TRANSFER PRICING IN INTERNATIONAL TAXATION

Basics

- X- Purchases goods- 100 rs; Sells it to associated co Y- 200 rs
- Y sells in open market- 400 rs
- If X- sold it direct- made profit of 300 rs
- Transaction b/w X and Y arranged and not governed by market forces
- Profit- 200 rs is shifted to Country of Y
    - Goods- transferred on price- arbitrary- 200 not market price 400
    - Pricing of CB, intra-firm transactions- related parties
    - CE v. UCE- ALP
    - TP- price/ value of GOS b/w independently operating units of an organisation
    - Effect- HC/SC- insufficient taxable income, excessive loss- siphon off profits, transfer to low tax jurisidction- revenue loss, drain on FE reserves

Transfer Pricing

- Price of G, S, I in transaction- TP- if transaction- carried out b/w related co.
- Related Co: owned, controlled by same entity- same group of co
- Sister, Associated, Affiliated, Controlled group of co
- Process- deciding transfer price for any particular transaction- TP
- 4 Broad Categories- All TP cases
  - Goods- Physical products- finished and intermediary goods, raw material
  - Services- Commerical- Banking, legal advice, consulting, fin service, education, medical treatment, IT
  - IP- creations, innovations of mind- enables and benefits- Patent, TM, CP
  - Intra-corporate lending: loans from one business unit of a co to another
- While TP- generally transactions b/w entities- in diff countries- sometimes same country

Transfer Pricing Chart

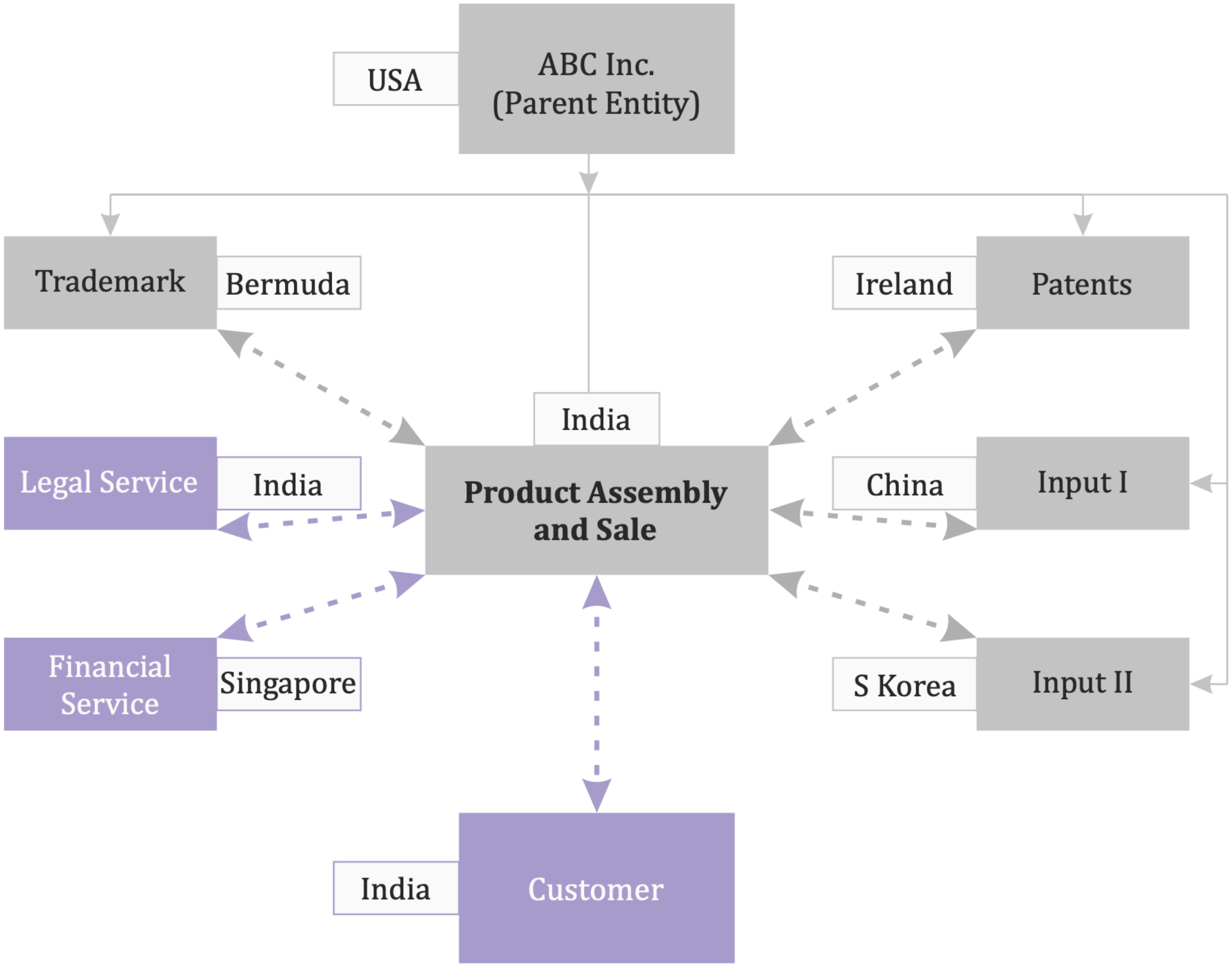


Chart- Decoded

- ABC MNC- USA entity- subsidiaries in various countries
- Grey box- represent business entity owned by ABC with country name besides
- Text inside box- represent functions performed by subsidiary
- Thin solid line- ownership
- Thick dotted lines- transactions related to goods, services, intangibles
- Colored box and lines- unrelated entity and transaction with unrelated entity
    - All entities- ownership, control in grey box- related entities, sister companies
    - Thick dotted lines- accompanied price- transfer price
        - Indian entity- legal service- makes royalties payment to Bermuda entity= TP
        - Indian entity- receives inputs from China/Korea- payment made= TP

