

TRANSFER PRICING

AN COMPLETE NOTES FOR CA-FINAL (INCLUSIVE OF RTP,MTP)

G's publiCations
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Computation of income from international transaction having regard to arm's length price. (SECTION 92)

92. (1) Any income arising from an international transaction shall be computed having regard to the arm's length price.

Explanation. —For the removal of doubts, it is hereby clarified that the allowance for any expense or interest arising from an international transaction shall also be determined having regard to the arm's length price.

(2) Where in an international transaction or specified domestic transaction, two or more associated enterprises enter into a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises, the cost or expense allocated or apportioned to, or, as the case may be, contributed by, any such enterprise shall be determined having regard to the arm's length price of such benefit, service or facility, as the case may be.

(2A) Any allowance for an expenditure or interest or allocation of any cost or expense or any income in relation to the specified domestic transaction shall be computed having regard to the arm's length price.

(3) The provisions of this section shall not apply in a case where the computation of income under sub-section (1) or sub-section (2A) or the determination of the allowance for any expense or interest under sub-section (1) or sub-section (2A), or the determination of any cost or expense allocated or apportioned, or, as the case may be, contributed under sub-section (2) or sub-section (2A), has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be, computed on the basis of entries made in the books of account in respect of the previous year in which the international transaction or specified domestic transaction was entered into.

Determination of income in the case of non-residents. (RULE-10)

R.10. In any case in which the Assessing Officer is of opinion that the actual amount of the income accruing or arising to any non-resident person whether directly or indirectly, through or from any business connection in India or through or from any property in India or through or from any asset or source of income in India or through or from any money lent at interest and brought into India in cash or in kind cannot be definitely ascertained, the amount of such income for the purposes of assessment to income-tax may be calculated :—

- (i) at such percentage of the turnover so accruing or arising as the AO may consider to be reasonable, or
- (ii) on any amount which bears the same proportion to the total profits and gains of the business of such person (such profits and gains being computed in accordance with the provisions of the Act), as the receipts so accruing or arising bear to the total receipts of the business, or
- (iii) in such other manner as the Assessing Officer may deem suitable.

Meaning of associated enterprise. (SECTION 92A)

92A. (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—

(a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

(b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

(2) For the purposes of sub-section (1), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year, —

(a) one enterprise holds, directly or indirectly, shares carrying not less than **26%** of the voting power in the other enterprise; or

As the terms used are “shares” and “voting power”, it is apparent that this clause applies only to those cases where the investee enterprise is a company.

(b) any person or enterprise holds, directly or indirectly, shares carrying not less than **26%** of the voting power in each of such enterprises; or

For example, if AA of UK holds 26% voting power in BB of Germany and also in CC of India, then BB and CC shall be deemed to be associated enterprises. Even for this clause, shareholding may be direct or indirect holding.

(c) a loan advanced by one enterprise to the other enterprise constitutes not less than **51%** of the book value of the total assets of the other enterprise; or

(d) one enterprise guarantees not less than **10%** of the total borrowings of the other enterprise; or

(e) more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or

(f) more than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the 2 enterprises are appointed by the same person or persons; or

Clause (f) is an extension of the principle laid down in clause (e).

For example, the appointment of 7 out of 12 members of board of directors of B Ltd. and 6 out of 10 members of the board of directors of C Ltd. is controlled and has been made by A Ltd. By virtue of clause (f), B Ltd. and C Ltd. are associated enterprises.

Further, if the appointment of the executive director of B Ltd. and 6 out of 10 members of the board of directors of C Ltd. have been made by A Ltd., then B Ltd. and C Ltd. shall be regarded as associated enterprises.

(g) the manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of 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

(h) **90%** or more of the raw materials and consumables required for the **manufacture or processing** of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise; or

Since this clause relates to manufacture or processing of goods, it is important to note that the 90% criteria should be applied exclusively to raw materials and consumables used for manufacturing and processing only.

(i) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; or

Where the goods or articles manufactured and processed by one enterprise, (say, enterprise A) are sold
(i) to another enterprise (say, enterprise B) or
(ii) sold to another enterprise (say, enterprise C) specified by enterprise B, and
the prices and other conditions relating thereto are influenced by enterprise B, then enterprises A and B shall be associated enterprises.

While in clause (h), a minimum criteria of 90% has been mentioned, no such quantification has been done in clause (i). This clause covers only sale of goods manufactured or processed and **not the sale of traded goods**.

(j) where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; or

(k) where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such HUF or by a relative of a member of such HUF or jointly by such member and his relative; or

(l) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than 10% interest in such firm, association of persons or body of individuals; or

(m) there exists between the 2 enterprises, any relationship of mutual interest, as may be prescribed.

This residuary clause enables the CBDT to widen the scope by adding any relationship of mutual interest from time to time that will make any two enterprises as associated enterprises. However, no such relationship of mutual interest has yet been prescribed.

RTP NOV-15: - Discuss whether transfer pricing provisions under the Income-tax Act, 1961 are attracted in respect of the following cases -

(i) Transfer of technical knowhow by Alpha Ltd., an Indian company, to Beta Inc., a French company, which guarantees 15% of the borrowings of Alpha Ltd. (OR) RTP N-13:- Transfer of process patents by Omega Ltd. to Theta Inc., an Australian company, which guarantees 20% of the borrowings of Omega Ltd. (OR) RTP N-16: Transfer of industrial design

by X Ltd., an Indian company, to Y Inc., a US company, which guarantees 20% of the borrowings of X Ltd.

(ii) Purchase of plant and machinery by Phi Ltd., an Indian company, from Rho Inc., a Swedish company. Phi Ltd. is the subsidiary of Rho Inc. (or) RTP N-13: - Sale of tools and equipment by Gamma Ltd., an Indian company, to Delta Inc., a Danish company. Gamma Ltd. is the subsidiary of Delta Inc. (or) RTP N-16: Purchase of equipment by A Ltd., an Indian company, from B Inc., a Japanese company. A Ltd. is the subsidiary of B Inc.

(i) The scope of the term “intangible property” has been amplified to include, inter alia, industrial design, which is a engineering related intangible asset. Transfer of intangible property falls within the scope of the term “international transaction”. Since Y Inc., a US company, guarantees not less than 10% of the borrowings of X Ltd., an Indian company, Y Inc. and X Ltd. are deemed to be associated enterprises under section 92A(2). Therefore, since transfer of industrial design by X Ltd., an Indian company, to Y Inc., a US company, is an international transaction between associated enterprises, the provisions of transfer pricing are attracted in this case.

(ii) Purchase of tangible property falls within the scope of international transaction. Tangible property includes plant and machinery. Rho Inc. and Phi Ltd. are associated enterprises, since Rho Inc., being a holding company of Phi Ltd., fulfils the condition of holding shares carrying not less than 26% of the voting power in Phi Ltd. Therefore, purchase of plant and machinery by Phi Ltd., an Indian company, from Rho Inc., a Swedish company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

RTP M-14

(I) Sale of integrated circuit masks by Indus Ltd. to Amazon Inc., a US company, which guarantees 25% of the borrowings of Indus Ltd., an Indian company.

The scope of the term “intangible property” has been amplified to include, inter alia, integrated circuit masks and masters, which is a data processing intangible. Transfer of intangible property falls within the scope of the term “international transaction”. Since Amazon Inc. guarantees not less than 10% of the borrowings of Indus Ltd., Amazon Inc. and Indus Ltd. are associated enterprises. Therefore, since transfer of integrated circuit masks by Indus Ltd. to Amazon Inc. is an international transaction between associated enterprises, the provisions of transfer pricing are attracted in this case.

ICMAI PTP SET-1 (JUNE 2016)

Speedy motors ltd, an indian company, declared income of Rs.20 crores computed in accordance with chapter iv-d but before making any adjustments in respect of the following transactions for the year ended on 31.03.2016:

A. Royalty of \$50,00,000 was paid to fista ltd. For use of technical know-how in the manufacturing of van. However, fista ltd had provided the same know-how to another indian company for \$ 45,00,000. The manufacture of van by speedy motors ltd is wholly dependent on the use of technical know-how, in respect of which fista ltd has exclusive rights.

B. Loan of euro 5 crores with interest @ 10% p.a. Advanced by hughes ltd, a french company, was outstanding on 31.03.2016. The total book value of assets of speedy motors ltd on the date

was Rs.500 crores. Hughes Ltd had also advanced similar loan to another indian company @ 8% p.a. Total interest paid for the year was euro 0.5 crore.

C. 7,000 vans sold to hitech ltd which holds 41% shares in speedy motors ltd at a price which is less by \$ 100 each van than the price charged from bento ltd.

Briefly explain the provisions of the act affecting all these transactions and compute taxable income of speedy motors ltd for A.Y.2016-2017 assuming that the value of 1\$ and of 1 euro was Rs.65 and Rs.75, respectively, throughout the year.

Solution: -

Any income arising from an international transaction, where two or more “associated enterprises” enter into a mutual agreement or arrangement, shall be computed having regard to arm’s length price as per the provisions of Chapter X of the Act.

Section 92A defines an “associated enterprise” and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts, it is clear that “Speedy Motors Ltd.” is associated with :-

Entity	Existence of Association	Reason	Section
Fista Ltd.	Yes	The Assessee is wholly dependent on use of Technical Know-how which is exclusively owned by Fista Ltd.	92A(2)(g)
Hughes Ltd.	Yes	Hughes Ltd has financed an amount which is more than 51% of the Book Value of the Total Assets of Speedy Motors Ltd.	92A(2)(c)
Hitech Ltd.	Yes	Hitech Ltd holds Shares carrying more than 26% of the voting power in Speedy Motors Ltd.	92A(2)(a)

2.Computation of Total Income

Assessee: Speedy Motors Ltd.

Previous Year: 2015 – 2016

Assessment year: 2016–17

Particulars	Rs.in Crores	Rs.in Crores
Income as computed under Chapter IVD (before adjustments)		20.00
Less: Adjustments for International transactions		
Excess Payment of Royalty of \$ 5,00,000 (\$ 5,00,000 × Rs.65)	3.25	
Excess Interest Paid on Loan of EURO 5 Crores (€ 75 × 5 Crores × 2 ÷ 100)	7.50	
Difference in Price of Van @ \$100 each for 7,000 Vans (\$100 × 7,000 × Rs.65)	4.55	15.30
Taxable Profits and Gains from Business or Profession		4.70

Meaning of expressions used in computation of arm's length price. (RULE-10A)

10A. For the purposes of this rule and rules 10AB to 10E, —

(a) **"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 40A(2)(b) in respect of a transaction referred to in clause (a) of sub-section (2) of the said section;
 - (B) other units or undertakings or businesses of such assessee in respect of a transaction referred to in section 80A or, as the case may be, sub-section (8) of section 80-IA;
 - (C) any other person referred to in sub-section (10) of section 80-IA in respect of a transaction referred to therein;

- (D) other units, undertakings, enterprises or business of such assessee, or other person referred to in sub-section (10) of section 80-IA, as the case may be, in respect of a transaction referred to in section 10AA or the transactions referred to in Chapter VI-A to which the provisions of sub-section (8) or, as the case may be, the provisions of sub-section (10) of section 80-IA are applicable;
- (aa) **"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;]
- (ab) **"uncontrolled transaction"** means a transaction between enterprises other than associated enterprises, whether resident or non-resident;
- (b) **"property"** includes goods, articles or things, and intangible property;
- (c) **"services"** include financial services;
- (d) **"transaction"** includes a number of closely linked transactions.

Circular No – 2/2013 dated 26-03-2013

Sub: Circular on application of profit split method

It has been brought to the notice of CBDT that clarification is needed for selection of profit split method (PSM) as most appropriate method. The issue has been examined in CBDT. It is hereby clarified that while selecting PSM as the most appropriate method, the following points may be kept in mind:

1. Since there is no correlation between cost incurred on R&D activities and return on an intangible developed through R&D activities, the use of transfer pricing methods [like Transactional Net Margin Method] that seek to estimate the value of intangible based on cost of intangible development (R&D cost) plus a return, is generally discouraged.

2. Rule 10B (1)(d) of Income Tax Rules 1962 (the Rules) provides that profit split method (PSM) may be applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction. The PSM determines appropriate return on intangibles on the basis of relative contributions made by each associated enterprise.

3. Selection and application of PSM will depend upon following factors as prescribed under Rule 10C (2) of the Rules:

the nature and class of the international transaction;

the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprise;

the availability, coverage and reliability of data necessary for application of the method;

the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprise entering into such transactions;

the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprise entering into such transactions;

the nature, extent and reliability of assumptions required to be made in application of a method

4. It is evident from the above that Rule 10C (2) of the Rules stipulates availability, coverage and reliability of data necessary for the application of the method as one of the several factors in selection of most appropriate method. Accordingly, in a case, where the Transfer Pricing Officer (TPO) is of view that PSM cannot be applied to determine the arm's length price of international transactions involving intangibles due to non-availability of information and reliable data required for application of the method, he must record reasons for non-applicability of PSM before considering TNMM or comparable uncontrolled price method (CUP) as most appropriate method depending upon facts and circumstances of the case.

5. Application of Profit Split Method requires information mainly about the taxpayer and associated enterprises. Section 92D of the income-tax Act, 1961 provides for maintenance of relevant information and documents by the taxpayer as prescribed under Rule 10D of the Rules. Therefore, there should be good and sufficient reason for non-availability of such information with the taxpayer.

6. Depending upon facts and circumstances of the case, TPO may consider TNMM or CUP method as appropriate method by selecting comparable's engaged in development of intangibles in same line of business and make upward adjustments taking into account transfer of intangibles without additional remuneration, location savings and location specific advantage

Circular No. 03 /2013 dated 26-03-2013

Subject: Circular on conditions relevant to identify development centres engaged in contract R&D services with insignificant risk

It has been brought to the notice of CBDT that there is divergence of views amongst the field officers and taxpayers regarding the functional profile of development centres engaged in contract R&D services for the purposes of transfer pricing audit. Moreover, while at times taxpayers have been insisting that they are contract R&D service providers with insignificant risk, the TPOs are treating them as full or significant risk-bearing entities and making transfer pricing adjustments accordingly. The issue has been examined in CBDT. It is hereby clarified that a development centre in India may be treated as a contract R&D service provider with insignificant risk if the following conditions are cumulatively complied with:

1. Foreign principal performs most of the economically significant functions involved in research or product development cycle whereas Indian development centre would largely be involved in economically insignificant functions;
2. The principal provides funds/ capital and other economically significant assets including intangibles for research or product development and Indian development centre would not use any other economically significant assets including intangibles in research or product development;
3. Indian development centre works under direct supervision of foreign principal who not only has 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;
4. Indian development centre does not assume or has no economically significant realized risks. If a contract shows the principal to be controlling the risk but conduct shows that Indian development centre is doing so, then the contractual terms are not the final determinant of actual activities. In the case of 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; and

5. Indian development centre has no ownership right (legal or economic) on outcome of research which vests with foreign principal, and that it shall be evident from conduct of the parties.

The satisfaction of all the above mentioned conditions should be borne out by the conduct of the parties and not merely by the contractual terms'.

Meaning of international transaction. (SECTION 92B)

92B. (1) For the purposes of this section and sections 92, 92C, 92D and 92E, "international transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

(2) A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be an international transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise where the enterprise or the associated enterprise or both of them are non-residents irrespective of whether such other person is a non-resident or not.

Explanation. —For the removal of doubts, it is hereby clarified that—

(i) the expression "**international transaction**" shall include—

(a) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;

(b) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;

(c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;

(d) provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;

(e) a transaction of business restructuring or reorganisation, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date;

(ii) the expression "**intangible property**" shall include—

(a) **marketing related** intangible assets, such as, trademarks, trade names, brand names, logos;

(b) **technology related** intangible assets, such as, process patents, patent applications, technical documentation such as laboratory notebooks, technical know-how;

(c) **artistic related** intangible assets, such as, literary works and copyrights, musical compositions, copyrights, maps, engravings;

(d) **data processing related** intangible assets, such as, proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters;

(e) **engineering related** intangible assets, such as, industrial design, product patents, trade secrets, engineering drawing and schematics, blueprints, proprietary documentation;

(f) **customer related** intangible assets, such as, customer lists, customer contracts, customer relationship, open purchase orders;

(g) **contract related** intangible assets, such as, favourable supplier, contracts, licence agreements, franchise agreements, non-compete agreements;

(h) **human capital related** intangible assets, such as, trained and organised work force, employment agreements, union contracts;

(i) **location related** intangible assets, such as, leasehold interest, mineral exploitation rights, easements, air rights, water rights;

(j) **goodwill related** intangible assets, such as, institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value;

(k) methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data;

(l) any other similar item that derives its value from its intellectual content rather than its physical attributes.

RTP N-15: - Discuss whether transfer pricing provisions under the Income-tax Act, 1961 are attracted in respect of the following case

(I) Scientific research services provided by Sigma Inc., a German company to Theta Ltd., an Indian company. Sigma Inc. is a specified foreign company as defined in section 115BBD, in relation to Theta Ltd. (OR) RTP N-16: Marketing management services provided by LMN Inc., a French company to MNO Ltd., an Indian company. LMN Inc. is a “specified foreign company” as defined in section 115BBD, in relation to MNO Ltd.

(i) Clause (i) of Explanation to section 92B amplifies the scope of the term international transaction. According to the said Explanation, international transaction includes, inter alia, provision of scientific research services. Sigma Inc. is a specified foreign company in relation to Theta Ltd. Therefore, the condition of Theta Ltd. holding shares carrying not less than 26% of the voting power in Sigma Inc is satisfied. Hence, Sigma Inc. and Theta Ltd. are associated enterprises. Since the provision of scientific research services by Sigma Inc. to Theta Ltd. is an international transaction between associated enterprises, transfer pricing provisions are attracted in this case.

RTP M-15+MTP SEP-2015

XYZ Ltd., an Indian company, has entered into an agreement for sale of product M to Mr.Ganesh, an unrelated party, on 15/3/2016. Mr.Ganesh had entered into an agreement on 10/3/2016 (for sale of product M) with ABC Inc., a non-resident entity, which is a specified foreign company in relation to XYZ Ltd. Would the transaction between XYZ Ltd. and Mr.Ganesh be deemed as an international transaction entered into between two associated enterprises, if Mr. Ganesh is a resident and ordinarily resident for the P.Y.2015-16?

Section 92B(2) extends the scope of the definition of international transaction given in section 92B(1) by deeming a transaction entered into with a person other than an associated enterprise as a transaction with an associated enterprise, if the following conditions are satisfied:

- 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.

In such a case, a 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.

In this case, the agreement between the Indian company, XYZ Ltd. and unrelated party, Mr. Ganesh for sale of product M was entered into on 15/3/2016. Prior to that date (i.e., on 10/3/2016), Mr. Ganesh has entered into an agreement, for sale of product M, with ABC Inc., a non-resident entity. ABC Inc. is deemed to be an associated enterprise of XYZ Ltd. since it is a specified foreign company in relation to XYZ Ltd., which implies that XYZ Ltd. holds 26% or more in the nominal value of the equity share capital of ABC Inc.

In this case, there exists a prior agreement in relation to the transaction for sale of product M between the unrelated party, Mr. Ganesh and the associated enterprise, ABC Inc., which is a non-resident entity. Hence, the transaction entered into between XYZ Ltd., an Indian company and Mr. Ganesh for sale of product M is deemed to be an international transaction entered into between two associated enterprises, irrespective of the residential status of Mr. Ganesh.

RTP M-14

Discuss whether transfer pricing provisions under the Income-tax Act, 1961 are attracted in respect of the following transactions

(I) Provision of scientific research services by Nile Inc., a Kenyan company, to its Indian subsidiary, Brahmaputra Ltd.

The scope of the term “international transaction” has been amplified by the Finance Act, 2012 by insertion of Explanation to section 92B. According to the said Explanation, international transaction includes, inter alia, provision of scientific research services. Nile Inc. and Brahmaputra Ltd. are deemed to be associated enterprises, since Nile Inc., being a holding company of Brahmaputra Ltd., fulfils the condition of holding shares carrying not less than 26% of the voting power in Brahmaputra Ltd. Since the provision of scientific research services by Nile Inc., a Kenyan company to Brahmaputra Ltd., an Indian company, is an “international transaction” between associated enterprises, transfer pricing provisions are attracted in this case.

(II) Lease of equipment by Kaveri Ltd., an Indian company, from Thames Inc., a British company. Thames Inc. is a “specified foreign company” as defined in section 115BBD in relation to Kaveri Ltd.

Lease of tangible property falls within the scope of “international transaction”. Tangible property includes equipment. Thames Inc. is a specified foreign company in relation to Kaveri Ltd. Therefore, the condition of Kaveri Ltd. holding shares carrying not less than 26% of the voting power in Thames Inc is satisfied. Hence, Thames Inc. and Kaveri Ltd. are associated enterprises. Therefore, lease of equipment by Kaveri Ltd., an Indian company, from Thames Inc., a British company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

RTP N-13

Legal services provided by Alpha Inc., USA to Beta Ltd., an Indian company. Alpha Inc. is a “specified foreign company” as defined in section 115BBD, in relation to Beta Ltd.

The scope of the term “international transaction” has been amplified by the Finance Act, 2012 by insertion of Explanation to section 92B. According to the said Explanation, international transaction includes, inter alia, provision of legal services. Alpha Inc. is a specified foreign company in relation to Beta Ltd. Therefore, the condition of Beta Ltd. holding shares carrying not less than 26% of the voting power in Alpha Inc is satisfied. Hence, Alpha Inc. and Beta Ltd. are associated enterprises. Since the provision of legal services by Alpha Inc. to Beta Ltd. is an “international transaction” between associated enterprises, transfer pricing provisions are attracted in this case.

Meaning of specified domestic transaction. (SECTION 92BA)

What are the “specified domestic transactions” which are subject to transfer pricing provisions? (MAY-2013) (HINT- (i)-(vi))

92BA. For the purposes of this section and sections 92, 92C, 92D and 92E, "specified domestic transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely: —

- (i) any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;
- (ii) any transaction referred to in section 80A;
- (iii) any transfer of goods or services referred to in sub-section (8) of section 80-IA; (i.e. inter unit transfers)
- (iv) any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;
- (v) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or
- (vi) any other transaction as may be prescribed, and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of 5 crore rupees. **(w.e.f.1-4-2016 it is 20 Crore).**

RTP N-16+ N-15+N-13: - Discuss whether transfer pricing provisions under the Income-tax Act, 1961 are attracted in respect of the following cases

(I) Ms. Nidhi, a resident Indian, is a director of Delta Ltd, an Indian company. Delta Ltd. pays salary of Rs.45 lakhs per annum to Yashasvi, who is Ms. Nidhi's daughter. (OR) Ms. Poorna, a resident Indian, is a director of ABC Ltd, an Indian company. ABC Ltd. pays salary of Rs.22 lakhs per annum to Manasi, who is Ms. Poorna's daughter.

(II) Alpha Ltd., an Indian company, has two units Sun & Moon. Sun, which commenced business three years back, is engaged in the development of a highway project, for which purpose an agreement has been entered into with the Central Government. Moon is carrying on the business of trading in cement. Moon transfers cement of the value of Rs.65 lakhs to Sun for Rs.45 lakhs.

(i) This transaction falls within the meaning of specified domestic transaction under section 92BA, since the salary payment has been made to a related person referred to in section 40A(2)(b) i.e., relative (i.e., daughter) of Ms. Nidhi, who is a director of Delta Ltd. However, such a transaction would be treated as a specified domestic transaction to attract transfer pricing provisions only if the aggregate of such transactions as specified in section 92BA during the year by Delta Ltd. Exceeds a sum of Rs.20 crore. **(up to 31.03.2016 it is Rs.5 Crore).**

(ii) Unit Sun is eligible for deduction@100% of the profits derived from its eligible business (i.e., the business of developing an infrastructure facility, namely, a highway project in this case) under section 80-IA. However, Unit Moon is not engaged in any eligible business. Since Unit Moon has transferred cement to Unit Sun at a price lower than the fair market value, it is an inter -Unit transfer of goods between eligible business and other business, where the consideration for transfer does not correspond with the market value of goods. Therefore, this transaction would fall within the

meaning of specified domestic transaction to attract transfer pricing provisions, if the aggregate value of transactions specified in section 92BA during the year exceeds a sum of Rs.20 crore. **(up to 31.03.2016 it is Rs.5 Crore).**

RTP M-14

(i) Mr. Krishna, a resident Indian, holds 30% equity share capital in Yamuna Ltd, a domestic company. Yamuna Ltd. hires vehicles owned by Mr. Krishna's daughter and pays rent of Rs. 3 lakh.

(ii) Ganga Ltd., a domestic company, has two units Chambal & Damodar. The Chambal unit, which commenced business two years back, is engaged in the business of developing an irrigation project. The Damodar unit is carrying on the business of trading in water pumps. The Damodar unit transfers water pumps to the value of Rs.5 lakh to the Chambal unit for Rs.3 lakh.

