TRANSFER PRICING

Overview of Transfer Pricing regulations

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OUR PLAN FOR THE EVENING

1. Need for Transfer Pricing regulations
2. Concept of Transfer Pricing
3. International Transaction
4. Associated Enterprises
5. Specified domestic transaction
6. Benchmarking methods
7. Form No. 3CEB
8. TP Documentation

Need for Transfer Pricing Regulations

Increasing participation of MNC's in various countries has given rise to new and complex issues arising from intra-group transactions.

Profits derived by such group entities can be controlled by the MNE by manipulating the prices charged and paid in such intra group transactions, thereby, leading to erosion of tax revenues.

To curb tax avoidance by abuse of transfer pricing and with a view to ensure fair and equitable sharing of tax revenues b/w tax nations (i.e. the residence and source countries), various countries introduced TP regulations in their domestic tax laws based on OECD BEPS Action Plans.

India introduced TP provisions vide Finance Act, 2001 (w.e.f AY 2002-03) and amended from time to time.

Concept of Transfer Pricing

- **Section 92(1)**

  Any ***income*** arising from an ***international transaction*** shall be computed having regard to the ***arm's length price***
  Explanation : the allowance for any ***expense or interest*** arising from an international transaction shall also be determined having regard to the ***arm's length price***

- **Section 92(3)**
  The provisions are not intended to be applied in case determination of arm's length price reduces the income chargeable to tax or increases the loss as the case may be

Concept of Transfer Pricing

Transfer Price	• The price charged in a transaction between two associated enterprises
Arm's Length Price	• The price charged in a transaction b/w unrelated parties in uncontrolled situations
Controlled transaction	• Transaction b/w two associated enterprises or related parties
Uncontrolled transaction	• Transaction b/w two unrelated parties

Concept of Transfer Pricing

International transaction – Sec 92B

A transaction b/w 2 or more associated enterprises, either or both of whom are non-residents, in the nature of;

Tangible Property
- Purchase, sale, transfer, lease/use of property/article/product/thing
- Includes building, vehicle, machinery etc.

Intangible Property
- Purchase, sale, transfer, lease/use of intangible property
- Includes transfer of ownership/use of rights/other commercial right

Capital Financing
- Long/short term borrowing/lending
- Guarantee
- Purchase/sale of securities
- Advances/receivables, payments/any debt arising during the course of business

Provision of services
- Market research/development
- Technical service
- Scientific research
- Legal/accounting etc.

Mutual agreement/ arrangement
- Allocation/apportionment of or any contribution to any cost/expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided

International transaction

Business restructuring/reorganization

- 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.

Business restructuring/reorganization (As per ICAI Guidance Note & OECD guidelines)

- Restructuring/reorganization could be in the form of ***operational change*** (in functional, asset and risk profile of the entity) or ***organizational change*** (in ownership structure/management of the entity). It could include a change in the nature or scope of transactions among controlled entities, a shift in the allocation of risks, a change in responsibility for specific functions or commencement or termination of relationship etc.

- Examples of Business Restructuring:
  - ➢ Conversion of full-fledged distributor into a low risk distributor
  - ➢ Merger of two AEs to form a single entity
  - ➢ Demerger of a business unit of an enterprise with an AE

International transaction

Sl. No	International transaction	Facts & Issue	Case law	Decision
1	Issue of shares at premium	• Face value of Rs.10 each on premium of Rs.8,509 per share to holding company. • The AO/TPO valued each equity share at Rs.53,775 and made an adjustment of Rs.45,256 per share, by treating shortfall in premium as income. • **Issue – whether TP provisions are machinery or substantive – existence of income element for applicability of TP provisions**?	Vodafone India Services (P.) Ltd. V. UOI [2014] 50 taxmann.com 300 (Bombay HC)	• TP provisions are machinery to arrive at ALP of a transaction b/w AEs. • Substantive charging provisions are found in Sec 4, 5, 15, 22, 28, 45 & 56 of the Act. • Any income arising from an international transaction must satisfy the test of income under the Act and find its home in one of the above heads

CBDT accepted the decision of the court vide Instruction No.02/2015 dated 29.01.2015

International transaction

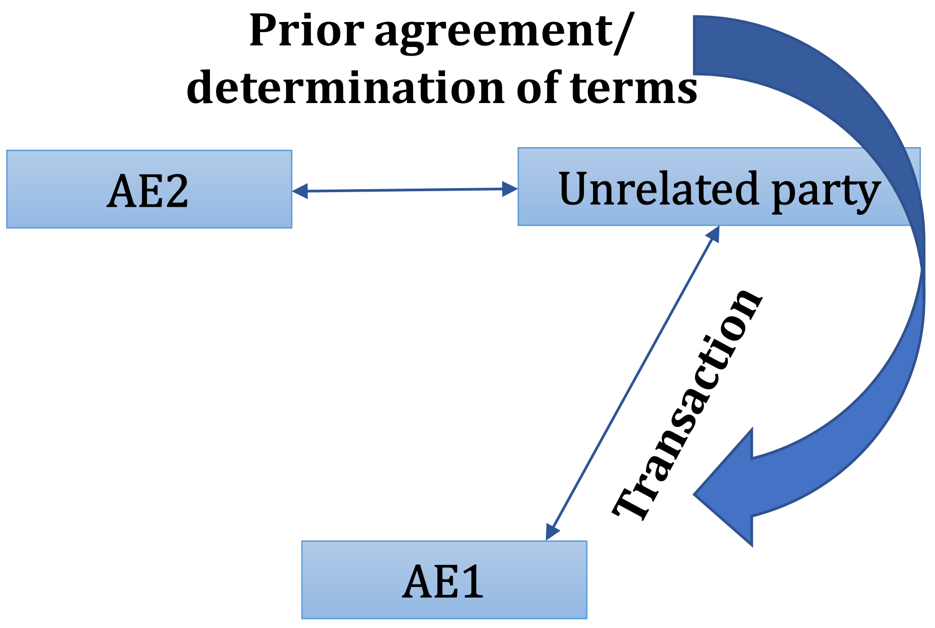
Sl. No	International transaction	Facts & Issue	Case law	Decision
2	Interest on delayed realization of receivables	• Amounts receivable from AEs outstanding for > allowed credit period . • **Issue – Notional interest is an international transaction?**	HBL Power Systems Ltd. v. DCIT [2021] 128 taxmann.com 201 (Hyd - ITAT)	• It is an international transaction – Sec 92(1) r.w explanation (i) (c) of Sec 92B
		• **Issue – whether AO/TPO justified in charging notional interest on a international transaction which was already at ALP**?	ERM India (P.) Ltd. v. NeAC – [2021] 132 taxmann.com 220 (Delhi-ITAT)	• No additional imputation of interest on outstanding receivables is warranted if pricing/profitability of assessee is more than working capital adjusted margin of comparable companies.

