

TRANSFER PRICING AND OTHER PROVISIONS TO CHECK AVOIDANCE OF TAX

AMENDMENTS BY THE FINANCE (No.2) ACT, 2014

(a) Deemed International Transaction [Section 92B(2)]

Effective from: A.Y.2015-16

(i) Section 92B(1) defines an "international transaction" as a transaction in the nature of purchase, sale, lease of tangible or intangible property, provision of services, lending or borrowing of money etc. between two or more associated enterprises, either or both of whom are non-residents.

(ii) Section 92B(2) extends the scope of the definition of international transaction by deeming a transaction entered into with an unrelated person as a transaction with an associated enterprise, if there exists a prior agreement in relation to the transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between the other person and the associated enterprise.

(iii) However, the language of section 92B(2) gives rise to an issue as to whether it is necessary for the unrelated person to also be a non-resident for the transaction to be treated as an international transaction.

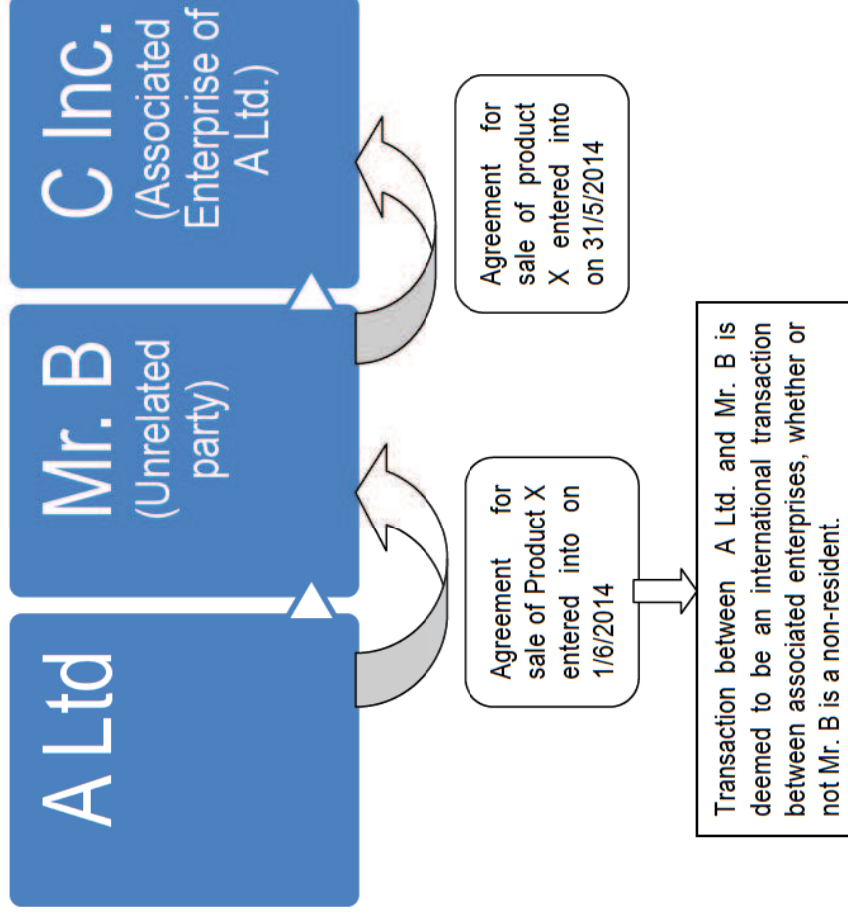
(iv) Therefore, in order to settle this issue, section 92B has been amended to provide that where, in respect of a transaction entered into by an enterprise with a person other than an associated enterprise (hereinafter referred to as "other person"),

- there exists a prior agreement in relation to the relevant transaction between the other person and the associated enterprise or,
- where the terms of the relevant transaction are determined in substance between such other person and the associated enterprise; and
- either the enterprise or the associated enterprise or both of them are non-residents,

then such transaction entered into between the enterprise and the other person shall be deemed to be an **international transaction** entered into between two associated enterprises, **whether or not such other person is a non-resident**.