(i) This transaction falls within the meaning of "specified domestic transaction" under section 92BA, since the rental payment has been made to a related person referred to in section 40A(2)(b) i.e., relative (i.e., daughter) of Mr. Krishna, who has substantial interest in the business of Yamuna Ltd., since he is the beneficial owner of shares carrying not less than 20% voting power. However, such a transaction would be treated as a "specified domestic transaction" to attract transfer pricing provisions only if the aggregate of such transactions as specified in section 92BA during the year by Yamuna Ltd. exceeds a sum of Rs.20 crore. **(up to 31.03.2016 it is Rs.5 Crore).**

(ii) The Chambal Unit is eligible for deduction@100% of the profits derived from its eligible business (i.e., the business of developing an infrastructure facility, being an irrigation project) under section 80-IA. However, the Damodar Unit is not engaged in any "eligible business". Since the Damodar Unit has transferred water pumps to the Chambal Unit at a price lower than the fair market value, it is an inter-Unit transfer of goods between eligible business and other business, where the consideration for transfer does not correspond with the market value of goods. Therefore, this transaction would fall within the meaning of "specified domestic transaction" to attract transfer pricing provisions, if the aggregate value of transactions specified in section 92BA during the year exceed Rs.20 crores. **(up to 31.03.2016 it is Rs.5 Crore).**

Computation of arm's length price. (SECTION 92C)

92C. (1) The arm's length price in relation to an international transaction or specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe **(R.10B)**, namely: —

- (a) comparable uncontrolled price method;
- (b) resale price method;
- (c) cost plus method;
- (d) profit split method;
- (e) transactional net margin method;
- (f) such other method as may be prescribed **(R.10AB+10B)** by the Board.

(2) The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed **(R.10C)**:

Provided that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices:

Provided further that if the variation between the arm's length price so determined and price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed such percentage not exceeding 3 per cent of the latter, as may be notified by the Central Government in the Official Gazette in this behalf, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price :

Provided also that where more than one price is determined by the most appropriate method, the arm's length price in relation to an international transaction or specified domestic transaction undertaken on or after the 1st day of April, 2014, shall be computed in such manner as may be prescribed and accordingly the **first and second proviso shall not apply**.

Explanation. —For the removal of doubts, it is hereby clarified that the provisions of the second proviso shall also be applicable to all assessment or reassessment proceedings pending before an Assessing Officer as on the 01.10.2009.

(2A) Where the first proviso to sub-section (2) as it stood before its amendment by the Finance (No. 2) Act, 2009, is applicable in respect of an international transaction for an assessment year and the variation between the arithmetical mean referred to in the said proviso and the price at which such transaction has actually been undertaken exceeds 5 per cent of the arithmetical mean, then, the assessee shall not be entitled to exercise the option as referred to in the said proviso.

(2B) Nothing contained in sub-section (2A) shall empower the Assessing Officer either to assess or reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154 for any assessment year the proceedings of which have been completed before the 1-10- 2009.

(3) Where during the course of any proceeding for the assessment of income, the **Assessing Officer** is, on the basis of material or information or document in his possession, of the opinion that—

(a) the price charged or paid in an international transaction or specified domestic transaction has not been determined in accordance with sub-sections (1) and (2); or

(b) any information and document relating to an international transaction or specified domestic transaction have not been kept and maintained by the assessee in accordance with the provisions contained in sub-section (1) of section 92D and the rules made in this behalf; or

(c) the information or data used in computation of the arm's length price is not reliable or correct; or

(d) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of section 92D, the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction or specified domestic transaction in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him:

Provided that an opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer.

(4) Where an arm's length price is determined by the Assessing Officer under sub-section (3), the Assessing Officer may compute the total income of the assessee having regard to the arm's length price so determined:

Provided that no deduction under section 10A or section 10AA or section 10B or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this sub-section:

Provided further that where the total income of an associated enterprise is computed under this sub-section on determination of the arm's length price paid to another associated enterprise from which tax has been deducted or was deductible under the provisions of Chapter XVIIIB, the income of the other associated enterprise shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise.

For example, if XYZ Ltd. has paid royalty of Rs.100 to its associated enterprise ABC Ltd., it would have deducted Rs.20 as tax under section 115A read with section 195 and remitted the balance of Rs.80 to ABC Ltd. If the Assessing Officer computes the arm's length price of royalty to be Rs.75 and substitutes it for the actual amount paid, i.e. Rs.100, ABC Ltd., will not be able to demand either a re-computation of the royalty income received by it or a refund of tax in excess of what is due on the basis of the arm's length price.

NOV-2011

State the consequences that would follow if the Assessing Officer makes adjustment to arm's length price in international transactions of the assessee resulting in increase in taxable income. What are the remedies available to the assessee to dispute such adjustment? (6 Marks)

In case the Assessing Officer makes adjustment to Arm's Length Price in an international transaction which results in increase in taxable income of the assessee, the following consequences shall follow: -

(1) No deduction under section 10A, section 10AA, section 10B or Chapter VI-A shall be allowed from the income so increased.

(2) No corresponding adjustment would be made to the total income of the other associated enterprise (in respect of payment made by the assessee from which tax has been deducted or is deductible at source) on account of increase in the total income of the assessee on the basis of the arm's length price so recomputed.

The remedies available to the assessee to dispute such an adjustment are: -

(1) In case the assessee is an eligible assessee under section 144C, he can file his objections to the variation made in the income within 30 days [of the receipt of draft order by him] to the Dispute Resolution Panel and Assessing Officer. Appeal against the order of the DRP can be made to the ITAT.

(2) In any other case, he can file an appeal under section 246A to the Commissioner (Appeals) against the order of the Assessing Officer within 30 days of the date of service of notice of demand.

(3) The assessee can opt to file an application for revision of order of the Assessing Officer under section 264 within 1 year from the date on which the order sought to be revised is communicated, provided the time limit for appeal to the Commissioner (Appeals) or the Income-tax Appellate Tribunal has expired or the assessee has waived the right of such an appeal. The eligibility conditions stipulated in section 264 should be fulfilled.

MAY-16

Assessing Officer can complete the assessment of income from international transaction in disregard of the order passed by the Transfer Pricing Officer by accepting the contention of assessee.

Ans. The statement is not correct.

Section 92CA (4) provides that on receipt of the order of the Transfer Pricing Officer determining the arm's length price of an international transaction, the Assessing Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer.

The order of the Transfer Pricing Officer is binding on the Assessing Officer. Therefore, the Assessing Officer cannot complete the assessment of income from international transactions in disregard of the order of Transfer Pricing Officer by accepting the contention raised by the assessee.

Computation of Arm's length price - Notified tolerable limit for determination of ALP - Notification No. 45/2014, dated 23-9-2014

In exercise of the powers conferred by the **second proviso** to sub-section (2) of section 92C of the Income tax Act, 1961, the Central Government hereby notifies that where the variation between the arm's length price determined under section 92C and the price of which the international transaction or specified domestic transaction has actually been undertaken does not exceed 1% of the latter in respect of **wholesale trading** and 3% of the latter. In all other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price for assessment year 2014-15.

Explanation. —For the purposes of this notification, “**wholesale trading**” means an international transaction or specified domestic transaction of trading in goods, which fulfils the following conditions, namely: —

- (i) purchase cost of finished goods is 80 % or more of the total cost pertaining to such trading activities; and
- (ii) average monthly closing inventory of such goods is 10 % or less of sales pertaining to such trading activities.

RTP N-10(modified)

Examine the price which would be deemed as the arm's length price in the following cases -

(1) Case I

Price at which the international transaction was effected - Rs.10 lakh Arm's length price determined by applying the arithmetical mean - Rs.11 lakh

(2) Case II

Price at which the international transaction was effected - Rs.40 lakhs Arm's length price determined by applying the arithmetical mean - Rs.41 lakh

Solution: - Section 92C (2) has been amended to provide that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such price. However, if the variation between the transfer price and arithmetical mean, so determined, is within 3% of the transfer price, then the transfer price shall be deemed to be the arm's length price and no adjustment is required to be made.

(1)	(2)	(3)	(4)	(5)
Case	Transfer Price(TP)	ALP determined by applying the arithmetical mean	TP + 3% OF TP	ALP for the Transfer Pricing Adjustment [If (3) > (4), then ALP = (3); If (4) > (3), then ALP = (2)]
I	Rs.10 Lakh	Rs.11 Lakh	Rs.10.3Lakh	Rs.11 Lakh
II	Rs.40 Lakh	Rs.41 lakhs	Rs.41.2Lakh	Rs.40 lakhs

Other method of determination of arm's length price. (RULE – 10AB)

R.10AB. For the purposes of clause (f) of sub-section (1) of section 92C, the other method for determination of the arm's length price in relation to an international transaction or a specified domestic 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.

Determination of arm's length price under section 92C. (RULE – 10B)

R.10B. (1) For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction *or a specified domestic transaction* shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely: —

(a) **comparable uncontrolled price method**, by which, —

- (i) the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;
- (ii) such price is adjusted to account for differences, if any, between the international transaction *or the specified domestic transaction* and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the price in the open market;
- (iii) the adjusted price arrived at under sub-clause (ii) is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction *or the specified domestic transaction*;

(b) **resale price method**, by which, —

- (i) the price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise, is identified;
- (ii) such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;
- (iii) the price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;
- (iv) the price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction *or the specified domestic transaction* and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;
- (v) the adjusted price arrived at under sub-clause (iv) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise;

(c) **cost plus method**, by which, —

- (i) the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;
- (ii) the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;

- (iii) the normal gross profit mark-up referred to in sub-clause (ii) is adjusted to take into account the functional and other differences, if any, between the international transaction *or the specified domestic transaction* and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;
- (iv) the costs referred to in sub-clause (i) are increased by the adjusted profit mark-up arrived at under sub-clause (iii);
- (v) the sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise;

(d) **profit split method**, which may be applicable mainly in international transactions *or specified domestic transactions* involving transfer of unique intangibles or in multiple international transactions *or specified domestic transactions* which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which—

- (i) the combined net profit of the associated enterprises arising from the international transaction *or the specified domestic transaction* in which they are engaged, is determined;
- (ii) the relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;
- (iii) the combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under sub-clause (ii);
- (iv) the profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction *or the specified domestic transaction*:

Provided that the combined net profit referred to in sub-clause (i) may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction *or specified domestic transaction* in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution in the manner specified under sub-clauses (ii) and (iii), and in such a case the aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction *or the specified domestic transaction* ;

(e) **transactional net margin method**, by which, —

- (i) the net profit margin realised by the enterprise from an international transaction *or a specified domestic transaction* entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the

enterprise or having regard to any other relevant base;

- (ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;
- (iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction *or the specified domestic transaction* and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;
- (iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii);
- (v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction *or the specified domestic transaction*;

(f) *any other method as provided in rule 10AB.*

(2) For the purposes of sub-rule (1), the comparability of an international transaction *or a specified domestic transaction* with an uncontrolled transaction shall be judged with reference to the following, namely: —

- (a) the specific characteristics of the property transferred or services provided in either transaction;
- (b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;
- (c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;
- (d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

(3) An uncontrolled transaction shall be comparable to an international transaction *or a specified domestic transaction* if—

- (i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or
- (ii) Reasonably accurate adjustments can be made to eliminate the material effects of such differences.

(4) The data to be used in analysing the comparability of an uncontrolled transaction with an international transaction *or a specified domestic transaction* shall be the data relating to the financial year (*hereafter in this rule and in rule 10CA referred to as the 'current year'*) in which the international transaction *or the specified domestic transaction* has been entered into:

Provided that data relating to a period not being more than **2 years** prior to *the current year* may also be considered if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared:

Provided further that the **first proviso shall not apply** while analysing the comparability of an uncontrolled transaction with an international transaction or a specified domestic transaction, entered into on or after the 1-04-2014.

(5) In a case where the most appropriate method for determination of the arm's length price of an international transaction or a specified domestic transaction, entered into on or after the 1st day of April, 2014, is the method specified in clause (b), clause (c) or clause (e) of sub-section (1) of section 92C, then, notwithstanding anything contained in sub-rule (4), the data to be used for analysing the comparability of an uncontrolled transaction with an international transaction or a specified domestic transaction shall be,—

- (i) the data relating to the current year; or
- (ii) the data relating to the financial year immediately preceding the current, if the data relating to the current year is not available at the time of furnishing the return of income by the assessee, for the assessment year relevant to the current year:

Provided that where the data relating to the current year is subsequently available at the time of determination of arm's length price of an international transaction or a specified domestic transaction during the course of any assessment proceeding for the assessment year relevant to the current year, then, such data shall be used for such determination irrespective of the fact that the data was not available at the time of furnishing the return of income of the relevant assessment year.

Can the Transfer Pricing Officer accept use of multiple-year data for determination of Arm's Length Price in an international transaction? (3 Marks) (Nov 2010)

Rule 10B of the Income-tax Rules, 1962, has prescribed the methods of determining Arm's Length Price under section 92C.

As per Rule 10B(4), the data to be used in analysing the comparability of an uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into. However, data relating to a period of maximum 2 years prior to such financial year may also be considered if such data reveals the facts which could have an influence on the determination of transfer prices in relation to the transactions being compared.

In effect, the transfer pricing officer can use the data of maximum 2 years prior to the relevant financial year for determination of arm's length price in an international transaction provided the same influence the determination of transfer price in the relevant financial year.

Provided further that the first proviso shall not apply while analysing the comparability of an uncontrolled transaction with an international transaction or a specified domestic transaction, entered into on or after the **1-04-2014**.

I.Limited, an Indian Company supplied billets to its holding company, U. Limited, UK during the previous year 2015-16. I.Limited also supplied the same product to another UK based company, V. Limited, an unrelated entity. The transactions with U. Limited are priced at Euro 500 per MT (FOB), whereas the transactions with V. Limited are priced at Euro 700 per MT (CIF). Insurance and Freight amounts to Euro 200 per MT. Compute the arm's length price for the transaction with U. Limited. (4 Marks) (Nov 2009)

In this case, I Limited, the Indian company, supplied billets to its foreign holding company, U Limited. Since the foreign company, U Limited, holds more than 26% shares in I Limited, I Limited and U Limited shall be deemed to be associated enterprises within the meaning of section 92A.

As I Limited supplies similar product to an unrelated entity, V Limited, UK, the transactions between I Limited and V. Limited can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between I. Limited and U Limited. Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

Transactions with U Limited are on FOB basis, whereas transactions with V Limited are on CIF basis. This difference has to be adjusted before comparing the prices.

Particulars	Amount (in Euro)
Price per MT of billets to V. Limited	700
Less: Cost of insurance and freight per M.T.	200
Adjusted Price per M.T.	500

Since the adjusted price for V. Limited, UK and the price fixed for U Limited are the same; the arm's length price is Euro 500 per MT. Since the sale price to related party (i.e., U Limited) and unrelated party (i.e., V Limited) is the same, the transaction with related party U Limited has also been carried out at arm's length price.

Most appropriate method. (RULE-10C)

10C. (1) For the purposes of sub-section (1) of section 92C, the most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction *or specified domestic transaction*, and which provides the most reliable measure of an arm's length price in relation to the international transaction *or the specified domestic transaction, as the case may be*.

(2) In selecting the most appropriate method as specified in sub-rule (1), the following factors shall be taken into account, namely: —**RTP MAY 2011 (In the context of transfer pricing provisions, what are the factors to be considered while selecting the most appropriate method?)**

- (a) the nature and class of the international *or the specified domestic transaction*;
- (b) the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;
- (c) the availability, coverage and reliability of data necessary for application of the method;
- (d) the degree of comparability existing between the international transaction *or the specified domestic transaction* and the uncontrolled transaction and between the enterprises entering into such transactions;
- (e) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction *or the specified domestic transaction* and the comparable uncontrolled transaction or between the enterprises entering into such transactions;
- (f) The nature, extent and reliability of assumptions required to be made in application of a method.

Computation of arm's length price in certain cases. (RULE-10CA)

10CA. (1) Where in respect of an international transaction or a specified domestic transaction, the application of the most appropriate method referred to in sub-section (1) of section 92C results in determination of more than one price, then the arm's length price in respect of such international transaction or specified domestic transaction shall be computed in accordance with the provisions of this rule.

(2) A dataset shall be constructed by placing the prices referred to in sub-rule (1) in an ascending order and the arm's length price shall be determined on the basis of the dataset so constructed:

Provided that in a case referred to in clause (i) of sub-rule (5) of rule 10B, where the comparable uncontrolled transaction has been identified on the basis of data relating to the current year and the enterprise undertaking the said uncontrolled transaction, [not being the enterprise undertaking the

international transaction or the specified domestic transaction referred to in sub-rule (1)], has in either or both of the two financial years immediately preceding the current year undertaken the same or similar comparable uncontrolled transaction then,—

- (i) the most appropriate method used to determine the price of the comparable uncontrolled transaction or transactions undertaken in the aforesaid period and the price in respect of such uncontrolled transactions shall be determined; and
- (ii) the weighted average of the prices, computed in accordance with the manner provided in sub-rule (3), of the comparable uncontrolled transactions undertaken in the current year and in the aforesaid period preceding it shall be included in the dataset instead of the price referred to in sub-rule (1):

Provided further that in a case referred to in clause (ii) of sub-rule (5) of rule 10B, where the comparable uncontrolled transaction has been identified on the basis of the data relating to the financial year immediately preceding the current year and the enterprise undertaking the said uncontrolled transaction, [not being the enterprise undertaking the international transaction or the specified domestic transaction referred to in sub-rule (1)], has in the financial year immediately preceding the said financial year undertaken the same or similar comparable uncontrolled transaction then,—

- (i) the price in respect of such uncontrolled transaction shall be determined by applying the most appropriate method in a similar manner as it was applied to determine the price of the comparable uncontrolled transaction undertaken in the financial year immediately preceding the current year; and
- (ii) the weighted average of the prices, computed in accordance with the manner provided in sub-rule (3), of the comparable uncontrolled transactions undertaken in the aforesaid period of two years shall be included in the dataset instead of the price referred to in sub-rule (1) :

Provided also that where the use of data relating to the current year in terms of the proviso to sub-rule (5) of rule 10B establishes that, —

- (i) the enterprise has not undertaken same or similar uncontrolled transaction during the current year; or
- (ii) the uncontrolled transaction undertaken by an enterprise in the current year is not a comparable uncontrolled transaction,

then, irrespective of the fact that such an enterprise had undertaken comparable uncontrolled transaction in the financial year immediately preceding the current year or the financial year immediately preceding such financial year, the price of comparable uncontrolled transaction or the weighted average of the prices of the uncontrolled transactions, as the case may be, undertaken by such enterprise shall not be included in the dataset.

(3) Where an enterprise has undertaken comparable uncontrolled transactions in more than one financial year, then for the purposes of sub-rule (2) the weighted average of the prices of such transactions shall be computed in the following manner, namely: —

- (i) where the prices have been determined using the method referred to in clause (b) of sub-rule (1) of rule 10B, the weighted average of the prices shall be computed with weights being assigned to

the quantum of sales which has been considered for arriving at the respective prices;

- (ii) where the prices have been determined using the method referred to in clause (c) of sub-rule (1) of rule 10B, the weighted average of the prices shall be computed with weights being assigned to the quantum of costs which has been considered for arriving at the respective prices;
- (iii) where the prices have been determined using the method referred to in clause (e) of sub-rule (1) of rule 10B, the weighted average of the prices shall be computed with weights being assigned to the quantum of costs incurred or sales effected or assets employed or to be employed, or as the case may be, any other base which has been considered for arriving at the respective prices.

(4) Where the most appropriate method applied is a method other than the method referred to in clause (d) or clause (f) of sub-section (1) of section 92C and the dataset constructed in accordance with sub-rule (2) consists of 6 or more entries, an arm's length range beginning from the thirty-fifth percentile of the dataset and ending on the sixty-fifth percentile of the dataset shall be constructed and the arm's length price shall be computed in accordance with sub-rule (5) and sub-rule (6).

(5) If the price at which the international transaction or the specified domestic transaction has actually been undertaken is within the range referred to in sub-rule (4), then, the price at which such international transaction or the specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price.

(6) If the price at which the international transaction or the specified domestic transaction has actually been undertaken is outside the arm's length range referred to in sub-rule (4), the arm's length price shall be taken to be the median of the dataset.

(7) In a case where the provisions of sub-rule (4) are not applicable, the arm's length price shall be the arithmetical mean of all the values included in the dataset:

Provided that, if the variation between the arm's length price so determined and price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed such percentage not exceeding three per cent of the latter, as may be notified by the Central Government in the Official Gazette in this behalf, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price.

(8) For the purposes of this rule, —

- (a) "the 35th percentile" of a dataset, having values arranged in an ascending order, shall be the lowest value in the dataset such that at least 35 % of the values included in the dataset are equal to or less than such value:

Provided that, if the number of values that are equal to or less than the aforesaid value is a whole number, then the 35th percentile shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset;

- (b) "the 65th percentile" of a dataset, having values arranged in an ascending order, shall be the lowest value in the dataset such that at least 65 % of the values included in the dataset are equal to or less than such value:

Provided that, if the number of values that are equal to or less than the aforesaid value is a whole number, then the 65th percentile shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset;

- (c) "the median" of the dataset, having values arranged in an ascending order, shall be the lowest

value in the dataset such that at least 50% of the values included in the dataset are equal to or less than such value:

Provided that, if the number of values that are equal to or less than the aforesaid value is a whole number, then the median shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.

Illustration 1.—The data for the current year of the comparable uncontrolled transactions or the entities undertaking such transactions is available at the time of furnishing return of income by the assessee and based on the same, seven enterprises have been identified to have undertaken the comparable uncontrolled transaction in the current year. All the identified comparable enterprises have also undertaken comparable uncontrolled transactions in a period of two years preceding the current year. The Profit level Indicator (PLI) used in applying the most appropriate method is operating profit as compared to operating cost (OP/OC). The weighted average shall be based upon the weight of OC as computed below :

Sl. No.	Name	Year 1	Year 2	Year 3 [Current Year]	Aggregation of OC and OP	Weighted Average
1	2	3	4	5	6	7
1	A	OC = 100 OP = 12	OC = 150 OP = 10	OC = 225 OP = 35	Total OC = 475 Total OP = 57	OP/OC = 12%
2	B	OC = 80 OP = 10	OC = 125 OP = 5	OC = 100 OP = 10	Total OC = 305 Total OP = 25	OP/OC = 8.2%
3	C	OC = 250 OP = 22	OC = 230 OP = 26	OC = 250 OP = 18	Total OC = 730 Total OP = 66	OP/OC = 9%
4	D	OC = 180 OP = (-)9	OC = 220 OP = 22	OC = 150 OP = 20	Total OC = 550 Total OP = 33	OP/OC = 6%
5	E	OC = 140 OP = 21	OC = 100 OP = (-)8	OC = 125 OP = (-)5	Total OC = 365 Total OP = 8	OP/OC = 2.2%
6	F	OC = 160 OP = 21	OC = 120 OP = 14	OC = 140 OP = 15	Total OC = 420 Total OP = 50	OP/OC = 11.9%
7	G	OC = 150 OP = 21	OC = 130 OP = 12	OC = 155 OP = 13	Total OC = 435 Total OP = 46	OP/OC = 10.57%

From the above, the dataset will be constructed as follows:

Sl no	1	2	3	4	5	6	7
Values	2.2%	6%	8.2%	9%	10.57%	11.9%	12%

For construction of the arm's length range the data place of thirty-fifth and sixty-fifth percentile shall be computed in the following manner, namely:

Total no. of data points in dataset $\times (35/100)$

Total no. of data points in dataset $\times (65/100)$

Thus, the data place of the thirty-fifth percentile = $7 \times 0.35 = 2.45$.

Since this is not a whole number, the next higher data place, i.e. the value at the third place would have at least 35% of the values below it. The thirty-fifth percentile is therefore value at the third place, i.e. 8.2%.

The data place of the sixty-fifth percentile is = $7 \times 0.65 = 4.55$.

Since this is not a whole number, the next higher data place, i.e. the value at the fifth place would have at least 65% per cent of the values below it. The sixty-fifth percentile is therefore value at fifth place, i.e. 10.57%.

The arm's length range will be beginning at 8.2% and ending at 10.57%.

Therefore, if the transaction price of the international transaction or the specified domestic transaction has OP/OC percentage which is equal to or more than 8.2% and less than or equal to 10.57%, it is within the range. The transaction price in such cases will be deemed to be the arm's length price and no adjustment shall be required. However, if the transaction price is outside the arm's length range, say 6.2%, then for the purpose of determining the arm's length price the median of the dataset shall be first determined in the following manner:

The data place of median is calculated by first computing the total number of data point in the dataset * (50/100). In this case it is $7 \times 0.5 = 3.5$.

Since this is not a whole number, the next higher data place, i.e. the value at the fourth place would have at least fifty per cent of the values below it (median).