Deemed International transaction

Section 92B(2)

A transaction with an unrelated party is deemed to be an international transaction, if;

- a ***prior agreement*** exists b/w unrelated party and AE in relation to such transaction; or
- the ***terms of such transaction*** are determined in substance b/w unrelated party and AE
- Either or both of AEs are non-residents irrespective of whether such unrelated party is a non-resident or not. (***Amended vide Finance Act, 2014***)

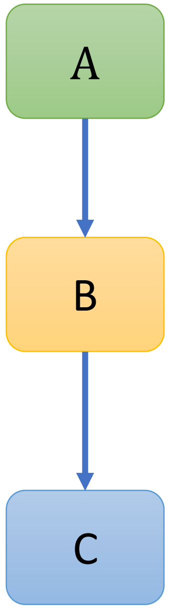


Associated Enterprises

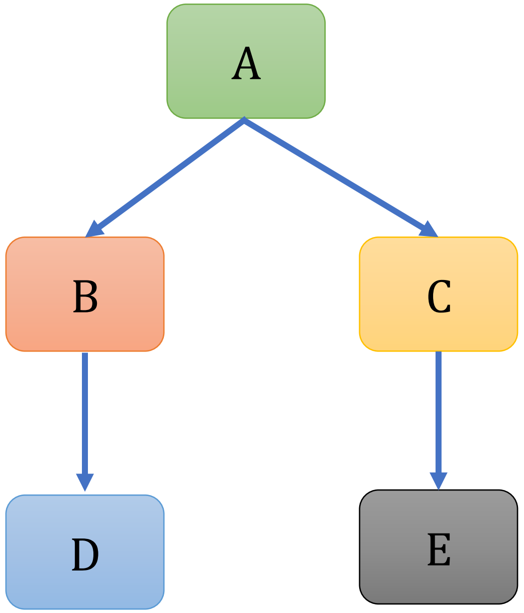
Section 92A(1)
Two enterprises are associated enterprises, if;

a) one enterprise participates directly or indirectly in the ***management/control/capital*** of other enterprise; or

b) Same enterprise participates directly or indirectly in the ***management/control/capital*** of both enterprises



Both A & B are AE's of C
B – Direct participation
A – Indirect participation



Both B & C are AE's – A common
C & E are also AE's of D – ultimate holding A

Deemed Associated Enterprises – Sec 92A(2)

Holding

- >=26% ***direct/indirect voting power*** by enterprise
- >=26% ***direct/indirect voting power by same person*** in each enterprise
- ***Loan*** >=51% of book value of total assets
- ***Guarantees*** >= 10% of total borrowings
- > 10% ***interest*** in Firm/AOP/BOI

Management

- Appointment > 50% of ***BOD*** or one or more ***executive director*** by an enterprise
- Appointment by ***same person*** in each enterprise

Activities

- ***100% dependence on use of intangibles*** for manufacture/processing /business
- Direct/indirect supply of >=90% of ***raw materials/consumables*** required for manufacturing/processing under influenced prices and conditions
- Sale under ***influenced*** prices and conditions

Control

- One enterprise ***controlled*** by ***an Individual*** and the other by himself or his relative or jointly
- One enterprise ***controlled by HUF*** and the other by a member of HUF, his relative or jointly by member and relative.

Inter play b/w Sec. 92A(1) & 92A(2)

Sub-section (1) & (2) of Section 92A are independent of each other or operate jointly?

- Basic Rule - Sub-sec (1) – does not begin with a subjective clause "subject to sub-section (2)";
- Sub-sec (2) starts with for the purposes of sub-section (1);
- Explanatory memorandum to Finance Act, 2002

