

India



KPMG Observation

The Indian Transfer Pricing regulations were introduced in 2001 and are largely in line with the Organisation for Economic Co-operation and Development (OECD) guidelines.

Since its introduction, the Indian transfer pricing regulations have come of age – both in terms of quality of audits as well as the revenue generated for the Indian Government. Further, over the past few years, there has been significant guidance from Income-Tax Tribunals and higher Appellate Authorities on various fundamental transfer pricing issues across various industries.

The Indian Government introduced significant amendments relating to transfer pricing, both in the 2009 Finance Act and as proposals in the Draft Direct Taxes Code Bill, 2010 (DTC). The 2009 Union Budget saw the introduction of safe harbour provisions and the setting up of the Alternate Dispute Resolution Panel. In addition, the draft DTC proposed the introduction of advance pricing agreements (APA), general anti-avoidance rules (GAAR), thin capitalization, rationalization of penalty provisions and changes in various other administrative procedures. The revised version second draft of the DTC has been tabled before the Indian Parliament. It is proposed that the DTC, if enacted into a law, will come into force on 1 April 2012 and will replace the current Indian Income-tax and Wealth tax laws (which have been in force for almost five decades).

Basic Information

Tax authority name

Central Board of Direct Taxes (CBDT).

Citation for transfer pricing rules

Sections 92 to 92F of Income-tax Act, 1961 (Act); Rules 10A to 10E of Income-tax Rules, 1962.

Effective date of transfer pricing rules

1 April 2001.

What is the relationship threshold for transfer pricing rules to apply between parties?

Indian transfer pricing provisions incorporate a very wide definition of associated enterprises to include direct and indirect participation in the management or control of capital as well as certain conditions wherein two enterprises are “deemed” to be associated enterprises. Significant conditions among these include:

- Direct/indirect shareholding giving rise to 26 percent or more of voting power;
- 90 percent or more purchase of raw materials/sale of manufactured goods by an enterprise from/to the other enterprise at prices and conditions influenced by latter;
- Authority to appoint more than 50 percent of the board of directors or one or more of the executive directors;
- Dependency in relation to intellectual property rights (know-how, patents, trademarks, copyrights, trademarks, licenses, franchises, etc.) owned by either party; and
- Dependency relating to borrowings i.e. advancing of loans amounting to not less than 51 percent of total assets or provision of guarantee amounting to not less than ten percent of the total borrowings, etc.

What is the statute of limitations on assessment of transfer pricing adjustments?

Thirty-three months from the end of the assessment year (the year immediately following the tax year. The tax year in India is the financial year beginning 1 April – 31 March of the succeeding year) in which the income was first assessable.

Transfer Pricing Disclosure Overview

Are disclosures related to transfer pricing required to be prepared or submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Filing of Accountant’s report in Form No. 3CEB certifying the arm’s-length nature of the international transaction with Associated Enterprises is required to be filed with the Revenue authorities by the

Company. The report is to be obtained from a Chartered Accountant and is to be filed with Revenue authorities by the due date (presently 30th September after the end of the financial year).

What types of transfer pricing information must be disclosed?

As stated above, the Accountant's Report is required to certify that appropriate documentation has been maintained by the taxpayer and the information disclosed in the certificate is true and correct.

The following information is generally disclosed therein:

- Name, address, permanent account number and status of the taxpayer;
- Name, nature of relationship and other details (as prescribed) of the Associated Enterprise with whom the taxpayer has entered into international transactions during the year;
- Description of the international transaction entered into, including quantity, value, paid/payable – received/receivable and the method adopted to test the arm's-length criterion, etc.

Transfer Pricing Study Overview

Is preparation of a transfer pricing study required – i.e. can the taxpayer be penalized for mere failure to prepare a study?

Yes, in case the aggregate value of international transaction exceeds INR10 million.

Failure to maintain the prescribed information documentation contemporaneously attracts a penalty of two percent of the value of the international transaction. Further, failure to furnish information/documents during a transfer pricing audit can also attract an additional penalty of two percent of the value of the international transaction.

Other than complying with a requirement per the previous question, describe the benefits, if any, of preparing and maintaining a transfer pricing study?