The median is the value at fourth place, i.e., 9%. Therefore, the arm's length price shall be considered as 9% and adjustment shall accordingly be made.

Illustration 2. —The data of the current year is available in respect of enterprises A, C, E, F and G at the time of furnishing the return of income by the assessee and the data of the financial year preceding the current year has been used to identify comparable uncontrolled transactions undertaken by enterprises B and D. Further, if the enterprises have also undertaken comparable uncontrolled transactions in earlier years as detailed in the table, the weighted average and dataset shall be computed as below:

Sl. No.	Name	Year 1	Year 2	Year 3 [Current Year]	Aggregation of OC and OP	Weighted Average
1	2	3	4	5	6	7
1	A	OC = 100 OP = 12	OC = 150 OP = 10	OC = 225 OP = 35	Total OC = 475 Total OP = 57	OP/OC = 12%
2	B	OC = 80 OP = 10	OC = 125 OP = 5		Total OC = 205 Total OP = 15	OP/OC = 7.31%
3	C	OC = 250 OP = 22	OC = 230 OP = 26	OC = 250 OP = 18	Total OC = 730 Total OP = 66	OP/OC = 9%
4	D		OC = 220 OP = 22		Total OC = 220 Total OP = 22	OP/OC = 10%
5	E			OC = 100 OP = (-)5	Total OC = 100 Total OP = (-)5	OP/OC = (-)5%
6	F	OC = 160 OP = 21	OC = 120 OP = 14	OC = 140 OP = 15	Total OC = 420 Total OP = 50	OP/OC = 11.9%
7	G	OC = 150 OP = 21	OC = 130 OP = 12	OC = 155 OP = 13	Total OC = 435 Total OP = 46	OP/OC = 10.57%

From the above, the dataset will be constructed as follows:

Sl no	1	2	3	4	5	6	7
Values	(-5) %	7.31%	9%	10%	10.57%	11.9%	12%

If during the course of assessment proceedings, the data of the current year is available and the use of such data indicates that B has failed to pass any qualitative or quantitative filter or for any other reason the transaction undertaken is not a comparable uncontrolled transaction, then, B shall not be considered for inclusion in the dataset. Further, if the data available at this stage indicates a new comparable uncontrolled transaction undertaken by enterprise H, then, it shall be included. The weighted average and dataset shall be recomputed as under:

Sl. No.	Name	Year 1	Year 2	Year 3 [Current Year]	Aggregation of OC and OP	Weighted Average
1	2	3	4	5	6	7
1	A	OC = 100 OP = 12	OC = 150 OP = 10	OC = 225 OP = 35	Total OC = 475 Total OP = 57	OP/OC = 12%
2	C	OC = 250 OP = 22	OC = 230 OP = 26	OC = 250 OP = 18	Total OC = 730 Total OP = 66	OP/OC = 9%
3	D		OC = 220 OP = 22	OC = 150 OP = 20	Total OC = 370 Total OP = 42	OP/OC = 11.35%
4	E			OC = 100 OP = (-)5	Total OC = 100 Total OP = (-)5	OP/OC = (-)5%
5	F	OC = 160 OP = 21	OC = 120 OP = 14	OC = 140 OP = 15	Total OC = 420 Total OP = 50	OP/OC = 11.9%
6	G	OC = 150 OP = 21	OC = 130 OP = 12	OC = 155 OP = 13	Total OC = 435 Total OP = 46	OP/OC = 10.57%
7	H	OC = 150 OP = 12		OC = 80 OP = 10	Total OC = 230 Total OP = 22	OP/OC = 9.56%

From the above, the dataset will be constructed as follows:

Sl no	1	2	3	4	5	6	7
Values	(-5) %	9%	9.56%	10.57%	11.35%	11.9%	12%

Illustration 3. — In a given case the dataset of 20 prices arranged in ascending order is as under :

Sl. No.	Profits (in Rs. Thousand)
1	2
1	42.00
2	43.00
3	44.00
4	44.50
5	45.00
6	45.25
7	47.00
8	48.00
9	48.15
10	48.35
11	48.45
12	48.48
13	48.50
14	49.00
15	49.10
16	49.35
17	49.50
18	49.75
19	50.00
20	50.15

Applying the formula given in the Illustration 1, the data place of the thirty-fifth and sixty-fifth percentile is determined as follows:

Thirty-fifth percentile place = $20 * (35/100) = 7$.

Sixty-fifth percentile place = $20 * (65/100) = 13$.

Since the thirty-fifth percentile place is a whole number, it shall be the average of the prices at the seventh and next higher, i.e.; eighth place. This is $(47+48)/2 = \text{Rs. } 47,500$.

Similarly, the sixty-fifth percentile will be average of thirteenth and fourteenth place prices. This is $(48.5+49)/2 = \text{Rs. } 48,750$

The median of the range (the fiftieth percentile place) = $20 \times (50/100) = 10$

Since the fiftieth percentile place is a whole number, it shall be the average of the prices at the tenth and next higher, i.e.; eleventh place. This is $(48.35+48.45)/2 = \text{Rs. } 48,400$.

Thus, the arm's length range in this case shall be from Rs. 47,500 to Rs. 48,750.

Consequently, any transaction price which is equal to or more than Rs. 47,500 but less than or equal to Rs. 48,750 shall be considered to be within the arm's length range.

NOTIFICATION NO 86/2015 DATED 29-10-2015

In exercise of the powers conferred by the third proviso to sub-section (2) of section 92C of the Income-tax Act, 1961 read with proviso to sub-rule (7) of rule 10CA of the Income-tax Rules, 1962, the Central Government hereby notifies that where the variation between the arm's length price determined under section 92C and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed one percent. of the latter in respect of wholesale trading and three percent. of the latter in all other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price for Assessment Year 2015-2016.

Explanation. - For the purposes of this notification, “**wholesale trading**” means an international transaction or specified domestic transaction of trading in goods, which fulfils the following conditions, namely: -

- (i) purchase cost of finished goods is 80 % or more of the total cost pertaining to such trading activities; and
- (ii) average monthly closing inventory of such goods is 10 % or less of sales pertaining to such trading activities.

Reference to Transfer Pricing Officer. (SECTION 92CA)

RTP M-12 “The Finance Act, 2011 has expanded the scope of powers of the Transfer Pricing Officer” - Discuss the correctness or otherwise of this statement? (asked in nov-12) (4 Marks)

92CA. (1) Where any person, being the assessee, has entered into an international transaction or specified domestic transaction in any previous year, and the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval of the Principal Commissioner or Commissioner, refer the computation of the arm's length price in relation to the said international transaction or specified domestic transaction under section 92C to the Transfer Pricing Officer.

(2) Where a reference is made under sub-section (1), the Transfer Pricing Officer shall serve a notice on the assessee requiring him to produce or cause to be produced on a date to be specified therein, any evidence on which the assessee may rely in support of the computation made by him of the arm's length price in relation to the international transaction or specified domestic transaction referred to in sub-section (1).

(2A) Where any other international transaction other than an international transaction referred under sub-section (1), comes to the notice of the Transfer Pricing Officer during the course of the proceedings before him, the provisions of this Chapter shall apply as if such other international transaction is an international transaction referred to him under sub-section (1).

(2B) where in respect of an international transaction, the assessee has not furnished the report under section 92E and such transaction comes to the notice of the Transfer Pricing Officer during the course of the proceeding before him, the provisions of this Chapter shall apply as if such transaction is an international transaction referred to him under sub-section (1).

(2C) nothing contained in sub-section (2B) shall empower the Assessing Officer either to assess or reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year, proceedings for which have been completed before the **1-07-2012**.

(3) On the date specified in the notice under sub-section (2), or as soon thereafter as may be, after hearing such evidence as the assessee may produce, including any information or documents referred to in sub-section (3) of section 92D and after considering such evidence as the Transfer Pricing Officer may require on any specified points and after taking into account all relevant materials which he has gathered, the Transfer Pricing Officer shall, by order in writing, determine the arm's length price in relation to the international transaction or specified domestic transaction in accordance with sub-section (3) of section 92C and send a copy of his order to the Assessing Officer and to the assessee.

(3A) Where a reference was made under sub-section (1) before the 1-06-2007 but the order under sub-section (3) has not been made by the Transfer Pricing Officer before the said date, or a reference under sub-section (1) is made on or after the 1-06-2007, an order under sub-section (3) may be made at any time before 60 days prior to the date on which the period of limitation referred to in section 153, or as the case may be, in section 153B for making the order of assessment or reassessment or recomputation or fresh assessment, as the case may be, expires.

(4) On receipt of the order under sub-section (3), the Assessing Officer shall proceed to compute the total income of the assessee under sub-section (4) of section 92C in conformity with the arm's length price as so determined by the Transfer Pricing Officer.

(5) With a view to rectifying any mistake apparent from the record, the Transfer Pricing Officer may amend any order passed by him under sub-section (3), and the provisions of section 154 shall, so far as may be, apply accordingly.

(6) Where any amendment is made by the Transfer Pricing Officer under sub-section (5), he shall send a copy of his order to the Assessing Officer who shall thereafter proceed to amend the order of assessment in conformity with such order of the Transfer Pricing Officer.

(7) The Transfer Pricing Officer may, for the purposes of determining the arm's length price under this section, exercise all or any of the powers specified in clauses (a) to (d) of sub-section (1) of section 131 or sub-section (6) of section 133 or section 133A.

Explanation. —For the purposes of this section, "**Transfer Pricing Officer**" means a Joint Commissioner or Deputy Commissioner or Assistant Commissioner authorised by the Board to perform all or any of the functions of an Assessing Officer specified in sections 92C and 92D in respect of any person or class of persons.

Power of Board to make safe harbour rules. (SECTION 92CB)

92CB. (1) The determination of arm's length price under section 92C or section 92CA shall be subject to safe harbour rules.

(2) The Board may, for the purposes of sub-section (1), make rules for safe harbour.

Explanation. —For the purposes of this section, "safe harbour" means circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee.

Rules 10TA to 10TG and Form No. 3CEFA (for international transactions). (I propose to opt for the safe harbour rules under section 92CB of the Income-tax Act, 1961 read with rule 10TA to rule 10TG of Income-tax Rules, 1962.)

Rules 10TH to 10THD and Form No. 3CEFB (For domestic transactions). (I propose to opt for the safe harbour rules under section 92CB of the Income-tax Act, 1961 read with rules 10TH to 10THD of the Income-tax Rules, 1962.)

Definitions. (RULE – 10TA)

10TA. For the purposes of this rule and rule 10TB to rule 10TG, —

(a) "contract research and development services wholly or partly relating to software development" means the following, namely: —

(i) research and development 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 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) research and development on software tools or technologies in specialised 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;

(b) "**core auto components**" means, —

(i) engine and engine parts, including piston and piston rings, engine valves and parts 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;

(c) "**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.

Explanation. —For the purposes of this clause, explicit corporate guarantee does not include letter of comfort, implicit corporate guarantee, performance guarantee or any other guarantee of similar nature;

(d) "**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;

(e) "**information technology enabled services**" means the following business process outsourcing services provided mainly with the assistance or use of information technology, namely: —

- (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; or
- (xv) clinical database management services excluding clinical trials,

but does not include any research and development services whether or not in the nature of contract research and development services;

(f) "**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;

(g) "**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: —

- (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; or
- (vii) market research,

but does not include any research and development services whether or not in the nature of contract research and development services;

(h) "**non-core auto components**" mean auto components other than core auto components;

(i) "**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%

(j) "**operating expense**" means 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:

—

- (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;

(k) "**operating revenue**" means 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: —

- (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.

(l) "**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;

(m) "**software development services**" means, —

- (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,

but does not include any research and development services whether or not in the nature of contract research and development services.]

Eligible assessee. (RULE-10TB)

10TB. (1) Subject to the provisions of sub-rules (2) and (3), the 'eligible assessee' means a person who has exercised a valid option for application of safe harbour rules in accordance with rule 10TE, and—

- (i) is engaged in providing software development services or information technology enabled services or knowledge process outsourcing services, with insignificant risk, to a non-resident associated enterprise (hereinafter referred as foreign principal);
- (ii) has made any intra-group loan;
- (iii) has provided a corporate guarantee;
- (iv) is engaged in providing contract research and development services wholly or partly relating to software development, with insignificant risk, to a foreign principal;
- (v) is engaged in providing contract research and development services wholly or partly relating to generic pharmaceutical drugs, with insignificant risk, to a foreign principal; or
- (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.

(2) For the purposes of identifying an eligible assessee, with insignificant risk, referred to in item (i) of sub-rule (1), the Assessing Officer or the Transfer Pricing Officer, as the case may be, shall have regard to the following factors, namely: —

- (a) the foreign principal performs most of the economically significant functions involved, including the critical functions such as conceptualisation and design of the product and providing the strategic direction and framework, either through its own employees or through its other associated enterprises, while the eligible assessee carries out the work assigned to it by the foreign principal;
- (b) the capital and funds and other economically significant assets including the intangibles required, are provided by the foreign principal or its other associated enterprises, and the eligible assessee is only provided a remuneration for the work carried out by it;
- (c) the eligible assessee works under the direct supervision of the foreign principal or its associated enterprise which not only has the capability to control or supervise but also actually controls or supervises

the activities carried out through its strategic decisions to perform core functions as well as by monitoring activities on a regular basis;

(d) the eligible assessee does not assume or has no economically significant realised risks, and 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, the contractual terms shall not be the final determinant;

(e) the eligible assessee has no ownership right, legal or economic, on any intangible generated or on the outcome of any intangible generated or arising during the course of rendering of services, which vests with the foreign principal as evident from the contract and the conduct of the parties.

(3) For the purposes of identifying an eligible assessee, with insignificant risk, referred to in items (iv) and (v) of sub-rule (1), the Assessing Officer or the Transfer Pricing Officer, as the case may be, shall have regard to the following factors, namely: —

(a) the foreign principal performs most of the economically significant functions involved in research or product development cycle, including the critical functions such as conceptualisation and design of the product and providing the strategic direction and framework, either through its own employees or through its other associated enterprises while the eligible assessee carries out the work assigned to it by the foreign principal;

(b) the foreign principal or its other associated enterprises provides the funds or capital and other economically significant assets including intangibles required for research or product development and also provides a remuneration to the eligible assessee for the work carried out by it;

(c) the eligible assessee works under the direct supervision of the foreign principal or its other associated enterprise which 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 by monitoring activities on a regular basis;

(d) the eligible assessee does not assume or has no economically significant realised risks, and 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, the contractual terms shall not be the final determinant;

(e) the eligible assessee has no ownership right, legal or economic, on the outcome of the research which vests with the foreign principal and is evident from the contract as well as the conduct of the parties.

Eligible international transaction(RULE-10TC)

10TC. 'Eligible international transaction' means an international transaction between the eligible assessee and its associated enterprise, either or both of whom are non-resident, and which comprises of:

- (i) provision of software development services;
- (ii) provision of information technology enabled services;
- (iii) provision of knowledge process outsourcing services;
- (iv) advance of intra-group loan;
- (v) provision of corporate guarantee, where the amount guaranteed, —

(a) does not exceed 100 crore rupees; or

(b) exceeds 100 crore rupees, and the credit rating of the associated enterprise, done by an agency registered with the SEBI, is of the adequate to highest safety;

(vi) provision of contract research and development services wholly or partly relating to software development;

(vii) provision of contract research and development services wholly or partly relating to generic pharmaceutical drugs;

(viii) manufacture and export of core auto components; or

(ix) manufacture and export of non-core auto components, by the eligible assessee.

Safe Harbour. (RULE-10TD)

10TD. (1) 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 as specified in sub-rule (2).

(2) The circumstances referred to in sub-rule (1) in respect of the eligible international transaction specified in column (2) of the Table below shall be as specified in the corresponding entry in column (3) of the said Table:

SL. NO	Eligible International Transaction	Circumstances
1	Provision of software development services referred to in item (i) of rule 10TC.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is - (i) not less than 20 % where the aggregate value of such transactions entered into during the previous year does not exceed a sum of 500 crore rupees; or (ii) not less than 22 % where the aggregate value of such transactions entered into during the previous year exceeds a sum of 500 crore rupees.
2	Provision of information technology enabled services referred to in item (ii) of rule 10TC.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is - (i) not less than 20 % where the aggregate value of such transactions entered into during the previous year does not exceed a sum of 500 crore rupees; or (ii) not less than 22 % where the aggregate value of such transactions entered into during the previous year exceeds a sum of 500 crore rupees.
3	Provision of knowledge process outsourcing services referred to in item (iii) of rule 10TC.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 25 %
4	Advancing of intra-group loans referred to in item (iv) of rule 10TC where the amount of loan does not exceed 50 crore rupees.	The Interest rate declared in relation to the eligible international transaction is not less than the base rate of State Bank of India as on 30th June of the relevant previous year plus 150 basis points.
5	Advancing of intra-group loans referred to in item (iv) of rule 10TC where the amount of loan exceeds 50 crore rupees.	The Interest rate declared in relation to the eligible international transaction is not less than the base rate of State Bank of India as on 30th June of the relevant previous year plus 300 basis points.
6	Providing corporate guarantee referred to in sub-item (a) of item (v) of rule 10TC.	The commission or fee declared in relation to the eligible international transaction is at the rate not less than 2 % per annum on the amount guaranteed.
7	Providing corporate guarantee referred to in sub-item (b) of item (v) of rule 10TC.	The commission or fee declared in relation to the eligible international transaction is at the rate not less than 1.75% per annum on the amount guaranteed.
8	Provision of contract research and development services wholly or partly relating to software development referred to in item (vi) of rule 10TC.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 30 %
9	Provision of contract research and development services wholly or partly relating to generic pharmaceutical drugs referred to in item (vii) of rule 10TC.	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 %
10	Manufacture and export of core auto components referred to in item (viii) of rule 10TC.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 12 %
11	Manufacture and export of non-core auto components referred to in item (ix) of rule 10TC.	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 %

(3) The provisions of sub-rules (1) and (2) shall apply for the assessment year 2013-14 and 4 assessment years immediately following that assessment year.

(4) No comparability adjustment and allowance under the **second proviso** to sub-section (2) of section 92C shall be made to the transfer price declared by the eligible assessee and accepted under sub-rules (1) and (2) above.

(5) The provisions of sections 92D and 92E in respect of an international transaction shall apply irrespective of the fact that the assessee exercises his option for safe harbour in respect of such transaction

MTP SEP-2014: Aarti Limited, an Indian company, is engaged in manufacturing electronic components. 74% of shares of the company are held by Alex Inc., incorporated in USA. Aarti Limited has borrowed funds from Alex Inc. at LIBOR plus 150 points. The LIBOR prevalent at the time of borrowing is 4% for US \$. The borrowings allowed under the External Commercial Borrowings guidelines issued under Foreign Exchange Management Act are LIBOR plus 200 basis points. Discuss whether the borrowing made by Aarti Limited is at arm's length ('LIBOR' means London Inter- Bank Offer Rate).

Ans. One of the methods for determination of arm's length price in an international transaction is Comparable Uncontrolled Price method (CUP). Under the CUP method, the price charged or paid for property transferred or services rendered in a comparable uncontrolled transaction, or a number of such transactions, is identified. Such price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions, which could materially affect the price in the open market. The adjusted price so arrived at is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction.

Alex Inc., USA and Aarti Limited, the Indian company are associated enterprises since the former holds 74% shares in the latter.

The arm's length rate of interest can be determined by using CUP method having regard to the rate of interest on external commercial borrowing permissible as per guidelines issued under Foreign Exchange Management Act. The interest rate permissible is LIBOR plus 200 basis points i.e., $4\% + 2\% = 6\%$, which can be taken as the arm's length rate. The interest rate applicable on the borrowing by Aarti Limited, India from Alex Inc., USA, is LIBOR plus 150 basis points i.e., $4\% + 1.5\% = 5.5\%$. Since the rate of interest, i.e. 5.5% is less than the arm's length rate of 6%, the borrowing made by the Aarti Ltd. is not at arm's length. However, in this case, the taxable income of Aarti Ltd., India, would be lower if the arm's length rate is applied. Hence, no adjustment is required since the law of transfer pricing will not apply if there is a negative impact on the existing profits.

Procedure. (RULE-10TE)

10TE. (1) For the purposes of exercise of the option for safe harbour, the assessee shall furnish a **Form 3CEFA**, complete in all respects, to the Assessing Officer on or before the due date specified in Explanation 2 below sub-section (1) of section 139 for furnishing the return of income for—

- (i) the relevant assessment year, in case the option is exercised only for that assessment year; or
- (ii) the first of the assessment years, in case the option is exercised for more than 1 assessment year:

Provided that the return of income for the relevant assessment year or the first of the relevant assessment years, as the case may be, is furnished by the assessee on or before the date of furnishing of **Form 3CEFA**.

(2) The option for safe harbour validly exercised shall continue to remain in force for the period specified in **Form 3CEFA** or a period of 5 years whichever is less:

Provided that the assessee shall, in respect of the assessment year or years following the initial assessment year, 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 shown:

Provided further that an option for safe harbour shall not remain in force in respect of any assessment year following the initial assessment year, if—

(i) the option is held to be invalid for the relevant assessment year by the Transfer Pricing Officer under sub-rule (11) or by the Commissioner under sub-rule (8) in respect of an objection filed by the assessee against the order of the Transfer Pricing Officer under sub-rule (11), as the case may be; or

(ii) the eligible assessee opts out of the safe harbour, for the relevant assessment year, by furnishing a declaration to that effect, to the Assessing Officer.

(3) On receipt of **Form 3CEFA**, the Assessing Officer shall verify whether—

(i) the assessee exercising the option is an eligible assessee; and

(ii) the transaction in respect of which the option is exercised is an eligible international transaction, before the option for safe harbour by the assessee is treated to be validly exercised.

(4) Where the Assessing officer doubts the valid exercise of the option for the safe harbour by an assessee, he shall make a reference to the TPO for determination of the eligibility of the assessee or the international transaction or both for the purposes of the safe harbour.

(5) For the purposes of sub-rule (4) and sub-rule (10), the TPO may require the assessee, by notice in writing, to furnish such information or documents or other evidence as he may consider necessary, and the assessee shall furnish the same within the time specified in such notice.

(6) Where—

(a) the assessee does not furnish the information or documents or other evidence required by the Transfer Pricing Officer; or

(b) the TPO finds that the assessee is not an eligible assessee; or

(c) the Transfer Pricing Officer finds that the international transaction in respect of which the option referred to in sub-rule (1) has been exercised is not an eligible international transaction,

the Transfer Pricing Officer shall, by order in writing, declare the option exercised by the assessee under sub-rule (1) to be invalid and cause a copy of the said order to be served on the assessee and the Assessing Officer:

Provided that no order declaring the option exercised by the assessee to be invalid shall be passed without giving an opportunity of being heard to the assessee.

(7) If the assessee objects to the order of the Transfer Pricing Officer under sub-rule (6) or sub-rule (11) declaring the option to be invalid, he may file his objections with the Commissioner, to whom the Transfer Pricing Officer is subordinate, within **15 days** of receipt of the order of the Transfer Pricing Officer.

(8) On receipt of the objection referred to in sub-rule (7), the Commissioner shall after providing an opportunity of being heard to the assessee pass appropriate orders in respect of the validity or otherwise of the option exercised by the assessee and cause a copy of the said order to be served on the assessee and the Assessing Officer.

(9) In a case where option exercised by the assessee has been held to be valid, the Assessing officer shall proceed to verify whether the transfer price declared by the assessee in respect of the relevant eligible international transactions is in accordance with the circumstances specified in sub-rule (2) of rule 10 TD and, if it is not in accordance with the said circumstances, the Assessing Officer shall adopt the operating profit margin or rate of interest or commission specified in sub-rule (2) of rule 10TD.

(10) Where the facts and circumstances on the basis of which the option exercised by the assessee was held to be valid have changed and the Assessing Officer has reason to doubt the eligibility of an assessee or the international transaction for any assessment year other than the initial Assessment Year falling within the period for which the option was exercised by the assessee, he shall make a reference to the Transfer Pricing Officer for determination of eligibility of the assessee or the international transaction or both for the purpose of safe harbour.

Explanation. —For purposes of this sub-rule the facts and circumstances include: —

- (a) functional profile of the assessee in respect of the international transaction;
- (b) the risks being undertaken by the assessee;
- (c) the substantive contractual conditions governing the role of the assessee in respect of the international transaction;
- (d) the conduct of the assessee as referred to in sub-rule (2) or sub-rule (3) of rule 10TB; or
- (e) the substantive nature of the international transaction.

(11) The Transfer Pricing Officer on receipt of a reference under sub-rule (10) shall, by an order in writing, determine the validity or otherwise of the option exercised by the assessee for the relevant year after providing an opportunity of being heard to the assessee and cause a copy of the said order to be served on the assessee and the Assessing Officer.

(12) Nothing contained in this rule shall affect the power of the Assessing Officer to make a reference under section 92CA in respect of international transaction other than the eligible international transaction.

