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Overview

Economic Laws Practice, Taxand India

Economic Laws Practice is a leading full-service law firm in India and assists in planning, streamlining, managing, and solving complex transfer pricing issues to mitigate transfer pricing risk and aligning it with the client's global business operations and objectives. Services include strategic advice on the remuneration model that aligns with value chains, providing solution-based economic analysis, and documenting positions to support regulatory requirements, resolving disputes and gaining tax certainty. We have outlined below transfer pricing engagements / analysis carried out by us:

- Transfer pricing study and documentation;
- Inter-company transfer pricing policies for tangible goods, intangibles and services;
- Transfer pricing planning Services and litigation;
- Supply chain advisory.

General : Transfer Pricing Framework

The Transfer Pricing "TP" Regulations were introduced in India in the year 2001, in order to prevent erosion of Indian tax base. The Indian TP Regulations are contained in Chapter X of the Income-tax Act, 1961 "IT Act" under the title "Special Provisions relating to avoidance of tax". The Indian TP Regulations recognize the "arm's length principle" and require income from an international transaction to be computed having regard to the arm's length price. Further, India TP regulations have evolved over the years and various provisions / concepts were introduced in order to align the same with global developments such as:

- Introduction to Advance Pricing Agreement in 2012;
- Safe Harbour Rules - the Central Board of Direct Taxes "CBDT" was empowered to make Safe Harbour Rules vide Finance Act 2009 and the same were introduced / notified in the year 2013
- Framework for use of multiple year data and range concept in benchmarking analysis
- Three tier TP documentation structure as per BEPS (Base Erosion and Profit Shifting) Action Plan 13 in 2016;
- Secondary adjustment provisions and limiting interest deduction for thinly capitalized companies in 2017

The TP legislation in India is broadly based on the OECD TP Guidelines including the contents of the three-tier TP documentation structure, transfer pricing methods etc. Though OECD Guidelines are not directly applicable, both the taxpayers and the Revenue authorities have placed reliance on the OECD TP guidelines especially in cases where guidance is not available under the domestic legislation.

Accepted Transfer Pricing Methodologies

As per India TP Regulations, six methods are prescribed for determining the arm's length price of an international transaction. The said six prescribed methods under the India TP Regulations are as under:

- Comparable Uncontrolled Price "CUP"
- Resale Price Method "RPM"
- Cost Plus Method "CPM"
- Profit Split Method "PSM"
- Transactional Net Margin Method "TNMM"
- Other Method – This method has been prescribed by the CBDT 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 transactions, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.

Further, there is no hierarchy in selection from the above-mentioned methods and the most appropriate method can be selected for determining the arm's length price of the international transaction considering the Functions, Asset & Risk Analysis of the Associated Enterprises "AE".

Transfer Pricing Documentation Requirements

The taxpayers who have entered into international transactions with their AE have to obtain a report, certified from an Accountant (being an independent Chartered Accountant), in prescribed Form no. 3CEB wherein Chartered Accountant has to certify inter alia the nature, quantum, arm's length value and the method considered to be the most appropriate method of such international transaction. Taxpayers have to electronically file the Form no. 3CEB certified by an Accountant before the due date i.e. 31st October.

As per India TP Regulations, mandatory TP documentation as prescribed under the Income-tax Rules, 1962, is required to be maintained by the Taxpayers where the aggregate value of international transactions with their AE exceeds INR 10 million. The documentation is required to be submitted only when the same is called for by the tax authorities.

Master File is required to be electronically filed in Form no. 3CEAA where the value of international transactions of the enterprise with its AE exceeds INR 500 million (INR 100 million in case of intangible related transactions) during the relevant accounting year and the consolidated global turnover of the International Group "IG" exceeds INR 5 billion. The due date of filing Form no. 3CEAA is 30th November.