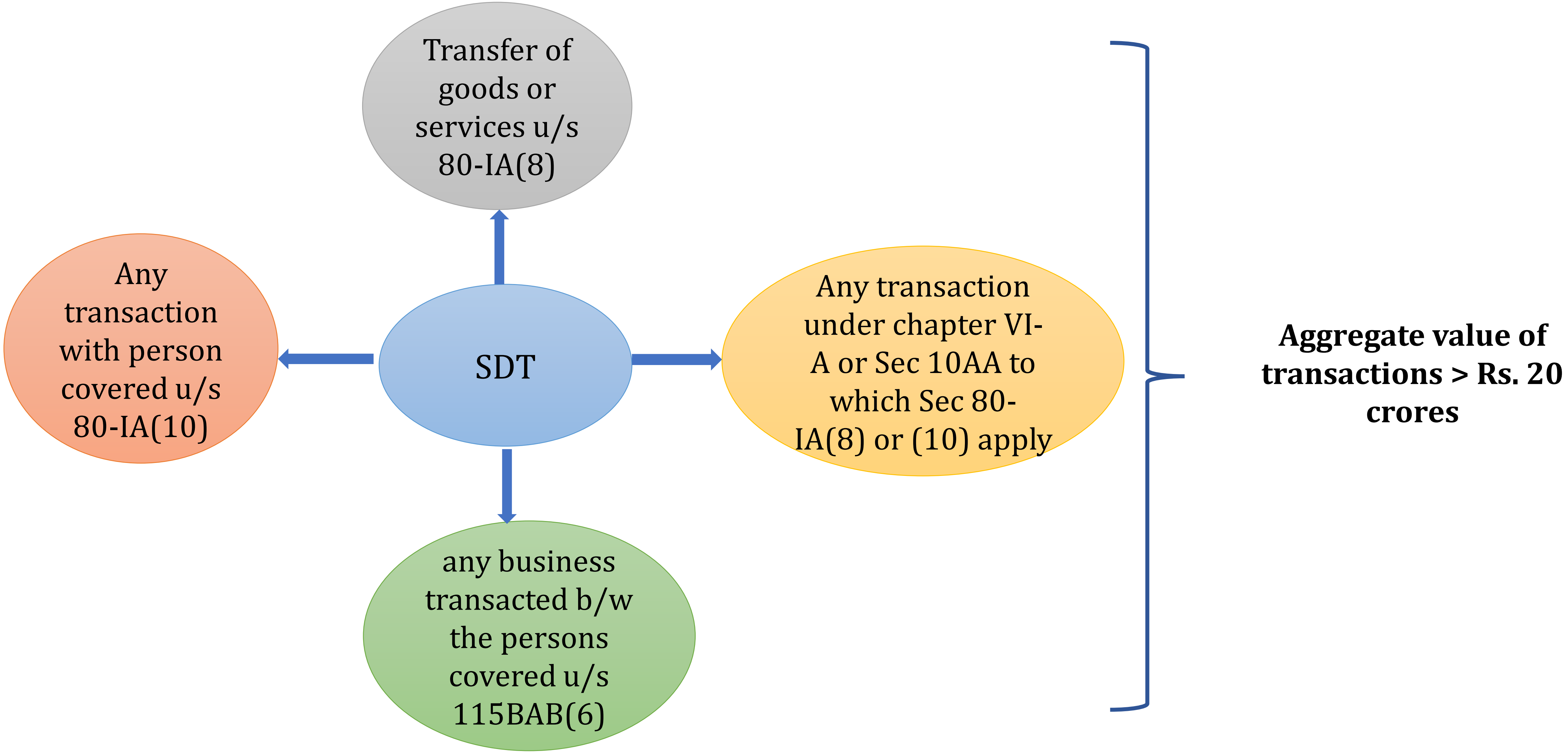
  It is proposed to amend sub-section (2) of the said section to clarify that the mere fact of participation by one enterprise in the management or control or capital of the other enterprise, or the participation of one or more persons in the management or control or capital of both the enterprises shall not make them associated enterprises, unless the criteria specified in sub-section (2) are fulfilled.

- Once the requirements of sub-sec (2) are fulfilled, 2 enterprises will be treated as AE's – such interpretation would render provisions of sub-sec (1) otiose or superfluous.
- ***In order to constitute relationship of an AE, the parameters laid down in both sub-sections (1) & (2) should be fulfilled.***

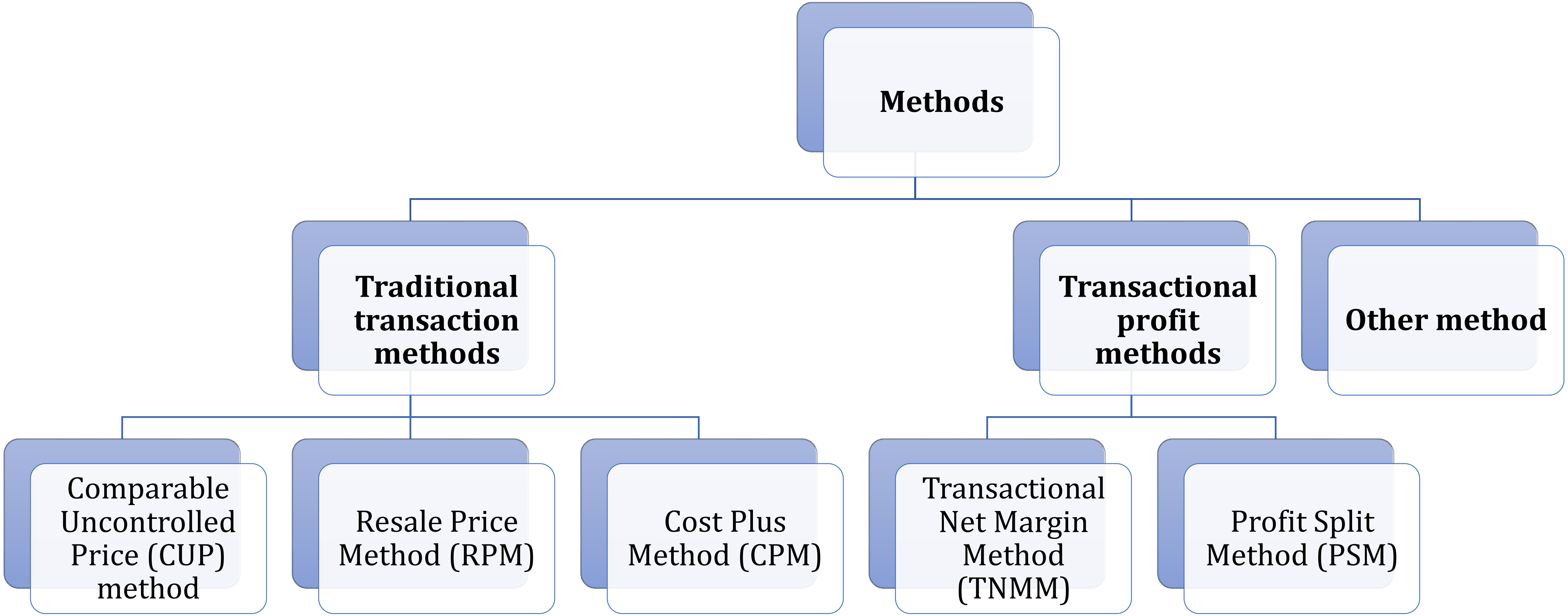
  Case law references;