(13) Where no option for safe harbour has been exercised under sub-rule (1) by an eligible assessee in respect of an eligible international transaction entered into by the assessee or the option exercised by the assessee is held to be invalid, the arm's length price in relation to such 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 in sub-rule (2) of rule 10TD.

(14) For the purposes of this rule, —

(i) no reference under sub-rule (4) shall be made by an Assessing Officer after expiry of a period of **2 months** from the end of the month in which **Form 3CEFA** is received by him;

(ii) no order under sub-rule (6) or sub-rule (11) shall be passed by the Transfer Pricing Officer after expiry of a period of **2 months** from the end of the month in which the reference from the Assessing officer under sub-rule (4) or sub-rule (10), as the case may be, is received by him;

(iii) the order under sub-rule (8) shall be passed by the Commissioner within a period of **2 months** from the end of the month in which the objection filed by the assessee under sub-rule (7) is received by him.

(15) If the Assessing Officer or the Transfer Pricing Officer or the Commissioner, as the case may be, does not make a reference or pass an order, as the case may be, within the time specified in sub-rule (14), then the option for safe harbour exercised by the assessee shall be treated as valid.

Safe harbour rules not to apply in certain cases. (RULE-10TF)

10TF. Nothing contained in rules 10TA, 10TB, 10TC, 10TD or rule 10TE shall apply in respect of eligible international transactions entered into with an associated enterprise located in any country or territory notified under section 94A or in a no tax or low tax country or territory.

Mutual Agreement Procedure not to apply. (RULE-10TG)

10TG. 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 under an agreement for avoidance of double taxation entered into with a country or specified territory outside India as referred to in section 90 or 90A.

Safe Harbour Rules for Specified Domestic Transactions (RULE-10TH)

10TH. Definitions. — For the purposes of this rule and rules 10THA to 10THD, —

- (a) **"Appropriate Commission"** shall have the same meaning as assigned to it in sub-section (4) of section 2 of the Electricity Act, 2003
- (b) **"Government company"** shall have the same meaning as assigned to it in sub-section (45) of section 2 of the Companies Act, 2013

Eligible assessee. (RULE- 10THA)

10THA. The '**eligible assessee**' means a person who has exercised a valid option for application of safe harbour rules in accordance with the provisions of rule 10THC, and—

- (i) is a Government company engaged in the business of **generation, supply, transmission or distribution** of electricity; or
- (ii) is a co-operative society engaged in the business of procuring and marketing milk and milk products.

Eligible specified domestic transaction. (RULE-10THB)

10THB. The '**Eligible specified domestic transaction**' means a specified domestic transaction undertaken by an eligible assessee and which comprises of: —

- (i) supply of electricity or

- (ii) transmission of electricity; or
- (iii) wheeling of electricity; or
- (iv) purchase of milk or milk products by a co-operative society from its members.

Safe Harbour. (RULE-10THC)

10THC. (1) Where an eligible assessee has entered into an eligible specified domestic transaction in any previous year relevant to an assessment year and the option exercised by the said assessee is treated to be validly exercised under rule 10THD, the transfer price declared by the assessee in respect of such transaction for that assessment year shall be accepted by the income-tax authorities, if it is in accordance with the circumstances as specified in sub-rule (2).

(2) The circumstances referred to in sub-rule (1) in respect of the eligible specified domestic transaction specified in column (2) of the Table below shall be as specified in the corresponding entry in column (3) of the said Table: —

S.No.	Eligible specified domestic transaction	Circumstances
1.	Supply of electricity, transmission of electricity, wheeling of electricity referred to in clause (i), (ii) or (iii) of rule 10THB, as the case may be.	The tariff in respect of supply of electricity, transmission of electricity, wheeling of electricity, as the case may be, is determined or the methodology for determination of the tariff is approved by the Appropriate Commission in accordance with the provisions of the Electricity Act, 2003
2.	Purchase of milk or milk products referred to in clause (iv) of rule 10THB.	The price of milk or milk products is determined at a rate which is fixed on the basis of the quality of milk, namely, fat content and Solid Not FAT (SNF) content of milk; and— (a) the said rate is irrespective of, — (i) the quantity of milk procured; (ii) the percentage of shares held by the members in the co-operative society; (iii) the voting power held by the members in the society; and (b) such prices are routinely declared by the co-operative society in a transparent manner and are available in public domain.

(3) No comparability adjustment and allowance under the second proviso to sub-section (2) of section 92C shall be made to the transfer price declared by the eligible assessee and accepted under sub-rule (1).

Procedure. (RULE-10THD)

10THD. (1) For the purposes of exercise of the option for safe harbour, the assessee shall furnish a **Form 3CEFB**, complete in all respects, to the Assessing Officer on or before the due date specified in Explanation 2 to sub-section (1) of section 139 for furnishing the return of income for the relevant assessment year:

Provided that the return of income for the relevant assessment year is furnished by the assessee on or before the date of furnishing of **Form 3CEFB**:

Provided further that in respect of eligible specified domestic transactions, other than the transaction referred to in clause (iv) of rule 10 THB, undertaken during the previous year relevant to the assessment

year beginning on the 01.04.2013 or beginning on the 01.04.2014 or beginning on the 01.04.2015 Form 3CEFB may be furnished by the assessee on or before the 31.03.2016

Provided also that in respect of eligible specified domestic transactions, referred to in clause (iv) of rule 10 THB, undertaken during the previous year relevant to the assessment year beginning on the 01.04.2013 or beginning on the 01.04.2014 or beginning on the 01.04.2015, Form 3CEFB may be furnished by the assessee on or before the 31.12.2015.

(2) On receipt of Form 3CEFB, the Assessing Officer shall verify whether—

- (i) the assessee exercising the option is an eligible assessee; and
- (ii) the transaction in respect of which the option is exercised is an eligible specified domestic transaction,

before the option for safe harbour by the assessee is treated to be validly exercised.

(3) Where the Assessing Officer doubts the valid exercise of the option for the safe harbour by an assessee, he may require the assessee, by notice in writing, to furnish such information or documents or other evidence as he may consider necessary, and the assessee shall furnish the same within the time specified in such notice.

(4) Where—

- (a) the assessee does not furnish the information or documents or other evidence required by the Assessing Officer; or
- (b) the Assessing Officer finds that the assessee is not an eligible assessee; or
- (c) the Assessing Officer finds that the specified domestic transaction in respect of which the option referred to in sub-rule (1) has been exercised is not an eligible specified domestic transaction; or
- (d) the tariff is not in accordance with the circumstances specified in sub-rule (2) of rule 10THC,

the Assessing Officer shall, by order in writing, declare the option exercised by the assessee under sub-rule (1) to be invalid and cause a copy of the said order to be served on the assessee:

Provided that no order declaring the option exercised by the assessee to be invalid shall be passed without giving an opportunity of being heard to the assessee.

(5) If the assessee objects to the order of the Assessing Officer under sub-rule (4) declaring the option to be invalid, he may file his objections with the Principal Commissioner or the Commissioner or the Principal Director or the Director, as the case may be, to whom the Assessing Officer is subordinate, within 15 days of receipt of the order of the Assessing Officer.

(6) On receipt of the objection referred to in sub-rule (5), the Principal Commissioner or the Commissioner or the Principal Director or the Director, as the case may be, shall after providing an opportunity of being heard to the assessee, pass appropriate orders in respect of the validity or otherwise of the option exercised by the assessee and cause a copy of the said order to be served on the assessee and the Assessing Officer.

(7) For the purposes of this rule, —

- (i) no order under sub-rule (4) shall be made by an Assessing Officer after expiry of a period of 3 months from the end of the month in which **Form 3CEFB** is received by him;
- (ii) the order under sub-rule (6) shall be passed by the Principal Commissioner or Commissioner or Principal Director or Director, as the case may be, within a period of 2 months from the end of the month in which the objection filed by the assessee under sub-rule (5) is received by him.

(8) If the Assessing Officer or the Principal Commissioner or the Commissioner or the Principal Director or the Director, as the case may be, does not pass an order within the time specified in sub-rule (7), then the option for safe harbour exercised by the assessee shall be treated as valid.

RTP N-14

Examine the following transactions and discuss whether the transfer price declared by the following assessee, who have exercised a valid option for application of safe harbour rules, can be accepted by the Income-tax Authorities –

	Assessee	International transaction	Aggregate value of transactions entered into in the P.Y.2013-14	Declared Operating Margin	Operating Expense
(1)	A Ltd., an Indian company	Provision of system support services to X Inc., which is a "specified foreign company" in relation to A Ltd.	₹ 600 crore	₹ 90 crore	₹ 450 crore
(2)	B Ltd., an Indian company	Provision of data processing services with the use of information technology to Y Inc., its foreign subsidiary.	₹ 400 crore	₹ 62 crore	₹ 300 crore
(3)	C & Co., a partnership firm registered under the Partnership Act, 1932	Provision of contract R & D services relating to development of internet technology, to XYZ & Co., a foreign firm, which holds 12% interest in C & Co.	₹ 100 crore	₹ 20 crore	₹ 70 crore
(4)	D Ltd., an Indian company	Provision of contract R & D services relating to generic pharmaceutical drug, to ABC Inc., a foreign company which guarantees 15% of the total borrowings of D Ltd.	₹ 50 crore	₹ 9 crore	₹ 30 crore
(5)	Sole proprietary concern of Mr.E, solely engaged in the original manufacture and export of	100% export of automobile transmission and steering parts to LMN LLP, a foreign LLP, controlled by Mr.E jointly with his relatives.	₹ 12 crore	₹ 1 crore	₹ 10 crore

	automobile transmission and steering parts.				
(6)	F Ltd. an Indian company, solely engaged in the original manufacture and export of non-core auto components.	100% export of non-core auto components to GKG Inc., a foreign company. F Ltd. appoints two-thirds of the Board of Directors of GKG Inc.	₹ 12 crore	₹ 1 crore	₹ 10 crore

In all the above cases, it may be assumed that the Indian entity which provides the services assumes insignificant risk. It may also be assumed that the foreign entities referred to above are non-resident in India.

Would your answer change, if in any of the cases mentioned above, the foreign entity is located in a notified jurisdictional area?

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 Notification No.73/2013 dated 18.9.2013, prescribed safe harbour rules. Rule 10TD provides that 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 set out thereunder.

An eligible assessee is a person who has exercised a valid option for application of safe harbour rules and is engaged in, inter alia, providing the following services, with insignificant risk, to a non-resident associated enterprise –

(i) software development services; or (ii) information technology enabled services; or (iii) knowledge process outsourcing services; or (iv) contract R & D services wholly or partly relating to software development; or (v) contract R & D services wholly or partly relating to generic pharmaceutical drugs.

A person who 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 also falls within the definition of eligible assessee if he has exercised a valid option for application of safe harbour rules.

(1) X Inc. is a specified foreign company in relation to A Ltd. Therefore, the condition of A Ltd. holding shares carrying not less than 26% of the voting power in X Inc is satisfied. Hence, X Inc. and A Ltd. are deemed to be associated enterprises. Therefore, provision of systems support services by A Ltd., an Indian company, to X Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Systems support services falls within the definition of “software development services”, and hence, is an eligible international transaction. Since A Ltd. is providing software development services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee. Since the aggregate value of transactions entered into in the P.Y.2013-14 exceed ` 500 crore, A Ltd. should have declared an operating profit margin of not less than 22% in relation to operating expense, to be covered within the safe harbour rules. However, since A Ltd. has declared an operating profit margin of only 20% (i.e., 90/450X100) The same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by A Ltd.

(2) Y Inc., a foreign company, is a subsidiary of B Ltd., an Indian company. Hence, Y Inc. and B Ltd. are associated enterprises. Therefore, provision of data processing services by B Ltd., an Indian company, to Y Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Data processing services with the use of information technology falls within the definition of “information technology enabled services”, and is hence, an eligible international transaction. Since B Ltd. is providing

data processing services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the aggregate value of transactions entered into in the P.Y.2013-14 does not exceed ` 500 crore, B Ltd. should have declared an operating profit margin of not less than 20% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since B Ltd. has declared an operating profit margin of 20.67% (i.e. $62/300 \times 100$) the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by B Ltd in respect of such international transaction.

(3) XYZ & Co., a foreign firm holds 12% interest in C & Co., an Indian firm. Therefore, the condition of one enterprise, being a foreign firm, holding not less than 10% interest in another enterprise, being an Indian firm, is satisfied. Hence, XYZ & Co. and C & Co. are deemed to be associated enterprises. Therefore, provision of contract R & D services relating to software development by C & Co., an Indian firm, to XYZ & Co., a foreign firm, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Development of internet technology falls within the meaning of “contract R&D services wholly or partly relating to software development”, and hence, is an eligible international transaction. Since C & Co., an Indian firm, is providing contract R & D services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Irrespective of the aggregate value of transactions entered into in the P.Y.2013-14, C & Co. should have declared an operating profit margin of not less than 30% in relation to operating expense, to be covered within the safe harbour rules. However, since C & Co. has declared an operating profit margin of only 28.57% (i.e. $20/70 \times 100$) the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by C & Co.

(4) ABC Inc., a foreign company, guarantees 15% of the total borrowings of D Ltd., an Indian company. Since ABC Inc. guarantees not less than 10% of the total borrowings of D Ltd., ABC Inc. and D Ltd. are deemed to be associated enterprises. Therefore, provision of contract R & D services relating to generic pharmaceutical drug by D Ltd., an Indian company, to ABC Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Provision of contract R& D services in relation to generic pharmaceutical drug is an eligible international transaction. Since D Ltd. is providing such services to a non- resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Irrespective of the aggregate value of transactions entered into in the P.Y.2013-14, D Ltd. should have declared an operating profit margin of not less than 29% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since D Ltd. has declared an operating profit margin of 30% (i.e. $9/30 \times 100$) the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by D Ltd in respect of such international transaction.

(5) LMN LLP, a foreign LLP, is controlled by Mr.E jointly with his relatives. Mr. E also has control over his own sole proprietorship concern. Therefore, the sole proprietorship concern of Mr.E in India and LMN LLP are deemed to be associated enterprises.

Automobile transmission and steering parts fall within the meaning of “core auto components”, and hence, 100% export of all such parts originally manufactured by the sole proprietorship concern of Mr.E is an eligible international transaction. Since the sole proprietorship concern of Mr.E is solely engaged in the original manufacture and 100% export of such parts and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Irrespective of the aggregate value of transactions entered into in the P.Y.2013-14, the sole-proprietorship concern of Mr.E should have declared an operating profit margin of not less than 12% in relation to operating expense, to be covered within the safe harbour rules. However, since A Ltd. has declared an operating profit margin of only 10% (i.e., $1/10 \times 100$), the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by Mr.E.

(6) F Ltd. and GKG Inc. are deemed to be associated enterprises since F Ltd. appoints more than half of the Board of Directors of GKG Inc. Manufacture and export of non-core auto components is an eligible international transaction. Since F Ltd. is engaged in original manufacture of non-core auto components and 100% export of the same, it is an eligible assessee.

Irrespective of the aggregate value of transactions entered into in the P.Y.2013-14, F Ltd. should have declared an operating profit margin of not less than 8.5% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since F Ltd. has declared an operating profit margin of 10% (i.e., $1/10 \times 100$) the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by F Ltd in respect of such international transaction.

The safe harbour rules shall not apply in respect of eligible international transactions entered into with an associated enterprise located in a notified jurisdictional area. Therefore, if in any of the cases mentioned above, the foreign entity is located in a NJA, the safe harbour rules shall not be applicable, irrespective of the operating profit margin declared by the assessee.

Advance pricing agreement. (SECTION 92CC)

MTP OCTOBER-15: “In the Indian context, Advance Pricing Agreements entered into for determining arm’s length price in relation to an international transaction is valid only for a period, not exceeding 5 years, prospective to the date of agreement and cannot be applied in respect of prior period transactions” – Discuss the correctness or otherwise of this statement.

92CC. (1) The Board, with the approval of the Central Government, may enter into an advance pricing agreement with any person, determining the arm's length price or specifying the manner in which arm's length price is to be determined, in relation to an international transaction to be entered into by that person.

(2) The manner of determination of arm's length price referred to in sub-section (1), may include the methods referred to in sub-section (1) of section 92C or any other method, with such adjustments or variations, as may be necessary or expedient so to do.

(3) Notwithstanding anything contained in section 92C or section 92CA, the arm's length price of any international transaction, in respect of which the advance pricing agreement has been entered into, shall be determined in accordance with the advance pricing agreement so entered.

(4) The agreement referred to in sub-section (1) shall be valid for such period not exceeding 5 consecutive previous years as may be specified in the agreement.

(5) The advance pricing agreement entered into shall be binding—

(a) on the person in whose case, and in respect of the transaction in relation to which, the agreement has been entered into; and

(b) on the Principal Commissioner or Commissioner, and the income-tax authorities subordinate to him, in respect of the said person and the said transaction.

(6) The agreement referred to in sub-section (1) shall not be binding if there is a change in law or facts having bearing on the agreement so entered.

(7) The Board may, with the approval of the Central Government, by an order, declare an agreement to be *void ab initio*, if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts.

(8) Upon declaring the agreement *void ab initio*, —

(a) all the provisions of the Act shall apply to the person as if such agreement had never been entered into; and

(b) notwithstanding anything contained in the Act, for the purpose of computing any period of limitation under this Act, the period beginning with the date of such agreement and ending on the date of order under sub-section (7) shall be excluded:

Provided that where immediately after the exclusion of the aforesaid period, the period of limitation, referred to in any provision of this Act, is less than **60 days**, such remaining period shall be extended to **60 days** and the aforesaid period of limitation shall be deemed to be extended accordingly.

(9) The Board may, for the purposes of this section, prescribe a scheme specifying therein the manner, form, procedure and any other matter generally in respect of the advance pricing agreement.

(9A) The agreement referred to in sub-section (1), may, subject to such conditions, procedure and manner as may be prescribed, provide for determining the arm's length price or specify the manner in which arm's length price shall be determined in relation to the international transaction entered into by the person during any period not exceeding 4 previous years preceding the first of the previous years referred to in sub-section (4), and the arm's length price of such international transaction shall be determined in accordance with the said agreement.

(10) Where an application is made by a person for entering into an agreement referred to in sub-section (1), the proceeding shall be deemed to be pending in the case of the person for the purposes of the Act.

Advance Pricing Agreement Scheme, rules 10F to 10T, rule 44GA and Form Nos. 3CEC to 3CEF.

For Roll Back of Agreement, see rules 10MA and 10RA and Form No. 3CEDA.

Meaning of expressions used in matters in respect of advance pricing agreement. (RULE-10F)

10F. For the purposes of this rule and rules 10G to 10T, —

- (a) **"agreement"** means an advance pricing agreement entered into between the Board and the applicant, with the approval of the Central Government, as referred to in sub-section (1) of section 92CC of the Act;
- (b) **"application"** means an application for advance pricing agreement made under rule 10-I;
- (ba) **"applicant"** means a person who has made an application;
- (c) **"bilateral agreement"** means an agreement between the Board and the applicant, subsequent to, and based on, any agreement referred to in rule 44GA between the competent authority in India with the competent authority in the other country regarding the most appropriate transfer pricing method or the arms' length price;
- (d) **"competent authority in India"** means an officer authorised by the Central Government for the purpose of discharging the functions as such for matters in respect of any agreement entered into under section 90 or 90A of the Act;
- (e) **"covered transaction"** means the international transaction or transactions for which agreement has been entered into;
- (f) **"critical assumptions"** means the factors and assumptions that are so critical and significant that neither party entering into an agreement will continue to be bound by the agreement, if any of the factors or assumptions is changed;
- (g) **"most appropriate transfer pricing method"** means any of the transfer pricing method, referred to in sub-section (1) of section 92C of the Act, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or function performed by such persons or such other relevant factors prescribed by the Board under rules 10B and 10C;
- (h) **"multilateral agreement"** means an agreement between the Board and the applicant, subsequent to, and based on, any agreement referred to in rule 44GA between the competent authority in India with the competent authorities in the other countries regarding the most appropriate transfer pricing method or the arms' length price;
- (ha) **"rollback year"** means any previous year, falling within the period not exceeding four previous years, preceding the first of the previous years referred to in sub-section (4) of section 92CC;
- (i) **"tax treaty"** means an agreement under section 90, or section 90A of the Act for the avoidance of double taxation;
- (j) **"team"** means advance pricing agreement team consisting of income-tax authorities as constituted by the Board and including such number of experts in economics, statistics, law or any other field as may be nominated by the DGIT (International Taxation);
- (k) **"unilateral agreement"** means an agreement between the Board and the applicant which is neither a bilateral nor multilateral agreement.

Persons eligible to apply. (RULE-10G)

10G. Any person who—

- (i) has undertaken an international transaction; or

(ii) is contemplating to undertake an international transaction,
shall be eligible to enter into an agreement under these rules.

Pre-filing consultation(RULE-10H)

10H. (1) Any person proposing to enter into an agreement under these rules may, by an application in writing, make a request for a pre-filing consultation.

(2) The request for pre-filing consultation shall be made in **Form No. 3CEC** (Application for a pre-filing meeting) to the Director General of Income-tax (International Taxation).

(3) On receipt of the request in **Form No. 3CEC**, the team shall hold pre-filing consultation with the person referred to in rule 10G.

(4) The competent authority in India or his representative shall be associated in pre-filing consultation involving bilateral or multilateral agreement.

(5) The pre-filing consultation shall, among other things, —

- (i) determine the scope of the agreement;
- (ii) identify transfer pricing issues;
- (iii) determine the suitability of international transaction for the agreement;
- (iv) discuss broad terms of the agreement.

(6) The pre-filing consultation shall—

- (i) not bind the Board or the person to enter into an agreement or initiate the agreement process;
- (ii) not be deemed to mean that the person has applied for entering into an agreement.

Application for advance pricing agreement. (RULE-10-I)

10-I. (1) Any person, referred to in rule 10G may, if desires to enter into an agreement furnish an application in **Form No. 3CED** (Application for an Advance Pricing Agreement) along with the requisite fee.

(2) The application shall be furnished to Director General of Income-tax (International Taxation) in case of unilateral agreement and to the competent authority in India in case of bilateral or multilateral agreement.

(3) Application in **Form No. 3CED** may be filed by the person referred to in rule 10G at any time—

- (i) before the first day of the previous year relevant to the first assessment year for which the application is made, in respect of transactions which are of a continuing nature from dealings that are already occurring; or
- (ii) before undertaking the transaction in respect of remaining transactions.

(4) Every application in **Form No. 3CED** shall be accompanied by the proof of payment of fees as specified in sub-rule (5).

(5) The fees payable shall be in accordance with following table based on the amount of international transaction entered into or proposed to be undertaken in respect of which the agreement is proposed:

Amount of international transaction entered into or proposed to be undertaken in respect of which agreement is proposed during the proposed period of agreement.	Fee
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Amount not exceeding Rs. 100 crores	10 Lacs
Amount not exceeding Rs. 200 crores	15 Lacs
Amount exceeding Rs. 200 crores	20 Lacs

Withdrawal of application for agreement. (RULE-10J)

10J. (1) The applicant may withdraw the application for agreement at any time before the finalisation of the terms of the agreement.

(2) The application for withdrawal shall be in **Form No. 3CEE**. (Application for withdrawal of APA request)

(3) The fee paid shall not be refunded on withdrawal of application by the applicant.

Preliminary processing of application. (RULE-10K)

10K. (1) Every application filed in **Form No. 3CED** shall be complete in all respects and accompanied by requisite documents.

(2) If any defect is noticed in the application in **Form No. 3CED** or if any relevant document is not attached thereto or the application is not in accordance with understanding reached in any pre-filing consultation referred to in rule 10H, the DGIT (International Taxation) (for unilateral agreement) and competent authority in India (for bilateral or multilateral agreement) shall serve a deficiency letter on the applicant before the expiry of 1 month from the date of receipt of the application.

(3) The applicant shall remove the deficiency or modify the application within a period of **15 days** from the date of service of the deficiency letter or within such further period which, on an application made in this behalf, may be extended, so however, that the total period of removal of deficiency or modification does not exceed **30 days**.

(4) The DGIT (International Taxation) or the competent authority in India, as the case may be, on being satisfied, may pass an order providing that application shall not be allowed to be proceeded with if the application is defective and defect is not removed by applicant in accordance with sub-rule (3).

(5) No order under sub-rule (4) shall be passed without providing an opportunity of being heard to the applicant and if an application is not allowed to be proceeded with, the fee paid by the applicant shall be refunded.

Procedure. (RULE-10L)

10L. (1) If the application referred to in rule 10K has been allowed to be proceeded with, the team or the competent authority in India or his representative shall process the same in consultation and discussion with the applicant in accordance with provisions of this rule.

(2) For the purpose of sub-rule (1), it shall be competent for the team or the competent authority in India or its representative to—

- (i) hold meetings with the applicant on such time and date as it deems fit;
- (ii) call for additional document or information or material from the applicant;
- (iii) visit the applicant's business premises; or
- (iv) make such inquiries as it deems fit in the circumstances of the case.