Example

If A Ltd., an Indian company, has entered into an agreement for sale of product X to Mr.B, an unrelated party, on 1/6/2014 and Mr.B has entered into an agreement for sale of product X with C Inc., a non-resident entity, which is a specified foreign company in relation to A Ltd., on 30/5/2014, then, the transaction between A Ltd. and Mr.B shall be deemed to be an international transaction entered into between two associated enterprises, irrespective of whether or not Mr. B is a non-resident.



Note – C Inc. is deemed to be an associated enterprise of A Ltd. since it is a specified foreign company in relation to A Ltd., which means that A Ltd. holds 26% or more in the nominal value of the equity share capital of C Inc.

(b) Introduction of "Range Concept" for determination of arm's length price [Section 92C(2)]

Effective from: A.Y.2015-16

- (i) Section 92C(2) provides that the arm's length price (ALP) in relation to an international transaction or specified domestic transaction has to be determined by applying the most appropriate method.

- (ii) As per the first proviso to section 92C(2), where more than one price is determined by applying the most appropriate method, the ALP shall be taken to be the arithmetical mean of such prices.
- (iii) However, if the variation between the ALP so determined and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed such percentage, not exceeding 3%, as may be notified by the Central Government, the price at which the transaction has actually been undertaken would be deemed to be the ALP.
- (iv) This year, the Finance Minister, in his budget speech, had proposed to introduce the “range concept” for determination of ALP, for aligning Transfer Pricing Regulations in India with the best practices.
- (v) Accordingly, a third proviso has been inserted in section 92C(2) to provide that in case of an international transaction or specified domestic transaction undertaken on or after 1.4.2014, where more than one price is determined by the most appropriate method, the ALP shall be computed in the prescribed manner (based on “range concept” to be specified by way of Rules) and the computation methodology given in the first and second proviso, based on arithmetic mean, shall be ignored.

(c) Provision for roll back in APA Scheme [Section 92CC]

Effective from: 1st October, 2014

- (i) Under section 92CC, the CBDT may, with the approval of the Central Government, enter into an advance pricing agreement (APA) with any person for determining the Arm's Length Price (ALP) or specifying the manner in which ALP is to be determined in relation to an international transaction to be entered into by that person.
- (ii) The agreement entered into is valid for a period, not exceeding five previous years, as may be mentioned in the agreement. Once the agreement is entered into, the ALP of the international transaction, which is subject matter of the APA, would be determined in accordance with such an APA, except where there is a change in law or facts having a bearing on the agreement so entered.
- (iii) In certain countries, the APA scheme provides for “roll back” mechanism to sort out ALP issues relating to transactions entered into during the period prior to APA. The “roll back” provisions refer to the applicability of the methodology of determination of ALP in relation to the international transactions which have already been entered into in a period prior to the period covered under an APA. However, the “roll back” scheme is not a blanket scheme and is provided on case to case basis and on fulfillment of certain conditions.
- (iv) In order to reduce current pending as well as future litigation in respect of the transfer pricing matters, sub-section (9A) has been inserted in section 92CC to provide roll back mechanism in the APA scheme.
- (v) Accordingly, the APA may, subject to such prescribed conditions, procedure and manner, provide for determining the ALP or for specifying the manner in which ALP is to

be determined in relation to an international transaction entered into by a person during any period not exceeding four previous years preceding the first of the previous years for which the APA applies in respect of the international transaction to be undertaken.

SIGNIFICANT NOTIFICATIONS/CIRCULARS

1. **Transfer Pricing Rules made applicable to Specified Domestic Transactions as well [Notification No. 41/2013 dated 10.06.2013]**

With effect from A.Y 2013-14, the transfer pricing provisions have been extended to Specified Domestic Transactions. Accordingly, the transfer pricing rules prescribed for international transactions have been suitably amended to make the same applicable for specified domestic transactions, as well.

