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# Global Transfer Pricing Review

India

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TAX



# India



## KPMG observation

The Indian Transfer Pricing Regulations were introduced in 2001 and are largely in line with the Organisation for Economic Co-operation and Development (OECD) Guidelines.

Since their introduction in 2001, the Indian Transfer Pricing Regulations have come of age — both in terms of quality of audits as well as the revenue generated for the Indian government. Further, over the past few years, there has been significant guidance from Income Tax Tribunals and higher Appellate Authorities on various fundamental transfer pricing issues across industries.

The Indian Transfer Pricing Regulations extend to international as well as domestic transactions between associated enterprises. The Regulations have been developing over the years and now also aim to cover: debts arising during course of business; business reorganizations or restructuring (included irrespective of whether the same has an impact on current year's profits, income, losses or assets); and intangible properties including marketing intangibles, human assets or technology related intangibles, etc. The introduction of the Advance Pricing Agreement (APA) program in 2012 has been followed by the introduction of APA rollback regulations in 2015. All taxpayers who have filed for APAs to date will also be eligible to file for rollback of their APAs up to a maximum period of four prior years, subject to certain conditions. Even those taxpayers who have signed APAs with the government will also be eligible for APA rollbacks. However, it is important to note that before availing of a rollback of APA terms, the taxpayers and the Revenue authorities need to withdraw any pending litigation.

### *OECD-BEPS initiative*

India has been actively involved in various action points of the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan, and is engaging closely with other G20 member countries in respect of the BEPS initiative. India is also part of the BEPS Bureau, which is coordinating and guiding the work being done in all areas, and will seek to implement the guidelines issued by OECD from time to time under the BEPS initiative.

Indian transfer pricing authorities have already been adopting the OECD's approach on BEPS in relation to intangible-related returns and concurs that such returns should reside with the entity which makes strategic decisions around creation of the intangibles, and not with the entity which has mere ownership of title and funding capacity. India therefore believes that by adopting the "significant people functions" approach in determining the economic owner of intangibles, the disconnect between profit and economic activity will be significantly resolved.

In respect of the OECD's guidance on transfer pricing documentation and Country-by-Country (CbyC) reporting, the Indian Revenue authorities are of the view that the proposed three tier structure (i.e. master file, local file, and CbyC report) would assist in making proper risk assessments and identifying cases where transfer pricing audits are required.

## Transfer pricing study snapshot

### The purpose of a transfer pricing study

	Applicable	Required to be contemporaneous	Thresholds apply/exist
Legal requirements	●	●	●
Protection from penalties	●	●	●
Reduce risk of adjustment	●	●	●
Shifts burden of proof	●	●	●

## Basic information

### Tax authority name

Central Board of Direct Taxes (CBDT).

### Citation for transfer pricing rules

Sections 92 to 92F of Income-tax Act, 1961 (Act); Rules 10A to 10TF of Income-tax Rules, 1962, which now includes new Rule 10MA introducing the provisions for rollback of APAs.

### Effective date of transfer pricing rules

1 April 2001.

### What is the relationship threshold for transfer pricing rules to apply between parties?

The transfer pricing provisions incorporate a very wide definition of associated enterprises to include direct and indirect participation in the management, control or capital as well as certain conditions wherein two enterprises are “deemed” to be associated enterprises.

Significant conditions include:

- direct/indirect shareholding giving rise to 26 percent or more of voting power
- 90 percent or more purchase of raw materials/sale of manufactured goods by an enterprise from/to the other enterprise at prices and conditions influenced by the latter
- authority to appoint more than 50 percent of the board of directors or one or more of the executive directors
- dependency in relation to intellectual property rights (know-how, patents,

trademarks, copyrights, trademarks, licenses, franchises, etc.) owned by either party

- dependency relating to borrowings — i.e. advancing of loans amounting to not less than 51 percent of total assets or provision of guarantee amounting to not less than 10 percent of the total borrowings, etc.