(3) For the purpose of sub-rule (1), the applicant may, if he considers it necessary, provide further document and information for consideration of the team or the competent authority in India or his representative.

(4) For bilateral or multilateral agreement, the competent authority shall forward the application to DGIT (International Taxation) who shall assign it to one of the teams.

(5) The team, to whom the application has been assigned under sub-rule (4), shall carry out the enquiry and prepare a draft report which shall be forwarded by the DGIT (International Taxation) to the competent authority in India.

(6) If the applicant makes a request for bilateral or multilateral agreement in its application, the competent authority in India shall in addition to the procedure provided in this rule invoke the procedure provided in **rule 44GA**.

(7) The DGIT (International Taxation) (for unilateral agreement) or the competent authority in India (for bilateral or multilateral agreement) and the applicant shall prepare a proposed mutually agreed draft agreement enumerating the result of the process referred to in sub-rule (1) including the effect of the arrangement referred to in sub-rule (5) of rule 44GA which has been accepted by the applicant in accordance with sub-rule (8) of the said rule.

(8) The agreement shall be entered into by the Board with the applicant after its approval by the Central Government.

(9) Once an agreement has been entered into the DGIT (International Taxation) or the competent authority in India, as the case may be, shall cause a copy of the agreement to be sent to the Commissioner of Income-tax having jurisdiction over the assessee.

Terms of the agreement. (RULE-10M)

10M. (1) An agreement may among other things, include—

- (i) the international transactions covered by the agreement;
- (ii) the agreed transfer pricing methodology, if any;
- (iii) determination of arm's length price, if any;
- (iv) definition of any relevant term to be used in item (ii) or (iii);
- (v) critical assumptions;
- (va) rollback provision referred to in rule 10MA;
- (vi) the conditions if any other than provided in the Act or these rules.

(2) The agreement shall not be binding on the Board or the assessee if there is a change in any of critical assumptions or failure to meet conditions subject to which the agreement has been entered into.

(3) The binding effect of agreement shall cease only if any party has given due notice of the concerned other party or parties.

(4) In case there is a change in any of the critical assumptions or failure to meet the conditions subject to which the agreement has been entered into, the agreement can be revised or cancelled, as the case may be.

(5) The assessee which has entered into an agreement shall give a notice in writing of such change in any of the critical assumptions or failure to meet conditions to the DGIT (International Taxation) as soon as it is practicable to do so.

(6) The Board shall give a notice in writing of such change in critical assumptions or failure to meet conditions to the assessee, as soon as it comes to the knowledge of the Board.

(7) The revision or the cancellation of the agreement shall be in accordance with rules 10Q and 10R respectively.

Amendments to Application. (RULE-10N)

10N. (1) An applicant may request in writing for an amendment to an application at any stage, before the finalisation of the terms of the agreement.

(2) The DGIT (International Taxation) (for unilateral agreement) or the competent authority in India (for bilateral or multilateral agreement) may, allow the amendment to the application, if such an amendment does not have effect of altering the nature of the application as originally filed.

(3) The amendment shall be given effect only if it is accompanied by the additional fee, if any, necessitated by such amendment in accordance with fee as provided in rule 10-I.

Furnishing of Annual Compliance Report. (RULE-10-O)

10-O. (1) The assessee shall furnish an annual compliance report to DGIT (International Taxation) for each year covered in the agreement.

(2) The annual compliance report shall be in **Form 3CEF. (Annual Compliance Report on Advance Pricing Agreement)**

(3) The annual compliance report shall be furnished in quadruplicate, for each of the years covered in the agreement, within **30** days of the due date of filing the income-tax return for that year, or within 90 days of entering into an agreement, whichever is later.

(4) The DGIT (International Taxation) shall send one copy of annual compliance report to the competent authority in India, one copy to the Commissioner of Income-tax who has the jurisdiction over the income-tax assessment of the assessee and one copy to the Transfer Pricing Officer having the jurisdiction over the assessee.

Compliance Audit of the agreement. (RULE-10P)

10P. (1) The Transfer Pricing Officer having the jurisdiction over the assessee shall carry out the compliance audit of the agreement for each of the year covered in the agreement.

(2) For the purposes of sub-rule (1), the Transfer Pricing Officer may require—

- (i) the assessee to substantiate compliance with the terms of the agreement, including satisfaction of the critical assumptions, correctness of the supporting data or information and consistency of the application of the transfer pricing method;
- (ii) the assessee to submit any information, or document, to establish that the terms of the agreement has been complied with.

(3) The Transfer Pricing Officer shall submit the compliance audit report, for each year covered in the agreement, to the DGIT (International Taxation) in case of unilateral agreement and to the competent authority in India, in case of bilateral or multilateral agreement, mentioning therein his findings as regards compliance by the assessee with terms of the agreement.

(4) The DGIT (International Taxation) shall forward the report to the Board in a case where there is finding of failure on part of assessee to comply with terms of agreement and cancellation of the agreement is required.

(5) The compliance audit report shall be furnished by the Transfer Pricing Officer within six months from the end of the month in which the Annual Compliance Report referred to in rule 10-O is received by the Transfer Pricing Officer.

(6) The regular audit of the covered transactions shall not be undertaken by the Transfer Pricing Officer if an agreement has been entered into under rule 10L except where the agreement has been cancelled under rule 10R.

Revision of an agreement. (RULE-10Q)

10Q. (1) An agreement, subsequent to it having been entered into, may be revised by the Board, if,—

- (a) there is a change in critical assumptions or failure to meet a condition subject to which the agreement has been entered into;
- (b) there is a change in law that modifies any matter covered by the agreement but is not of the nature which renders the agreement to be non-binding; or
- (c) there is a request from competent authority in the other country requesting revision of agreement, in case of bilateral or multilateral agreement.

(2) An agreement may be revised by the Board either suo motu or on request of the assessee or the competent authority in India or the DGIT (International Taxation).

(3) Except when the agreement is proposed to be revised on the request of the assessee, the agreement shall not be revised unless an opportunity of being heard has been provided to the assessee and the assessee is in agreement with the proposed revision.

(4) In case the assessee is not in agreement with the proposed revision the agreement may be cancelled in accordance with rule 10R.

(5) In case the Board is not in agreement with the request of the assessee for revision of the agreement, the Board shall reject the request in writing giving reason for such rejection.

(6) For the purpose of arriving at the agreement for the proposed revision, the procedure provided in rule 10L may be followed so far as they apply.

(7) The revised agreement shall include the date till which the original agreement is to apply and the date from which the revised agreement is to apply.

Cancellation of an agreement. (RULE-10R)

10R. (1) An agreement shall be cancelled by the Board for any of the following reasons:

- (i) the compliance audit referred to in rule 10P has resulted in the finding of failure on the part of the assessee to comply with the terms of the agreement;
- (ii) the assessee has failed to file the annual compliance report in time;
- (iii) the annual compliance report furnished by the assessee contains material errors; or
- (iv) the agreement is to be cancelled under sub-rule (4) of rule 10Q or sub-rule (7) of rule 10RA.

(2) The Board shall give an opportunity of being heard to the assessee, before proceeding to cancel an application.

(3) The competent authority in India shall communicate with the competent authority in the other country or countries and provide reason for the proposed cancellation of the agreement in case of bilateral or multilateral agreement.

(4) The order of cancellation of the agreement shall be in writing and shall provide reasons for cancellation and for non-acceptance of assessee's submission, if any.

(5) The order of cancellation shall also specify the effective date of cancellation of the agreement, where applicable.

(6) The order under the Act, declaring the agreement as void ab initio, on account of fraud or misrepresentation of facts, shall be in writing and shall provide reason for such declaration and for non-acceptance of assessee's submission, if any.

(7) The order of cancellation shall be intimated to the Assessing Officer and the Transfer Pricing Officer, having jurisdiction over the assessee.

Renewing an agreement. (RULE-10S)

10S. Request for renewal of an agreement may be made as a new application for agreement, using the same procedure as outlined in these rules except pre-filing consultation as referred to in rule 10H.

Miscellaneous. (RULE-10T)

10T. (1) Mere filing of an application for an agreement under these rules shall not prevent the operation of Chapter X of the Act for determination of arms' length price under that Chapter till the agreement is entered into.

(2) The negotiation between the competent authority in India and the competent authority in the other country or countries, in case of bilateral or multilateral agreement, shall be carried out in accordance with the provisions of the tax treaty between India and the other country or countries

Procedure to deal with requests for bilateral or multilateral advance pricing agreements. (RULE-44GA)

44GA. (1) Where a person has made request for a bilateral or multilateral advance pricing agreement in an application filed in **Form No. 3CED** in accordance with rule 10-I, the request shall be dealt with subject to provisions of this rule.

(2) The process for bilateral or multilateral advance pricing agreement shall not be initiated unless the associated enterprise situated outside India has initiated process of advance pricing agreement with the competent authority in the other country.

(3) The competent authority in India shall, on intimation of request of the applicant for a bilateral or multilateral agreement, consult and ascertain willingness of the competent authority in other country or countries, as the case may be, for initiation of negotiation for this purpose.

(4) In case of willingness of the competent authority in other country or countries, as the case may be, the competent authority in India shall enter into negotiation in this behalf and endeavour to reach a set of terms which are acceptable to the competent authority in India and the competent authority in the other country or countries, as the case may be.

(5) In case of an agreement after consultation, the competent authority in India shall formalise a mutual agreement procedure arrangement with the competent authority in other country or countries, as the case may be, and intimate the same to the applicant.

(6) In case of failure to reach agreement on such terms as are mutually acceptable to parties mentioned in sub-rule (4), the applicant shall be informed of the failure to reach an agreement with the competent authority in other country or countries.

(7) The applicant shall not be entitled to be part of discussion between competent authority in India and the competent authority in the other country or countries, as the case may be; however, the applicant can communicate or meet the competent authority in India for the purpose of entering into an advance pricing agreement.

(8) The applicant shall convey acceptance or otherwise of the agreement within 30 days of it being communicated.

(9) The applicant, in case the agreement is not acceptable may at its option continue with process of entering into an advance pricing agreement without benefit of mutual agreement process or withdraw application in accordance with rule 10J.

Roll Back of the Agreement. (RULE-10MA)

10MA. (1) Subject to the provisions of this rule, the agreement may provide for determining the arm's length price or specify the manner in which arm's length price shall be determined in relation to the international transaction entered into by the person during the rollback year (hereinafter referred to as "rollback provision").

(2) The agreement shall contain rollback provision in respect of an international transaction subject to the following, namely: —

- (i) the international transaction is same as the international transaction to which the agreement (other than the rollback provision) applies;
- (ii) the return of income for the relevant rollback year has been or is furnished by the applicant before the due date specified in Explanation 2 to sub-section (1) of section 139;
- (iii) the report in respect of the international transaction had been furnished in accordance with section 92E;
- (iv) the applicability of rollback provision, in respect of an international transaction, has been requested by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant; and
- (v) the applicant has made an application seeking rollback in Form 3CEDA in accordance with sub-rule (5);

(3) Notwithstanding anything contained in sub-rule (2), rollback provision shall not be provided in respect of an international transaction for a rollback year, if, —

- (i) the determination of arm's length price of the said international transaction for the said year has been subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement; or
- (ii) the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year.

(4) Where the rollback provision specifies the manner in which arm's length price shall be determined in relation to an international transaction undertaken in any rollback year then such manner shall be the same as the manner which has been agreed to be provided for determination of arm's length price of the same international transaction to be undertaken in any previous year to which the agreement applies, not being a rollback year.

(5) The applicant may, if he desires to enter into an agreement with rollback provision, furnish along with the application, the request for the same in **Form No. 3 CEDA** (Application for rollback of an Advance Pricing Agreement) with proof of payment of an additional fee of **5 lakh rupees**:

Provided that in a case where an application has been filed on or before the 31.03.2015, Form No.3CEDA along with proof of payment of additional fee may be filed at any time on or before the 30.06.2015 or the date of entering into the agreement whichever is earlier:

Provided further that in a case where an agreement has been entered into on or before the 31.03.2015 Form No.3CEDA along with proof of payment of additional fee may be filed at any time on or before the 30.06.2015 and, notwithstanding anything contained in rule 10Q, the agreement may be revised to provide for rollback provision in the said agreement in accordance with this rule

Procedure for giving effect to rollback provision of an Agreement. (RULE-10RA)

- 10RA. (1) The effect to the rollback provisions of an agreement shall be given in accordance with this rule.
- (2) The applicant shall furnish modified return of income referred to in section 92CD in respect of a rollback year to which the agreement applies along with the proof of payment of any additional tax arising as a consequence of and computed in accordance with the rollback provision.
- (3) The modified return referred to in sub-rule (2) shall be furnished along with the modified return to be furnished in respect of first of the previous years for which the agreement has been requested for in the application.
- (4) If any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is the subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant before furnishing the modified return for the said year.
- (5) If any appeal filed by the Assessing Officer or the Principal Commissioner or Commissioner is pending before the Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the Assessing Officer or the Principal Commissioner or the Commissioner, as the case may be, within 3 months of filing of modified return by the applicant.
- (6) The applicant, the Assessing Officer or the Principal Commissioner or the Commissioner, shall inform the Dispute Resolution Panel or the Commissioner (Appeals) or the Appellate Tribunal or the High Court, as the case may be, the fact of an agreement containing rollback provision having been entered into along with a copy of the same as soon as it is practicable to do so.
- (7) In case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled.

Effect to advance pricing agreement. (SECTION 92CD)

- 92CD. (1) Notwithstanding anything to the contrary contained in section 139, where any person has entered into an agreement and prior to the date of entering into the agreement, any return of income has been furnished under the provisions of section 139 for any assessment year relevant to a previous year to which such agreement applies, such person shall furnish, within a period of three months from the end of the month in which the said agreement was entered into, a modified return in accordance with and limited to the agreement.
- (2) Save as otherwise provided in this section, all other provisions of this Act shall apply accordingly as if the modified return is a return furnished under section 139.
- (3) If the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the agreement applies have been completed before the expiry of period allowed for furnishing of modified return under sub-section (1), the Assessing Officer shall, in a case where modified return is filed in accordance with the provisions of sub-section (1), proceed to assess or reassess or recompute the total income of the relevant assessment year having regard to and in accordance with the agreement.

(4) Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the agreement applies are pending on the date of filing of modified return in accordance with the provisions of sub-section (1), the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the agreement taking into consideration the modified return so furnished.

(5) Notwithstanding anything contained in section 153 or section 153B or section 144C, —

(a) the order of assessment, reassessment or recomputation of total income under sub-section (3) shall be passed within a period of one year from the end of the financial year in which the modified return under sub-section (1) is furnished;

(b) the period of limitation as provided in section 153 or section 153B or section 144C for completion of pending assessment or reassessment proceedings referred to in sub-section (4) shall be extended by a period of 12 months.

(6) For the purposes of this section, —

(i) "agreement" means an agreement referred to in sub-section (1) of section 92CC;

(ii) the assessment or reassessment proceedings for an assessment year shall be deemed to have been completed where—

(a) an assessment or reassessment order has been passed; or

(b) no notice has been issued under sub-section (2) of section 143 till the expiry of the limitation period provided under the said section.

Circular No. 10/2015 DATED 10.06.2015

Subject: Clarifications on Rollback Provisions of Advance Pricing Agreement Scheme

The Advance Pricing Agreement provisions were introduced in 2012 through insertion of sections 92CC and 92CD in the Income-tax Act, 1961 by the Finance Act, 2012. Subsequently, the Advance Pricing Agreement Scheme was notified vide S.O. 2005 (E), dated 30/8/2012, thereby inserting Rules 10F to 10T and Rule 44GA in the Income-tax Rules, 1962.

2. Rollback provisions in the APA Scheme were introduced through subsection (9A) inserted in section 92CC by the Finance (No. 2) Act, 2014 and the relevant rules, namely, Rules 10MA and 10RA, have been notified recently vide S.O. 758(E) dated 14th March, 2015 and S.O. 915(E) dated 1st April, 2015. Subsequent to the notification of the rules, requests for clarification regarding certain issues have been received in the Central Board of Direct Taxes. In order to clarify such issues, the Board has decided to adopt a Question and Answer format and the clarifications are hereby provided as below:

Q.1 Under rule 10 MA(2)(ii) there is a condition that the return of income for the relevant roll back year has been or is furnished by the applicant before the due date specified in Explanation 2 to sub-section (1) of section 139 of the Income tax Act (hereinafter referred to as the 'Act'). It is not clear as to whether applicants who have filed returns under section 139(4) or 139(5) of the Act would be eligible for roll back.

Answer: The return of income under section 139(5) of the Act can be filed only when a return under section 139(1) has already been filed. Therefore, the return of income filed under section 139(5) of the Act, replaces the original return of income filed under section 139(1) of the Act. Hence, if there is a return which is filed under section 139(5) of the Act to revise the original return filed before the due date specified in Explanation 2 to sub-section (1) of section 139, the applicant would be entitled for rollback on this revised return of income.

However, rollback provisions will not be available in case of a return of income filed under section 139(4) because it is a return which is not filed before the due date.

Q.2 Rule 10MA (2)(i) mandates that the rollback provision shall apply in respect of an international transaction that is same as the international transaction to which the agreement (other than the rollback provision) applies. It is not clear what is the meaning of the word “same”. Further, it is not clear whether this restriction also applies to the Functions, Assets, Risks (FAR) analysis.

Answer: The international transaction for which a rollback provision is to be allowed should be the same as the one proposed to be undertaken in the future years and in respect of which the agreement has been reached. There cannot be a situation where rollback is finalised for a transaction which is not covered in the agreement for future years. The term same international transaction implies that the transaction in the rollback year has to be of same nature and undertaken with the same associated enterprise(s), as proposed to be undertaken in the future years and in respect of which agreement has been reached. In the context of FAR analysis, the restriction would operate to ensure that rollback provisions would apply only if the FAR analysis of the rollback year does not differ materially from the FAR validated for the purpose of reaching an agreement in respect of international transactions to be undertaken in the future years for which the agreement applies. The word “materially” is generally being defined in the Advance Pricing Agreements being entered into by CBDT. According to this definition, the word “materially” will be interpreted consistently with its ordinary definition and in a manner that a material change of facts and circumstances would be understood as a change which could reasonably have resulted in an agreement with significantly different terms and conditions.

Q.3 Rule 10MA (2)(iv) requires that the application for rollback provision, in respect of an international transaction, has to be made by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant. Clarification is required as to whether rollback has to be requested for all four years or applicant can choose the years out of the block of four years.

Answer: The applicant does not have the option to choose the years for which it wants to apply for rollback. The applicant has to either apply for all the four years or not apply at all. However, if the covered international transaction(s) did not exist in a rollback year or there is some disqualification in a rollback year, then the applicant can apply for rollback for less than 4 years. Accordingly, if the covered international transaction(s) were not in existence during any of the rollback years, the applicant can apply for rollback for the remaining years. Similarly, if in any of the rollback years for the covered international transaction(s), the applicant fails the test of the rollback conditions contained in various provisions, then it would be denied the benefit of rollback for that rollback year. However, for other rollback years, it can still apply for rollback.

Q.4 Rule 10 MA (3) states that the rollback provision shall not be provided in respect of an international transaction for a rollback year if the determination of arm’s length price of the said international transaction for the said year has been the subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement. Further, Rule 10 RA (4) provides that if any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant. There is a need to clarify the phrase “Tribunal has passed an order disposing of such appeal” and on the mismatch, if any, between Rule 10MA (3) and Rule 10RA (4).

Answer: The reason for not allowing rollback for the international transaction for which Appellate Tribunal has passed an order disposing of an appeal is that the ITAT is the final fact finding authority and hence, on factual issues, the matter has already reached finality in that year. However, if the ITAT has not decided the matter and has only set aside the order for fresh consideration of the matter by the lower authorities with

full discretion at their disposal, the matter shall not be treated as one having reached finality and hence, benefit of rollback can still be given. There is no mismatch between Rule 10MA (3) and Rule 10RA (4).

Q.5 Rule 10MA(3)(ii) provides that rollback provision shall not be provided in respect of an international transaction for a rollback year if the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year. It may be clarified whether the rollback provisions in such situations can be applied in a manner so as to ensure that the returned income or loss is accepted as the final income or loss after applying the rollback provisions.

Answer: It is clarified that in case the terms of rollback provisions contain specific agreement between the Board and the applicant that the agreed determination of ALP or the agreed manner of determination of ALP is subject to the condition that the ALP would get modified to the extent that it does not result in reducing the total income or increasing the total loss, as the case may be, of the applicant as declared in the return of income of the said year, the rollback provisions could be applied. For example, if the declared income is Rs. 100, the income as adjusted by the TPO is Rs. 120, and the application of the rollback provisions results in reducing the income to Rs. 90, then the rollback for that year would be determined in a manner that the declared income Rs. 100 would be treated as the final income for that year.

Q.6 Rule 10RA (7) states that in case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled. It is to be clarified as to whether the entire agreement is to be cancelled or only that year for which roll back fails.

Answer: The procedure for giving effect to a rollback provision is laid down in Rule 10RA. Sub-rules (2), (3), (4) and (6) of the Rule specify the actions to be taken by the applicant in order that effect may be given to the rollback provision. If the applicant does not carry out such actions for any of the rollback years, the entire agreement shall be cancelled. This is because the rollback provision has been introduced for the benefit of the applicant and is applicable at its option. Accordingly, if the rollback provision cannot be given effect to for any of the rollback years on account of the applicant not taking the actions specified in sub-rules (2), (3), (4) or (6), the entire agreement gets vitiated and will have to be cancelled.

Q.7 If there is a Mutual Agreement Procedure (MAP) application already pending for a rollback year, what would be the stand of the APA authorities? Further, what would be the view of the APA Authorities if MAP has already been concluded for a rollback year?

Answer: If MAP has been already concluded for any of the international transactions in any of the rollback year under APA, rollback provisions would not be allowed for those international transactions for that year but could be allowed for other years or for other international transactions for that year, subject to fulfilment of specified conditions in Rules 10MA and 10RA. However, if MAP request is pending for any of the rollback year under APA, upon the option exercised by the applicant, either MAP or application for roll back shall be proceeded with for such year.

Q.8 Rule 10MA (1) provides that the agreement may provide for determining ALP or manner of determination of ALP. However, Rule 10MA (4) only specifies that the manner of determination of ALP should be the same as in the APA term. Does that mean the ALP could be different?

Answer: Yes, the ALP could be different for different years. However, the manner of determination of ALP (including choice of Method, comparability analysis and Tested Party) would be same.

Q.9 Will there be compliance audit for roll back? Would critical assumptions have to be validated during compliance audit?

Answer: Since rollback provisions are for past years, ALP for the rollback years would be agreed after full examination of all the facts, including validation of critical assumptions. Hence, compliance audit for the

rollback years would primarily be to check if the agreed price or methodology has been applied in the modified return.

Q.10 Whether applicant has an option to withdraw its rollback application? Can the applicant accept the rollback results without accepting the APA for the future years?

Answer: The applicant has an option to withdraw its roll back application even while maintaining the APA application for the future years. However, it is not possible to accept the rollback results without accepting the APA for the future years. It may also be noted that the fee specified in Rule 10MA(5) shall not be refunded even where a rollback application is withdrawn.

Q.11 For already concluded APAs, will new APAs be signed for rollback or earlier APAs could be revised?

Answer: The second proviso to Rule 10MA (5) provides for revision of APAs already concluded to include rollback provisions.

Q.12 For already concluded APAs, where the modified return has already been filed for the first year of the APA term, how will the time-limit for filing modified return for rollback years be determined?

Answer: The time to file modified return for rollback years will start from the date of signing the revised APA incorporating the rollback provisions.

Q.13 In case of merger of companies, where one or more of those companies are APA applicants, how would the rollback provisions be allowed and to which company or companies would it be allowed?

Answer: The agreement is between the Board and a person. The principle to be followed in case of merger is that the person (company) who makes the APA application would only be entitled to enter into the agreement and be entitled for the rollback provisions in respect of international transactions undertaken by it in rollback years. Other persons (companies) who have merged with this person (company) would not be eligible for the rollback provisions.

To illustrate, if A, B and C merge to form C and C is the APA applicant, then the agreement can only be entered into with C and only C would be eligible for the rollback provisions. A and B would not be eligible for the rollback provisions. To illustrate further, if A and B merge to form a new company C and C is the APA applicant, then nobody would be eligible for rollback provisions.

Q.14 In case of a demerger of an APA applicant or signatory into two or more companies (persons), who would be eligible for the rollback provisions?

Answer: The same principle as mentioned in the previous answer, i.e., the person (company) who makes an APA application or enters into an APA would only be entitled for the rollback provisions, would continue to apply. To illustrate, if A has applied for or entered into an APA and, subsequently, demerges into A and B, then only A will be eligible for rollback for international transactions covered under the APA. As B was not in existence in rollback years, availing or grant of rollback to B does not arise.