Maintenance of transfer pricing documentation assists in demonstrating that the taxpayer made bonafide attempts to determine and ensure that its transfer prices are at arm's-length. In such cases where the taxpayer has determined its transfer prices as above, in case the tax authorities question the taxpayers' approach of transfer pricing, burden of proof shifts to tax authorities.

To satisfy the requirement and/or obtain the benefits, are there any requirements on when the transfer pricing study must be prepared and submitted?

The transfer pricing documentation must be prepared on a contemporaneous basis, and should be maintained for a period of nine years from the end of the relevant financial year. Generally, the notice of audit (issued by the revenue authorities to the taxpayer initiating a transfer pricing audit) specifies the period within which the taxpayer is required to furnish information as specified in the notice.

What are the major elements required or recommended to be included in a transfer pricing study?

The transfer pricing regulations have prescribed an illustrative list of information and supporting documents required to maintain by taxpayers entering into an international transaction. The prescribed documentation includes information (such as corporate overview, Indian operations, etc.) on the parties involved in the international transactions, as well as specific information relating to the reportable international transactions. More specifically, such documentation is required to incorporate:

- Description of ownership structure of the taxpayer, profile of the multinational group, including names, addresses, legal status and country of tax of,

and relationship with, all associated enterprises.

- Business overview of the taxpayer and of associated enterprises and description of industry in which the taxpayer operates.
- Description of functions performed, risks assumed, assets utilized of transacting parties;
- Nature, terms, volume and value of each international transaction and details of property/service involved, commercial agreements, assumptions and policies with respect to the transactions with associated enterprises and third parties, if any.
- Record of comparable uncontrolled transactions and economic analysis performed to evaluate their comparability with the relevant international transaction.
- Description of methods considered, explanation regarding selection and application for determining the arm's-length price in relation to each international transaction.
- Details of comparable data used in applying most appropriate method and adjustment made to account for differences between controlled and uncontrolled transactions.
- Underlying supporting documentation such as copies of invoices, contracts, etc.

Transfer Pricing Methods

Which transfer pricing methods are acceptable?

Comparable uncontrolled price (CUP) method; resale price method (RPM); cost plus method (CPLM); profit split method (PSM); and transactional net margin method (TNMM).

The regulations also permit the Central Board of Direct Taxes (CBDT) to prescribe any other method – however, no other method has been prescribed to date.

Is there a priority among the acceptable methods?

No.

If there is no priority of methods, is there a “best method” rule?

Yes. The most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction, and which provides the most reliable measure of an arm’s-length price in relation to an international transaction.

Transfer Pricing Audit and Penalties

When the tax authority requests a taxpayer’s transfer pricing documentation, how long does the taxpayer have to submit its documentation?

Generally, the notice of audit (issued by the Revenue authorities to the taxpayer initiating a transfer pricing audit) specifies the period within which the taxpayer is required to furnish information as specified in the notice.

If an adjustment is proposed by the tax authority, are dispute resolution options available to the taxpayer outside of competent authority?

In case the taxpayer contests an adjustment proposed by the revenue authorities, there is an appellate mechanism available. The appellate machinery has several stages including: (i) Appellate Commissioner (recently complimented by Dispute Resolution Panel), (ii) Jurisdictional Appellate Tribunals, (iii) Jurisdictional High Courts and lastly, (iv) National Supreme Court.

For a taxpayer to get a conclusive decision by the Indian judiciary, it could take from three to eight years.

If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

The Indian Transfer Pricing regulations have prescribed the following penalty provisions summarized below.

Nature of default	Penalty prescribed
Failure to maintain prescribed information/ documents	2 percent of value of international transaction
Failure to furnish information/ documents during audit	2 percent of value of international transaction
Adjustment to taxpayer’s income	100 to 300 percent of tax on adjustment amount
Failure to furnish accountant’s report	INR100,000

To what extent are transfer pricing penalties enforced?

The above imposition of penalties is discretionary and depends upon the facts and circumstances of each individual case.

Can transfer pricing penalties be reduced or removed for reasons other than documentation?

Please refer to information provided above.

Special Considerations

Are secret comparables used by tax authorities?

Yes. India’s transfer pricing regulations contain no guidance on the use of secret comparables. Practically, the Indian Revenue authorities have been using secret comparables in the course of transfer pricing audits. Recent judicial decisions have held that secret comparables (which are not available to the taxpayer at the time of setting its transfer prices) should not be used in the course of transfer pricing audits against the taxpayer.

