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India’s market began to emerge on the global stage in 1991 with the implementation of several governmental policies relating to foreign trade and foreign direct investment. This move towards globalization brought about new requirements relating to taxation and other laws as multinational corporations began investing in India and acquiring local companies. There were many transactions taking place between the same group of companies and the transfer price between them started playing a major role in impacting the profits and losses of Indian companies. Amendment in taxation laws for such transactions then became the need of the hour so that tax planning could be kept under check and protect against tax evasion.

With these concerns in mind, the Indian Tax Authorities first introduced the Transfer Pricing Regulations (TPR) through the Finance Act, 2001, and made it effective from the Financial year ending March 2002. These provisions were set to be governed by the Income Tax Act, 1961, and were based on the Transfer Pricing guidelines of the Organization for Economic Co-Operation and Development.

The Transfer Pricing Laws have been enumerated under Sections 92 to 92F of the Indian Income Tax Act, 1961 and cover intra-group cross-border transactions. Rules and regulations prescribe that income arising from International Transactions or Specified Domestic Transactions between Associated Enterprises (AE) should be computed using the arm’s-length price principle.

TPR was introduced with a view to provide a detailed statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the cases of multinational enterprises, and also introduced new s 92A to 92F in the Act, relating to computation of income from an international transaction having regard to the arm’s length price, meaning of associated enterprise, meaning of international transaction, computation of arm’s length price, maintenance of information and documents by persons entering into international transactions and definitions of certain expressions occurring in the said sections.

The legislative intention, underlying the TPR, is to prevent the shifting of profits by manipulating prices charged or paid in international transactions, thereby eroding India’s tax base. The explanatory memorandum of Finance Bill, 2001 explains that the TPR was introduced to curb transfer pricing abuse.
The term “International transactions” refers to transactions between two (or more) AEs involving the sale, purchase or lease of tangible or intangible property, the provision of services or cost-sharing agreements, lending/borrowing of money or any other transaction having a bearing on the profits, income, losses or assets of such enterprises.

For a transaction to be an international transaction, it should satisfy the following two conditions cumulatively:

- It must be a transaction between two associated enterprises and
- At least one of the two enterprises must be a non-resident.

Transaction between 2 “associated enterprises”

- At least 1 is Non-resident
- Both AE’s Non-resident
- A foreign enterprise and its Indian PE

Apply

Apply if income of NR is assessable in India

Apply
"International transaction" shall include:

- purchase, sale, transfer, lease or use of tangible property
- purchase, sale, transfer, lease or use of intangible property
- provision of services
- capital financing including lending or borrowing or guarantee
- any other transaction having a bearing on the profits, income, losses or assets of such enterprises
- a transaction of business restructuring or re-organization
- Mutual agreement between 2 AE’s for allocation of cost or expense w.r.t. service/facility provided
A transaction between an enterprise and an unrelated person shall be deemed to be a transaction between associated enterprises if in relation to that transaction—

There exists a prior agreement between such other person and the associated enterprise; or

The terms of the transaction are determined between such unrelated person and the associated enterprise.

Illustration:
Enterprise X of India and enterprise Y of Australia are associated enterprises. Enterprise Z of Singapore is not an associated enterprise of enterprise X. Enterprise Y and enterprise Z enter into an agreement for determining the terms of transactions between enterprise X and enterprise Z. The transaction as may be entered between enterprise X and enterprise Z which is governed by such an agreement existing between Y and Z shall be deemed to be a transaction between two associated enterprises.
“Specified domestic transaction” (SDT) means the following transactions, not being international transactions, provided the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of INR 200 million (prior to 1st April, 2016, it was INR 50 million). It covers the below transactions:

- **a)** any expenditure for which payment is made to a person referred to in section 40A(2)(b)
- **b)** any transaction referred to in section 80A
- **c)** any transfer of goods or services referred to in section 80-IA (8)
- **d)** any business transacted between the assessee and other person as referred to in section 80-IA (10)
- **e)** any transaction referred to any other section under Chapter VI-A or section 10AA, to which provision of section 80IA(8)/(10) are applicable

In other words, SDT covers:
- Any expenditure with respect to which deduction is claimed while computing profits and gains of business or profession.
- Any transaction related to businesses eligible for profit-linked tax incentives, for example, infrastructure facilities (Section 80-IA) and SEZ units (section 10AA).
- Any other transactions as may be specified.
It is the price applied to unrelated enterprises (i.e., fair market price) in uncontrolled conditions. Transfer Pricing relates to determination of correct market price i.e. arm’s length price (ALP).

For tax purposes, companies are required to record the exchange of goods using the arms-length principal, which states that the prices charged by the affiliated companies should be equivalent to the prices that would have been charged by a third-party.

Furthermore, not only the income, even the allowance for any expense or interest arising from an international transaction or specified domestic transaction shall be determined as per the arm’s length price (Explanation to section 92(1)).

