

# Recent Trends & Controversies in Transfer Pricing

Chamber of tax Consultants

International tax Study Circle meeting: 27-02-2021

CA Heena Khajanchi

# Background

Sr. No.	Particulars
1	Transfer pricing law introduced in India –April 2001
2	Specified Domestic Transaction- 2013 to 2017
3	Definition of international transaction retrospectively amended by FA, 2012
4	Safe Harbour Rules
5	Option to use sixth method –Other Method- Rule 10AB
6	Advance Pricing Agreements
7	Multiple years data for benchmarking
8	Interquartile range between 35 and 65 percentile
9	Thin Capitalisation- Section 94B
10	Secondary Adjustment- Section92CE
11	Transfer pricing amendments in Finance Bill 2020 Application to AO for re-computation of book profits- section 115JB(2D) Due date for filing of returns for partners extended to 30 <sup>th</sup> Nov., where Transfer pricing applies to the firm –section 139- Exp 2-aa

# Recent Trends- Transfer Pricing



- European commission to appeal the Apple Case to the Court of Justice of the European Union.- estimate US\$ 15.8 bn tax liability
- Coca Cola set to appeal against the IRS decision- estimates US\$12bn tax liability.
- IRS took Facebook to US tax court over valuation of its intangible assets-
- Indian government appealing The Hague Decision in the Vodafone case . The permanent Court of Arbitration in the Hague ruled in favour of Vodafone against the Income-tax department.
- Federal Court of Appeal , Canada ruled in favor of Cameco transactions and use of subsidiaries in Luxembourg and Switzerland to trade uranium in Europe were in line with the arms length principle and Canada's TP Rules.
- Permanent Court of arbitration at the Hague ruled in favor of Cairn against the Indian Income-tax department on 23-12-2020.
- Implications of discontinuation of LIBOR on Intercompany loans

# Recent Controversies

# Recent Controversies- Foreign Associated Enterprise Tested Party

- Meaning of enterprise- u/s 92F(iii)

"enterprise" means a person (including a permanent establishment of such person) who is, or has been, or is proposed to be, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights, or the provision of services of any kind, or in carrying out any work in pursuance of a contract, or in investment, or providing loan or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, whether such activity or business is carried on, directly or through one or more of its units or divisions or subsidiaries, or whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or places;

- Meaning of associated Enterprise- u/s 92A(1) & (2)

“(1) For the purposes of this section and sections 92, 92B, 92C, 92D, 92E and 92F, "associated enterprise", **in relation to another enterprise, means an enterprise—.....”**

- UN TP guidelines-Para 5.3.3- Selection of Tested Party

“The tested party normally should be the less complex party to the controlled transaction and should be the party in respect of which the most reliable data for comparability is available. **It may be the local or the foreign party.** If a taxpayer wishes to select the foreign associated enterprise as the tested party, it must **ensure that the necessary relevant information about it and sufficient data on comparables is furnished to the tax administration and vice versa in order for the latter to be able to verify the selection and application of the transfer pricing method.**”

- OECD TP Guidelines- Para 3.18- Choice of Tested Party

“ As a general rule, the tested party is the one to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found”

## Recent Controversies- Foreign Associated Enterprise Tested Party

- *Yamaha Motor India Pvt Ltd. Vs ACIT [2014] 50 taxmann.com 444 (Delhi - Trib.)*

“8.4 There is no condition that this method cannot be used when the tested party is an associated enterprise. The contention of the revenue that the basic condition of resale price method is that **'the property has to be obtained by the enterprise i.e. the assessee from an associated enterprise is incorrect.'** In the Act as well as Rules the words **'enterprise' and 'associated enterprise' have been used interchangeably.** Thus, the argument that enterprise will mean 'the assessee' and associated enterprise will mean 'the other party' to whom the assessee has sold or purchased the goods is incorrect. The above interpretation gets supported by the definition of 'enterprise' given in section 92F(iii). Similarly 'associated enterprise' has been defined in section 92A.”

- *Ranbaxy Laboratories Ltd vs ACIT [2016] 68 taxmann.com 322 (Delhi - Trib.)*

“Certain principles that emerge in selection of tested party are as follows:

- i. The tested party normally should be the least complex party to the controlled transactions.
- ii. Availability of Most reliable data of tested party and requirement of minimum adjustments is also one of the most important aspects in selection of tested party.
- iii. There is no bar against the selection of Tested party either Local party or Foreign party. Neither Income-tax Act and nor any guidelines on Transfer pricing provides so. Therefore selection of tested party is to further the object of comparability analysis by making it less complex and requiring fewer adjustments.
- iv. There may be many circumstances where the data related to one party to the controlled transaction may be available easily, readily and in abundance. However the first step is to look at the FAR study of that party and if found to be complex than other party, then such party should be rejected as tested party and preference may be given to another entity which is least complex and is having reasonably reliable data for comparability. Therefore, the driving force in selection of tested party should be the least complex FAR of the party than the volume of comparable data.”

# Recent Controversies- Foreign Associated Enterprise Tested Party

Virtusa Consulting Services (P.) Ltd. Vs DCIT [2021] 124 taxmann.com 309 (Madras)

-Yamaha decision referred and considered

ACIT vs ITC Infotech India Ltd. [2020] 115 taxmann.com 290 (Kolkata - Trib.)