RTP M-15

“In the Indian context, Advance Pricing Agreements entered into for determining arm’s length price in relation to an international transaction is valid only for a period, not exceeding 5 years, prospective to the date of agreement and cannot be applied in respect of prior period transactions” – Discuss the correctness or otherwise of this statement.

The statement is not correct.

Under section 92CC, the CBDT may, with the approval of the Central Government, enter into an advance pricing agreement with any person for determining the Arm’s Length Price or specifying the manner in

which the arm's length price is to be determined in relation to an international transaction to be entered into by that person.

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 arm's length price of the international transaction, which is subject matter of the advance pricing agreement, would be determined in accordance with such an advance pricing agreement, except where there is a change in law or facts having a bearing on the agreement so entered.

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 by the Finance (No.2) Act, 2014 to provide roll back mechanism in the advance pricing agreement scheme.

The "roll back" provisions refer to the applicability of the methodology of determination of arm's length in relation to the international transactions which have already been entered into in a period prior to the period covered under an advance pricing agreement.

Accordingly, the advance pricing agreement may, subject to such prescribed conditions, procedure and manner, provide for determining the arm's length price or for specifying the manner in which arm's length price is to be determined in relation to an international transaction entered into by a person during any period not exceeding 4 previous years preceding the first of the previous years for which the advance pricing agreement applies in respect of the international transaction.

Maintenance and keeping of information and document by persons entering into an international transaction or specified domestic transaction. (SECTION 92D)

92D. (1) Every person who has entered into an international transaction or specified domestic transaction shall keep and maintain such information and document in respect thereof, as may be prescribed (**RULE - 10D**)

(2) Without prejudice to the provisions contained in sub-section (1), the Board may prescribe the period for which the information and document shall be kept and maintained under that sub-section.

(3) The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceeding under this Act, require any person who has entered into an international transaction or specified domestic transaction to furnish any information or document in respect thereof, as may be prescribed under sub-section (1), within a period of **30** days from the date of receipt of a notice issued in this regard:

Provided that the Assessing Officer or the Commissioner (Appeals) may, on an application made by such person, extend the period of **30** days by a further period not exceeding 30 days.

Information and documents to be kept and maintained under section 92D. – RULE-10D

10D. (1) Every person who has entered into an international transaction *or a specified domestic transaction* shall keep and maintain the following information and documents, namely: —

- (a) a description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises;
- (b) a profile of the multinational group of which the assessee enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions *or specified domestic transactions, as the case may be*, have been entered into by the assessee, and ownership linkages among them;
- (c) a broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the associated enterprises with whom the assessee has transacted;

- (d) the nature and terms (including prices) of international transactions *or specified domestic transactions* entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;
- (e) a description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involved in the international transaction *or the specified domestic transaction*;
- (f) a record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately, which may have a bearing on the international transactions *or the specified domestic transactions* entered into by the assessee;
- (g) a record of uncontrolled transactions taken into account for analysing their comparability with the international transactions *or the specified domestic transactions* entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions *or specified domestic transactions, as the case may be*;
- (h) a record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction *or specified domestic transaction*;
- (i) a description of the methods considered for determining the arm's length price in relation to each international transaction *or specified domestic transaction* or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case;
- (j) a record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction *or the specified domestic transaction* and the comparable uncontrolled transactions, or between the enterprises entering into such transactions;
- (k) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price;
- (l) details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under these rules and consequent adjustment made to the total income for tax purposes;
- (m) any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

(2) Nothing contained in sub-rule (1), in so far as it relates to an international transaction, shall apply in a case where the aggregate value, as recorded in the books of account, of international transactions entered into by the assessee does not **exceed 1 crore rupees**:

Provided that the assessee shall be required to substantiate, on the basis of material available with him, that income arising from international transactions entered into by him has been computed in accordance with section 92.

(2A) Nothing contained in sub-rule (1), in so far as it relates to an eligible specified domestic transaction referred to in rule 10 THB, shall apply in a case of an eligible assessee mentioned in rule 10 THA and-

(a) the eligible assessee, referred to in clause (i) of rule 10 THA, shall keep and maintain the following information and documents, namely: -

(i) a description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises;

(ii) a broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the associated enterprises with whom the assessee has transacted;

(iii) the nature and terms (including prices) of specified domestic transactions entered into with each associated enterprise and the quantum and value of each such transaction or class of such transaction;

(iv) a record of proceedings, if any, before the regulatory commission and orders of such commission relating to the specified domestic transaction;

(v) a record of the actual working carried out for determining the transfer price of the specified domestic transaction;

(vi) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the transfer price; and

(vii) any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the transfer price;

(b) the eligible assessee, referred to in clause (ii) of rule 10THA, shall keep and maintain the following information and documents, namely: -

(i) a description of the ownership structure of the assessee co-operative society with details of shares or other ownership interest held therein by the members;

(ii) description of members including their addresses and period of membership;

(iii) the nature and terms (including prices) of specified domestic transactions entered into with each member and the quantum and value of each such transaction or class of such transaction;

(iv) a record of the actual working carried out for determining the transfer price of the specified domestic transaction;

(v) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the transfer price;

(vi) the documentation regarding price being routinely declared in transparent manner and being available in public domain; and

(vii) any other information, data or document which may be relevant for determination of the transfer price.”.

(3) The information specified in *sub-rules (1) and (2A)* shall be supported by authentic documents, which may include the following:

(a) official publications, reports, studies and data bases from the Government of the country of residence of the associated enterprise, or of any other country;

(b) reports of market research studies carried out and technical publications brought out by institutions of national or international repute;

(c) price publications including stock exchange and commodity market quotations;

(d) published accounts and financial statements relating to the business affairs of the associated enterprises;

(e) agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions *or the specified domestic transactions, as the case may be*;

(f) letters and other correspondence documenting any terms negotiated between the assessee and

the associated enterprise;

(g) documents normally issued in connection with various transactions under the accounting practices followed.

(4) The information and documents specified under *sub-rules (1), (2) and (2A)*, should, as far as possible, be contemporaneous and should exist latest by the specified date referred to in clause (iv) of section 92F:

Provided that where an international transaction *or a specified domestic transaction* continues to have effect over more than one previous year, fresh documentation need not be maintained separately in respect of each previous year, unless there is any significant change in the nature or terms of the international transaction *or the specified domestic transaction, as the case may be*], in the assumptions made, or in any other factor which could influence the transfer price, and in the case of such significant change, fresh documentation as may be necessary under *sub-rules (1), (2) and (2A)* shall be maintained bringing out the impact of the change on the pricing of the international transaction *or the specified domestic transaction*.

(5) The information and documents specified in *sub-rules (1), (2) and (2A)* shall be kept and maintained for a period of 8 years from the end of the relevant assessment year.

Report from an accountant to be furnished by persons entering into international transaction or specified domestic transaction. (SECTION 92E)

92E. Every person who has entered into an international transaction or specified domestic transaction during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date in the prescribed form duly signed and verified in the prescribed manner by such accountant and setting forth such particulars as may be prescribed **(RULE-10E+3CEB)**

Report from an accountant to be furnished under section 92E. (RULE-10E)

10E. The report from an accountant required to be furnished under section 92E by every person who has entered into an international transaction or a specified domestic transaction during a previous year shall be in Form No. 3CEB and be verified in the manner indicated therein.

Definitions of certain terms relevant to computation of arm's length price, etc. (SECTION 92F) +(RULE -10A)

92F. In sections 92, 92A, 92B, 92C, 92D and 92E, unless the context otherwise requires, —

(i) "**accountant**" shall have the same meaning as in the *Explanation* below sub-section (2) of section 288;

(ii) "**arm's length price**" means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions;

(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;

(iiia) "**permanent establishment**", referred to in clause (iii), includes a fixed place of business through which the business of the enterprise is wholly or partly carried on;

(iv) **"specified date"** shall have the same meaning as assigned to "due date" in *Explanation 2* below sub-section (1) of section 139;

139(1) Exp-2 (aa) in the case of an assessee who is required to furnish a report referred to in section 92E, the 30th day of November of the assessment year;

(v) **"transaction"** includes an arrangement, understanding or action in concert, —

(A) whether or not such arrangement, understanding or action is formal or in writing; or

(B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceeding.

Instruction No. 15/2015 dated 16-10-2015

Subject: Revised and Updated Guidance for Implementation of Transfer Pricing Provisions-Regarding

The provisions relating to transfer pricing are contained in Sections 92 to 92F of the Income-tax Act (hereinafter referred to as 'the Act'). These provisions came into force w.e.f. Assessment Year 2002-2003 and have seen a number of amendments over the years, including the insertion of Safe Harbour and Advance Pricing Agreement provisions and the extension of the applicability of transfer pricing provisions to Specified Domestic Transactions.

2. In terms of the provisions, any income arising from an international transaction or specified domestic transaction between two or more associated enterprises shall be computed having regard to the Arm's Length Price. Instruction No. 3 was issued on 20-05-2003 to provide guidance to the Transfer Pricing Officers and the Assessing Officers to operationalise the transfer pricing provisions and to have procedural uniformity. Due to a number of legislative, procedural and structural changes carried out over the last few years, Instruction No. 3 of 2003 is being replaced with this Instruction to provide updated and adequate guidance on the transfer pricing provisions pertaining to international transactions.

3. Reference to Transfer Pricing Officer (TPO)

3.1 The power to determine the Arm's Length Price (ALP) in an international transaction is contained in sub-section (3) of Section 92C of the Act. However, Section 92CA of the Act, inter-alia, provides that where the Assessing Officer (AO) considers it necessary or expedient so to do, he may refer the computation of ALP in relation to an international transaction to the Transfer Pricing Officer (TPO). Sub-section (3) of Section 92CA provides that the TPO, after taking into account the material available with him shall, by an order in writing, determine the ALP in accordance with sub-section (3) of Section 92C of the Act. Sub-section (4) of Section 92CA provides that on receipt of the order of the TPO, the AO shall proceed to compute the total income of the taxpayer in conformity with the ALP determined by the TPO. Thus, while the determination of ALP, wherever reference is made to him, is required to be done by the TPO under sub-section (3) of Section 92CA read with sub-section (3) of Section 92C, the computation of total income in conformity with the ALP so determined by the TPO is required to be done by the AO under sub-section (4) of Section 92C read with sub-section (4) of Section 92CA of the Act.

3.2 In order to make a reference to the TPO, the AO has to first satisfy himself that the taxpayer has entered into an international transaction with an associated enterprise. One of the sources from which the factual information regarding international transaction can be gathered is Form No. 3CEB filed by the taxpayer, which is in the nature of an accountant's report containing basic details of an international transaction entered into by the taxpayer during the year and the associated enterprise with which such transaction is entered into, the nature of documents maintained and the method followed. Thus, the primary details regarding such international transactions would normally be available in the accountant's report. The AO can arrive at a prima facie belief on the basis of these details whether a reference to the TPO is necessary. No detailed enquiries are needed at this stage and the AO should not embark upon scrutinising the correctness or otherwise of the price of the international transaction at this stage.

However, in the following situations, the AO must, as a jurisdictional requirement, record his satisfaction that there is an income or a potential of an income arising and/or being affected on determination of the ALP of an international transaction before he proceeds to determine the ALP under sub-section (3) of Section 92C of the Act or to refer the matter to the TPO to determine the ALP under sub-section (1) of Section 92CA of the Act:

(a) where the taxpayer has not filed the Accountant's report under Section 92E of the Act but international transactions undertaken by it come to the notice of the AO;

(b) where the taxpayer has not declared one or more international transaction in the Accountant's report filed under Section 92E of the Act and the said transaction or transactions come to the notice of the AO; and

(c) where the taxpayer has declared the international transaction or transactions in the Accountant's report filed under Section 92E of the Act but has made certain qualifying remarks to the effect that the said transaction or transactions are not international transactions or do not impact the income of the taxpayer.

In all the above situations, the AO must provide an opportunity of being heard to the taxpayer before recording his satisfaction or otherwise.

3.3 The exercise of finding out whether any income arises and/or is affected or potentially arises and/or is potentially affected by the determination of the ALP of the international transaction would certainly be a factor, in addition to other factors, in determining whether or not it is necessary or expedient to refer the matter to the TPO. In case no objection is raised by the taxpayer to the applicability of Chapter X [Sections 92 to 92F] of the Act, then the prima-facie view of the AO would be sufficient before referring the international transaction to the TPO for determining the ALP. However, where the applicability of Chapter X [Sections 92 to 92F] of the Act to the facts of the taxpayer's case is objected to, the assessee's objection should be considered and specifically dealt with so as to make sufficient compliance with the principles of natural justice.

3.4 Before making a reference to the TPO, the AO has to seek the approval of the Principal Commissioner or Commissioner as provided in the Act. The provisions of Section 92CA of the Act, inter-alia, refer to the international transaction. Hence, all international transactions, in relation to which a reference to the TPO is considered necessary, have to be explicitly mentioned in the letter through which the reference is being made.

3.5 Since transfer pricing cases are now being selected for scrutiny on the basis of risk parameters, there is no requirement of selecting a transfer pricing case for scrutiny on the basis of the value of the international transaction. Consequently, there would be no requirement of referring an international transaction to the TPO for determination of its ALP merely because the value of the international transaction is above a particular limit. In particular, where a case has been selected for scrutiny only on non-TP issues and the case also involves international transactions with AEs, the case shall not be referred to the TPO irrespective of the value of the international transaction or aggregate value of all international transactions. The only exception to this would be a case selected for scrutiny on non-TP parameters where the AO comes to know that the taxpayer has entered into international transaction or transactions but the taxpayer has either not filed the Accountant's report under Section 92E or has not disclosed the said international transaction or transactions in the Accountant's report filed. In such exceptional situations, the AO may refer the matter to the TPO after providing an opportunity of being heard to the taxpayer.

3.6 Since the case will be selected for scrutiny before making the reference to the TPO, the AO may proceed to examine other aspects of the case during the pendency of assessment proceedings but must wait for the report/order of the TPO on the value of international transactions before making final assessment.

4. Role of Transfer Pricing Officer

4.1 The role of the TPO begins after a reference is received from the AO. In terms of Section 92CA of the Act, this role is limited to the determination of the ALP in relation to international transaction(s) referred to him by the AO. However, if any other international transaction comes to the notice of the TPO during the course of the proceedings before him, then he is empowered to determine the ALP of such other international transactions also by virtue of sub-sections (2A) and (2B) of Section 92CA of the Act. The transfer price has to be determined by the TPO in terms of Section 92C of the Act. The price has to be determined by using any one of the methods stipulated in sub-section (1) of Section 92C and by applying the most appropriate method referred to in sub-section (2) thereof. There may be occasions where application of the most appropriate method provides results which are different but equally reliable. In all such cases, further scrutiny may be necessary to evaluate the appropriateness of the method, the correctness of the data, weight given to various factors and so on. The selection of the most appropriate method will depend upon the facts of the case and the factors mentioned in rules contained in Rule 10C. The TPO, after taking into account all relevant facts and data available to him, shall determine the ALP and pass a speaking order. The TPO, being an Additional/ Joint CIT, shall obtain the approval of the jurisdictional CIT (Transfer Pricing) before passing the order. On the other hand, the TPO, being a Deputy/Assistant CIT, shall obtain the approval of the jurisdictional Additional/ Joint CIT before passing the order. The jurisdictional CIT (TP) should assign a limited number of important and complex cases, not exceeding 50, to the Additional/ Joint CIT (TPOs) working in the same jurisdiction. For the selection of such important and complex cases by the CIT(TP), the concerned CCIT (International Taxation) shall frame appropriate guidelines.

4.2 The order passed by the TPO should contain details of the data used, reasons for arriving at a certain price and the applicability of methods. It may be emphasised that the application of method including the application of the most appropriate method, the data used, factors governing the applicability of respective methods, computation of price under a given method will all be subjected to judicial scrutiny. It is, therefore, necessary that the order of the TPO contains adequate reasons on all these counts. Copies of the documents or the relevant data used in arriving at the arm's length price should be made available to the AO for his records and use at subsequent stages of appellate or penal proceedings.

4.3 In addition to the above, the TPO is required to carry out the Compliance Audit of the Advance Pricing Agreements (APAs) entered into by the Board and the taxpayers in accordance with Rule 10 P of the Income-tax Rules.

4.4 The TPO is also required to play an important role in respect of Safe Harbour provisions. Whenever a reference is made to the TPO under sub-rule (4) or sub-rule (10) of Rule 10 TE of the Income-tax Rules, the TPO has to carefully examine all the facts and circumstances of the taxpayer's exercise of an option for Safe Harbour and pass an order in writing as mandated in sub-rule (6) or sub-rule (11) of the said Rule, respectively.

5. Role of the AO after Determination of ALP

Under sub-section (4) of Section 92C of the Act, the AO has to compute the total income of the assessee having regard to the ALP determined by him under sub-section (3) of the same Section. Where the determination of ALP is done by the TPO under sub-section (3) of Section 92CA of the Act, the AO has to compute the total income of the assessee under sub-section (4) of Section 92C (read with sub-section (4) of Section 92CA) in conformity with the ALP so determined by the TPO.

6. Maintenance of Data Base

It is to be ensured by the CIT (Transfer Pricing) that the references received from the AOs by the TPOs in his jurisdiction are dealt with expeditiously and accurate record of all events connected with the whole process of determination of ALP is maintained. This record is to be maintained by each TPO in the format enclosed as **Annexure** – to this Instruction. This format will serve as an important database for future action and also help in bringing about uniformity in the determination of the ALP in identical or substantially identical cases. The CIT (TP) must ensure that the separate data maintained by all TPOs under

their jurisdiction are consolidated into one report for the entire charge after the completion of each transfer pricing audit cycle

7. Applicability

The above guidance is applicable only to transfer pricing provisions in respect of international transactions. Similar guidance in respect of transfer pricing provisions pertaining to specified domestic transactions are under consideration of the CBDT. Till such time the guidance pertaining to specified domestic transactions is not issued, paragraph 3.5 of this Instruction shall apply to the effect that where a case has been selected for scrutiny on non-TP parameters and the case also involves specified domestic transactions with AEs, the case shall not be referred to the TPO irrespective of the value of the specified domestic transaction or aggregate value of all specified domestic transactions. The only exception to this would be a case selected for scrutiny on non-TP parameters where the AO comes to know that the taxpayer has entered into specified domestic transaction or transactions but the taxpayer has either not filed the Accountant's report under Section 92E of the Act or has not disclosed the said specified domestic transaction or transactions in the Accountant's report filed. In such exceptional situations, the AO may refer the matter to the TPO after providing an opportunity of being heard to the taxpayer.

8. This Instruction issues under Section 119 of the Act and supersedes Instruction No.3 of 2003 with immediate effect.

Special measures in respect of transactions with persons located in notified jurisdictional area. (PLINJA) (SECTION 94A)

94A. (1) The Central Government may, having regard to the lack of effective exchange of information with any country or territory outside India, specify by notification in the Official Gazette such country or territory as a notified jurisdictional area in relation to transactions entered into by any assessee.

(2) Notwithstanding anything to the contrary contained in this Act, if an assessee enters into a transaction where one of the parties to the transaction is a person located in a notified jurisdictional area, then—

(i) all the parties to the transaction shall be deemed to be associated enterprises within the meaning of section 92A;

(ii) any transaction in the nature of purchase, sale or lease of tangible or intangible property or provision of service or lending or borrowing money or any other transaction having a bearing on the profits, income, losses or assets of the assessee including a mutual agreement or arrangement for allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided by or to the assessee shall be deemed to be an international transaction within the meaning of section 92B,

and the provisions of sections 92, 92A, 92B, 92C [except the second proviso to sub-section (2)], 92CA, 92CB, 92D, 92E and 92F shall apply accordingly.

(3) Notwithstanding anything to the contrary contained in this Act, no deduction, —

(a) in respect of any payment made to any financial institution located in a notified jurisdictional area shall be allowed under this Act, unless the assessee furnishes an authorisation in the prescribed form authorising the Board or any other income-tax authority acting on its behalf to seek relevant information from the said financial institution on behalf of such assessee; and

(b) in respect of any other expenditure or allowance (including depreciation) arising from the transaction with a person located in a notified jurisdictional area shall be allowed under any other provision of this Act, unless the assessee maintains such other documents and furnishes such information as may be prescribed, in this behalf.

(4) Notwithstanding anything to the contrary contained in this Act, where, in any previous year, the assessee has received or credited any sum from any person located in a notified jurisdictional area and the assessee does not offer any explanation about the source of the said sum in the hands of such person or in the hands of the beneficial owner (if such person is not the beneficial owner of the said sum) or the explanation offered by the assessee, in the opinion of the Assessing Officer, is not satisfactory, then, such sum shall be deemed to be the income of the assessee for that previous year.

(5) Notwithstanding anything contained in any other provisions of this Act, where any person located in a notified jurisdictional area is entitled to receive any sum or income or amount on which tax is deductible under **Chapter XVII-B**, the tax shall be deducted at the **highest** of the following rates, namely: —

- (a) at the rate or rates in force;
- (b) at the rate specified in the relevant provisions of this Act;
- (c) at the rate of 30 %.

(6) In this section, —

(i) "**person located in a notified jurisdictional area**" shall include, —

- (a) a person who is resident of the notified jurisdictional area;
- (b) a person, not being an individual, which is established in the notified jurisdictional area; or
- (c) a permanent establishment of a person not falling in sub-clause (a) or sub-clause (b), in the notified jurisdictional area;

(ii) "**permanent establishment**" shall have the same meaning as defined in clause (iiia) of section 92F;

(iii) "**transaction**" shall have the same meaning as defined in clause (v) of section 92F.

Furnishing of authorisation and maintenance of documents etc. for the purposes of section 94A.(RULE-21AC)

21AC. (1) For the purposes of clause (a) of sub-section (3) of section 94A, the authorisation to be submitted by the assessee, shall be in Form No. 10FC.

(2) The assessee shall cause the first copy of the duly filled **Form No. 10FC** to be deposited with or transmitted to the financial institution referred to in clause (a) of sub-section (3) of section 94A.

(3) The second copy of the **Form No. 10FC** along with the evidence of the first copy of said Form having been deposited or transmitted to the financial institution shall be submitted by the assessee to the Assessing Officer having jurisdiction over him.

(4) For the purpose of ensuring that the authorisation in **Form No. 10FC** is legally enforceable, the assessee shall take all necessary steps as are required under any law for the time being in force in India or outside India.

(5) For the purposes of clause (b) of sub-section (3) of section 94A, the assessee who has entered into a transaction with a person located in a notified jurisdictional area (hereinafter referred to as the specified person) shall, in addition to information and documents referred to in sub-rule (1) of rule 10D, keep and maintain the following information and documents, namely: —

- (a) a description of the ownership structure of the specified person, including name and address of individuals or other entities, whether located in the notified jurisdictional area or outside, having directly or indirectly more than 10% shareholding or ownership interests;

- (b) a profile of the multinational group of which the specified person is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom the assessee has entered into a transaction, and ownership linkage among them;
- (c) a broad description of the business of the specified person and the industry it operates in;
- (d) any other information, data or document, which may be relevant for the transaction with the specified person.

(6) The information and documents specified in sub-rule (5) shall be for the period up to the due date of filing of return of income under sub-section (1) of section 139.

(7) The information and documents specified in sub-rule (5) shall be kept and maintained for a period of 8 years from the end of the relevant assessment year.

FORM 10FC -Authorisation for claiming deduction in respect of any payment made to any financial institution located in a notified jurisdictional area

RTP N-15+N-12: - Mr. Manas, a non-resident individual, is due to receive interest of Rs. 6,25,000 in March 2016 from a notified infrastructure debt fund eligible for exemption under section 10(47). He incurred expenditure amounting to Rs.32,000 for earning such income. Assuming that Mr. Manas is a resident of a Notified Jurisdictional Area (NJA), discuss the tax implications in his hands and the applicability of provisions relating to deduction of tax at source from such interest.

The interest income received by Mr. Manas, a non-resident, from a notified infrastructure debt fund would be subject to a concessional tax rate of 5% under section 115A on the gross amount of such interest income. Therefore, the tax liability of Mr. Manas in respect of such income would be Rs. 32,188 (being 5% of Rs.6,25,000 plus education cess@2% and secondary and higher education cess@1%).

Under section 194LB, tax is deductible @5% on interest paid by such fund to a non - resident. However, since Mr. Manas is a resident of a Notified Jurisdictional Area (NJA), tax would be deductible@30% as per section 94A, and not@ 5% specified under section 194LB. This is on account of the provisions of section 94A(5), which provides that "Notwithstanding anything contained in any other provision of this Act, where a person located in a NJA is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVII-B, the tax shall be deducted at the highest of the following rates, namely –

- (a) at the rate or rates in force;
- (b) at the rate specified in the relevant provision of the Act;
- (c) at the rate of 30%.

RTP M-14 + asked in May-12(4 Marks)

Godavari Ltd., an Indian company, exports dry fruits to Karyotis Inc for an amount of Rs.51 lacs. Karyotis Inc is located in a Notified Jurisdictional Area (NJA).