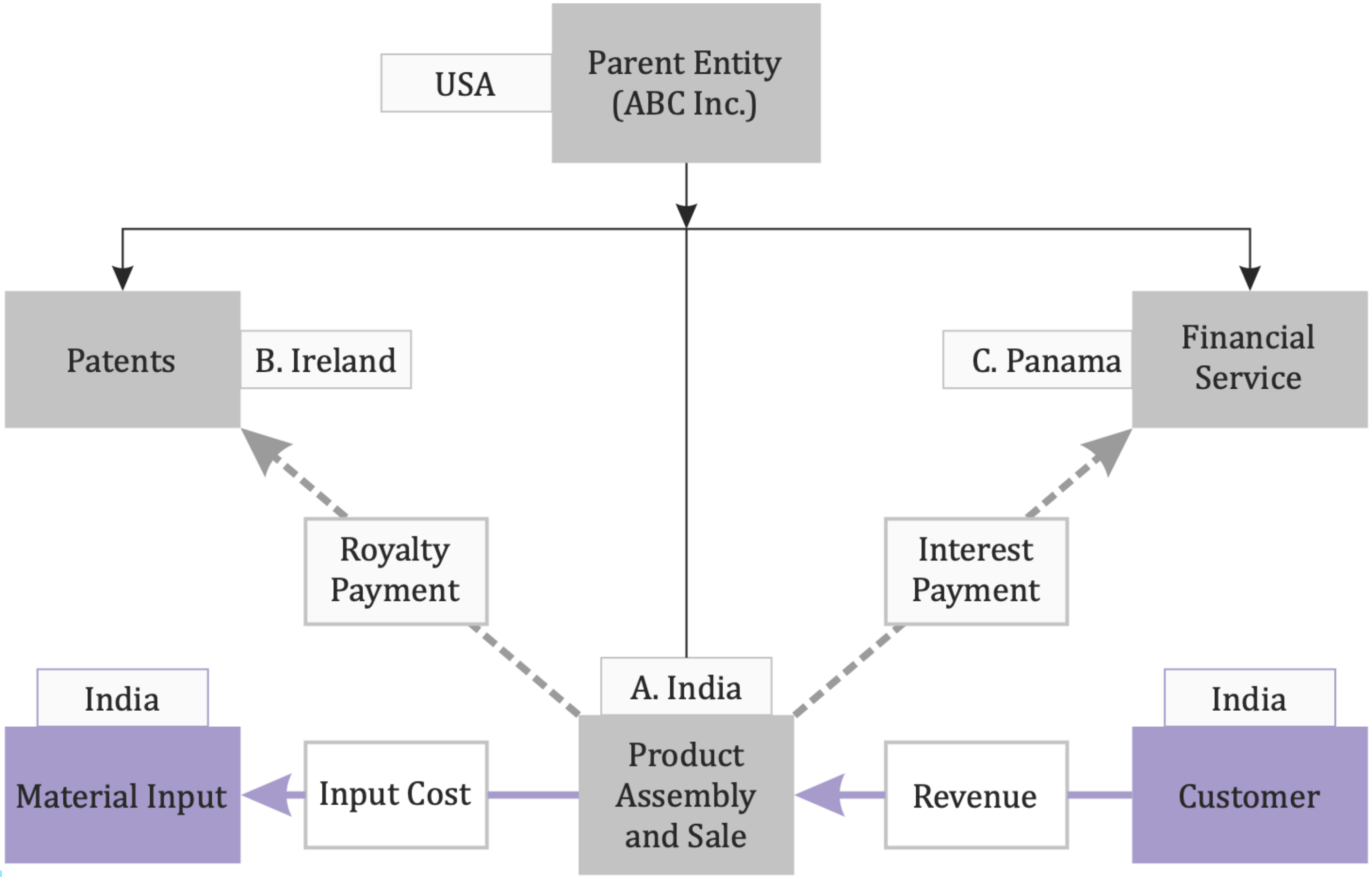
TP and Tax Avoidance

- Unrelated parties- act in self-interest
  - Buyer minimises price v. Sell maximises price
  - Price level set- process- market price/ fair value of GoS
- MNC- Integrated services- generate profit from synergy b/w various activities
- 2 Companies- corporate group- engage in transaction
  - Not try to increase indv. Profit level
  - Focus on overall/ aggregate profit of PC/ CC
  - Price set- not MP/FV; TP not equals MP
  - Reason: Avoid paying taxes in particular country
    - Shift profit to low tax jurisdictions

TP and Tax Avoidance

- Abusive TP
    - Regulatory and economic differences b/w countries
    - Tax liability- 1. Value of transactions 2. Value of properties 3. Level of income
    - 2 subsidiaries of MNC- situated in 2 countries- different tax regulations
    - Tax base, tax rates, accounting standards, disclosure requirements
    - Through mutual understanding- profit, costs shifted from 1 to another jurisdiction
    - Reducing total tax payable by the corporation
- Note: TP by itself not amount to tax avoidance
- Issue: TP deviating from MP- Abusive TP

TP and Tax Avoidance



TP and Tax Avoidance

	Case I			Case II		
	A	B	C	A	B	C
1. Material Input Cost	100			100		
2. Royalty Payment	100			150		
3. Interest Payment	100			150		
4. Total Cost (1+2+3)	300	50	50	400	50	50
5. Total Revenue	500	100	100	500	150	150
6. Profit (5-4)	200	50	50	100	100	100
7. Tax Rate	30%	10%	10%	30%	10%	10%
8. Tax	60	5	5	30	10	10
9. Total Tax by MNC (A+B+C)	70			50		

*Highlighted cells in case II represent the changed entries using transfer pricing