In respect of deeming provisions, the regulations are now extended to transactions between an enterprise and an independent person where there is a prior arrangement between the independent person and associated enterprise, irrespective of whether such independent person is a non-resident or resident. Therefore, even transactions between two resident and independent enterprises may be covered under Transfer Pricing regulations if there is a prior arrangement between one independent enterprise and associated enterprise of the other independent enterprise.

### What is the statute of limitations on assessment of transfer pricing adjustments?

The time limit for completion of a transfer pricing audit is typically 34 months from the end of the assessment year (the year immediately following the tax year). The tax year in India is the financial year (FY) i.e. 1 April – 31 March. Further, the time limit for completion of the regular tax audit (scrutiny by the Assessing Officer) is 36 months from the end of the assessment year.

However, even after the 36 months have passed, if the tax authority has reason to believe that at least 100,000 Indian rupees (INR) of taxable income has escaped assessment for any assessment year, they may reopen the assessment for those particular years, provided they issue the required notice for reopening the assessment within six years from the end of the relevant assessment year.

Further, in all cases where it is found that an international transaction has not been reported (either by non-filing or non-inclusion in the Accountant’s Report) it is considered as avoidance of income and could be reopened under the provisions of the Act.

## Transfer pricing disclosure overview

### Are disclosures related to transfer pricing required to be submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Yes. Filing of the Accountant’s Report in Form No. 3CEB certifying the arm’s length nature of the international transactions and specified domestic transactions with Associated Enterprises is required to be prepared by the taxpayer and submitted to the revenue authorities. The report has to be obtained from a Chartered Accountant and submitted to the revenue authorities by the statutory due date (presently 30 November after the end of the relevant FY).

However, Transfer Pricing Study report or documentation (including the Functional analysis and Economic analysis) that supports the Accountant Report, has to be shared with the Revenue authorities, only when and if the taxpayers case is selected for detailed audit by the Revenue authorities.

#### What types of transfer pricing information must be disclosed?

As previously stated, the Accountant's Report is required to certify that appropriate documentation has been maintained by the taxpayer and the information disclosed is true and correct.

The following information is generally disclosed:

- name, address, permanent account number and status of the taxpayer
- name, nature of relationship and other details (as prescribed) of the Associated Enterprise with whom the taxpayer has entered into international transactions/ domestic transactions during the year
- description of international transactions entered into, including quantity, value, paid/payable, received/receivable and the method used to test arm's length criteria.

However, as mentioned above the Transfer Pricing Study has to be prepared by the statutory due date (30 November) but shared only on request.

#### What are the consequences of failure to submit disclosures?

The Indian Transfer Pricing Regulations have penal provisions for failure to prepare or submit disclosures:

- failure to maintain prescribed information/documents: two percent of value of international transactions / domestic transaction
- failure to file Accountant's report by deadline: INR100,000 (approximately 1,667 US dollars (USD))
- failure to report any international transaction/domestic transactions which is required to be reported: two percent of the value of international transaction/domestic transaction
- providing incorrect information or documents: penalty of two percent of the value of international transaction/ domestic transaction
- failure to furnish information or documents during the audit: two

percent of the value of international transaction/domestic transaction.

### Transfer pricing study overview

Can documentation be filed in a language other than the local language? If yes, which ones?

Yes, English.

When a transfer pricing study is prepared, should its content follow Chapter V of the Organisation for Economic Co-operation and Development (OECD) Guidelines?

No. India is not a member of the OECD thus does not follow the OECD Guidelines. However, there are similarities in the Indian transfer pricing Regulations and Chapter V of the regulations with respect to preparation of a transfer pricing study. The taxpayers and the Indian tax authorities have resorted to the OECD Guidelines to support principles found in the Indian Transfer Pricing Regulations and where guidance is not available. The Indian Transfer Pricing Regulations are relied upon where there are differences from the OECD Guidelines. Also a recent High Court ruling specifies, that India is not a member of the OECD, and hence these Guidelines have only persuasive status; and do not have any legal sanction.

Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No.

### Transfer pricing methods

Does your country follow the transfer pricing methods outlined in Chapter II of the OECD Guidelines? If exceptions apply, please describe.

No. The transfer pricing methods in the Indian Transfer Pricing Regulations are to be followed when preparing the transfer pricing study.