Sharing /contribution of cost or expense of any benefit, etc. shall also be at arm’s length price (section 92(2)).

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.

It has been notified that the ‘other method’ for determination of the arm’s-length price in relation to an international transaction shall be any method which takes into account the price which has been charged for the same or similar transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.
The provisions of arm’s length price shall not apply in a case where the computation of income or the determination of the allowance for any expense or interest, or the determination of any cost or expense allocated or apportioned 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.
The relationship of associated enterprises (AEs) is defined by Section 92A of the Act to cover direct/indirect participation in the management, control or capital of an enterprise by another enterprise. It also covers situations in which the same person (directly or indirectly) participates in the management, control or capital of both the enterprises.

Two enterprises shall be deemed to be associated enterprises w.r.t. various cases given below:

**Case 1: Sec 92A(2)(a): Shareholding having at least 26% voting power**
One enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise

A Ltd → At least 26% → B Ltd

Or,

A Ltd → At least 26% → 50% → B Ltd

Or,

A Ltd → B Ltd. (40%) → C Ltd

*A, B and C are Associated Enterprises*

**Case 2: Sec 92A(2)(b): Shareholding having at least 26% voting power by same person**
any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises

B → 26% → A Ltd
B → 40% → C Ltd

*A Ltd. and C Ltd. are Associated Enterprises*
Case 3: Sec 92A(2)(c): Advancement of loan
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.

Case 4: Sec 92A(2)(d): Guarantee of Borrowings
One enterprise guarantees not less than 10% of the total borrowings of the other enterprise;

Case 5: Sec 92A(2)(e): Appointment of BOD
At least 51% 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.

Case 6: Sec 92A(2)(f): Appointment of BOD by same person
At least 51% 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 two enterprises are appointed by the same person or persons.

*A Ltd. and B Ltd. are Associated Enterprises*
**Case 7: Sec 92A(2)(g): Commercial rights of manufacture/ processing**
The business of one enterprise is wholly dependent on the use of know-how, patent, technical know-how, etc. of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights.

![Diagram of Case 7: A Ltd to B Ltd. B Ltd operates its business using trademark of A Ltd. Thus, both are AE’s.]

**Case 8: Sec 92A(2)(h): Supply of raw materials/ consumables**
At least 90% 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.

![Diagram of Case 8: A Ltd to B Ltd. A or X supplies 90% raw materials to B at prices controlled by A. Thus, A and B are AE’s.]

**Case 9: Sec 92A(2)(i): Sale of goods/ articles**
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.

![Diagram of Case 9: B Ltd to C Ltd. B sells its articles to C or Z at prices controlled by C. Thus, B and C are AE’s.]

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**Case 10: Sec 92A(2)(j): Control by same person/ his relative**
Where one enterprise is controlled by an individual, the other is also controlled by such individual and/or his relative.

![Diagram](image)

**Case 11: Sec 92A(2)(k): Control by HUF or its member/ relative**
Where one enterprise is controlled by a HUF, the other enterprise is controlled by a member of such HUF or relative of such member or jointly by such member & his relative.

![Diagram](image)

**Case 12: Sec 92A(2)(l): Interest in Firm/ AOP/ BOI**
Where one enterprise is a Firm, AOP or BOI, and the other enterprise holds not less than 10% interest in such Firm, AOP or BOI.
The following are the important statutes of law:

- Each person or association who has involved in an international transaction should maintain an up-to-date record of each transaction as prescribed by the legislation.
- All income acquired by the company by means of any international transaction shall be calculated at arm’s length price. There are various methods to calculate the arm’s length price, depending on the nature and type of the transaction, the nature of the group or the association involved, or any other features of the transactions involved. These methods are introduced by the Central Board of Direct Taxes, generally known as the ‘Board’. Some of them include the resale price method, cost plus method, comparable uncontrolled price method, and transactional net margin method.
- If there are two or more appropriate prices assumed for a certain transaction, the arm’s length price will be calculated as the average of the prices.
- At the end of a financial year, the person or group involved in an international transaction should submit the report of it in Form 3CEB under the guidance of a Chartered Accountant. This form has to be filed before he files the Income Tax return of the same period.

The group or person who does not adhere to these rules is liable to pay the penalties as imposed by the Board.
Where the aggregate value, as recorded in books of accounts of international transaction entered into by the enterprise exceed INR 10 million, and for specified domestic transactions, it is imperative that the documentation maintained should be adequate to substantiate the arm’s-length price of the international transactions or specified domestic transactions. **Such requirements can broadly be divided into two parts:**

The first part includes information on the ownership structure of the taxpayer, a group profile, and a business overview of the taxpayer and AEs, including prescribed details such as the nature, terms, quantity and value of international transactions. The rules also require the taxpayer to document a comprehensive transfer pricing study.