Rule No.	Particulars	Amendment
10A	Meaning of expressions used in computation of Arm's length price	Definition of “associated enterprise” and “enterprise” included “Associated Enterprise” shall - (i) have the same meaning as assigned to it in section 92A; and (ii) in relation to a specified domestic transaction entered into by an assessee, include -- (A) the persons referred to in section 40A(2)(b) in respect of a transaction referred to in section 40A(2)(a); (B) other units or undertakings or businesses of such assessee in respect of a transaction referred to in section 80A or section 80-IA(8); (C) any other person referred to in section 80-IA(10) in respect of a transaction referred to therein; (D) other units, undertakings, enterprises or business of such assessee, or other person referred to in section 80-IA(10) or in respect of a transaction referred to in section 10AA or the transactions referred to in Chapter VI-A to which the provisions of section 80-IA(8) or section 80-IA(10) are applicable; “Enterprise” shall have the same meaning as assigned to it in clause (iii) of section 92F and shall, for the purposes of a specified domestic transaction, include a unit, or an enterprise, or an undertaking or a business of a person who undertakes such transaction.

10AB	Other methods of determination of ALP	This Rule provides that for the purpose of section 92C(1)(f), the other method for determination of the arm's length price in relation to an international transaction shall be 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. This Rule has now been made applicable to specified domestic transactions as well.
10B	Determination of ALP under section 92C	The methods for determination of arm's length price specified in this Rule for the purpose of section 92C(2) in relation to an international transaction shall also be made applicable in respect of specified domestic transactions.
10C	Most appropriate method	Sub-rule (1) provides that, for the purposes of section 92C(1), the most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction, and which provides the most reliable measure of an arm's length price in relation to an international transaction. Sub-rule (2) specifies the factors to be taken into account in selecting the most appropriate method. This Rule is now made applicable in respect of a specified domestic transaction as well.
10D	Information and documents to be kept and maintained under section 92D	Sub-rule (1) requires every person who has entered into an international transaction to maintain the requisite information and documents as detailed thereunder. As per sub-rule (2), maintenance of information and documents shall not apply where the aggregate value of international transactions does not exceed 1 crore rupees. However, sub-rule (1) shall be applicable for every specified domestic transaction irrespective of its value.
10E	Report from an accountant to be furnished under section 92E	This rule provides for submission of audit report from a chartered accountant by every person who has entered into an international transaction. This provision would now apply to a person entered into a specified domestic transaction as well.

2.

Notification of Safe Harbour Rules [Notification No. 73/2013, dated 18.09.2013]

Section 92CB(1) provides that the determination of arm's length price under section 92C or section 92CA shall be subject to safe harbour rules. Safe harbour means circumstances in which the income tax authorities shall accept the transfer price declared by the assessee.

Section 92CB(2) empowers the CBDT to prescribe such safe harbour rules or circumstances under which the transfer price declared by the assessee shall be accepted by the Income-tax Authorities.

Accordingly, in exercise of the powers conferred by section 92CB read with section 295 of the Income-tax Act, 1961, the CBDT has, vide this notification, prescribed safe harbour rules. These rules are explained hereunder:

Safe Harbour [Rule 10TD read with Rule 10TA, Rule 10TB and Rule 10TC]

Where an eligible assessee has entered into an eligible international transaction and the option exercised by the said assessee is not held to be invalid under Rule 10TE, the transfer price declared by the assessee in respect of such transaction shall be accepted by the income-tax authorities, if it is in accordance with the circumstances mentioned below:

S. No.	Eligible International Transaction ⁵	Circumstances	Definition																			
(i)	Provision of software development services	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is – <table><tr><td>Not less than the of such transactions entered into during the previous year</td><td>20%</td><td>does not exceed a sum of ₹ 500 crore;</td><td>22%</td><td>exceeds a sum of ₹ 500 crore.</td></tr></table>	Not less than the of such transactions entered into during the previous year	20%	does not exceed a sum of ₹ 500 crore;	22%	exceeds a sum of ₹ 500 crore.	"Software development services" means,- <table><tr><td>(i)</td><td>business application software and information system development using known methods and existing software tools;</td></tr><tr><td>(ii)</td><td>support for existing systems;</td></tr><tr><td>(iii)</td><td>Converting or translating computer languages;</td></tr><tr><td>(iv)</td><td>adding user functionality to application programmes;</td></tr><tr><td>(v)</td><td>debugging of systems;</td></tr><tr><td>(vi)</td><td>adaptation of existing software; or</td></tr><tr><td>(vii)</td><td>preparation of user documentation.</td></tr></table> It, however, does not include any R&D services whether or not in the nature of contract R&D services.	(i)	business application software and information system development using known methods and existing software tools;	(ii)	support for existing systems;	(iii)	Converting or translating computer languages;	(iv)	adding user functionality to application programmes;	(v)	debugging of systems;	(vi)	adaptation of existing software; or	(vii)	preparation of user documentation.
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(vii)	preparation of user documentation.																					
(ii)	Provision of information technology enabled services	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is –	"Information technology enabled services" means the following business process outsourcing services provided mainly with the assistance or use of information technology, namely:-																			