The methods prescribed in the Indian Transfer Pricing Regulations are similar to those outlined in Chapter II of the OECD Guidelines. However, the Indian Transfer Pricing Regulations permits the Central Board of Direct Taxes (CBDT) to prescribe any other method. And under this provision CBDT inserted "Other

Method" in addition to the above five prescribed methods in the Transfer Pricing rules via a Notification applicable from FY 2011-12.

The "Other Method" is described as "any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts".

Proper documentation specifying the rejection reasons for non-application of the above five prescribed methods and the appropriateness of the "Other Method" based on the facts and circumstances of the case would have to be maintained by the taxpayer.

### Transfer pricing audit and penalties

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? And if so, how many days?

Yes, 30 days.

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? Please explain.

Generally, the notice of an audit by the revenue authorities specifies the period within which the taxpayer is required to provide the required documentation.

If an adjustment is proposed by the tax authority, what dispute resolution options are available?

There is an appellate mechanism if the taxpayer contests an adjustment proposed by the revenue authorities. It includes several stages:

- Appellate Commissioner (complemented by Dispute Resolution Panel)
- Jurisdictional Appellate Tribunals
- Jurisdictional High Courts
- National Supreme Court.

It can take three to eight years for a taxpayer to obtain a conclusive decision by the Indian judiciary.

The assessment/appellate procedure in India are generally rules-based and the authorities typically will not negotiate a settlement.

Use of mutual agreement procedure (MAP) under the tax treaties can be invoked as an alternative dispute resolution mechanism. India has entered into various double taxation treaties to avoid tax disputes whether jurisdictional conflicts or matters of interpretation.

In matters pertaining to potential double taxation or taxation not in accordance with a double tax convention, the option available before or after exhaustion of any domestic administrative appeals process is either to apply for MAP under the relevant tax treaty; or litigate the matter through the courts.

The Advance Pricing Agreements (APA) mechanism was introduced in July 2012, and provides the taxpayers with an alternate mechanism for resolution of potential transfer pricing disputes. The response to the Indian APA program has been very positive so far and a few APAs are expected to be signed in 2015.

### **What defenses are available with respect to penalties? If so, what rates are applied and under what conditions?**

The Indian Transfer Pricing Regulations have prescribed the following penalty provisions summarized below:

- in case of a post-inquiry adjustment, there is deemed to be a concealment of income — 100-300 percent of tax on the adjusted amount
- failure to maintain documents — two percent of the value of transaction
- failure to furnish documents — two percent of the value of transaction
- maintaining or furnishing incorrect information or documents — two percent of the value of transaction
- failure to furnish accountant's report — INR100,000 (USD1667)
- failure to report a transaction in accountant's report — two percent of the value of transaction.

### **To what extent are transfer pricing penalties enforced?**

The above imposition of penalties is discretionary and depends upon the facts and circumstances of each individual case.

### **What defenses are available with respect to penalties?**

Please refer to the information provided previously. In addition, the intent of the taxpayer is also given due consideration, i.e. whether the intent is mala fide or whether the taxpayer had made bona fide attempts to comply with the prescribed regulations. Establishing bona fide intent can provide some defense for the taxpayer.

### **What trends are being observed currently?**

After the new government took charge, there have been lot of policy changes and positive outcomes to long debated transfer pricing litigation issues like the share valuation and the marketing intangibles controversies. In case of the share valuation issue the government has decided to accept the High Court's ruling and not to challenge it before the Supreme Court though there was an avenue to do so. Further in case of marketing intangibles issue, though the same will be covered under the ambit of Transfer Pricing Regulations, the High Court has delved deep into the fundamentals of transfer pricing and economics and has placed substantial reliance on detailed international guidance in the OECD and the ATO guidelines, by approving that there may not be a separate remuneration for marketing intangibles if such compensation is already provided by way of lower import prices or reduced payment of royalties.

Indian Revenue authorities continue to determine the arm's length value of the intra-group services as "Nil" alleging that such charges are simply a means of profit repatriation and leads to erosion of India's tax base.