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Country by Country Reporting "CbCR" provisions are applicable where the annual consolidated group revenue of the IG in the immediately preceding accounting year is more than INR 64 billion. CbCR requirements are to be complied with in India if the Ultimate Parent Entity "UPE" of the IG is resident in India or where the IG has designated an alternate reporting entity for the purposes of filing CbCR in India. The due date for filing CbCR in the prescribed Form no. 3CEAD in India is 12 months from the end of reporting accounting year of the UPE preparing consolidated financial statements.

CbCR filing requirements are also triggered in India if:

- the UPE of the IG is a resident of a country with whom India does not have an agreement for exchange of the CbCR; or
- the UPE of the IG is not obligated to file CbCR in its jurisdiction; or
- there has been a systematic failure on part of the UPEs jurisdiction to share information and such failure has been intimated to the Indian entity

Local Jurisdiction Benchmarks

Under India TP Regulations, benchmarking exercise is required to evaluate the arm's length nature of the international transaction. A local benchmark is generally preferred. However, in certain situations wherein the tested party is the entity outside India, selecting global benchmark may be used as the same may be more beneficial. Benchmarking analysis may be challenged by the tax authorities on account of comparability analysis and use of appropriate filters if comparable benchmarks include loss-making entities, high margin entities, high value intangibles, etc. Further, internal comparables are acceptable for the tax authorities.

Advance Pricing Agreement "APA"/Bilateral Advance Pricing Agreement "BAPA" Overview

APA is an agreement between the tax administration and taxpayer, which determines, in advance, the arm's length price or specifies the manner of the determination of arm's length price (or both), in relation to an international transaction.

The APA programme was introduced in India in the Finance Act, 2012 and seeks to provide certainty for 5 prospective years with a roll back option for 4 previous years. Taxpayers can opt for unilateral, bilateral or a multilateral APA and there are no thresholds on the value of international transactions for the Taxpayers to opt for APAs. Any taxpayer who has undertaken an international transaction or is contemplating to undertake an international transaction is eligible to file for an APA. The APA Rules provide for a preliminary consultation before formally lodging an APA application. In such consultation, the taxpayer and the APA team will discuss and clarify the scope of the APA, the transfer pricing issues involved and whether an APA can be executed or not. An application for a unilateral agreement should be made to the Director General of Income Tax (international taxation) "DG-IT". For BAPA/MAPA, application should be made to the Competent Authority in India. The Competent Authority will send the application to DG-IT who in turn will send it to respective APA teams. The APA filing fee depends upon the amount of the proposed covered transactions over the proposed APA term, as below:

- 1 million INR for international transactions up to 1 billion INR
- 1.5 million INR for international transactions up to 2 billion INR
- 2 million INR for international transactions greater than 2 billion INR

There is no specific time lines within which the APA process is to be concluded. Generally, it takes around 2-3 years for UAPA and 3-5years for BAPA.

Transfer Pricing Audits

The entities may be subject to TP audits where the tax returns are selected for scrutiny assessment depending upon the risk parameters. The tax / TP officer may request for TP documentation maintained by taxpayer for the purpose of its audit and such documentation is to be provided within 10 days from the date of receipt of notice from the TP officer. The tax / TP officer may also independently determine the arm's length price of the international transaction entered by the taxpayer during the audit period and if there is variance in arm's length price determined by TP officer and arm's length price computed by taxpayer, such difference may be regarded as primary adjustment and be taxable in India for the taxpayer.

Transfer Pricing Penalties

The Indian tax laws provide for various penalties for non-compliance or violations relating to transfer pricing provisions in India. Various penalties as per India TP Regulations as mentioned below:

- 2% of value of international transaction for failure to maintain specified information / documents, failure to report transactions in Form no. 3CEB and TP documentation, maintenance of incorrect information, failure to submit information during TP audits
- INR 0.1 million for failure to file Form 3CEB
- 50% of tax amount in case of underreporting of income
- 200% of tax amount in case of misreporting of income
- INR 0.5 million for failure to furnish master file
- INR 5,000 per day for one month, INR 15,000 per day after one month, INR 50,000 per day after the date of service of penalty order for failure to furnish CbCR before the statutory due date.
- INR 0.5 million for furnishing inaccurate information