-UN & OECD guidelines referred and considered

Tata Motors European Technical Centre Plc. Vs ADIT [2014] 52 taxmann.com 411 (Mumbai - Trib.)-

-UN & OECD guidelines referred and considered

-Restored to TPO for considering the Foreign AE comparability

Majesco Software & Solutions India Pvt. Ltd. Vs ACIT ITA no. 7070/Mum/2019

-UN & OECD guidelines referred and considered

-Carraro India Pvt. Ltd. Vs DCIT- 104 taxmann.com 166(Pune-Trib) – UN & OECD guidelines not referred

Eaton Industrial Systems (P.) Ltd. vs DCIT [2020] 113 taxmann.com 267 (Pune - Trib.)

-UN & OECD guidelines not referred or considered

-Decisions of Yamaha/Ranbaxy etc. not referred

Onward Technologies Ltd vs DCIT [2014] 44 taxmann.com 295 (Mumbai - Trib.)

-UN & OECD guidelines not referred or considered

# Recent Controversies- Guarantee Commission

- **Corporate Guarantee**

A direct/written assurance regarding the fulfillment of the obligations of the other company.

*Associated Capsules Pvt. Ltd vs ACIT- [2020] 121 taxmann.com 103 (Mumbai - Trib.)*

- Corporate guarantee commission @ 0.5%
- Guarantee commission to be charged to the extent of actual exposure of facility availed

- **Letter of negative lien**

A negative lien, is a right of a person to restrict another person from disposing of or creating encumbrance over a property belonging to the latter which is in the latter's possession or control till the time the debt or other obligation (for which such negative lien is conferred) is discharged.

*Essar Shipping Ltd vs ACIT - [2020] 116 taxmann.com 424 (Mumbai - Trib.)*

- No liability in case of default
- 0.25% addition sustained

- **Letter of Comfort**

A letter of comfort is a written document that provides a level of assurance that an obligation will ultimately be met. A letter of comfort is often couched in vague wording, in order to prevent the issuer from being saddled with a legally enforceable obligation.

*Indian Hotels Company Ltd. Vs DCIT [2019] 112 taxmann.com 340 (Mumbai - Trib.)*

- Outside the ambit of international transaction
- The assessee has not bound itself for repaying the loans in the event of default by AE

# Recent Controversies- Management Fees

- Para 10.5.3.2 UN TP Guidelines

“Firstly, it must be determined if a service has been rendered and second, it must be determined if the charge for such service is arm’s length

As regards the first test, the approach followed is to determine if the services:

- Provide the recipient with economic and commercial benefit;
- Are not services that the recipient is already performing for itself (duplicate service test); and
- Are not shareholder services.

As regards the second part of the test, the audit approach seeks to confirm the following:

- That the cost base is appropriate to the services provided;
- That the mark-up is arm’s length;
- That the allocation keys applied are commensurate to the services provided.”

- Para 7.10 OECD TP Guidelines

“Examples of shareholder activities”

# Recent Controversies- Management Fees

- ***Michelin India Pvt. Ltd vs JCIT-[2020] 117 taxmann.com 422 (Delhi - Trib.)***
  - The Assessing Officer cannot sit in judgment, with such decision of businessman to hold that the group companies were being paid in the name of management fee, though there were sufficient management personnel available. Such observation cannot be the basis for benchmarking the allowability of the expenditure in the case of the assessee.
  - The benefit, if any, arising to the assessee against the avilment of such support services is not necessary to be proved by the assessee.
  - The sufficiency of avilment of services can be gone into by Assessing Officer,
- ***ACIT vs Spicer India (P.) Ltd. - [2019] 109 taxmann.com 20 (Pune - Trib.)***
  - **Commercial expediency- S.A. Builders Ltd v CIT**
  - **To facilitate smooth running of business**
- ***Waters (India) P. Ltd vs DCIT- [2021] 124 taxmann.com 115 (Bangalore - Trib.)***
  - demonstrate and satisfy Evidence Test or rendition test and benefit test
  - services provided by AE are neither duplicative nor shareholder's activity

# Guidance TP implications of COVID 19 pandemic



- Consensus view of the 137 members of the Inclusive framework on BEPS
- Four priority issues
  - (i) Comparability analysis
  - (ii) Losses and allocation of COVID-19 specific costs
  - (iii) Government assistance programs
  - (iv) Advance Pricing Agreements
- Hazard Risks
  - (i) Marketplace risk
  - (ii) Operational risk
  - (iii) Financial Risk

# Comparability Analysis



- Reduced reliance on historical data- consider practical approaches
- Pre-existing Company agreement having fixed returns:
  - Need to perform comparability analysis
  - Renegotiation of terms & conditions
- Sources of contemporaneous information-FY 2020
  - (i) Publicly available information- effect of COVID 19 on business or industry
  - (ii) Changes in sales volume
  - (iii) Changes in capacity utilisation
  - (iv) Incremental or exceptional costs
  - (v) Government assistance & Government interventions
  - (vi) Interim/ Quarterly financial statements
  - (vii) Macroeconomic
  - (viii) Statistical variance analysis
  - (ix) Budget vis a vis actual
  - (x) Learnings of previous recessionary periods
- TNMM- availability of information pertaining to FY 2020