Further in case of captive R&D service providers, while earlier the focus of revenue audits had largely been on the level of mark-ups, recently the Indian Revenue authorities have classified in some cases these services as 'high value' and have sought to apply the Profit Split Method ('PSM') for performing a transfer pricing adjustment. The basis of the adjustment assumed that the R&D center performed non-routine functions and contributed to the creation of unique intellectual property which in-turn got

transferred to the foreign affiliates without appropriate compensation.

To illustrate, in the most recently completed round of transfer pricing audits concluded, in January 2015 the Indian transfer pricing authorities have made adjustments to the tune of INR470 billion, i.e. approximately USD7.8 billion.

It is important to note that from the next assessment cycle beginning from March 2016 pertaining to FY 2012 - FY 2013, even the domestic transactions will be audited by the revenue authorities. It is expected that newer disputes may arise as a result.

## **Special considerations**

### **Are secret comparables used by tax authorities?**

Yes, although the Transfer Pricing Regulations contain no guidance on the use of secret comparables. Practically, the Indian revenue authorities have been using secret comparables in the course of transfer pricing audits. There are judicial rulings which have held that secret comparables (which are not available to the taxpayer at the time of setting its transfer prices) should not be used in the course of transfer pricing audits against the taxpayer.

### **Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?**

Yes. In transfer pricing audits conducted, the Indian revenue authorities have consistently shown a marked preference for selecting Indian comparables and accordingly, in accepting the corresponding economic analysis. The tax authorities prefer local comparables in the benchmarking set and often reject foreign comparables on the basis of geographical differences or cite lack of data availability as reasons.

### **Do tax authorities have requirements or preferences regarding databases for comparables?**

The tax authorities generally use two Indian databases, being Prowess and CapitalinePlus. In practice these two databases are also widely used by the taxpayers.

### Does the tax authority generally focus on the interquartile range in a TNMM analysis?

No.

### Does the tax authority have other preferences in benchmarking? If so, please describe.

The concept of Arithmetic Mean is used where more than one arm's length price was determined, till FY ended on 31 March 2014. The Finance Minister, in his budget speech of 10 July 2014, announced that the concept of price range for determination of ALP, will be introduced in the income tax rules, to align the Indian transfer pricing regulations with international leading practices. The existing concept of arithmetic mean would continue to apply where the number of available comparables are inadequate. Accordingly, the tolerance band which was available to the taxpayers shall not be available to the taxpayers for the transactions undertaken from 1 April 2014. The provisions in this regard, for the actual implementation of range concept are awaited, as the deadline for filing the return of income for FY 2014 - FY2015 shall be 30 November, 2015.

### What level of interaction do tax authorities have with customs authorities?

There is a lack of consistency between customs valuation procedures and Transfer Pricing Regulations under tax laws. The departments work at divergent purposes in relation to the same transactions. Suitable methods for valuation of imported goods should be established which are acceptable to both customs law and the transfer pricing regulations. To this end, the Indian revenue authorities set up a Joint Working Group, comprising transfer pricing and customs officers. Considering the lack of synchronization, this initiative was undertaken by the revenue authorities in order to bring greater harmonization, coordination and communication between the two departments as regards valuation of imported goods.

### Are there limitations on deductibility of management fees beyond the arm's length principle?

No, management fees are deductible. However, a commercial expediency test and a benefits test are rigorously applied by tax authorities with respect to payment of management fees.

### Are management fees subject to withholding?

Yes.

### Are there limitations on the deductibility of royalties beyond the arm's length principle?

No. Royalties paid are deductible. However, a commercial expediency test and a benefits test are rigorously applied by tax authorities with respect to payment of royalty.

### Are royalties subject to withholding?

Yes.

### Are taxpayers allowed to file tax return numbers that differ from book numbers?

Yes, but only upward adjustments to income are permitted. In the course of conducting the benchmarking analysis (forming part of the preparation of the transfer pricing documentation of the taxpayer), where the taxpayer believes that the value of the international transaction reported in the financial statements is different from the arm's length price, the taxpayer may only make an upward adjustment for the additional amount of income to be offered to tax in the corporate tax return, to the extent of the difference between the actual transaction price and the arm's length price determined. The adjustment would also be required to be carried out prior to filing the Transfer Pricing Accountant's Report in Form No.3CEB. However, downward adjustments are not permitted.