⁵ Eligible international transaction means an international transaction between the eligible assessee and its associated enterprise, either or both of whom are non-residents, and which comprises of the transactions described in column (2) of the above table.

(iii)	Provision of knowledge process outsourcing services		The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 25%, irrespective of the aggregate value of the transactions entered into during the previous year.																													
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			prescribed percentage	20%	does not exceed a sum of ₹ 500 crore;	22%	exceeds a sum of ₹ 500 crore.																									
			It, however, does not include any R&D services whether or not in the nature of contract R&D services.																													
			(i)	back office operations	(ii)	call centres or contact centre services	(iii)	data processing and data mining	(iv)	insurance claim processing	(v)	legal databases	(vi)	creation and maintenance of medical transcription excluding medical advice	(vii)	translation services	(viii)	payroll	(ix)	remote maintenance	(x)	revenue accounting	(xi)	support centres	(xii)	website services	(xiii)	data search integration and analysis	(xiv)	remote education excluding education content development	(xv)	clinical database management services excluding clinical trials
			"Knowledge process outsourcing services" means the following business process outsourcing services provided mainly with the assistance or use of information technology requiring application of knowledge and advanced analytical and technical skills, namely:-																													

(vi)	Provision of contract R&D services wholly or partly relating to software development.	The operating profit margin declared by the eligible assessee from the international transaction in relation to operating expense incurred is not less than 30%, irrespective of the aggregate value of the transactions entered into during the previous year.	(i) R & D producing new theorems and algorithms in the field of theoretical computer science; (ii) development of information technology at the level of operating systems, programming languages, data management, communications software
(v)	Providing corporate guarantee	Where the amount fee declared in relation to the eligible international transaction is at the rate not less than - does not exceed 2% p.a. on the amount guaranteed. exceeds ₹ 100 crore and the credit rating of the enterprise done by an agency registered with the SEBI is of the adequate to the highest safety	“Corporate guarantee” means explicit corporate guarantee extended by a company to its wholly owned subsidiary being a non-resident in respect of any short-term or long-term borrowing. Explicit corporate guarantee, however, does not include - (i) letter of comfort; (ii) implicit corporate guarantee; (iii) performance guarantee; or (iv) any other guarantee of similar nature.

(iv)	Advancing of intra-group loans	Where the amount of loan does not exceed ₹ 50 crore. Where the amount of loan exceeds ₹ 50 crore. The interest rate declared in relation to the eligible international transaction is not less than the base rate of SBI as on 30th June of the relevant previous year + 1.5%. The interest rate declared in relation to the eligible international transaction is not less than the base rate of SBI as on 30th June of the relevant previous year + 3%.	“Intra-group loan” means loan advanced to wholly owned subsidiary being a non-resident, where the loan - (i) is sourced in Indian rupees (ii) is not advanced by an enterprise, being a financial company including a bank or a financial institution or an enterprise engaged in lending or borrowing in the normal course of business; and (iii) does not include credit line or any other loan facility which has no fixed term for repayment;
			It, however, does not include any R&D services whether or not in the nature of contract R&D services. (i) geographic information system (ii) human resources services (iii) engineering and design services (iv) animation or content development and management (v) business analytics (vi) financial analytics (vii) market research