  Vinca Developers Private Limited. Vs. ACIT ITA No.6070/Mum/2017 (Mumbai – ITAT)

Specified domestic transactions (Sec 92BA)



Prescribed Transfer Pricing Methods



Comparable Uncontrolled Price (CUP) Method

- **Rule 10B(1)(a)**

  Steps involved in the application of this method;

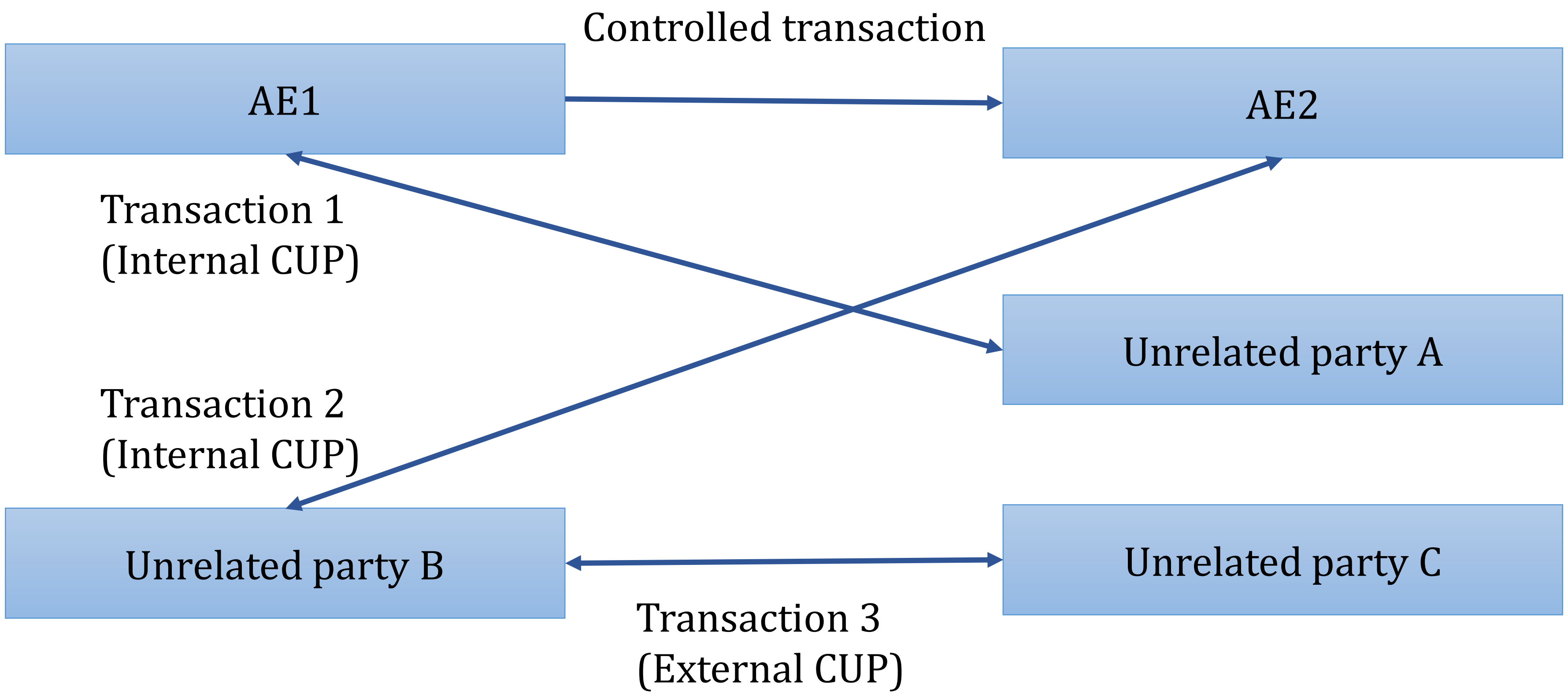
  - Identify the ***price charged or paid*** in ***comparable uncontrolled transaction***(s);
  - The above price should be ***adjusted to account for differences,*** if any which could ***materially effect*** the price in the open market;
  - The ***adjusted price is the arm's length price***

- Comparable uncontrolled transaction can be used as CUP if one of the following two conditions is met:
  - ***none of the differences*** (if any) between the transactions being compared or between the enterprises undertaking those transactions could ***materially affect the price in the open market***; or
  - ***reasonably accurate adjustments*** can be made to ***eliminate the material effects of such differences***.