# Pragmatic approaches to comparability issue



- To be considered by Tax administrators to minimise disputes
  - (i) Reasonable commercial judgement- contemporaneous documentation
  - (ii) Ex-ante approach or outcome-testing approach
  - (iii) Flexibility in amendments of Returns
  - (iv) Allowance f compensating adjustments
  - (v) Access to MAP
  - (vi) Usage of one or more TP methods
- Price adjustment mechanisms
- Revised search criterion- depending upon economic conditions
- Usage of loss making comparable

# Allocation of COVID-19 specific costs

- Analysis of risks in commercial or financial relations
- Method to allocation non-recurring operating costs
  - Limited Risk service provider
  - Contract service provider
- Revised intercompany agreements
  - Can entities operating under limited risk arrangements incur losses
  - Circumstances – modification of existing agreements
  - Potential compensation for renegotiation
  - Considering restructuring the agreement vs losing a key customer/supplier
- Force majeure clauses- impossibility of performance

# Government Assistance Programs



- Economically relevant characteristic
- Local market features
  - Market advantage
  - Increase in revenues, decrease in costs
  - Benefits of govt assistance transfer to independent customer/suppliers
  - Independent enterprise allocate such benefits between them
- Affect on price of controlled transaction
- Modification of allocation of risk
- Affect on comparability analysis
  - Change in comparability analysis
  - Application of CPM, RPM or TNMM- Tested party PLI

# Advance Pricing Arrangements

- Impact on APA's owing to change in economic conditions
  - Impact on failure to meet critical assumptions
  - Impact of COVID 19 on businesses
  - Duration of disruption
- Tax administration approaches on breach of critical assumption
  - Revision/ Cancellation or Revocation of APA- Rule 10Q/ 10R
  - Notification of failure to meet critical assumptions- Rule 10L
  - Documenting failure to meet critical assumptions- description, business forecast, proposed/implemented modifications to pre-existing agreements, detailed P & L, third party behaviour
  - Independent enterprise allocate such benefits between them
- Impact of domestic law in response to non-compliance with an existing APA
  - Rule 10P- Compliance Audit of Agreement
- Impact on APA under negotiation

# Future of Transfer Pricing – OECD Pillar 1 & 2



- October 2015: [BEPS Action 1 - Addressing the Tax Challenges of the Digital Economy](#)
- March 2018: Delivery of the [Interim Report](#)
- January 2019: Delivery of [Policy Note](#)
- February-March 2019: [Public Consultation](#)
- May 2019: [Programme of Work](#) to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy
- November 2019: Public Consultation - [Secretariat Proposal for a "Unified Approach" under Pillar One](#)
- December 2019: Public Consultation - [Global Anti-Base Erosion \(GloBE\) Proposal under Pillar Two](#)
- January 2020: [Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy](#)
- October 2020: Delivery of the Reports on the Blueprints of Pillar One and Pillar Two
- October-December 2020: Public Consultation - [Reports on the Pillar One and Pillar Two Blueprints](#)
- January 2021: Public Consultation Meetings - [Reports on the Pillar One and Pillar Two Blueprints](#)

# Future of Transfer Pricing- OECD Pillar 1

- Blue print for Pillar One - which would establish new rules on where tax should be paid (“nexus” rules) and a fundamentally new way of sharing taxing rights between countries. The aim is ensure that digitally-intensive or consumer-facing Multinational Enterprises (MNEs) pay taxes where they conduct sustained and significant business, even when they do not have a physical presence, as is currently required under existing tax rules.
- Key elements of Pillar One
  - a new taxing right for market jurisdictions over a share of residual profit calculated at an MNE group (or segment) level (Amount A)
  - a fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction, in line with the ALP (Amount B)
  - processes to improve tax certainty through effective dispute prevention and resolution mechanisms
- Eleven building blocks have been identified as essential to the construction of Pillar One

Amount A		Amount B	
Scope	Nexus	Scope	Dispute prevention and Resolution for Amount A
Revenue Sourcing	Tax Base determination		
Profit allocation	Elimination of Double Taxation	Quantum	Dispute prevention and Resolution beyond Amount A
Implementation & Administration			

# OECD Pillar 1-Determination of Amount A

Sr. No.	Steps
Step-1	Apply global revenue test to MNE group consolidated financial accounts
Step-2	Apply de minimis foreign source in-scope revenue test
Step-3	Use consolidated financial accounts to determine MNE group PBT
Step-4	Determine whether the MNE group has to segment the PBT measure
Step-5	Accounting for losses
Step-6	Apply nexus test to identify eligible market jurisdictions
Step-7	Allocate Amount A to eligible market jurisdictions through a formula
Step-8	Potential marketing and distribution profits safe harbour for MNEs with taxable presence in the market
Step-9	Elimination of double taxation and payment of Amount A tax liability
Step-10	Submission of self-assessment through common platform and early certainty process

Questions ???