(vii)	Provision of contract R&D services wholly or partly relating to generic pharmaceutical drugs	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 29%, irrespective of the aggregate value of the transactions entered into during the previous year.	and software development tools; (iii) development of internet technology; (iv) research into methods of designing, developing, deploying or maintaining software; (v) software development that produces advances in generic approaches for capturing, transmitting, storing, retrieving, manipulating or displaying information; (vi) experimental development aimed at filling technology knowledge gaps as necessary to develop a software programme or system; (vii) R & D on software tools or technologies in specialized areas of computing (image processing, geographic data presentation, character recognition, artificial intelligence and such other areas); or (viii) upgradation of existing products where source code has been made available by the principal. "Generic pharmaceutical drug" means a drug that is comparable to a drug already approved by the regulatory authority in dosage form, strength, route of administration, quality and performance characteristics, and intended use.
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(viii)	Manufacture and export of core auto components	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 12%, irrespective of the aggregate value of the transactions entered into during the previous year.	engine and engine parts, including piston and piston rings, engine valves and parts and cooling systems and parts and power train components; (ii) transmission and steering parts, including gears, wheels, steering systems, axles and clutches; (iii) suspension and braking parts, including brake and brake assemblies, brake linings, shock absorbers and leaf springs; "Core auto components" means, "Non-core auto components" mean auto components other than core auto components.	(ix) Manufacture and export of non-core auto components The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 8.5%, irrespective of the aggregate value of the transactions entered into during the previous year.
(ix)	Manufacture and export of non-core auto components			

Notes:

- (1) The above provisions shall apply for A.Y. 2013-14 to A.Y. 2017-18.
- (2) The second proviso to section 92C(2) provides that if the variation between the arm's length price determined and the price at which the transaction has been undertaken does not exceed such percentage, not exceeding 3%, as may be notified by the Central Government in the Official Gazette, the price at which the transaction has actually been undertaken shall be deemed to be the arm's length price. However, no comparability adjustment and allowance under the second proviso to section 92C(2) shall be made to the transfer price declared by the eligible assessee and accepted under the Safe Harbour Rules given above.
- (3) Section 92D requiring every person who has entered into an international transaction to keep and maintain the prescribed information and documents and section 92E requiring such person to obtain a report from an accountant and furnish such report on or before the specified date in prescribed form and manner, shall apply irrespective of the fact that the assessee exercises his option for safe harbor in respect of such transaction.

Meaning of certain terms used above

Term	Meaning																
(i) Operating expense [Rule 10TA]	The costs incurred in the previous year by the assessee in relation to the international transaction during the course of its normal operations including depreciation and amortisation expenses relating to the assets used by the assessee, but not including the following, namely, - <table border="1"> <tr><td>(i)</td><td>interest expense;</td></tr> <tr><td>(ii)</td><td>provision for unascertained liabilities;</td></tr> <tr><td>(iii)</td><td>pre-operating expenses;</td></tr> <tr><td>(iv)</td><td>loss arising on account of foreign currency fluctuations;</td></tr> <tr><td>(v)</td><td>extraordinary expenses;</td></tr> <tr><td>(vi)</td><td>loss on transfer of assets or investments;</td></tr> <tr><td>(vii)</td><td>expense on account of income-tax; and</td></tr> <tr><td>(viii)</td><td>other expenses not relating to normal operations of the assessee;</td></tr> </table>	(i)	interest expense;	(ii)	provision for unascertained liabilities;	(iii)	pre-operating expenses;	(iv)	loss arising on account of foreign currency fluctuations;	(v)	extraordinary expenses;	(vi)	loss on transfer of assets or investments;	(vii)	expense on account of income-tax; and	(viii)	other expenses not relating to normal operations of the assessee;
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(vii)	expense on account of income-tax; and																
(viii)	other expenses not relating to normal operations of the assessee;																
(ii) Operating revenue [Rule 10TA]	The revenue earned by the assessee in the previous year in relation to the international transaction during the course of its normal operations but not including the following, namely, - <table border="1"> <tr><td>(i)</td><td>interest income;</td></tr> <tr><td>(ii)</td><td>income arising on account of foreign currency fluctuations;</td></tr> <tr><td>(iii)</td><td>income on transfer of assets or investments;</td></tr> <tr><td>(iv)</td><td>refunds relating to income-tax;</td></tr> <tr><td>(v)</td><td>provisions written back;</td></tr> <tr><td>(vi)</td><td>extraordinary incomes; and</td></tr> <tr><td>(vii)</td><td>other incomes not relating to normal operations of the assessee;</td></tr> </table>	(i)	interest income;	(ii)	income arising on account of foreign currency fluctuations;	(iii)	income on transfer of assets or investments;	(iv)	refunds relating to income-tax;	(v)	provisions written back;	(vi)	extraordinary incomes; and	(vii)	other incomes not relating to normal operations of the assessee;		
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(iii) Operating profit margin [Rule 10TA]	Operating profit margin, in relation to operating expense, means the ratio of operating profit, being the operating revenue in excess of operating expense, to the operating expense expressed in terms of percentage;																