TP and Tax Avoidance- Case I

- ABC- Subsidiary in India, Ireland, Panama
    - Total cost of A= Material payment costs from third party+ royalty payment made to sister concern+ interest payment made to sister concern= 100+100+100= 300
    - A's revenue from selling products to customer= 500
    - A's profit= 500-300= 200
    - B, C have total cost of 50 each
    - B, C revenue from A and Ors= 100
    - B's Profit= 100-50= 50
- Tax Rate for India= 30%; For Ireland, Panama- 10%
- Tax- for A- 60; B-5; C- 5 making total tax by MNC- 70

TP and Tax Avoidance- Case II

- ABC- Subsidiary in India, Ireland, Panama
  - Presuming A sets TP at 150 for B, C in place of 100
  - Total cost= 100+150+150= 400
  - For B, C- revenue from A and ors= 150
  - If total revenue by A=500; total cost=400; Profit=100
  - B, C- profit= 100
- Tax Rate for India= 30%; For Ireland, Panama- 10%
- Tax- for A- 30; B-10; C-10 making total tax by MNC- 50
- For India loss of 30, while Panama and Ireland gain 5 each
- Assinging different TP to intra-group transactions- MNCs reduce total tax liability

<u>TP and Tax Avoidance- Real-World Complications</u>

- Real-world business- MNC- complex- many subsidiaries
    - Parent Co- USA establish R&D subsidiaries in France
    - Patent resulting from R&D centres- registered in low tax jurisdiction
    - Patent, TM- registered in Ireland, Bermuda- beneficial tax rules
- ICT- many services- one geographical location- no need for physical presence
- Establishment of subsidiaries- beneficial taxation- more rampant
- More acute with TP case- with Shell Co or Tax Haven or both
- Assigning different TP to intra-group transactions- MNCs reduce total tax liability

TP and Tax Avoidance- Acute Cases

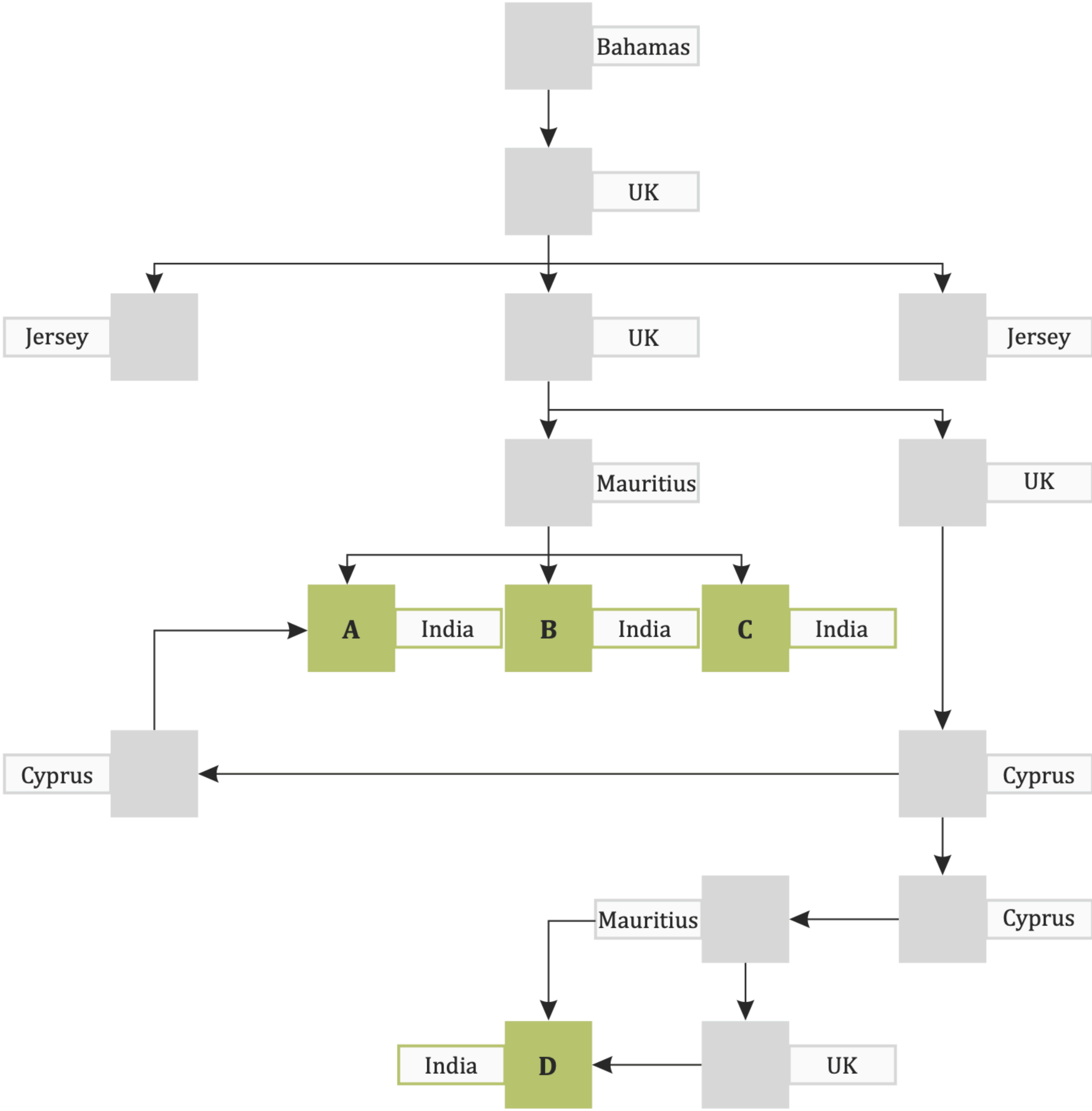
- Shell Co or Tax Haven or both
  - Shell Co- not engage in any real economic, business activities
  - Not possess/ own significant physical asset
  - Merely used instrument for financial transactions, owing IP on behalf of owner
  - Very few Ee, little assets, low, negligible cost of daily operations
  - Symbolic office premises to meet legal obligations
  - Established with ease and negligible monetary cost
- 2 Purposes: Carry out transactions on behalf of parent entity
- Act as intermediary in series of transactions, act as owner of certain properties