Godavari Ltd. charges Rs.52 lacs and Rs.53 lacs for sale of similar goods to Danube Inc and Mississippi Inc, respectively, which are not located in a NJA and both of them, are not associated enterprises of Godavari Ltd.

If the permissible variation notified by Central Government for such class of international transactions is 3% of the transaction price, state the tax implications under section 94A in respect of the above transaction entered into by Godavari Ltd. with Karyotis Inc.

As per section 94A, in case an assessee enters into any transaction where one of the parties thereto is located in the Notified Jurisdictional Area (NJA) then the parties to the transaction shall be treated as associated enterprises and the transaction shall be deemed to be an international transaction. The transfer

pricing provisions would, therefore, be attracted in such a case. However, the benefit of permissible variation between the transfer price and the arm's length price, as notified by the Central Government, shall not be available in such a case.

Since Karyotis Inc. is located in a NJA, the transaction of export of dry fruits by the Indian company, Godavari Ltd., would be deemed to be an international transaction and Karyotis Inc. and Godavari Ltd. would be deemed to be associated enterprises.

Therefore, the provisions of transfer pricing would be attracted in this case.

The prices of Rs.52 lakhs and Rs.53 lakhs charged for sale of similar goods to Danube Inc. and Mississippi Inc., respectively, being independent entities located in a non-NJA country, can be taken into consideration for determining the arm's length price (ALP) under Comparable Uncontrolled Price (CUP) Method.

Since more than one price is determined by the CUP Method, the ALP would be the arithmetical mean of such prices.

Therefore, $ALP = Rs.52,50,000$ i.e., $[(Rs.52,00,000 + Rs.53,00,000)/2]$ Transfer Price = Rs.51,00,000 Since the ALP is more than the transfer price, the ALP of Rs.52,50,000 would be considered for computing the income from the international transaction between Godavari Ltd. and Karyotis Inc. The benefit of permissible variation @ 3% of transfer price in respect of such class of international transactions is not available in respect of this transaction, since one of the parties thereto is located in a NJA.

RTP M-12

Geomatics Ltd., an Indian company, provides technical services to a company, MNC Inc., located in a Notified Jurisdictional Area (NJA) for a consideration of Rs.40 lakhs in January, 2016. It charges Rs.48 lakhs and Rs.52 lakhs for similar services rendered to Alpha Inc. and Beta Inc., respectively, which are not located in a NJA. Alpha Inc. and Beta Inc. are not associated enterprises of Geomatics Ltd.

Assuming that the variation notified by the Central Government for such class of international transactions is 3% of the transaction price, discuss the tax implications under section 94A read with section 92C in respect of the above transaction of provision of technical services by Geomatics Ltd. to MNC Inc.

Since MNC Inc. is located in a notified jurisdictional area (NJA), the transaction of provision of technical services by the Indian company, Geomatics Ltd., would be deemed to be an international transaction and MNC Inc. and Geomatics Ltd. would be deemed to be associated enterprises. Therefore, the provisions of transfer pricing would be attracted in this case.

The prices of Rs.48 lakhs and Rs.52 lakhs charged for similar services from Alpha Inc and Beta Inc, respectively, being independent entities located in non-NJA countries, can be taken into consideration for determining the arm's length price (ALP) under Comparable Uncontrolled Price (CUP) Method.

Since more than one price is determined by the CUP Method, the ALP would be the arithmetical mean of such prices. Therefore, the $ALP = Rs.50,00,000$ i.e., $(48,00,000+52,00,000)/2$ Transfer price = Rs.40,00,000

Since the ALP is more than the transfer price, the ALP of Rs.50 lakhs would be considered as the income arising from the international transaction between Geomatics Ltd. and MNC Inc.

It may be noted that the benefit of permissible variation between the ALP and the transfer price at the rate notified by the Central Government for a particular class of international transaction would not be available where transfer pricing provisions are attracted under section 94A. Therefore, it is not necessary to determine the impact, if any, of such permissible variation.

MAY 2014 (8 MARKS)

VKS Internationals Ltd., the assessee, has sold goods on 12-1-2016 to L Ltd., located in a notified jurisdictional area (NJA), for Rs.10.5 crores. The sale price of identical goods sold to an unfamiliar customer in New York during the year was Rs.11.5 crores. While the second sale was on CIF basis, the sale to L Ltd. was on F.O.B. basis. Ocean freight and insurance amount to Rs.20 lacs.

India has a Double Taxation Avoidance Agreement with the U.S.A. The assessee has a policy of providing after-sales support services to the tune of Rs.14 lacs to all customers except L Ltd. The ALP worked out as per Cost plus method for identical goods is Rs.12.1 crores. You are required to compute the ALP for the sales made to L Ltd., and the amount of consequent increase, if any, in profits of the assessee company.

A transaction where one of the parties thereto is a person located in a notified jurisdictional area (NJA) would be deemed to be an international transaction and all parties to the transaction would be deemed as associated enterprises under section 92A. The transaction of sale to L Ltd. located in a NJA, has a bearing on the profit/income/ loss/assets of the assessee company, and hence, the same shall be deemed to be an international transaction within the meaning of section 92B. Accordingly, all the provisions of transfer pricing would be attracted in case of such a transaction. However, the benefit of permissible variation between the ALP and the transfer price [provided for 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.

Arm's length price (ALP) means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises in uncontrolled conditions.

Section 92C provides that the ALP shall be determined by any of the prescribed methods, being the most appropriate method, having regard to the nature of transaction or other relevant factors.

From the information given in the question, ALP can be computed by applying Comparable Uncontrolled Price (CUP) method. The ALP worked out as per Cost Plus Method (CPM) is also given in the question.

Assuming that the CUP method is the most appropriate method, the ALP of the transaction with L Ltd. located in NJA, would be: -

Particulars	Rs. in crores
Sale price of identical goods (on CIF basis)	11.50
Less: Ocean freight and insurance	(0.20)
	11.30
Less: Cost of after-sales support services	(0.14)
Arm's length price (ALP) of the transaction with NJA	11.16
Less: Actual Transfer Price (of the transaction with NJA)	(10.50)
Increase in profits of VKS International Ltd.	0.66

Thus, if CUP method is taken as the most appropriate method, the ALP would be Rs.11.16 crores and the increase in profits of VKS International Ltd. would be Rs.66 lakhs.

Notes:

(1) The first proviso to section 92C (2) states that where more than one price is determined by the most appropriate method, the ALP shall be taken to be the arithmetical mean of such prices. Thus, the first proviso to section 92C (2) would be attracted only in a case where more than one ALP is determined by applying the most appropriate method. From the facts given in the question, only one ALP can be determined using the most appropriate method, i.e., CUP Method, as assumed in this case. Therefore, the question of computing arithmetical mean does not arise. The ALP of Rs.12.10 crores as per Cost Plus Method (CPM) for identical goods cannot be used for determining the arithmetical mean since it is the ALP worked out by a method, other than the CUP method.

(2) As per the Guidance Note on Report under section 92E of the Income-tax Act, 1961, issued by ICAI, CUP Method may be adopted as the most appropriate method in respect of, inter alia, a transaction involving transfer of goods. Further, the Guidance Note also mentions that CPM is normally used only where raw materials or semi-finished goods are sold or where joint facility agreements or long-term buy- and-supply arrangements, or provision of services is involved. Accordingly, the above solution has been worked out taking CUP Method to be the most appropriate method, since the transaction in this case involves transfer of goods. It is assumed that the goods mentioned in the question are finished goods.

Alternatively, since the exact nature of goods transferred is not given, the question may be solved by assuming CPM as the most appropriate method. Even in such a case, the question of determining arithmetical mean does not arise due to the reason mentioned in (1) above.

NOV-2015 QUESTION (6 MARKS)

XE Ltd. is an Indian Company in which Zilla Inc., a US company, has 28% shareholding and voting power. Following transactions were effected between these two companies during the financial year 2015-16.

(i) XE Ltd. sold 1,00,000 pieces of T-shirts at \$ 2 per T-Shirt to Zilla Inc. The identical T-Shirts were sold to unrelated party namely Kennedy Inc., at \$ 3 per T-Shirt.

(ii) XE Ltd. borrowed \$ 2,00,000 from a foreign lender based on the guarantee of Zilla Inc. For this, XE Ltd. paid \$ 10,000 as guarantee fee to Zilla Inc. To an unrelated party for the same amount of loan, Zilla Inc. collected \$ 7000 as guarantee fee.

(iii) XE Ltd. paid \$15,000 to Zilla Inc. for getting various potential customers details to improve its business. Zilla Inc. provided the same service to unrelated parties for \$ 10,000.

Assume the rate of exchange as 1 \$ = Rs.64

XE Ltd. is located in a Special Economic (SEZ) and its income before transfer pricing adjustments for the year ended 31st March, 2016 was Rs. 1,200 lakhs.

Compute the adjustments to be made to the total income of XE Ltd. State whether it can claim deduction under section 10AA for the income enhanced by applying transfer pricing provisions.

XE Ltd, the Indian company and Zilla Inc., the US company are deemed to be associated enterprises as per section 92A(2)(a), since Zilla Inc. holds shares carrying not less than 26% of the voting power in XE Ltd.

As per Explanation to section 92B, the transactions entered into between these two companies for sale of product, lending or guarantee and provision of services relating to market research is included within the meaning of "international transaction".

Accordingly, transfer pricing provisions would be attracted and the income arising from such international transactions have to be computed having regard to the arm's length price. In this case, from the information given, the arm's length price has to be determined taking the comparable uncontrolled price method to be the most appropriate method.

Particulars	Rs. In lakhs
Amount by which total income of XE Ltd. is enhanced on account of adjustment in the value of international transactions:	
(i) Difference in price of T-Shirt @ \$ 1 each for 1,00,000 pieces sold to Zilla Inc. (\$ 1 x 1,00,000 x 64)	64.00
(ii) Difference for excess payment of guarantee fee to Zilla Inc. for loan borrowed from foreign lender (\$ 3,000 x 64)	1.92
(iii) Difference for excess payment for services to Zilla Inc. (\$ 5,000 x 64)	3.20
	69.12
XE Ltd. cannot claim deduction under section 10AA in respect of Rs.69.12 lakhs, being the amount of income by which the total income is enhanced by virtue of the first proviso to section 92C (4)	

Fox Limited failed to furnish information and documents sought by the Transfer Pricing Officer (TPO). Can TPO levy penalty for such failure? How much would be the quantum of penalty imposable for the said failure? (4 Marks) (NOV-2015)

Under section 271G, if any person who has entered into an international transaction or specified domestic transaction fails to furnish any such information or document as required by section 92D (3) sought for by the Transfer Pricing Officer, then, such person shall be liable to a penalty which may be levied by the Assessing Officer or the Transfer Pricing Officer or the Commissioner (Appeals). Thus, with effect from 1st October, 2014, the Transfer Pricing Officer is a competent authority to levy penalty.

Section 271G confers aforesaid power to the Transfer Pricing Officer for levy of penalty. Penalty would be a sum equal to 2% of the value of international transaction or specified domestic transaction for each such failure.

Example on CUP Method

Typical transactions in respect of which the comparable uncontrolled price method may be adopted are:

(a) Transfer of goods; (b) Provision of services; (c) Intangibles; (d) Interest on loans.

“The CUP method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances. If there is any difference between the two prices, this may indicate that the conditions of the commercial and financial relations of the associated enterprises are not arm's length, and that the price in the uncontrolled transaction may need to be substituted for the price in the controlled transaction.”

Steps involved in the application of this method are:

- (i) Identify the price charged or paid in comparable uncontrolled transactions;
- (ii) The above price should be adjusted for transaction level the differences on the basis of functions performed, assets used and risks taken (FAR) analysis and enterprise level differences if any;
- (iii) The adjusted price is the arm's length price;

AE1 Ltd., is an Indian company. The shareholding pattern of AE1 Ltd., is as follows:

Shareholder's name	Status	% holding
AE2 Ltd.	Foreign Company	30
AE3 Ltd.	Indian Company	30
Financial Institutions	Indian Company	10
Public		30

AE1 Ltd., is a manufacturer of compact disc (CD) writers and its customers, inter alia, include AE2 Ltd, and M Ltd.

AE1 Ltd., during the year has supplied 10,000 nos. of the product to AE2 Ltd. at a price of Rs.2,000 per unit and 200 nos. of the same product to AE3 Ltd., at a price of Rs.2,750 per unit. AE1 Ltd., has sold 100 units of the same product to M Ltd. at Rs. 3000 Per.Unit

Analysis of the international transaction with comparable uncontrolled transaction 3,000 per unit.

	International transaction (with AE2 Ltd.)	Comparable uncontrolled transaction (with M Ltd.)	
Price	FOB	CIF	Freight and insurance Rs.550
Quantity	YES	NO	One CD of Rs.10 each for every CD

discount			writer plus Rs.20 per CD writer
Credit	1M	Cash and carry	Cost of credit 1.25% per month
Warranty	No	6M	Cost of warranty is Rs.250 per unit

Factors to be considered while determining ALP:

- (a) In the CUP method, one has to start from the price charged in the case of the comparable uncontrolled transaction.
- (b) In this illustration one has to start with the price charged by AE1 Ltd., to M Ltd.
- (c) The price charged to AE3 Ltd., cannot be considered as AE3 Ltd., is itself an associated enterprise of AE1 Ltd.
- (d) The price charged to M Ltd., will have to be increased by the value of credit which is at the rate at 1.25% p.m. (i.e. 15% p.a.). If the similar credit were offered to M Ltd., the price charged to M Ltd. would have been higher, after factoring this cost.
- (e) The price charged to M Ltd., will have to be reduced by the following;
 - (i) Rs.550 representing the freight and insurance –This is for the reason that if the price to M Ltd., had been on FOB basis, it would have been less by Rs.550.
 - (ii) Rs.250 per unit representing the estimated cost of warranty execution for a period of six months on the basis of a technical analysis and past experience - This is for the reason that if the warranty was not given, the price to M Ltd. would have been lower, without factoring this cost.
 - (iii) Rs.10 representing the cost of each CD – This is for the reason that if similar gift had been offered to M Ltd., the effective price to M Ltd., would have been less.
 - (iv) Rs.20 representing a quantity discount - This is for the reason that if similar discount had been offered to M Ltd., the effective price to M Ltd., would have been less.

Example on RPM

“An appropriate resale price margin is easiest to determine where the reseller does not add substantially to the value of the product. In contrast, it may be more difficult to use the resale price method to arrive at an arm’s length price where, before resale, the goods are further processed or incorporated into a more complicated product so that their identity is lost or transformed (e.g. where components are joined together in finished or semi-finished goods). Another example where the resale price margin requires particular care is where the reseller contributes substantially to the creation or maintenance of intangible property associated with the product (e.g. trademarks or trade names) which are owned by an associated enterprise. In such cases, the contribution of the goods originally transferred to the value of the final product cannot be easily evaluated.

Steps involved in the application of this method are:

- (i) identify the international transaction of purchase of property or services;
- (ii) identify the price at which such property or services are resold or provided to an unrelated party (resale price);

- (iii) identify the normal gross profit margin in a comparable uncontrolled transaction whether internal or external. The normal gross profit margin is that margin which an enterprise would earn from purchase of the similar product from an unrelated party and the resale of the same to another unrelated party.
- (iv) deduct the normal gross profit from the resale price.
- (v) deduct expenses incurred in connection with the purchase of goods;
- (vi) adjust the resultant amount for the differences between the uncontrolled transaction and the international transaction. These differences could be functional and other differences including differences in accounting practices. Further these differences should be such as would materially affect the amount of gross profit margin in the open market;
- (vii) the price arrived at is the arm's length price of the international transaction;

AE1 Ltd., is an Indian company. The shareholding pattern of AE1 Ltd., is as follows;

Shareholder's name	Status	% holding
AE2 Ltd.	Foreign Company	30
AE3 Ltd.	Indian Company	30
Financial Institutions	Indian Company	10
Public		30

AE1 Ltd., trades in compact disc (CD) writers. AE1 Ltd., procures CD writers both locally and in the international market. Its imports consist of CD writers purchased from AE2 Ltd. as well as other manufacturers (Non AEs).

AE1 Ltd., during the year purchased 100 CD writers from AE2 Ltd. at Rs.2,900 per unit. These are resold to A Ltd., at a price of Rs.3,000 per unit.

AE1 Ltd., has also purchased similar products from an unrelated supplier, viz. K Ltd., and has resold the same to M Ltd., who is also an unrelated party and has earned a gross profit of 15% on sales.

Analysis of the sales transactions

	Sales to A Ltd.	Sales to M Ltd.	
Price	Ex-shop	FOR Destination with cost of freight and insurance estimated at 2% of GP	Impact of Freight and insurance on GP is 2% as the sale price increases but corresponding expenses are not debited to trading account but to profit and loss account
Quantity discount	Yes - the cost of the same is estimated at 1% of GP	NO	Impact of quantity discount on GP is 1%
Free Gifts	No	One CD pack for every CD writer with no change in sale price	As cost of gift is not debited to trading account but to P & L Account, there is no impact on GP
Warranty	No	6 months warranty (without change in sale price) - cost of warranty is estimated at Rs.250 per unit	As cost of warranty is not debited to trading account but to P&L Account, there is no impact on GP

Analysis of the purchase transactions

	Purchase from AE2 Ltd. (International)	Purchase from K Ltd.	
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	transaction)		
Customs duty	Rs.25 per unit	Rs.25 per unit	No impact
Freight inwards	Rs.10 per unit	Nil	Cost of purchase from K Ltd., is lower
Quantity discount	Rs.15 per unit	Nil	Cost of purchase from K Ltd., is higher
Warranty	Nil	6 months warranty purchase price remaining unchanged	No impact

Factors to be considered while determining ALP:

(a) In the above example, the international transaction is the purchase transaction entered into by AE1 Ltd., with AE2 Ltd. which should be determined on the basis of arm's length price;



(b) The comparable uncontrolled transaction is the purchase transaction entered into by AE1 Ltd., with K Ltd.



(c) The starting point for arriving at the ALP of such purchase transaction is the resale price charged to A Ltd. viz. Rs.3,000 [Rule 10B(1)(b)(i)].

(d) From the said resale price, the normal gross profit margin which AE1 Ltd., would earn in a comparable uncontrolled transaction should be reduced. In this example, the actual gross profit margin earned by AE1 Ltd., in respect of its purchase from K Ltd, and its resale to M Ltd, is 15%.

(e) The following adjustments are made to arrive at the normal GP;

Actual gross profit margin with M Ltd.	15%
Less	
1. Difference between Ex-shop and FOR prices	(2%)
2. Difference due to quantity discount	(1%)
Normal gross profit margin with M Ltd.	12%

Note: While arriving at normal gross profits from the actual gross profits, only the differences in the sale transactions of AE1 Ltd., with A Ltd., and M Ltd., have been taken. The differences in the purchase transactions of AE1 Ltd., with AE2 Ltd. and K Ltd., affecting the gross profits are taken separately as provided in sub rule (iv).

(f) The resale price of Rs.3000. to M Ltd., is reduced by the normal gross profit margin of 12%. The resultant cost of sales is Rs.2640 (i.e. 3000- 360) [Rule 10B(1)(b)(ii)].

(g) The cost of sales so arrived at is reduced by the expenses incurred in connection with the purchase (international transaction) i.e. freight of Rs.10 and customs duty of Rs.25. The resultant amount is Rs.2605 (i.e. 2640-25-10) [Rule 10B(1)(b)(iii)].

(h) The above amount is further adjusted to take into account functional and accounting differences between the international transaction and the comparable uncontrolled transaction with AE2 Ltd the purchase transaction with K Ltd., which will affect the amount of gross profit margin as explained below.

(i) The aforesaid amount of Rs.2605 should be increased by Rs.10 being the freight incurred by AE1 Ltd., in the case of purchase from AE2 Ltd., but not incurred in case of purchase from K Ltd., This is for the reason that if a similar freight had been paid in respect of transaction with K Ltd, the gross profit margin from K Ltd., would have been lower and the resultant price would have been higher.

(j) A decrease by Rs.15 representing the quantity discount allowed by AE2 Ltd., is to be made. This is for the reason that if a similar discount had been allowed in respect of transaction with K Ltd, the gross profit margin from K Ltd., would have been higher and the resultant price would have been lower.

Determination of arm's length price under resale price method

1. Associated enterprises : AE1 Ltd. and AE2 Ltd.
2. Other enterprises : K Ltd. and M Ltd.
3. International transaction : AE1 Ltd. and AE2 Ltd.
4. Bought from AE2 Ltd. and resold to : A Ltd.
5. CUT is purchase from K Ltd. and sales to M Ltd.

Details	Rs. /unit
Price paid to AE2 Ltd.(FOB)	2,900
Quantity	100
Purchases cost (actual) (A)	2,90,000
Actual GP Margin on sales to M Ltd.(%)	15
Normal GP Margin on sales to M Ltd.(%)	12
Price charged to A Ltd.	3,000
Less: Normal GP margin	360
Balance	2,640
Less: Expenses connected with purchase (freight & customs duty paid)	35
Price before adjustment	2,605
Add:	
Freight incurred in case of purchase from AE2 Ltd.	10
Sub total	10
Less:	
Quantity discount allowed by AE2 Ltd.	15
Sub total	15
Arm's length price	2,600
Adjusted purchase cost (B)	2,60,000
Income increases by (A-B)	30,000

The following points are to be noticed:

- (i) The resale price method is to be adopted only when goods purchased from an associated enterprise are resold to unrelated parties.
- (ii) As provided in Rule 10B(1)(b)(iii), the expenses incurred in connection with the purchase from AE are to be reduced from cost of sales . In resale price method, the arm's length purchase price is arrived at reducing the normal gross profit margin from the resale price as the first step. If the computation is stopped at this step itself, the derived purchase amount would be inclusive of the such expenses. It is therefore necessary to reduce such expenses in arriving at the arm's length purchase price.

(iii) Adjustments have to be made also for accounting practices apart from functional and other differences. Differences in accounting practices may be because:

- (a) sales and purchases have been accounted for inclusive of taxes or exclusive of taxes;
- (b) method of pricing the goods namely, FOB or CIF;
- (c) fluctuations in foreign exchange.

(iv) In actual practice, the resale in any financial year may be also out of opening stock. Similarly, the goods purchased during the said year may remain in closing stock. Under the resale price method, the arm's length price of purchases from AE during the financial year should be determined. The process of determination under Rule 10B(1)(b) culminates in the cost of sales rather than value of purchase during the year. This 'cost of sales' should be converted into 'value of purchase'. For this purpose, the closing stock of goods purchased from AE should be added and the opening stock of purchases from AE should be deducted.

Example on Cost Plus Method (CPM)

Typical transactions where the cost plus method may be adopted are:

- (a) provision of Services
- (b) joint facility arrangements
- (c) transfer of semi-finished goods;
- (d) long term buying and selling arrangements.

Steps involved in the application of this method are:

- (i) Determine the direct and indirect cost of production in respect of property transferred or service provided to an associated enterprise.
- (ii) Identify one or more comparable uncontrolled transactions for same or similar property or service.
- (iii) Determine normal gross profit mark-up on costs in the comparable uncontrolled transaction. Such costs should be computed according to the same accounting norms. In other words, the components of costs of comparable uncontrolled transaction should be the same as those of international transaction.
- (iv) Adjust the gross profit mark-up to account for functional and other differences between the international transaction and the comparable uncontrolled transaction. Such adjustments should also be made for enterprise level differences.
- (v) The direct and indirect cost of production in the international transaction is increased by such adjusted gross profit mark-up.
- (vi) The resultant figure is the arm's length price.

AE1 Ltd., is an Indian company. The shareholding pattern of AE1 Ltd., is as follows:

Shareholder's name	Status	% holding
AE2 Ltd.	Foreign Company	30
AE3 Ltd.	Indian Company	30
Financial Institutions	Indian Company	10
Public		30

AE1 Ltd., develops software for various customers, who include AE2 Ltd. and M Ltd.

AE1 Ltd., during the year billed AE2 Ltd. Rs.2,00,000. The total cost (direct and indirect) for executing this work was Rs.1,75,000.

AE1 Ltd., provided similar services to M Ltd., and earned a gross profit (GP) of 50% on costs.

Analysis of transactions

	Transactions with AE2 LTD	Transactions with M LTD
Technology support	Yes	No - value of technology support incurred by AE1 Ltd., is Rs.17,500
Discount	Yes – Discount offered is Rs.8,750	No
Business risks and marketing	Yes – Value of the same is estimated at Rs.13,125	No
Credit	Yes – Cost of credit is estimated at Rs.2,625	No

Factors to be considered while determining ALP:

(a) In the CPM, one has to start with the gross profit mark-up which the enterprise earned in a comparable uncontrolled transaction. In this example, the comparable uncontrolled transaction is between AE1 Ltd., and M Ltd.