(iv) Eligible Assessee [Rule 10TB(1)]	A person who has exercised a valid option for application of safe harbor rules and - <table border="1"> <tr> <td>(i)</td><td>is engaged in providing the following services with insignificant risk -</td></tr> <tr> <td></td><td>software development services; or</td></tr> <tr> <td></td><td>information technology enabled services; or</td></tr> <tr> <td></td><td>knowledge process outsourcing services</td></tr> <tr> <td>(ii)</td><td>has made any intra-group loan;</td></tr> <tr> <td>(iii)</td><td>has provided a corporate guarantee;</td></tr> <tr> <td>(iv)</td><td>is engaged in providing contract R & D services wholly or partly relating to software development, with insignificant risk,</td></tr> <tr> <td>(v)</td><td>is engaged in providing contract research and development services wholly or partly relating to generic pharmaceutical drugs, with insignificant risk,</td></tr> <tr> <td>(vi)</td><td>is engaged in the manufacture and export of core or non-core auto components and where 90% or more of total turnover during the relevant previous year is in the nature of original equipment manufacturer sales</td></tr> </table> (i.e., foreign principal); associated enterprise to a non-resident	(i)	is engaged in providing the following services with insignificant risk -		software development services; or		information technology enabled services; or		knowledge process outsourcing services	(ii)	has made any intra-group loan;	(iii)	has provided a corporate guarantee;	(iv)	is engaged in providing contract R & D services wholly or partly relating to software development, with insignificant risk,	(v)	is engaged in providing contract research and development services wholly or partly relating to generic pharmaceutical drugs, with insignificant risk,	(vi)	is engaged in the manufacture and export of core or non-core auto components and where 90% or more of total turnover during the relevant previous year is in the nature of original equipment manufacturer sales
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Factors to be considered for identifying an eligible assessee with insignificant risk, referred to in clauses of (i), (iv) & (v) of Rule 10TB(1) defining an "Eligible assessee" [Rule 10TB (2) & (3)]

Particulars	Foreign Principal [For Clause (i)]	Foreign Principal [For Clauses (iv) & (v)]	Eligible Assessee [For clauses (i), (iv) & (v)]	Remark
(1) Economically significant functions	Performs most of the economically significant functions involved either through its own employees or through its	Performs most of the economically significant functions involved in research or product development cycle	Carries out the work assigned to it by the foreign principal.	Economically significant functions would include conceptualization and design of the product and providing

Procedure [Rule 10TE]

(1) Furnishing Form 3CEFA

- (i) For exercising the option for safe harbor, the assessee has to furnish Form 3CEFA, complete in all respects, to the Assessing Officer on or before the due date specified in *Explanation 2* below section 139(1), for furnishing return of income for –

the relevant assessment year	In case the option is exercised only for that assessment year
the first of the assessment years	In case the option is exercised for more than one assessment year.

- (ii) The return of income for the relevant assessment year or the first of the relevant assessment years, as the case may be, has to be furnished by the assessee on or before the date of furnishing Form 3CEFA.
- (iii) In respect of the assessment year or years following the initial assessment year, the assessee has to furnish a statement to the Assessing Officer before furnishing return of income of that year, providing –

- details of eligible transactions,
- their quantum and
- the profit margins or the rate of interest or commission.