TP and Tax Avoidance- Acute Cases

- Tax Haven
  - Low, no tax: Extremely low- territorial tax system- only citizens taxed, not foreigners
  - Lack of transparency: Escape from financial regulations- no due diligence process
  - Lack of effective exchange of information: Systematic efforts
  - No requirement of substantial value creation activity: no real business, eco activity
  - Mere transactions with no business allowed in tax havens
- Shell and Haven- tax avoidance for intangibles- ownership easy to assign
- Intangibles created in high tax jurisdiction and assigned to low tax jurisdiction
- Parent co/ subsidiaries make royalties- lowering tax liability
- Using Shell Co- trade mis-invoicing- abusing regulations

Corporate Structures

TA, TP



ATP Purpose

- Moving money or capital from 1 country to another: from source to residence
- Using tax benefits on loss: Countries providing relief who incur losses
    - Using concepts of set-off and carry-forward- assignment to LTJ
- Managing Cash Flow: Receiving capital in some and pays in other
    - Situation where cash payment is more than cash stock
    - Cash from surplus entity can be moved to deficit entity using TP
- Bypassing govt regulations:
    - Countries put cap on maximum value for export or import of certain goods
    - Such cap could have been avoided by under-invoicing

Govt Policies for TP

- Many countries have brought legislation- TP
- Standard guidelines for MNCs to decide TP
- Powers to ITA to adjust TP in transactions
- Power to compare with independent firms- ALP/ SAP
- OECD Guidelines on TP, 1995- 5 TP methods
- Many argue against- shift away from ALP and move towards unitary firms
- Unitary Taxation with Formula Apportionment (UT-FA)

History of TP

- OECD- Reports for TP Guidelines- 1979, 1984; first Guidelines- 1995
- Followed in many countries- Domestic TPR
- Parallel US TPR- both have methods to test prices and to adjust using AL range
- AL range- standards- Comparative, Reliable etc.
- UNCTAD, 1999- TP Manual; UN- 2013- Practical Manual on TP for Developing Countries
- OECD, US, UN Model Tax Convention

ALP

- UN MTC- Art.9 (1)
- Where: Enterprise of CS participates- D/ID- MCC of Enterprise- OCS
- Same persons participate- D/ID in MCC of an enterprise of CS and enterprise of OCS and in either case conditions- are made, imposed b/w 2 enterprises- Commercial, financial relations- differ from Independent enterprises
- Profits which would but for reason- not accured- included in profits of that enterprise
- Taxed accordingly.
- Sum, transactions b/w 2 RE- ALP- not specifically used in Art.9 but well accepted
- ALP- standard- price appropriate- if within range of prices- chared by Independent parties dealing with AL

Indian Law concerning TP

- History: 42(2) IITA, 1922- TP incorporated in Sec.92- ITA
- Enactment of ITA- Sec.92, Rule 11 ITR, 1962- methods of estimation of reasonble profit
- General, limited scope- no adjustments for NR
- Close connection- vague, undefined- provided for adjustment of profits and not prices
- Did not apply to indv. Transactions
- Payment of royalty- not part of regular business- b/w R and NR
- No detailed rules for documentation- to be maintained

Statutory Rules and Regulations

- FA 2001- Chapter X- Special Provisions relating to Avoidance of Tax- 92A-92F- TPC
- Detailed statutory framework- reasonable, fair, equitable profits and tax in India
- Computation of income from Int Transaction, ALP, AE, ALP, documentation, reports
- Levy of penalties for non-compliance- Annex I
- FA 2002, 2006, 2007, 2009, 2011- amendment
- FA 2012- Specified Domestic Transactions- 92BA; APA- 92CC, 92CD
- FA, 2014- ALP determination, roll back mechanism
- FA, 2016- BEPS AP 13- country by country reporting
- FA, 2017- Reduction in compliance burden- PA, SA, MLAT

Objectives of TP Regulation

- Regulate IT, SDT b/w AEs
- Ensure transaction b/w AEs carried out at ALP
- Enacted to curb arrangement- entered into b/w entities to shift profit from HTJ to LTJ
    - Such shifting- intended at overall objective of lowering tax base of group entities
- Prevent misuse of incentive of Indian Govt for developing some sectors

Conditions for application of TP (Sec.92)

- Whether AE?
  - If yes, check for IT/DIT
    - If yes, check ALP
    - If no, apply TP
  - If no, check for SDT
    - If yes, check value of transaction exceeds 20 cr
    - If yes, check ALP
    - If no, apply TP
- If ALP, yes, check for documentation, TP assessment procedures and apply TP for compliance

Associated Enterprises- Sec.92A

- Enterprise- eco activity- person- producing profits, independent manner, well defined actions, eco character
- Enterprise- Sec.95F- person incl. PE (92F(iiia) of such person- who is, has been, proposed to be engaged in the following activity- D, through 1 or more units, divisions, subdivisions
- Irrespective- unit, division, subsidiary located at same or diff place (or)
    - PSSDC of articles or goods
    - PCTLKF or any other business or commercial rights of similar nature
    - Data, doc, drawing, specification- Patent, invention, model, design, secret formula, process- 1E owner- another E- exclusive rights
    - Provision of services of any kind
    - Engaged in investment, providing loan or
    - Engaged in business of acquiring, holding, underwriting or dealing with SD, OS of any Body corporate

Associated Enterprises- 92A

- Enterprise- D/ID/Intermediaries- MCC of other enterprise
- DP= Co A———— Participates in MCC————- Co B
- IDP= Co A———— Co C (intermediary)———- Participates in MCC————- Co B
- **Identify AEs?**
- Co A——- MCC———— Co C
- Co A——- MCC———— Co B