The second part of the rules require adequate documentation be maintained to substantiate the information, analysis and studies documented under the first part of the rule. It also contains a recommended list of such supporting documents, including government publications, reports, studies, technical publications and market research studies undertaken by reputable institutions, price publications, relevant agreements, contracts and correspondence.

Companies to whom transfer pricing regulations are applicable are currently required to file their tax returns on or before 30 November following the close of the relevant tax year. The prescribed documents must be maintained for a period of eight years from the end of the relevant tax year, and must be updated annually on an ongoing basis.

It is also imperative to obtain an Independent Accountant’s Report in respect of all international transactions between AEs and the same has to be submitted by the due date of the tax return filing, on or before 30 November.

**Period for which records shall be kept maintained [Section 92D(2)]:**

The board may prescribed the period for which the information and document shall be kept and maintained under that sub-section. The Board, vide rule 10D(5) has since prescribed that the information and documents shall be kept and maintained for a period of **8 years** from the end of the relevant tax year.

**Failure to keep and maintain any such information and document shall attract a penalty.**
The Indian Transfer Pricing Regulations have prescribed the following penalty provisions summarized below:

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<td>In case of a post-inquiry adjustment, there is deemed to be a concealment of income</td>
<td>100-300 percent of tax on the adjusted amount</td>
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<td>Failure to maintain documents</td>
<td>2 percent of the value of transaction</td>
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<tr>
<td>Failure to furnish documents during TP audit</td>
<td>2 percent of the value of transaction</td>
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<tr>
<td>Maintaining or furnishing incorrect information or documents</td>
<td>2 percent of the value of transaction</td>
</tr>
<tr>
<td>Failure to furnish accountant’s report</td>
<td>INR 100,000 (One hundred thousand rupees)</td>
</tr>
<tr>
<td>Failure to report a transaction in accountant’s report</td>
<td>2 percent of the value of transaction</td>
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Transfer Pricing Litigation, Documentation and Study

Neeraj Bhagat & Company offers consulting on transfer pricing documentation in more qualitative and intelligent online study and the dispute on the basis of inputs issued by the clients. In addition, adequate tax advice will also be suggested and consulted on setting ARMs length price and adoption of the most appropriate method. This documentation differs from across industries and one company to another, but in the Laws of Transfer Pricing and concepts, we will be providing similar functional elements’ comparison of publicly available databases, both locally and globally, after comparison through the FAR analysis, based on economic and Indian market conditions. Our study involves the analysis of contemporaneous facts and research from public databases also to analyze correct Price Comparison of functional elements and the like.

Why NBC for Transfer Pricing Audit and Study?

Our best practical transfer pricing audit services directly enable us to develop more stringent, better quality products, and collaborate more effectively with our clients. Because we are a company of impartial financial professionals, many of the leading law firms in India and worldwide also attended us to create this value and sustainable solutions to their multinational corporate clients as experts on transfer pricing litigation and arbitration. Our team has significant experience to a higher level, and work together with multinational clients and their legal and tax consultants to deliver the highest standard of case counseling and support practice, the application of sophisticated techniques based on the economy when it is necessary, to address harder issues. Neeraj Bhagat & Company’s clients range from some of the biggest known and well-established enterprises in the world to medium enterprises and also involving a number of iconic brands.
Our Offices in India

**New Delhi:**
S-13, St. Soldier Tower, G-Block Commercial Complex, Vikas Puri, New Delhi – 110018 (India)

Phone : + 91 11 28543739  
: + 91 11 28544939  
: + 91 11 45527239
Fax    : + 91 11 43850030

**Gurgaon:**
1156, Tower B2, 11th Floor, Spaze I Tech Park, Sohna Road, Sector 49, Gurgaon-122001, Haryana (India)

Phone : + 91 124 4371317  
       + 91 124 4371318
Fax    : + 91 11 43850030

**Mumbai:**
Unit No.3, 1st Floor, New Laxmi Shopping Centre, A-Wing, H.D.Road, Ghatkopar (W), Mumbai – 400086 (India)

Phone : + 91 98202-63544  
       + 91 22-25110016

E-mail : info@neerajbhagat.com  
Website : www.neerajbhagat.com

Neeraj Bhagat & Company is a team of distinguished chartered accountant, corporate financial advisors and tax consultants in India. Our firm of chartered accountants represents a coalition of specialized skills that is geared to offer sound financial solutions and advices. The organization is a congregation of professionally qualified and experienced persons who are committed to add value and optimize the benefits accruing to clients.

NBC’s transfer pricing professionals help taxpayers to fulfill overseas documentation requirements in India and for the report preparation for transfer pricing documentation that analyze the nature of full competence in prices between companies. We also help multinationals with multiple FATS to prepare the global documentation, provided all documentation requirements efficiently and consistently. Our team of audit consultants has the expertise to know what the tax officials are looking for, and may help you prepare your documents properly the first time and thereafter.