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Local Hot Topics and Recent Updates

Outbound intra-group payments

While dealing with intra-group transactions, one often encounters situations wherein an AE being a service provider procures certain goods or services in its own name but for back-to-back sale to the foreign affiliate. In such cases, the key question is if mark-up should be charged or not on cost of all goods & services procured. In India, many multinational group entities enter into back-to-back arrangements for the group entities outside India. The problem is acute for such entities which though may procure capital intensive goods/ services for their related parties outside India but may incur only a nominal incremental cost towards the arrangement. Recently, Hon'ble Delhi Tribunal in the matter of ADM Agro Industries Kota & Akola P. Limited [TS-355-ITAT-2023(DEL)-TP]) held that where the taxpayer was purchasing goods from third parties in India and selling goods to its AE on a back-to-back basis, no mark-up was warranted on the cost of goods as the profit earned by the taxpayer was only linked to the operating expense incurred by it.

However, the aforesaid proposition may not apply to cases where an entity assumes significant risks with respect to the goods/ services procured, such as inventory risk, credit risk and product/ service delivery risk and also performs significant functions such as inventory management and vendor/ customer management.

Therefore, the factual matrix of the case needs to be critically evaluated to conclude whether a particular cost qualifies as a pass-through cost or not. For instance, in cases where the goods or services procured do not influence the functions performed and the risks undertaken by the entity, the cost of goods or services can assume the status of pass-through costs. The concept is usually prevalent in the case of service providers or limited risk distributors.

Notional interest on outstanding inter-company receivables

Outstanding inter-company balances, especially overdue balances, are often scrutinized by tax authorities. On one hand, the taxpayers contest that such outstanding balances are not a separate transaction as they emanate from the main controlled transaction, such as the provision of service or sale of goods, thereby not warranting any separate arm's length analysis. While on the other hand, the Indian tax authorities seek to re-characterise such outstanding receivables as an advance/loan extended to an AE under the garb of delay in realisation within a reasonable credit period. Further, there is some subjectivity involved with respect to the manner of making such adjustments in terms of what is considered a reasonable credit period, the arm's length interest rate to be used for computing notional interest, and allowing set-off for overdue payables, etc.

Litigation in connection with net margin of captive entities

Tax Authorities at lower levels typically tend to litigate the margins earned by low-end / back-end IT, IT Enabled and support service providers and propose high margins to be earned by taxpayers in India. In case of low net margins (typically less than 18-20 per cent), there is a likelihood of adjustment in the TP Assessment stage.

Filings and documentation for overseas entities earning income from India

Overseas entities having income taxable in India are required to undertake requisite compliances including filing of Form 3CEB and preparation and maintenance of Transfer Pricing Study Report. In certain cases, overseas entities relied upon the Transfer Pricing Study Report maintained by the Indian affiliate with whom they have entered into international transaction. However, recent trends suggest that Revenue Authorities are insisting on a separate Transfer Pricing Study Report prepared and maintained by such overseas entities.

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Documentation threshold

Master file	Value of international transaction exceeds INR 500 million (INR 100 in relation to intangibles) and international group turnover exceeds INR 5 billion
Local file	INR 10 million
CbCR	INR 64 billion

Submission deadline

Master file	30th November 2023 for FY 2022-23
Local file	10 days from the date of receipt of a notice from tax authorities calling for the information
CbCR	12 months from the end of reporting accounting year of the UPE

Penalty Provisions

Documentation – late filing provision	2% of value of international transaction for failure to maintain / submit the specified information / documents INR 0.5 million for failure to furnish master file
Tax return disclosure – late/incomplete/no filing	INR 0.1 million for failure to file Form 3CEB 2% of value of international transaction for failure to report transactions in Form no. 3CEB and TP documentation
CbCR – late/incomplete/no filing	INR 5,000 per day for one month, INR 15,000 per day after one month, INR 50,000 per day after the date of service of penalty order

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