- **CUP method warrants High degree of product comparability.**

Comparable Uncontrolled Price (CUP) Method

- **Types of CUP**



- ***Transaction 1, 2 & 3 are uncontrolled transactions***
- ***Typically Internal CUP is preferred over external CUP due to higher degree of comparability***

Comparable Uncontrolled Price (CUP) Method

- Typical transactions in respect of which the CUP method may be adopted are (As per ICAI Guidance Note);
  - ✓ Transfer of goods
  - ✓ Provision of services
  - ✓ Royalty for use of intangibles
  - ✓ Interest on loans

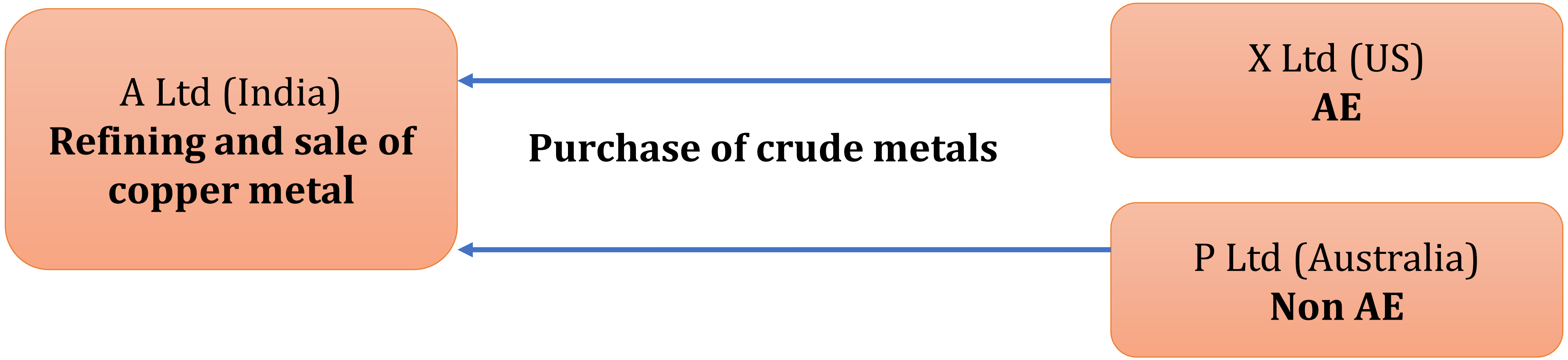
- Reasonably accurate adjustments may be made for differences in;
  - ✓ The type & quality of products
  - ✓ Delivery terms
  - ✓ Volume of sales & discounts
  - ✓ Product characteristics
  - ✓ Contractual terms

- Factors to be considered while selecting comparable uncontrolled transaction;
  - ✓ Type of product & similarity
  - ✓ Contractual terms
  - ✓ Geographical market
  - ✓ Market levels

- Reasonably accurate adjustments may not be possible for;
  - ✓ Unique & valuable trademarks
  - ✓ Fundamental differences in the products
  - ✓ Difference in the characterisation of the entity

Comparable Uncontrolled Price (CUP) Method

Illustration 1:



- Purchase from X Ltd. is for 10,000 MT at a price of Rs.30,000 per MT.
- Purchase from P Ltd. is for 2,500 MT at a price of Rs.40,000 per MT.
- Quantity discount of Rs.500 per MT is offered by X Ltd.
- Credit period allowed by X Ltd. is one month. Cost of the credit is 1.25% p.m.
- Transaction with X Ltd. is at FOB where with P Ltd. is CIF. Freight and insurance cost is Rs.1,000.
- Alloy mix (per MT) for purchase from X Ltd. is 0.5 kg gold and 1 kg silver. The alloy mix (per MT) for purchase from P Ltd. is 1 kg gold and 1 kg silver. cost of the gold is Rs.2,000 per kg.

Comparable Uncontrolled Price (CUP) Method

Solution 1:

Analysis of terms of the transactions:

Terms	International transaction (with X Ltd. – AE)	Comparable uncontrolled transaction (with P Ltd. – Non AE)	Remarks
Volume (MT)	10,000	2,500	
Price (per MT)	30,000	40,000	
Quantity discount	Yes	No	Quantity discount – Rs.500 per MT
Credit period	1 month	No	Cost of credit – 1.25% per month
Alloy mix (per MT)	0.5 kg gold & 1 kg silver	1 kg gold & 1 kg silver	Cost of gold – Rs.2,000 per kg
Delivery terms	FOB basis	CIF basis	Freight & insurance cost – Rs.1,000

Comparable Uncontrolled Price (CUP) Method

Solution 1:
Computation of ALP:

Particulars	Price per MT
Price (per MT)	40,000
Adjustments:	
Less: Quantity discount	(500)
Less: Alloy mix – gold content (0.5 kg*2,000)	(1,000)
Less: Freight & insurance cost	(1,000)
Add: Interest for the differential credit period (40,000*1.25%)	500
Arm's length price (ALP) per MT	**38,000**

Key aspects:

1. Very high degree of **product comparability** is required.
2. Other relevant aspects:

a) Contractual terms (i.e. warranties, credit terms, shipment terms etc.,)
b) Level of market (retail, wholesale etc.,)
c) Volumes

Conclusion: Since the actual purchase price (i.e. Rs.30,000) is lower than the ALP (i.e. Rs.38,000), international transaction of purchase from X Ltd. (AE) is meeting with arm's length requirements.