Deemed AE- 92A (2) (a)- (m)

- 12 situations- Deemed to be AE; 92A(1)- general, broad v. 92A(2)- Deemed AE
- Capital-based (ownership), Control based, management based relationships **anytime** in the PY

Capital Based Relationships

- **1. Enterprise Ownership**
- Enterprise- D/ID ownership in shares- has equal/more than 26% VP (Not incl. preference SH)
- Amazon US——- 35% stake—— Amazon India
- **2. Mutual holding**- any person- D/ID- has equal/ more than 26% VP in 2 or more enterprises
- Amazon US—— 28% stake——- Amazon UK
- Amazon US—— 31% stake——- Amazon Singapore
- DAEs= Amazon UK and Amazon Singapore
- **3. Substantial Lender**: Loan advanced by enterprise- equal/more than 51% of BV of assets of borrower
- Asset of Amazon Australia=150 cr; Loan from Amazon US= 100 cr
- Loan in Amazon Australia exceeds 51% BV of assets- Amazon Australia, Amazon US- DAE

<u>Capital Based Relationships</u>

- **4. Minority holding in a Firm, AoP, BoI**
- Enterprise- holds equal/more than 10% interest in Firm, AoP, BoI
- Amazon US——- 11% stake—— Amazon Paris Firm
- Amazon US, Amazon Paris Firm- DAE

Control Based Relationships

- **5. Guarantor for Borrowings**
- Enterprise guarantees- equal/more than 10% Total borrowings of OE
- JIL, US—-Guarantee for 150 Lakhs—- JAL, India—— 900 Lakhs loan from SBI
- **6. Dependency on Intangibles**
- Wholly dependent for its business on use of intangible assets- PC etc
- Such intangible asset owned by OE or OE has exclusive right to use, exploit intangible assets
- Popeyees India—-exclusive franchisee of Popeyees USA- brand name, know how, support etc from USA + PI have no other business- fully dependent on P, US- DAE
- **7. Supply Dependency:** Enterprise engaged in manufacturing, processing of G/A and equal/ more than 90% of raw materials or consumables
- Supplied by OE or persons specified by OE and prices, conditions- specified by OE
- BPCL India- Deals with Shell Dubai- supply of 100% crude oil by BPCL from shell or subsidiaries

Control Based Relationships

- **8. Sale Dependency-** Enterprise- engaged- manufacturing, processing of G/A and such G/A
- Sold to OE or sold to persons specified by OE and Prices, other conditions- specified by OE
- Hero India entered into agreement with Honda Japan to manufacture two-wheelers
- Hero India does not work for any other co- entire produces sold to Honda; Hero-Honda- DAE
- **9. Individual- Control-** When same indv/ his relative controls two enterprises
- Ravi Ruia- XYZ Co; Rewant Ruia- Numetal; Ravi—- 28% XYZ; 31% Numetal
- **10. HUF- Control-** 1E- controlled by HUF- OE is controlled by member of HUF, relative
- Haldirams HUF—— 28% in ABC; A, B of HUF—- 56% EFG
- Control- an indv, either himself or along with relatives has power- major decisions regarding management of both the enterprises
- Relative- u/s 2(41)- means spouse, brother, sister, lineal ascendant or descendant of indv.

Management Based Relationships

- **11. Appointment of Board**
- E with OE- appoints more than half of BoD or appoint 1 or more ED
- Flipkart India- 7D+2ED; Flipkart Singapore- 4% stake but appoints 4D; 3% stake with 1 ED
- **12. Appointment of Board in 2 or more entities**
- Person in 2 or more enterprises- appoints more than 1/2 BoD or appoint 1 or more ED
- Mukesh Ambani- power to appoint 70% BoD of RIL, RPL

Summary

Quantum of Interest	Criteria for AE
26% or more	SH with VP- D/ID
51% or more	Loan- BV of TA of OE
51% or more	BoD appointed by GB
90% or more	Supply of raw materials, consumables
10% or more	Total borrowing guarantees
10% or more	Interest by firm or AoP or BoI

IT and DIT- Sec.92B

- **Transaction- 92F (v)-** Arrangement/understanding/ AIC- whether or not
- Writing, enforceable by legal proceedings and
- B/w 2 or more AE- one or both AE should be NR
- Nature of transaction:
  - Purchase/sale/lease of tangible, intangible property
  - Provision of services
  - Lending, borrowing of money
  - Allocation, apportionment of, contribution to any cost, expense (mutual agreement)
  - Any other IT having bearing on PILA of enterprise

Expansion of IT- Explanation FA, 2012

- PSTLU-Tangible P- Building, transportation vehicle, machinery, equipment, tools
- PSTLU- Intangible P- transfer of ownerhsip- land use, PTCLFBKD etc
- Capital financing- long term, short term- BLG, purchase, sale of MS, advances etc
- PoS- including provision of market research, development, management, administration, technical services, repairs, design, consultation
- Transaction of business restructing, reorganisation- PILA- at time of transaction or future date
- Eg: 2AEs, 1 is NR- purchase of goods- IT
- Transaction b/w foreign head office and Indian branch, PE- IT
- Note: Transactions- PLA bearing- IT v. Business restructuring- not require PLA bearing

Expansion of IT- Explanation FA, 2012

- Intangible asset: Trademarks, tradenames, brand names, logos
- Technology related IA- process patent, patent application, technical docs
- Artistic related IA- literary works, copyrights, musical composition, copyrights, maps
- Data processing IA- proprietary computer software, software copyrights, intergrated circuits masks, masters, automated databases
- Engineering related IA- ID, product patents, trade secrets, drawings, blueprints, docs
- Customer related IA- Customer lists, contracts, relationships, open purchase orders
- Contract related IA- favorable supplier, contract, licence, franchise, non-compete
- Human capital related IA- trained, organised work force, employment agreements, union contracts

