selected
 - Having more than 80% of Non-AE Transactions
 - From above 15 Companies Selected and through FAR Analysis 12 rejected and 3 Selected.

Case Study 1 Contd...

- Criteria Set by TPO –
 - IT & ITES Companies - Selected
 - Having more than 80% of Non-AE Transactions – Selected
 - Companies having continuous three year losses – Removed
 - From above, 20 Companies Selected and through FAR Analysis 16 rejected and 4 Selected.
 - Average Margin Comes to 20% (TNMM)
- Based on this TPO made an addition for 15%.
- How can we prove this case at DRP ?

Case Study 2

- Assessee is into trading of Electronic goods in India manufactured by the AE.
- AE sells products only to Assessee.
- Details of External CUP were identified and with that the ALP was determined and TP study was closed by the Assessee accordingly.
- TPO is of the view that the comparable are not identically comparable and applied TNMM Method. Conditions did not include the T/O Threshold and segment analysis were not done by TPO.
- AE in Honkong is a loss-making company.
- How to prove this case ?


Advance Pricing Agreement (APA)

- Agreement between the Tax Payer (Assessee) and the Tax Authority.
- Useful to avoid future litigations
- ALP Computations will not ignored while entering into APA
- Method will be suitably amended based on the transaction.
- Maximum validity is 5 Years
- Roll Back Provision – 4 years.



THE NEW
NORMAL
LEADS TO
NEW ALP??

Questions that we are going to Face this year :

- Shutting down of Plant has happened in Indian Company how to deal with it ?
 - Sales Company is generating profit, but the group company is reporting losses due to Covid. How to address ?
 - Production company incurring costs without sale, How can it be passed to the entire supply chain?
 - Interest and License payment are leading to losses. What should we do ?
- 

THE NEW
NORMAL
LEADS TO
NEW ALP??
Contd...

- Industry margin may not be comparable for me due to Covid, How do I justify Cost Plus or TNMM ?
- Separate Function Asset & Risk (FAR) analysis needed during this pandemic situation ?
- Entered into APA agreement for ALP, But making loss now due to Covid, What is to be done ?
- Subsidiary Company abroad wanted waiver of Interest payable during FY 2020-21. Can we do?

Impact Areas

- Supply Chain
 - Decentralised Operations due to Covid
 - Impact of Profit or Loss of the Entire Supply Chain
- Human Resources in the Organisation
 - Management may be working from Different Locations due to stranded at Different Locations
 - No travel for performing services. Most possible services were done online.
 - Idle Capacity/ Increased Bench hours

Impact Areas

- Liquidity
 - Inter Company Financial Transactions may have to be restructured
 - Working Capital Requirements issues
 - Waiver/ Moratorium
 - Credit Rating Issues
- TP Policy
 - New Arm's Length possible ?
 - Increased Cost (Idle Cost, Logistics, Covid related Cost)
 - Possibility comparing the data with Industry Margin
 - How to deal with APA ?

Revalidating Models

- Trading Company of Foreign Holding Company
 - Need for revalidation due to decrease in sales, Import Challenges , Lower Demand Etc.
 - Royalty Payments might have resulting in loss since the sales is less
- Software Industry
 - Discontinuing projects will impact the profitability
 - Increased Fixed Cost during lockdown
 - Decreased productivity due to WFH



Revalidating Models Contd...

- TP Considerations :
 - Certain cost can be considered as Non- Operative Cost
 - Allocate the losses due to Pandemic to the Group.
 - Restructure the Agreements.
 - Cost Plus billing from Subsidiary may be changed if parent company is incurring losses due to the same
 - Provide Moratorium for the Loan and Interest which is in line with how Indian Bank's are Giving.
 - Interest can be converted to Loan how Indian Banks converted Interest to FITL. Etc...



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THANK
YOU

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CHARTERED ACCOUNTANTS

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