Transfer Pricing

Common Controversies & Litigation Process

India

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India TP Scenario

Common Controversies

Trading & Manufacturing Sector

⇒ **Creation of marketing intangibles - AMP:** It has been observed that the tax authorities, looks into the nature and quantum of marketing expenditure viz. advertisement, marketing and sales promotion expenses, which are being incurred by the Indian affiliate. The tax authorities tends to compare the ratio of such AMP expenses incurred (on sales turnover) by the Indian taxpayer with that of the ratio of AMP expenses incurred by the comparable companies. Accordingly the tax authorities, considers that the excess expenditure has been incurred towards building a brand which is legally owned by the foreign counter-part. Hence, the same requires an additional remuneration.

⇒ **Intra-Group Services:** It has been observed that the tax authorities, insist on need-benefit-evidence tests, to justify the ALP for certain Intra-Group Services such as management related support charges, sourcing related support charges and similar other expenses being paid by the Indian taxpayer to its foreign affiliate.

⇒ **Rejection of comparability analysis:** It has been observed, that the tax authorities rejects the comparability analysis undertaken by the Indian taxpayer i.e. rejection of segmental information, rejection of certain quantitative/qualitative filters being considered to arrive at final comparable data-set and the companies considered as comparable to the taxpayer's business/functions. The tax authorities undertakes fresh comparability analysis and arrives at a higher margin and accordingly, adjusts the transfer price of the international transaction(s).

⇒ **Pre-commencement Expenditure:** Controversy revolves around the recovery of pre-commencement expenses with/without mark-up

⇒ **Payment of royalty/technical know-how fees:** Rejection of the comparability analysis undertaken by the Indian tax payer to justify the royalty rates and tax authorities insists on justifying the purpose for making such payments

India TP Scenario

Common Controversies [Cont'd]

Service Sector

⇒ **Re-characterization of entity from "Captive Service Provider" to "Routine Service Provider":** In certain instances, it has been observed that the tax authorities, shall look into the functional analysis i.e. detailed review of functions performed, assets employed and risks assumed by the parties involved in the transaction. Accordingly, the tax authorities tends to shift the characterization of a captive service provider to a routine service provider, which requires higher profit margin

⇒ **Re-classification of low-end IT/IT enabled services to high-end IT/IT enabled services:** The tax authorities re-classifies the nature of services into high-end services, which requires more remuneration

⇒ **Contract R&D centers – Creation of Intangibles:** The tax authorities, at certain times, disregards the categorization of software R&D center as an genuine contract R&D center, and concludes that the same in engaged in certain of intangibles. Hence, the tax authorities inflicts high profit margin/remuneration on such R&D center

Other Issues

⇒ **Benchmarking of financial transactions:** In certain instances, it has been observed that the tax authorities, rejects the comparability analysis which has been undertaken to benchmark the financial transactions such as advancing/availing of loans (such as ECBs/RBDs denominated in foreign or Indian currency) and/ or corporate guarantees issued to the Indian/foreign counter-part.

⇒ **Outstanding Receivables and Notional Interest Income thereon:** In certain instances, it has been observed that the tax authorities, characterizes the receivables from the AE(s) which are due for longer period, as loans and advances provided to respective AE(s). Accordingly, the tax authorities proposes notional interest adjustment on such loans and advances.

Litigation Process in India

Routine TP Audit Scenario

A. Compliances

- Preparation of TP documentation; and
- Filing of Form no. 3CEB on or before 30th November

B. Audit by the TPO

- Reference to the TPO made by the AO
- TPO initiates the scrutiny
- TPO makes an adjustment and passes the order

C. Draft Assessment Order

- AO incorporates the TP adjustment as proposed by the TPO
- AO passes **"Draft Assessment Order"**

Option 1

D1. Objections before the DRP

- Filing of objections before DRP within 30 days of receipt of the draft assessment order
- DRP Issues directions **within 9 months** from end of month in which draft order is forwarded to eligible taxpayer. Directions are binding on AO
- AO passes **"Final Assessment Order"** 1 month from end of month in which directions is received

Option 2

D2. Appeal before the CIT(A)

- AO passes **"Final Assessment Order"** within 1 month from end of month in which acceptance is received or period of filing objections before DRP
- Filing of appeal before the CIT(A) within 60 days of the date of communication of the Final Assessment Order
- **No time limit is prescribed for disposal of appeal. CIT(A) may dispose of the appeal within 1 year from the end of FY in which appeal is filed**

E. Appeal before the Tribunal

- Appeal before the Tribunal is to be filed within a period of 60 days from the date on which order sought to be appealed against is communicated to the taxpayer
- The Tribunal hears the appeal and will pronounce its order
- Where it is possible, the Tribunal shall dispose off the appeal within a period of **4 years** from the end of the financial year in which appeal is filed

F. Appeal before the higher courts

- Orders passed by the Tribunal are final, an appeal lies to the **High Court** only if a **substantial question of law** arises for determination
- The taxpayer aggrieved by the order of High Court can file an appeal before **Supreme Court**

Thank You !!!

Lets Discuss Further !!!!

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