Expansion of IT- Explanation FA, 2012

- Location related IA- leasehold interest, mineral exploration rights, easements, air, water
- Goodwill related IA- instutitonal, professional practice, perosnal of professional, celebrity
- Methods, programmes, systems, procedures, campaign, survey, studies, forecasts, estimates
- Any other similar item- deriving value from intellectual content
- Wide range of ITA included- extend TPC to all IT involving exchange of intangibles which are not expressly available for trade
- Customer related IA- Customer lists, contracts, relationships, open purchase orders
- Contract related IA- favorable supplier, contract, licence, franchise, non-compete
- Human capital related IA- trained, organised work force, employment agreements, union contracts

Checklist Questions to Ask

- Whether intra-group services has been provided and
- What is the consideration in accordance with ALP?
- Whether IE in comparable circumstances willing to pay same

DIT- Sec.92B (2)

- Transaction- entered into by E with person other than AE- DIT
- B/w two AEs- if prior agreement in relation to relavant transaction or terms determined in substance b/w such person and AE
- Person other than AE- can be NR/R; AE- one of the enterprise should be NR
- Eg: If ABC Ltd, Indian Co- entered into agreement for sale of laptop to Mr. X (resident and URP)- 40K (goods worth 50K) on 15th Aug 2024
- Mr.X entered into agreement with LMN Inc- NR for sale of product @40K on 30 Aug
- Found LMN holds 45% in ABC
- Transaction b/w ABC and Mr.X be presumed DIT (check- prior agreement)

SDT- Sec.92BA

- Profits shifted from NTHU to THU- to prevent this- SDT
- Undertaking claiming profit-linked deduction
  - Business transacted b/w co opting for Sec.115BAB and person with whom co has close connection
  - Inter-unit transfer of GoS
  - Transactions with entities having close connection and generating more than ordinary profits
  - Transaction with Sec.80A, Chap VIA, Sec.10AA, Sec.35AD applies
  - Aggregate transaction value exceeds Rs.20 Cr
- All above are to be conducted at ALP
- TP adjustment to SDT is not required if effect is increasing loss, reducing income
- Since no avoidance of tax- not required to adjust

ALP- 92F (ii)

- Price which applied or proposed to be applied in transaction to be applied in transaction
- B/w Persons other than AE in uncontrolled conditions
- All IT, DIT, SDT be computed having regard to ALP
- Sec.92C- Methods to determine ALP for IT, SDT
- Always choose most appropriate method- having regard to nature of transaction
    - Comparable Uncontrolled Price Method
    - Resale Price Method
    - Cost Plus Method
    - Profit Split Method
    - Transactional Net Margin Method
    - Others as prescribed by Board- Rule 10AB
    - CUP, RPM, CPM- preferred v. PSM, TNMM- transactional profit methods/alternative methods

CUP

- Compares- price charged, paid for P transferred, services provided in CT v.
- Price charged or paid for PT, SP in comparable UCT in comparable circumstances
- UP- comparable with P of AE- CUP- most direct method
- Application involves
    - Identify price charged or paid in CUCT
    - Adjust at transaction level for differences on FARE differences, if any
    - Adjusted price- ALP
- Methods of CUP- Internal, External
  - Internal- One of AE enters into similar transactions- URP-RP- good comparable- FARE easy
  - External- If transaction b/w two independent enterprises- comparable conditions- GOS
  - Independent enterprise- buys, sells similar product- similar quantities under similar term from/ to another independent enterprise- similar market- External CUP

CUP

- If A, B AEs; C, D independent entities
- Internal- A and C; B and C
- External: Transactions b.w 2 URP- transaction between C, D
- Utilised- transfer of goods, provision of services, interest on loans, intangibles
- Steps in computation
  - Identify price charged for similar G/S provided in CUCT
  - Adjusted price- by quantity discount, insurance charge, freight charge, warranty etc.

CUP- Instance

- X, In supplies 50K machinery to HC- X, US- 3K per engine (Claim 10% volume discount)
- Also supplies 15K engines to Y, URP- 4K per engine
- UCTP= 4K; CTP= 3K
- VDP= 4K@10%= 400
- 4000-400 (adjustment)= 3600
- 3000 already accounted for
- 600 additional price- ALP

RPM

- Price at which PP/SO by E from AE is resold or are provided to URE is identified
- RP- reduced by amt of NGPM accruing to E or URE from purchase and resale of same or similar P or from obtaining and providing same or similar services- CUTC or no. of transactions
- Price so arrived- further reduced by expenses incurred by enterprise- connection with PP/SO
- Price so arrived- adjusted- Functional, other differences- incl. accounting practices- in IT, SDT and CUCT or b/w enterprises entering into such transactions materially affecting GPM
- Adjusted price above taken to be ALP
- May be adopted where G purchased and sold with little or no value addition- trading of goods
- Used in Distribution & Resale of G/S

RPM

- Steps for computation: 1. Identify PP/SO by enterprise from AE
- 2. Identify price at which P/S is resold or are provided to an URE
- 3. Deduct normal GP margin earned from UCT above
- 4. Reduce expenses incurred in connected with PP/SO
- 5. Adjust various factors like quantity discount, insurance, frieght

RPM- Instances

- Ford India- import Ford car-12L from Ford Germany- for sale in India
- Ford Germany resells imported car in India- 13.5L and incurs expense of 1.2L on import
- Renault India similar car imported from URE- 11.5L; Sells at 14L
- Sale Price of Renault= 14L; Purchase Price= 11.5L; Gross Margin= 2.5L; GM Ratio= 18%
- Sale Price of Ford=13.5L; Gross margin @18%= 2.43L; Expense on purchase=1.2L
- ALP= 13.5-2.43-1.2= 9.87L
- Actual purchase price=12L; Additional income per car= 12-9.87= 2.13L