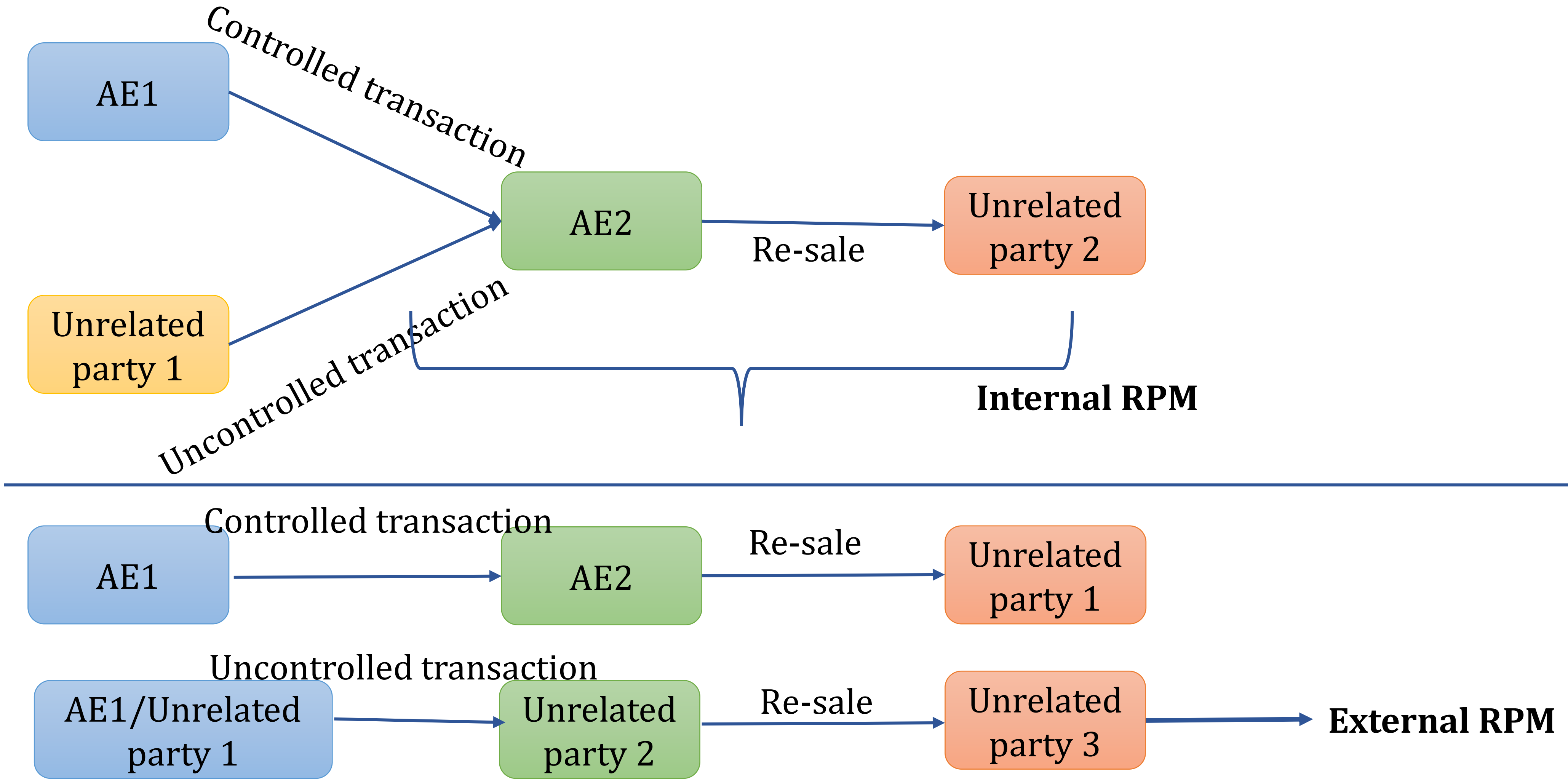
Resale Price Method (RPM)

Steps in computing ALP (Rule 10B(1)(b)):

Particulars	Amount (in Rs)
Resale price charged to unrelated enterprise in resale of property purchased/service obtained from an AE	XXX
Less: Normal gross profit margin in a comparable uncontrolled transaction whether internal or external	XXX
Less: Expenses (custom duty, etc) in connection with purchase of property/service from AEs	XXX
Add/Less: Functional/other differences (including differences in accounting practices, adjustments for opening & closing inventories) between the transactions / enterprises, which affect gross margin	XXX
Arm's length price (ALP)	XXX

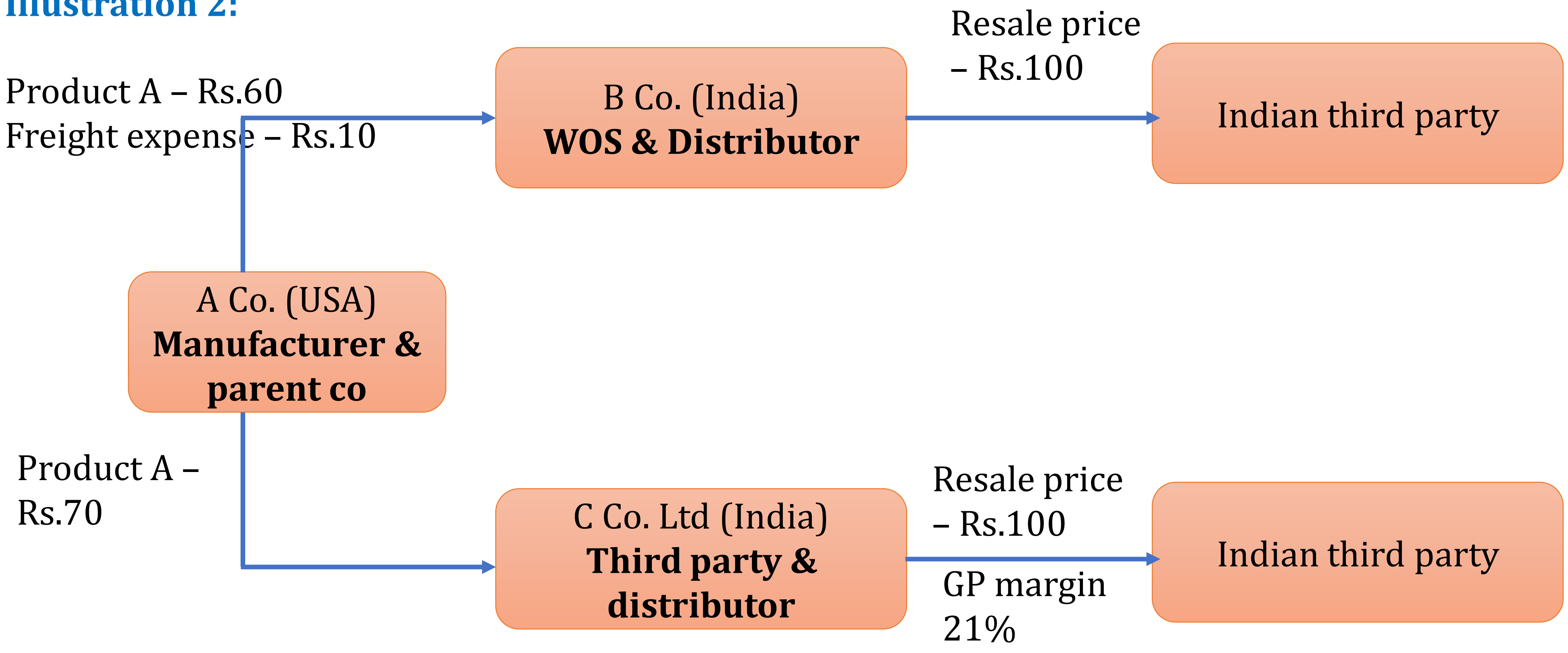
Resale Price Method (RPM)