### Other unique attributes?

Arithmetic Mean:

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of price range for determination of ALP, will be introduced in the income tax rules, to align the Indian transfer pricing regulations with international leading practices. However, the existing concept of arithmetic mean would continue to apply where the number of available comparables are inadequate. Accordingly, the tolerance band which was available to the taxpayers shall not be available to the taxpayers for the transactions undertaken from 1 April 2014. The provisions in this regard, for the actual implementation of range concept are awaited, as the deadline for filing the return of income for FY 2014 - FY2015 shall be 30 November, 2015.

Multiple-year data:

The Indian Revenue authorities do not generally permit use of multiple-year data. The data pertaining to the relevant FY has to be benchmarked against comparable data of the same FY. The use of multiple year is permitted only in the event, if the previous year's data reveals facts, which could have an influence on the determination of transfer prices in relation to the transactions being compared. The onus is on the taxpayer to show such inference. However, there is no option to use the previous year's data for the tested party.

In this regard, the Finance Minister in his budget speech of 10 July 2014, proposed to amend regulations to allow the use of multiple year data for comparability analysis. However, the provisions for actual implementation are still awaited.

## Tax treaty/double tax resolution

### What is the extent of the double tax treaty network?

India has an extensive tax treaty network and has entered into comprehensive tax treaties with 92 countries (as on 31 December 2014). India is also party to a series of treaties under negotiation.

### If extensive, is the competent authority effective in obtaining double tax relief?

Sometimes. India's general experience with MAPs is quite recent. Most MAP cases that the Indian Competent Authority has dealt with have been with the US, Japan and a few countries in Europe.

In practice, MAP as a mechanism for dispute resolution in regards to transfer pricing has not been found to be very successful until recently in India. The reason is that even after the consultation process has commenced, the process lasts for a long time and its outcome is uncertain. However, recently after the visit of the US President to India, the MAP cases between India and US, primarily in the IT /ITeS industry have been taken on fast track and are expected to be resolved soon.

### When may a taxpayer submit an adjustment to competent authority?

There are no formal rules.

### May a taxpayer go to competent authority before paying tax?

Yes, however before invoking MAP procedures, in some cases a bank guarantee generally needs to be submitted for the tax demand in question. This has been the procedure to date in MAP cases involving the US and UK. However, based on a recent Memorandum of Understanding signed between India and UK, the tax collection from the taxpayers of both the countries, will be suspended till the resolution of the pending MAP requests.

## Advance pricing agreements

### What APA options are available, if any?

Unilateral, bilateral, multilateral.

### Is there a filing fee for APAs?

Yes. The schedule of fees payable at the time of making the application is as follows:

- transaction value not exceeding INR1000 million — fee amount INR1 million
- transaction value not exceeding INR2000 million — fee amount INR1.5 million
- transaction value exceeding INR2000 million — fee amount INR2 million.

### Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

No.

### Are there any difficulties or limitations on the availability or effectiveness of APAs?

Yes. In the first three years of APAs, 386 formal APA applications were filed with the Indian Government. Multinational corporations dealing in diverse industries such as pharmaceuticals, consumer electronics, media, cement, telecom, etc. have filed applications. Several rounds of discussions are already in process and the experience has been satisfactory so far. International transfer pricing experts have welcomed the collaborative approach of the Indian APA team. Based on the latest available information, a total of nine APAs have been signed by the CBDT with the

taxpayer's of which eight are unilateral and one bilateral APA with Japan.

The option of APAs can be explored in case of complex and high value transactions or where the company is already undergoing transfer pricing audit scrutiny and hence would be selected for audits again or where the company needs financial certainty with regard to future tax implications. APAs would reduce the need for documentation and costs associated with audit and appeals over APA term and facilitate transfer pricing planning. Double taxation can be avoided in case of bilateral/multilateral APAs.

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