(2) Period for which the option for safe harbor shall remain in force

- (i) The period specified in Form 3CEFA or a period of five years, whichever is less.
- (ii) The option for safe harbor shall not remain in force in respect of any assessment year following the initial assessment year, if –

- (1) the option is held to be invalid for the relevant assessment year by the Transfer Pricing Officer or by the Commissioner in respect of an objection filed by the assessee against the order of the Transfer Pricing Officer,
- (2) the eligible assessee opts out of the safe harbor, for the relevant assessment year, by furnishing a declaration to that effect, to the Assessing Officer.

			associated enterprises	either through its own employees or through its associated enterprises	
(2)	Funds, Capital and other economically significant assets	Provides funds/ capital and other economically significant assets including intangibles required	Provides funds/ capital and other economically significant assets including intangibles required for research or product development.	Does not assume or has no economically significant realized risks. Receives remuneration from the Foreign Principal for carrying out the work.	If a contract shows that the foreign principal is obligated to control the risk but the conduct shows that the eligible assessee is doing so, then the contractual terms are not the final determinant.
(3)	Supervision and control	Has not only the capability to control or supervise but also actually controls or supervises the research activities carried out through its strategic decisions to perform core functions as well as monitor activities on regular basis.	Has not only the capability to control or supervise but also actually controls or supervises the research or product development through its strategic decisions to perform core functions as well as monitor activities on regular basis.	Works under the direct supervision of the foreign principal or its associated enterprise	
(4)	Ownership rights	Has ownership right on any intangible generated or on the outcome of intangible generated or arising during the course of rendering of services.	Has ownership right on the outcome of the research	Has no ownership right (legal or economic).	This fact should be evident from the conduct of the parties.

3. Notification of Cyprus as a Notified Jurisdictional Area under section 94A [Notification No. 86/2013 dated 01.11.2013]

In order to discourage assessee from entering into transactions with persons located in countries or territories outside India which do not have effective information exchange mechanism with India, section 94A empowers the Central Government to notify such country or territory outside India as a notified jurisdictional area (NJA).

Accordingly, in exercise of the powers conferred by section 94A(1), the Central Government has specified 'Cyprus' as a NJA for the purposes of the said section. The tax consequences of notifying Cyprus as a NJA under section 94A are as follows –

- (i) A transaction where one of the parties thereto is a person located in Cyprus would be deemed to be an international transaction and all parties to the transaction would be deemed as associated enterprises. Accordingly, all the provisions of transfer pricing would be attracted in respect of such transaction. However, the benefit of permissible variation between the arm's length price and the transfer price [provided in the second proviso to section 92C(2)] based on the rate notified by the Central Government would not be available in respect of such transaction.
- (ii) Person located in Cyprus shall include a person who is a resident of Cyprus and a person, not being an individual, which is established in Cyprus. It would also include a permanent establishment of any other person in Cyprus.
- (iii) Payments made to any financial institution located in Cyprus would not be allowed as deduction unless the assessee authorizes the CBDT or any other income-tax authority acting on its behalf to seek relevant information from the financial institution on behalf of the assessee.
- (iv) No deduction in respect of any other expenditure or allowance, including depreciation, arising from the transaction with a person located in Cyprus would be allowed unless the assessee maintains the prescribed documents and furnishes the prescribed information.
- (v) Any sum credited or received from a person located in Cyprus would be deemed to be the income of the recipient-assessee if he does not explain satisfactorily the source of such money in the hands of such person or in the hands of the beneficial owner, if such person is not the beneficial owner.
- (vi) The rate of TDS in respect of any payment made to a person located in Cyprus, on which tax is deductible at source, will be the higher of the following rates –
 - (1) rates specified in the relevant provision of the Income-tax Act, 1961; or
 - (2) rate or rates in force; or
 - (3) 30%.

4. Clarifications on Functional Profile of Development Centres engaged in contract R&D Services with insignificant risk – Conditions relevant to identify such Development Centres [Circular No.06/2013 dated 29.6.2013]

There exists divergent views amongst the field officers and taxpayers regarding the functional profile of development centres engaged in contract R & D services for the

Where transfer price in relation to an eligible international transaction declared by an eligible assessee is accepted by the income tax authorities under section 92CB, the assessee shall not be entitled to invoke Mutual Agreement Procedure (MAP) under an agreement for avoidance of double taxation entered into with a country or specified territory outside India as referred to in sections 90 or 90A.

No recourse to MAP [Rule 10TG]

"No tax or low tax country or territory" means a country or territory in which the maximum rate of income-tax is less than 15%.