What level of interaction do tax authorities have with customs authorities?

There is a lack of consistency between customs valuation procedures and transfer pricing regulations under tax laws. Both departments work at divergent purposes in relation to the same transactions. Suitable methods for valuation of imported goods should be established which are acceptable to both customs law and the Indian transfer pricing regulations. Towards this end, the Indian Revenue Authorities set up a Joint Working Group, comprising of transfer pricing and customs officers. Considering the lack of synchronization this initiative was undertaken by the Revenue Authorities in order to bring greater harmonization, coordination and communication between the two departments as regards valuation of imported goods.

Are management fees deductible?

Management fees are deductible; however, commercial expediency test and benefits test are rigorously applied by tax authorities with respect to payment of management fees.

Are management fees subject to withholding?

Management fees are subject to withholding tax and the rates specified in the domestic tax laws/the relevant tax treaty, whichever is more favorable to the taxpayer would apply.

Other unique attributes?

Arm’s-length range

The Indian transfer pricing regulations require the arm’s-length price in relation to an international transaction to be determined by any of the prescribed methods, being the most appropriate method. In a case where more than one price is determined by the most appropriate method, the arm’s-length price shall be the arithmetical mean of such prices. Further the transfer pricing regulations also incorporate the option of a five percent variation in the arithmetic

mean, in determining the arm's-length price. However, the transfer pricing laws have been amended effective 1 October 2009, whereby the price of the international transaction is deemed to be arm's-length, in cases where the difference between the arm's-length price determined and price at which the international transaction took place does not exceed five percent of the latter.

Multiple-year data

The Indian regulations do not generally permit use of multiple-year data. The data pertaining to the relevant financial year has to be benchmarked against comparable data of the same financial year. Comparable data of two previous years may only be considered if it is substantiated that the previous years have had an impact on the current year data of the comparables. However, there is no leeway to use previous year data for the tested party.

Other Recent Developments

The Indian transfer pricing authorities continue to adopt aggressive positions, including higher mark-ups for "services" companies, non-tolerance of losses in case of routine distributors, and seek appropriate benefit test for cross charges. Further, granting of interest free loans between associated enterprises has also been discouraged. It has been held that the interest rate on a cross border loan transaction between associated enterprises should be computed on an arm's-length basis.

Tax Treaty/Double Tax Resolution

What is the extent of the double tax treaty network?

India has an extensive tax treaty network and has entered into comprehensive tax treaties with 78 countries. India is also party to a series of treaties under negotiation.

If extensive, is the competent authority effective in obtaining double tax relief?

India's general experience with mutual agreement procedures (MAP) is quite recent. Most MAP cases that the Indian Competent Authority has dealt with have been with the U.S., Japan and a few countries in Europe.

In practice, MAP as a mechanism for dispute resolution in regard to transfer pricing disputes has not been found to be very successful until recently in India. The reason is that even after the consultation process has commenced, the process lasts for a longer time and its outcome is uncertain. However, recent experience indicates that this may be changing.

When may a taxpayer submit an adjustment to competent authority?

No formal rules.

May a taxpayer go to competent authority before paying tax?

Yes, however before invoking MAP procedures, in some cases, a bank guarantee generally needs to be submitted for the tax demand in question. This has been the procedure to date in MAP cases involving the U.S. and UK.

Advance Pricing Agreements

What advance pricing agreement (APA) options are available, if any?

Currently, there is no APA mechanism available under the Indian transfer pricing laws.

However, the DTC has proposed introduction of the APA regime and provides that under the APA, the taxpayer would enter into an agreement with the Revenue authorities on its transfer prices. If the taxpayer meets the criteria agreed in the APA, the taxpayer would not be subject to a transfer pricing adjustment and such an arrangement would remain valid for a period of five years.

Is there a filing fee for APAs?

Currently not applicable.

Language

In which language or languages can documentation be filed?

English.

KPMG in India

Mumbai

Rohan Phatarphekar

Tel: +91 22 3090 2000

Email: rohankp@kpmg.com

As email addresses and phone numbers change frequently, please email us at transferpricing@kpmg.com if you are unable to contact us via the information noted above.