RPM- Instances

- X sold machine to Y (AE)- Y sold same machinery to Z (URE) at 30% sale margin
- Y to Z- 2,10,000 and without making any additional expenses and change
- Find ALP
- Sale price to Y= 2,10,000
- GM= 2,10,000 x 30%= 63,000
- TP= 1,47,000

RPM

- Formula for TP in inter-company transactions of products is as follows
- TP= RSP x (1-GPM)
- TP- b/w product sold b/w seller co and related co
- RSP- resale of product sold by seller co to URC
- GPM- specific seller co should earn- defined as ratio of gross profit to net sales
- GP= Net sales- COGS

CPM

- D/ID costs of production incrred by E iro PT/SP to AE determined
- Amount of normal gross profit mark-up to such costs arising out of PT/SP of same or similar P/S by enterprises or by URE in CUCT or a no. of such transactions- determined
- Normal gross profit mark-up- so adjusted to take FOD and CUCT
- Costs mentioned in (i) increased by adjusting profit mark-up arrived at (iii)
- Sum so arrived- ALP for supply of property or provision of services
- CPM ALP= CP cost of producing tangible property plus approporate gross profit mark-up defined as the ratio of gross profit to COGS for CUCT
- For inter-group transactions of products
- TP= COGS x (1+ mark up)
- COGS- Cost of goods sold of manufacturing co
- Cost plus mark up= gross proft mark-up defined as ratio of gross profit to COGS

CPM- Instance

- Vodafone India provides support services to Vodafone HK @ USD 25/ hour
- VFI- URP similar service @ USD 36/hr
- VFHK makes immediate payment irrespective of credit period of 45 days
- For VFI- total D/ID cost is 15/hr and financial charge of USD 2 pm
- Cost of manpower for VFI- 40% more

CPM- Instance

- Hourly rate to URE= 36/hr
- D/ID cost=15; Add financial charge (USD 2pm x 1.5 m)= 3; Total cost=15+3=18
- Mark up on cost= 36-18= 18 (Mark up= 100%)
- **Cost to VFI**
- D/ID (40% more)= 15+40%= 21
- Mark-up=21
- ALP=21+21= 42
- TP was 25; Was supposed to have spent 42
- Additional income= 42-25= 17
- Used in provision of services, JF management, transfer of semifinished goods, LT BSA

TNMM

- Net Profit margin realised by enterprise from IT, SDT with AR is computed irt costs incurred, sales effect, assets employed by E or using any other relevant base
- NPM- realised by URE from CUCT or no. of transactions with same base
- NPM (ii) arising from CUCT adjusted to take account of differences
- NPM realised by enterprise and referred in (i) established to be same as NPM (iii)
- NPM established is taken into account to arrive at ALP
- Steps in computation: 1. Identify NM to enterprise from IT
- 2. Identify NM from CUCT; - 3. Adjust 2 with factors
- 4. ALP will be computed with adjusted NM computed above
- Used in provision of services, distribution of finished goods where RPM not applied, transfer of semi finished goods

TNMM- Instance

- McAfee Ltd procures antivirus software from PC, McAfee US @650 per pack
- Indian Co- incurs additional 200 per pack expenses for labelling- product sold at 1000
- It also procures widows software @ 3000 per pack; addl expenses-400; sells at 5000
- Sale price of widows= 5000; purchase price-3000, addl expenses-400
- Net margin=5000-3000-400=1600; NMR-32%
- Sale price of McAfee US software-1000; apply NMR 32%; Net margin= 320
- Total cost= 1000-320= Rs.680
- Reduce labelling expense= 680-200= 480 (ALP)
- Product charged by US- 650
- Addl. income= 650-480= 170

PSM

- Applied mainly in IT, SDT with transfer of unique intangibles, multiple IT/SDT- so interrelated- that cannot be evaluated separately for purpose of determining ALP for 1 transaction
- Combined NP of AE arising from IT, SDT in which engaged, determined
- Relative contribution made by each AP to earning of combined NP- evaluated FAR
- Determine based on external market data- URE- comparable function, similar circumstances
- Combined NP is then split amongst enterprises in proportion to relative contributions
- Profit thus apportioned to assessee is taken to arrive at ALP
- Alternatively: Combined NP be partially allocated to each enterprise- to provide basic return appropriate to each type of transaction engaged- wrt market returns achieved by URE
- Residual NP remaining after such allocation- split amongst enterprises in proportion to their relative contribution in manner specified

PSM

- Steps for computation: 1. Determine combined net profit of AE
- 2. Compare relative contribution earned by each for earning CNP using FAR of URE
- 3. Split 1 in proportion to 2 to arrive at ALP
- **Alternative Approach**
- 1. Partially allocate profit to each to arrive at basic return appropriate to type of transaction
- 2. Remaining profits shall be allocated on basis of relative contribution
- 3. Total NP of Enterprise=1+2
- Used in integrated services provided, transfer of unique intangibles, multiple inter-related transactions which cannot be separately evaluated

PSM- Instance

- Apple Inc. provides R&D services to its three AEs- India, UK, Korea
- Relative effort put in by group co- 10%, 40%, 50% respectively
- Apple Inc billed Indian Co for 31 L
- Total cost of Apple Inc= 2 Crores
- Share of Indian Co=10%
- ALP= 20L (10% of 2 Cr)
- Price charged= 31L; Addl. price= 31-20=11L

Steps in Computing ALP

- 1. **FARE Analysis**
  - Functions performed, Assets used, Risks assumed, Enterprise involved- CT
  - To do: Identify how they are among AEs; Assess importance of each function in the overall value chain
  - FAR analysis- starting point- determining ALP of IT
    - Determining nature of functions performed by taxpayer and AE
    - After which, determine true and correct characterization of entities
    - Providing guidance on selection of most appropriate method of TP analysis
    - Determining parameters for establishing comparability and undertaking eco adjustments