(ii) a no tax or low tax country or territory.

(i) any country or territory notified under section 94A [a Notified Jurisdictional Area (NJA)]; or

international transactions entered into with an associated enterprise located in –

The rules for safe harbor, contained in Rules 10TA, 10TB, 10TC, 10TD or 10TE, shall not apply in respect of eligible

Non-applicability of Safe Harbour Rules in certain cases [Rule 10TF]

(iii) Where the option exercised by the assessee is held to be invalid

(i) Where no option for safe harbor has been exercised by an eligible assessee in respect of an eligible international transaction entered into by the assessee; or

In the following cases, the arm's length price in relation to an international transaction shall be determined in accordance with the provisions of sections 92C and 92CA without having regard to the profit margin or the rate of interest or commission as specified rule 10TD -

(3) Circumstances requiring determination of ALP as per sections 92C and 92CA

purposes of determining arm's length price/transfer pricing. In some cases, while taxpayers insist that they are contract R & D service providers with insignificant risk, the TPOs treat them as full or significant risk-bearing entities and make transfer pricing adjustments accordingly.

The CBDT has, vide this Circular, addressed this issue by classifying the Research and Development Centres set up by foreign companies into three broad categories based on functions, assets and risk assumed by the centre established in India. While the three categories are not water-tight compartments, it is possible to distinguish them based on functions, assets and risk, as shown hereunder -

	Categories of R&D Centres	Nature of functions performed and level of risks assumed by the corresponding category of the Development Centre
(1)	Centres which are entrepreneurial in nature	Performs significantly important functions and assumes substantial risks
(2)	Centres which are based on cost-sharing arrangements	Performs functions which are of relatively lesser significance and assumes moderate risks.
(3)	Centres which undertake contract research and development	Performs functions which are of low significance and assumes minimal risks

The assessees, largely, tend to claim that the Development Centre in India is a contract R&D service provider with insignificant risk, and consequently, adopt the Transactional Net Margin Method (TNMM) as the most appropriate method.

The CBDT, after due consideration, has laid down the following guidelines for identifying the Development Centre as a contract R & D service provider with insignificant risk -

	Foreign Principal	Indian Development Centre	Remark
(1)	Performs most of the economically significant functions involved in research or product development cycle either through its own employees or through its associated enterprises.	Carries out the work assigned to it by the foreign principal.	Economically significant functions would include critical functions such as conceptualization and design of the product and providing the strategic direction and framework.
(2)	Provides funds/ capital and other economically significant assets including intangibles for research or	Does not assume or has no economically significant	If a contract shows that the foreign principal is obligated to control the risk but the conduct shows that the

	product development. Provides remuneration to the Indian Development Centre for the work carried out by the latter.	realized risks	Indian Development Centre is doing so, then the contractual terms are not the final determinant of actual activities.
(3)	Has not only the capability to control or supervise but also actually controls or supervises research or product development through its strategic decisions to perform core functions as well as monitor activities on regular basis.	Works under the direct supervision of the foreign principal or its associated enterprise	
(4)	Has ownership right on the outcome of the research	Has no ownership right (legal or economic) on the outcome of the research	This fact should be evident from the contract as well as from the conduct of the parties.

In the case of a foreign principal being located in a country/territory widely perceived as a low or no tax jurisdiction, it will be presumed that the foreign principal is not controlling the risk. However, the Indian Development Centre may rebut this presumption to the satisfaction of the revenue authorities. Low tax jurisdiction shall mean any country or territory notified in this behalf under section 94A of the Act or any other country or territory that may be notified for the purpose of Chapter X of the Act;

The Assessing Officer or the Transfer Pricing Officer, as the case may be, shall have regard to the guidelines above and shall take a decision based on the totality of the facts and circumstances of the case. In doing so, the Assessing Officer or the Transfer Pricing Officer, as the case may be, shall be guided by the conduct of the parties and not merely by the terms of the contract.

The Assessing Officer or the Transfer Pricing Officer, as the case may be, shall bear in mind the provisions of section 92C of the Income-tax Act, 1961 and Rule 10A to Rule 10C of the Income-tax Rules, 1962. He has to apply the guidelines laid down in the Circular and select the 'most appropriate method'.