Types of RPM



Resale Price Method (RPM)

Illustration 2:



Resale Price Method (RPM)

Terms of contract:

Particulars	Sale by B Co. (Subsidiary)	Sale by C Co. (Independent co.)
Quantity discount	Yes – 1% of GP	No
Warranty	No	Yes – 6 months (no change in sale price). Warranty cost is Rs.200 per unit

Resale Price Method (RPM)

Solution 2:
Computation of adjusted gross profit margin

Terms	Sale by B Co. (Subsidiary)	Sale by C Co. (Independent co.)	Effect on GP margin of C Co.
Quantity discount	Yes – the cost of the same is estimated1% of GP	No	1% on GP margin
Warranty	No	Yes – 6 months (no change in sale price). Warranty cost is Rs.200 per unit	As such cost is not debited to trading account, hence **no impact on GP margin**

Therefore, adjusted Gross profit margin of C Co. is 20% (21% less 1%)

Resale Price Method (RPM)

Solution 2:
Computation of ALP using RPM

Particulars	Amount (in Rs.)
Resale price charged by B Co. to third party	100
Less: Adjusted gross profit margin of C Co. (100*20%)	(20)
Cost of sales	80
Less: Freight exp incurred by B Co. for purchase from A Co.	(10)
Arm's length price	**70**

Conclusion: Since the actual purchase price (i.e. Rs.60) is lower than the ALP (i.e. Rs.70), international transaction of purchase from A Co. (AE) is meeting with arm's length requirements.

Application of RPM – Key aspects

1. **Reseller adds relatively little or no value to the goods through physical modification or by using intangible property:**
   - **Limited enhancements** such as packaging, repacking, labelling or minor assembly which generally does not add significant value to the goods is acceptable.
   - **Significant value addition** through physical modification such as converting rough diamonds into cut and polished diamonds adds significant value to the goods and hence, **RPM cannot be applied**.
   - Again, where goods are imported from AE and sold in local market by **adding brand name of Indian company**, then **RPM cannot be applied** since there is significant addition in value of goods due to the use of brand name of Indian company.
2. **High degree of functional comparability rather than product comparability**

   This is because, in RPM, the comparability is at Gross margin level and hence, differences in the functions would affect the gross margins.
3. **Minor differences in the products are acceptable** if they are **less likely** to have effect on the gross profit margin earned from sale of such products.

   E.g. Gross profit margin earned from trading of microwave ovens in controlled transactions can be compared with gross profit margin earned by unrelated parties from trading of toasters. This is because, both are consumer durables and fall in within the same industry.

Application of RPM – Key aspects

4. **Shorter the time gap** between purchase and resale, more accurate is the correct calculation of gross margin:
   - If sugar is purchased at the time of low demand and sold after 6 months when high demand, the gross margin is highly affected due to sales price. Hence, RPM can not be applied unless with adjustments.

5. **Not applicable** when goods purchased from AE also **re-sold to AE.**

Cost Plus Method (CPM)

Steps in computing ALP (Rule 10B(1)(c):

S. No	Particulars
1	Determine the direct and indirect cost of production in respect of property transferred or service provided to an AE
2	Determine normal gross profit mark-up on costs in the comparable uncontrolled transaction
3	Adjust the gross profit mark-up to account for functional and other differences b/w the international transaction and CUT
4	Direct and indirect cost of production in the international transaction is increased by such adjusted gross profit mark-up
5	Arm's length price (ALP)

Application of CPM – Key aspects

- Typical transactions where CPM may be adopted are (***As per ICAI Guidance Note***);
  - ✓ Provision of services
  - ✓ Transfer of semi finished goods
  - ✓ Joint facility arrangements
  - ✓ Long term buying and selling arrangements

- High degree of ***functional comparability*** rather than product comparability (FAR analysis)