(b) Such gross profit (GP) mark-up needs to be decreased by the following:

1. As AE1 Ltd., did not receive the technology support from M Ltd., it has priced its services higher resulting in its earning a higher GP with M Ltd.. The value of technology support of Rs.17,500 received from AE2 Ltd. is 10% of cost. Therefore, the GP with M Ltd., has to be reduced by 10%.

2. AE1 Ltd. did not provide discount to M Ltd., as volume of business from M Ltd., was not as high as that from AE2 Ltd. Had AE1 Ltd., offered similar discount to M Ltd., the GP with M Ltd., would have been lower. The discount of Rs.8,750 offered to AE2 Ltd. is 5% of cost. Therefore, the GP with M Ltd., has to be decreased by 5%.

3. AE1 Ltd., has incurred Rs.15,000 towards marketing functions in respect of its transactions with M Ltd., which is 7.5% of its cost. However, in its transactions with AE2 Ltd. the said functions are assumed by AE2 Ltd. Had AE1 Ltd., not incurred similar expenses with M Ltd., it would have settled for a lower GP. Therefore, the GP with M Ltd., has to be reduced by 7.5%.

4. The cost of credit of Rs.2,625 provided by AE1 Ltd., to AE2 Ltd. is 1.5% of its cost. However, in its transactions with M Ltd., such credit is not provided. Had AE1 Ltd., provided similar credit to M Ltd., it would have increased its price resulting in a higher GP. Therefore, the GP with M Ltd., has to be increased by 1.5%.

(c) The resultant gross profit mark-up is the arm's length gross profit mark up.

(d) The costs of AE1 Ltd., in its transactions with AE2 Ltd. should be increased by the arm's length gross profit mark up to arrive at the arm's length income.

Determination of arm's length price under costs plus method

1. Associated enterprise : AE1 Ltd. and AE2.
2. Other enterprise : AE1 Ltd. and M Ltd
3. International transaction : AE1 Ltd and AE2 Ltd
4. Comparable uncontrolled transaction : AE1 Ltd. and M Ltd

Determination of arm's length gross profit mark up

Details	
Gross profit mark up in case of M Ltd.	50.00%
Less:	
1. Technology support from AE2 Ltd.	10.00%
2. Quantity discount to AE2 Ltd not to M Ltd.	5.00%
3. Marketing functions performed by AE1 Ltd., in respect of M Ltd.	7.50%
Sub total	22.50%
Add:	
1. Cost of credit to AE2. Ltd.	1.50%
Sub total	1.50%
Arm's length gross profit mark-up (50-21)	29.00%

Determination of arm's length price

Details	
Direct and indirect costs incurred by AE1 Ltd. in respect of transactions with AE2 Ltd.	1,75,000
Arm's length gross profit mark up	29.00%
Arm's length income (A)	2,25,750
Actual price charged to AE2 Ltd. (B)	2,00,000
Income increases by (A-B)	25,750

The following points are to be noticed:

(i) In this method, the direct and indirect costs of production are to be determined. The terms 'direct' or 'indirect' costs are however not defined. A reference may therefore be made to the industry practice as well as the pronouncements of the ICAI

(ii) In determining the direct and indirect cost, the following factors have to be borne in mind:

(a) if the plant has been underutilised the costs may have to be suitably adjusted;

(b) absorption costing method is normally to be preferred.

(iii) This method is to be adopted only in cases of supply of property or services to an associated enterprise. This method is not to be applied when the enterprise is in receipt of property or services from an associated enterprise.

Example on Profit Split Method (PSM)

Typical transactions where the profit-split method may be used are transactions involving:

(a) integrated services provided by more than one enterprise for e.g., in case of financial service sector, where the activities performed by Indian company and foreign AEs in relation of a merger and acquisition transaction are so interrelated that it may not possible to segregate them;

(b) transfer of unique intangibles, for e.g. two associated enterprises contribute their respective intangibles to develop a new product or process and earn income from such product or process.

There are **two approaches** to this method, namely, total profits split and residual profit split.

Total profits split: The steps involved are as follows:

(i) Determine the combined net profit of the associated enterprises arising from the international transactions in which they are engaged. Such profits represent the profits earned from third parties due to the combined efforts of the associated enterprises. It may be noted that the 'combined net profit' referred

to in the rule is not the aggregate of entire profits earned by the associated enterprises. Example: AE1 may earn profits from certain transactions wherein there is no contribution by AE2 and vice versa. Such profits do not enter into the determination of combined net profit. Only those profits that are earned as a result of joint efforts of AE1 and AE2 should be taken as combined net profit.

(ii) Evaluate relative contribution made by each entity involved in the transaction on the basis of:

(a) functions performed; (b) assets employed; (c) risks assumed; (d) the reliable external market data indicating how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances. It may be noted that reference to 'external market data' indicates comparable uncontrolled transactions. The use of word 'external' does not preclude use of internal CUT. In the process of choosing CUTs, the function performed, assets used and risks taken (FAR) of the uncontrolled transactions would have been compared with the FAR of the international transactions. When the FAR of the international transaction and CUT are similar, the relative contribution adopted in the CUT should be applied to the international transaction. Any significant differences between the two should be suitably adjusted.

(iii) Thereafter, split the combined net profit in proportion to the relative contribution determined as above.

(iv) The profit so apportioned is taken to arrive at the arm's length price in relation to the international transaction. The profits so apportioned to the AE when added to the costs incurred by it in relation to international transaction would result in arm's length price.

Residual profit split approach

In this approach, firstly, a basic return is determined for each of the enterprises and profits of each such enterprise is ascertained. This amount is reduced from the combined net profits. Residual profits are allocated on the basis of relative contribution.

Steps involved in this approach are as follows:

(i) determine the combined net profit of the associated enterprises arising from the international transactions in which they are engaged.

(ii) At the first stage, depending on functions performed, assets employed and risks assumed, determine the basic return appropriate to the respective activities. Allocate the combined net profit on the basis of above. This step results in a partial allocation of the combined net profit to each enterprise. For this purpose, the allocation is undertaken with reference to margins of comparable uncontrolled entities.

(iii) the balance of the combined net profit is allocated on the basis of the evaluation of the relative contribution

(iv) the total net profit from such two-tier allocation is taken to arrive at the arm's length price. The profits so apportioned to the AE when added to the costs incurred by it in relation to international transaction would result in arm's length price.

AE1 Ltd., is an Indian company. The shareholding pattern of AE1 Ltd., is as follows;

Shareholder's name	Status	% holding
AE2 Ltd.	Foreign Company	30

AE3 Ltd.	Indian Company	30
Financial Institutions	Indian Company	10
Public		30

AE1 Ltd., is an investment advisory company, which in association with AE2 Ltd. assists its clients with foreign acquisitions.

AE3 Ltd., which is based in U.S.A., has worldwide presence. AE1 Ltd. is approached by M for identifying potential target companies for acquisitions in the USA. In order to serve M, AE1 Ltd. and AE3 Ltd., have each contributed integrally to identification of potential target and assisting M with the acquisition process. For the above, AE1 Ltd., received consideration of US\$ 50,000. The financials are as follows;

	AE1 Ltd.	AE3 Ltd.
Revenue	30000	20000
Cost	20000	8000
Profit	10000	12000

Factors to be considered:

(a) The normal basic return is ordinarily calculated as a percentage of the costs incurred or gross revenues or capital employed. In this example, it is assumed as a percentage of the cost.

(b) Based on the FAR analysis, the basic return for AE1 Ltd., and AE3 Ltd., are determined to be 15% and 10% respectively. Accordingly, the normal basic return for AE1 Ltd. in India for the aforesaid operation is US\$ 3000. The similar returns for AE3 Ltd., US\$ 800. The total basic return, thus, is US \$ 3,800.

(c) On the basis of functions performed, risks assumed and assets employed, the relative contribution may be taken at 70%, 30% for AE1 Ltd. and AE3 Ltd., respectively.

Determination of arm's length price under profit split method:

First Approach: Total Profit Split Method

1. Associated enterprises : AE1 Ltd. and AE3 Ltd.
2. Ultimate delivery of product is : By AE3 Ltd. to M Ltd.
3. International transaction : AE1 Ltd. and AE3 Ltd.

Details	US\$
Price charged by AE3 Ltd from M Ltd	50,000
AE3 Ltd share of revenue	20,000
AE1 Ltd share of revenue	30,000
Combined total profits	22,000
Evaluation of relative contribution	
AE1 Ltd : India return – 70%	15,400
AE3 Ltd : US return – 30%	6,600
Total	22,000
Total return for AE1 Ltd	15,400
Total cost of AE1 Ltd	20,000
Income of AE1 Ltd on arm's length price (A)	35,400
Actual revenue (B)	30,000
Increased income (A-B)	5,400

Note: In this example, the basic return is not required to be taken into account.

Second Approach: Residual profit split method

Details	US\$
Price charged by AE3 Ltd from M Ltd	50,000
AE3 Ltd share of revenue	20,000
AE1 Ltd share of revenue	30,000
Combined total profits	22,000
1. Basic return	
AE1 Ltd: India return	3,000
AE3 Ltd: US return	800
Total	3,800
2. Residual net profit	18,200
AE1 Ltd: India return – 70%	12,740
AE3 Ltd: US return – 30%	5,460
Total	18,200
Total return for AE1 Ltd (12740 + 3000)	15,740
Total cost of AE1 Ltd.	20,000
Income of AE1 Ltd. on arm's length price (A)	35,740
Actual revenue (B)	30,000
Increased income (A-B)	5,740

The following points are to be noticed:

- (a) It is the profit from a transaction with the associated enterprise that needs to be ascertained. If there are other transactions, which contribute to the profits, then the profits from transactions with associated enterprise may have to be arrived at on some approximation.
- (b) The rule itself provides an alternative method to arrive at the arm's length price being the two-tier profit split-method;
- (c) If in either of the alternatives, a range of figures is available, the arithmetical mean of such figures may be adopted as the arm's length price. It may however not be possible to adopt the arithmetical mean of the two alternatives.
- (d) Under the two-tier split-method, the basic rate of return may have to be adopted having regard to the profits compared to the net worth of the enterprise. Such rate of return may not be uniform for all the associated enterprises involved in the transaction.
- (e) This is the only method for which the Rule itself has prescribed the types of transaction to which it may be applicable.
- (f) Even though the computation proceeds with the profits from a transaction, the purpose is only to arrive at the arm's length price of a transaction. It is only by substituting the arm's length price for the price in the international transaction that an adjustment may be made to the income returned.

Example on TNMM

Typical transactions where the transactional net margin method may be adopted are:

- (a) provision for services
- (b) distribution of finished products where resale price method cannot be applied;
- (c) transfer of semi-finished goods where cost plus method cannot be applied;
- (d) transactions involving intangibles where profit split method cannot be applied.

steps involved in the application of this method are:

(i) Identify the net profit margin realised by the enterprise from an international transaction. Where the assessee also has transactions, segments or businesses where the international transactions with associated enterprises are not relevant, then the net profit margin to be considered for the purposes of this TNMM method should be such net profit margin as is derived only from the transactions, segments or businesses related to the international transaction. The net profit margin may be computed in relation to costs incurred or sales effected or assets employed or any other relevant base.

For example,

1. In case where the assessee acts as a distributor and the transaction pertains to import, the revenue may be used as base.

2. In case the transaction involves export of services/goods, costs may be taken as base.

(ii) Identify the net profit margin from a comparable uncontrolled transaction or a number of such transactions having regard to the same base; In practice, net profit margin is ascertained at segment level where segment data are available. The unallocated expenses are allocated on a reasonable basis and the segmental net profit is determined. Where segment data are not available, net profit is normally determined at enterprise level. Where internal CUT is available transaction level net profit may be determined.

(iii) In case internal CUT is not available, external CUT is taken. In such case, as discussed above, net profit margin should be taken at enterprise level (segmental or enterprise as a whole) of comparable companies. A search should be carried out to identify comparable companies on the basis of information and data available with the assessee. Where such information and data are not available, search may be carried out with reference to database in public domain.

(iv) The net profit margin so identified is adjusted to take into account the transaction level and enterprise level differences if any. The differences should be those that could materially affect the net profit margin in the open market;

(v) The adjusted net profit margin is taken into account to arrive at the arm's length price in relation to the international transaction.

Explanation-7 to Sub-section (1) of Section 271 (Concealment of Income)

Explanation 7.—Where in the case of an assessee who has entered into an international transaction or specified domestic transaction defined in section 92B, any amount is added or disallowed in computing the total income under sub-section (4) of section 92C, then, the amount so added or disallowed shall, for the purposes of clause (c) of this sub-section, be deemed to represent the income in respect of which particulars have been concealed or inaccurate particulars have been furnished, unless the assessee proves to the satisfaction of the Assessing Officer or the Commissioner (Appeals) or the Principal Commissioner or Commissioner that the price charged or paid in such transaction was computed in accordance with the provisions contained in section 92C and in the manner prescribed under that section, in good faith and with due diligence.

Penalty for failure to keep and maintain information and document, etc., in respect of certain transactions.

271AA. Without prejudice to the provisions of section 271 or section 271BA, if any person in respect of an international transaction or specified domestic transaction,—

- (i) fails to keep and maintain any such information and document as required by sub-section (1) or sub-section (2) of section 92D;
- (ii) fails to report such transaction which he is required to do so; or
- (iii) maintains or furnishes an incorrect information or document,

the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to **2%** of the value of each international transaction or specified domestic transaction entered into by such person.

Penalty for failure to furnish report under section 92E.

271BA. If any person fails to furnish a report from an accountant as required by section 92E, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of Rs.1 Lakh.

Penalty for failure to furnish information or document under section 92D.

271G. If any person who has entered into an international transaction or specified domestic transaction fails to furnish any such information or document as required by sub-section (3) of section 92D, the Assessing Officer or the Transfer Pricing Officer as referred to in section 92CA or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to 2% of the value of the international transaction or specified domestic transaction for each such failure.

ICMAI PTP-1 (DEC-15)

X Ltd, operating in India, is the dealer for the goods manufactured by ZOR Ltd of Japan. ZOR Ltd owns 55% of Shares of X Ltd, and out of 7 Directors of the Company, 4 were appointed by them. The Assessing Officer after verification of transactions of Rs.350 Lakhs of X Ltd for the relevant year and by noticing that the Company had failed to maintain the requisite records and had also not obtained the Accountants' Report, adjusted its Income by making an addition of Rs.35,00,000 to the declared income and also issued a Show Case Notice to levy various penalties. X Ltd seek your expert opinion.

1.Principle:-

- (a) Associated Enterprises: Write Section 92A(2)(a) & 92A(2)(e)
- (b) Assessing Officer's Powers u/s 92C(3) – Reproduce here i.e.(a) to (d) full of that sec.92C(3).
- (c) Penalty Provisions relating to non-compliance are also applicable.

2. Analysis and Conclusion:

(a) In the given question, since ZOR Ltd holds 55% of the Shares of X Ltd, both are Associated Enterprises.

(b) As the value of aggregate transactions of X Ltd with ZOR Ltd exceeds Rs.1 Crore, X Ltd should maintain the prescribed documents and records. Since X Ltd has not maintained the required documents, A.O. is empowered to determine the ALP based on the materials available to him and levy penalty, after giving opportunity of being heard to X Ltd. (Rule-10D(2)).

(Note: Assumed that Rs.350 Lakhs of transactions of X Ltd are carried out with ZOR Ltd)

(c) If the Accountants' Report is not obtained, then the A.O. can levy penalty of Rs.1 Lakh u/s 271BA.

ICMAI DEC-2015 SET-2

Boulevard Inc. a French Company, holds 40% of Equity in the Indian Company Vista Technologies Ltd (VTL). VTL is engaged in development of software and maintenance of the same for customers across the globe. Its clientele includes Boulevard Inc.

During the year, VTL had spent 2,000 Man Hours for developing and maintaining software for Boulevard Inc, with each hour being billed at Rs.1,250. Costs incurred by VTL for executing work for Boulevard Inc. amount to Rs.18,00,000.

VTL had also undertaken developing software for Bal Industries Ltd for which VTL had billed at Rs.2,700 per Man Hour. The persons working for Bal Industries Ltd and Boulevard were part of the same team and were of matching credentials and caliber. VTL had made a Gross Profit of 50% on the Bal Industries work.

VTL's transactions with Boulevard Inc. is comparable to transactions with Bal Industries, subject to following differences –

(i) Boulevard gives technical knowhow support to VTL which can be valued at 8% of the Normal Gross Profit. Bal Industries does not provide any such support.

(ii) Since the work for Boulevard involved huge number of man hours, a quantity discount of 14% of Normal Gross Profits was given.

(iii) VTL had offered 90 Days credit to Boulevard the cost of which is measured at 2% of the Normal Billing Rate. No such discount was offered to Bal Industries Ltd.

Compute ALP and the amount of increase in Total Income of Vista Technologies Ltd.

Solution: -

1. Computation of Arm's Length Gross Profit Mark Up

Particulars	%	%
Normal GP Mark Up		50
Less: Adjustment for Differences [14% of 50%]		
(i) Technical Support from Boulevard 8% of Normal GP [8% of 50%]	4	
(ii) Quantity Discount 14% of Normal GP	7	(11)
		39
Add: Cost of Credit to Boulevard 2% of Normal Bill [2% x 50%]	1	1
Arm's Length Gross Profit Mark-up		40

2. Computation of Increase in Total Income of VTL

Particulars	Rs.
Cost of Services Provided to VTL	18,00,000
Arm's Length Billed Value (Cost ÷ 100-Arm's Length Mark-up) = Rs.18 lakhs ÷ 100%-40%	30,00,000
Less: Actual Billing to Boulevard [2,000 Hours × Rs.1,250]	(25,00,000)

Therefore, increase in Total Income of VTL

5,00,000

Kio Japan and AB Ltd, an Indian Company are Associated Enterprises. AB Ltd manufactures Cellular Phones and sells them to Kio Japan and Geel, a Company based at Beijing. During the year AB Ltd supplied 2,50,000 Cellular Phones to Kio Japan at a price of Rs.3,000 per unit and 35,000 units to Geel at a price of Rs.4,800 per unit. The transactions of AB Ltd with Kio and Geel are comparable subject to the following considerations –

(i) Sales to Kio is on FOB basis, sales to Geel are CIF basis. Freight and Insurance paid by Kio for each unit is Rs.700.

(ii) Sales to Geel are under a free warranty for Two Years whereas sales to Kio are without any such warranty. The estimated cost of executing such warranty is Rs.500.

(iii) Since Kio's order was huge in volume, quantity discount of Rs.200 per unit was offered to it.

Compute Arm's Length Price and amount of increase in Total Income of AB Ltd, if any, due to such Arm's Length Price.

Solution: -

1. Computation of Arm's Length Price of Products sold to Kio Japan by AB Ltd

Particulars	Rs.	Rs.
Price per Unit in a Comparable Uncontrolled Transaction		4,800
Less: Adjustment for Differences -		
(a) Freight and Insurance Charges	700	
(b) Estimated Warranty Costs	500	
(c) Discount for Voluminous Purchase	200	(1,400)
Arm's Length Price for Cellular Phone sold to Kio Japan		3,400

2. Computation of Increase in Total Income of AB Ltd

Particulars	Rs.
Arm's Length Price per Unit	3,400
Less: Price at which actually sold to Kio Japan	(3,000)
Increase in Price per Unit	400
No. of Units sold to Kio Japan	2,50,000
Therefore, increase in Total Income of AB Ltd (2,50,000 × Rs.400)	10 Crores

ICMAI DEC-2015 SET-3

"Mingle Engineering Ltd", a Korean Non Resident Company, had entered into an agreement for designing, fabricating, hook-up and commissioning of a platform in Bombay High with "Crude Oil India Ltd" an Indian Company. The agreement entered into was in two parts, one for the value to be charged for fabrication of structure in Korea for Rs.20 Crores (having element of Profit in it of Rs.2 Crores) and other for the Installation and Commissioning of the structure in Bombay High for Rs.15 Crores (having element of Profit in it of Rs.1.5 Crores). The Korean Company will also be setting up an Office in India for the activity of installation and commissioning of the platform which is likely to be completed in 9 months.

On these facts, you are required to answer –

- (i) Whether the office of Mingle Engineering Ltd. to be opened in India be considered as its "Permanent Establishment" / "Business Connection"?
- (ii) The amount of profits, if any, of the Non-Resident Company subject to tax in India.
- (iii) The Income subject to Tax in India, when the ALP of the fabrications of structure is determined at Rs.19 Crores.

Solution: -

1. Permanent Establishment: The Korean Company for the purpose of commissioning of the platform in Bombay High Seas shall be having an office in India for a period of around 9 months. Maintaining of an Office by the Non-Resident in India for the conduct of its business shall be treated as a 'Permanent Establishment'

2. Principles of Taxation: In a contract for fabrication, designing, hook-up and commissioning of platform in Bombay High, fabrication work was completed in Korea. PE was established in India after fabrication but before installation. Hence, profits relating to fabrication in Korea are not taxable in India, but income relating to installation is taxable.

3. Conclusion:

(a) variation = $\text{Computed ALP} - \text{Actual Price} \div \text{Actual Price} = 19-20 \div 20 = 5\%$ (absolute % is taken, being Cost %)

(b) Since, the above variation exceeds the permissible 3% limit, the difference of Rs.1 Crore being excessive payment / cost is disallowed.

(c) So, Profits attributable to the PE are only Rs.1.5 Crores relating to activity of commissioning, hook up and installation of the platform in Bombay High, which is being conducted / supervised from the Office in India.

(d) The profits of Rs.2 Crores relating to the fabrication work of the platform is not taxable in India, because the completed structure is to be supplied from Korea. Such profits are not attributed to the PE, because the work of fabrication was completed in Korea prior to coming into existence of the PE connection in India. However, Income there from is subject to ALP.

ICMAI MTP DEC-15 SET-1

FLT LLP of France and Squar Ltd of India are associated enterprises. Squar Ltd. imports 5,000 compressors for Air Conditioners from FLT at Rs.7,800 per unit and these are sold to Bihar Cooling Solutions Ltd at a price of Rs.11,000 per unit. Squar Ltd. had also imported similar products from Cold Ltd and sold outside at a Gross Profit of 20% on Sales.

FLT offered a quantity discount of Rs.1,500 per unit. Cold Ltd. could offer only Rs.500 per unit as Quantity Discount. The freight and customs duty paid for imports from Poland had cost to Squar Ltd. Rs.1,200 a piece. In respect of purchase from Cold Ltd, Squar had to pay Rs.200 only as freight charges. Determine the Arm's Length Price and the amount of increase in Total Income of Squar Ltd.

Solution:

A. Computation of Arm's Length Price of Products bought from FLT, France by Squar Ltd.

Particulars	Rs.	Rs.
Resale Price of Goods Purchased from FLT		11,000
Less: Adjustment for differences		
(a) Normal gross Profit margin @ 20% of sale price [20% × Rs.11,000]		2,200
(b) Incremental Quantity Discount by FLT [Rs.1,500 – Rs.500]		1,000
(c) Difference in Purchase related Expenses [Rs.1,200 – Rs.200]		1,000
Arm's Length Price		6,800

B. Computation of Increase in Total Income of Squar Ltd

Particulars	Rs.	Rs.
Price at which actually bought from FLT LLP of France		7,800
Less : Arm's Length Price per unit under Resale Price Method		(6,800)
Decrease in Purchase Price per Unit		1,000
No. of Units purchased from FLT		1,000
Increase in Total Income of Squar Ltd [5,000 Units × Rs.1,000]		Rs.50,00,000

Himalaya Ltd is an Indian Company engaged in the business of developing and manufacturing Industrial components. Its Canadian Subsidiary Su-power Inc. supplies technical information and offers technical support to Himalaya for manufacturing goods, for a consideration of Euro 2,00,000 per year. Income of Himalaya Ltd is Rs.180 Lakhs. Determine the Taxable Income of Himalaya Ltd if Su- power charges Euro 2,60,000 per year to other entities in India. What will be the answer if Su- power charges Euro 1,20,000 per year to other entitles. (Rate per Euro may be taken at Rs.60).

Solution:

Computation of Total Income of Himalaya Ltd.

Particulars	Rs.	Rs.
When Price Charged for Comparable Uncontrolled Transaction	2,00,000	1,20,000
Price actually paid by Himalaya Ltd [€ 2,00,000 x 60]	1,20,00,000	1,20,00,000
Less: Price charged in Rupees (under ALP) [€ 2,60,000 x 60] [€ 1,20,000 x 60]	1,56,00,000	72,00,000
Incremental Profit on adopting ALP [A]	(36,00,000)	48,00,000
Total Income before adjusting for differences due to Arm's Length Price	1,80,00,000	1,80,00,000
Add: Difference on account of adopting Arm's Length Price [if (A) is positive]	Nil	48,00,000
Total Income of Himalaya Ltd	1,80,00,000	2,28,00,000

Note : U/s 92(3), Taxable Income cannot be reduced on applying ALP. Therefore, difference on account of ALP which reduces the Taxable Income is ignored.