Steps in Computing ALP

- **2. Selection of Tested Party**
  - Tested party- participant in CT whose profitability/ profit attributable to CT can be verified based on most appropriate data and requiring fewest and most reasonable adjustments
  - Reliable data regarding UTC be located
  - Most cases, tested party will be 'least complex' of CT- not own intangible property/ unique assets that distinguish it from potential UTC
- **3. Selection of Profit Level Indicator**
  - PLI is selected to test the profitability of tested party
  - PLIs are ratios that measure relationships between/w profits, costs incurred or resources employed
  - Variety of PLI can be calculated in any given case
  - Adopt denominator PLI being untainted, less-tainted

Why AR

- R- Taxpayer- some issue with transaction undertaken/ proposed- with NR
- NR have some issue in terms of transactions- undertaken/proposed by him in India
    - Need for clarification- Person makes application AAR
    - Provisions for AR- 245N-245V
    - Allowance to withdraw application- 30D from DoA

Where AR application not allowed?

- Q- already pending before ITA, ITAT, HC, SCI
    - Exception: R- Applicant- notified class/ category of persons- PSU
- Determination of FMV of any P
- Transaction designed for avoidance of IT
    - Exception: R-TP- PUS; R/NR- determination of impermissible avoidance arragement

Advance Rulings- Chap XIX-B

- **Sec.245N (a)- AR- means**
- Determination by authority irt- QoL/ QoF
    - transaction- undertaken/ proposed to be undertaken by NR-Applicant
    - **tax liability of NR** arising out of transaction- undertaken/ proposed by RA with NR
- Determination/ decision by authority
    - Computation of TI- pending before ITA/ AT including QoL, QoF relating to TI computation
    - Arrangement- proposed to be undertaken by any person- R/NR- impermissible avoidance arrangement
- **(b)- Applicant- means**
- NR, R, R falling with class, category as CG notifies, specifies; or in OGN; or arrangement (as above)
- Applicant under 28E, Customs Act; 23A, CEA; 96A of FA, 1994 (2017-2021)
- **(c)- Application- means-** made to authority for AR or Board of AR constituted by CG

Procedure on receipt of AAR

- Receiving application- send copy to PCIT, CIT- call for necessary, relevant records
- And return it back asap
- After examination- allow or reject application- check not allowed circumstances- AAP
- Recorded reasons for rejection- send to A, PCIT/CIT
- Application allowed- examine further material- pronounce AR on question specified
    - On request from applicant- before pronouncing AR- AAP in person or authorised rep
    - AR in writing- within 6m of receipt of application
    - Send copy to Applicant, PCIT/CIT
    - No ITA, ITAT decide any issue to which AAR application made by R
- AR pronounced- binding on applicant- who sought it + for transaction sought
- Binding on PCIT, CIT, ITA unless change in law, facts, basis of pronouncement
- If AR obtained by fraud, misrepresentation of faacts- *void ab initio*- as if never made

Procedure on receipt of AAR

- AAR power of Civil Court- Sec.131 powers
- Discovery, inspection, enforcing attendance, examining by oath, compelling accounts, commissions
- Power to regulate own proceedings in all matters arising out of IT Act
- All proceeding- deemed judicial proceeding under CrPC, IPC
- AAR- discontinued with 2021 FA- from date notified by CG-OGN
    - Alternative method- inserted 245-OB- CG- constitute BFAR (1.9.2021)
    - BFAR- HQ- Del and Mum
    - Sec.245W- Appeal to HC against BFAR- appeal by Applicant or Department
    - File within 60D- condone delay for 30 days
- 2022- e-AR Scheme, 2022- online application

M/s DIT (International Taxation), Mumbai v. M/s Morgan Stanley & Co (2007) SCI

- **Determinants:** India-US DTAA v. TP application
- DTAA- advocates ALP or methods of avoiding DT on Income
- MSG- FSC- investment banking, M&A, Unwriting equity and related transaction
- 3 lines of business- Securities investment management, investment banking, credit services
- MSCo- investment bank- fin advisory services, corporate lending, securities underwriting
- 1 of MSG- MSAS Pvt Ltd.- agreement for providing certain support services- MSCo
- MSCo outsourced certain activities to MSAS
- MSAS- support main office functions- equity, fixed income research, account reconciliation, IT enabled services, back office operation, data processing, support centre to MSCo

M/s DIT (International Taxation), Mumbai v. M/s Morgan Stanley & Co (2007) SCI

- May 2005- MSCo- AR application Form 34-C inviting AR as follows:
- Transaction between A and MSAS- AR sought is 2-fold
  - Whether A was having PE in India u/Art.5(1) of DTAA on account of services rendered by MSAS under SA, 2005?
  - If so, what amount of income attributable to such PE?
- **AAR (2006)**: A- not have FPB- PE under 5 (1) of DTAA
- MSAS- not Agency PE- 5(4) of DTAA
- PE if some Ee sent to India as stewards, deputation-ists in employment of MSAS
- Against the order, A and DoR- SLP- SCI

M/s DIT (International Taxation), Mumbai v. M/s Morgan Stanley & Co (2007) SCI

- **DOR:** MSAS in India- PE of MSCo in India- FPB in Mumbai
- Nature of activities performed- MSAS in Mumbai- Co represented the business presence of the MSCo in India
- Legally, financially dependent upon A and MSAS- constitute Agency PE- 5(4) DTAA
- Both contentions- rejected by AAR- However
    - Ruled by AAR- MSAS be regarded as Service PE- 5(2)(1)- proposed to send its Ee to India for undertaking stewardship activities, for undertaking to send some of its Ee to India as deputation-ists in employment of MSAS
    - Against this ruling- Applicant approached SCI
- 2nd Q- AAR- TNMM- appropirate ALP- service agreement- meets ALP u/Sec.92-C
- No futher income attributable in MSAS in India- DOR challenge this