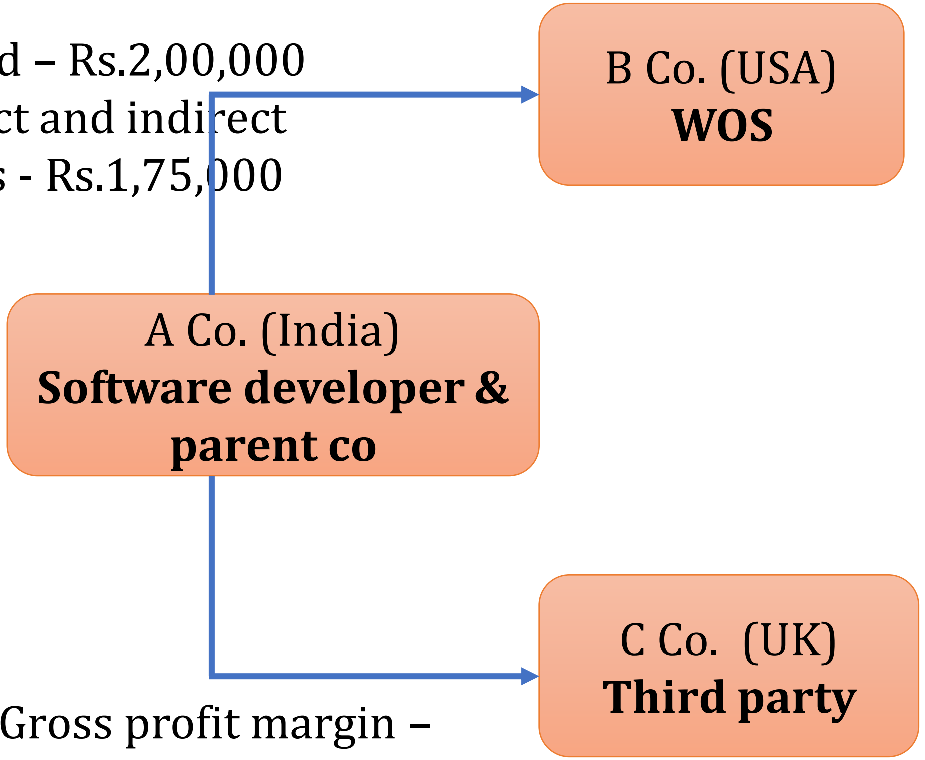
- Cost plus pricing is different from CPM. CPM can't be concluded as the most appropriate method only on the basis that pricing policy is cost plus mark-up.

- Factors that would effect application of CPM/may require adjustment;
  - ✓ Direct and indirect costs not defined
  - ✓ No uniform accounting practices
  - ✓ Contractual terms
  - ✓ Sales, marketing and advertising programs
  - ✓ Inventory levels
  - ✓ Capacity utilization
  - ✓ Lack of reliable external comparable data

Cost Plus Method (CPM)

Illustration 3:

Billed – Rs.2,00,000
Direct and indirect costs - Rs.1,75,000



Gross profit margin – 50% on costs

Terms	Transactions with B co. (AE)	Transaction with C Co. (CUT)
Technology support received	Yes - value of technology support incurred is Rs.17,500	No
Discount offered	Yes – Rs. 8,750	No
Expenses incurred towards marketing	No	Yes – Rs.13,125
Credit	Yes – Cost of credit is Rs.2,625	No

Cost Plus Method (CPM)

Solution 3:
Computation of adjusted gross profit margin

Terms	Services to B Co. (Subsidiary)	Services to C Co. (Independent co.)	Effect on GP margin of C Co.
Technology support received	Yes - value of technology support incurred is Rs.17,500	No	**-10%** (17,500/1,75,000)
Discount offered	Yes – Rs. 8,750	No	**-5%** (8,750/1,75,000)
Expenses incurred towards marketing	No	Yes – Rs.13,125	**-7.5%** (13,125/1,75,000)
Credit period	Yes – Cost of credit is Rs.2,625	No	**+1.5%** (2,625/1,75,000)

Therefore, adjusted Gross profit margin of C Co. is 29% (50% -10%-5%-7.5%+1.5%)

Cost Plus Method (CPM)

Solution 3:
Computation of ALP using CPM

Particulars	Amount (in Rs.)
Direct and indirect costs incurred in respect of international transaction	1,75,000
Add: Adjusted gross profit margin of C Co. (1,75,000*29%)	50,750
Arm’s length price	2,25,750
Actual price charged to B Co.	2,00,000
Income to be increased by	**25,750**

Transactional Net Margin Method (TNMM)

Steps in computing ALP (Rule 10B(1)(e)):

S. No	Particulars
1	Compute net profit margin of an enterprise in relation to costs incurred or sales effected or assets employed or any other relevant base
2	Compute the net profit margin realized by the enterprise or unrelated enterprise in a CUCT by applying the same base
3	Adjust NP margin realized from CUCT to account for differences affecting NP margin in the open market
4	Adjusted NP margin taken into a/c to arrive at ALP

Transactional Net Margin Method (TNMM)

- Most frequently used method, due to lack of availability of data for application of other methods
- Broad level of product comparability and high level of functional comparability
- Both Internal TNMM and external TNMM are possible
- Selection of the right comparables and PLI are critical factors
- Aggregation of transactions (Rule 10A(d) – transaction to include a number of “closely linked transactions”)
- Comparison at net profit margin level
- Internal TNMM – either at transactional level profit margin or entity level profit margin (segmental or enterprise as a whole)
- External TNMM - Entity level profit margin (segmental or enterprise as a whole)

Transactional Net Margin Method (TNMM)

- Rule 10B(e)(iii) requires that transaction level and enterprise level differences should be adjusted if such differences materially affect the amount of net profit margin.
- Some of the transaction level differences
  - ✓ Free gifts
  - ✓ Extended warranty
  - ✓ Pricing – FOB or CIF
  - ✓ Quantity discount
- Some of the enterprise level differences
  - ✓ Working capital
  - ✓ Cost of capital
  - ✓ Assets employed
  - ✓ Assured or risk bearing business
  - ✓ Capacity utilisation

- Points to be noted;
  - ✓ Uniform PLI to be followed, unless circumstances justify an alternate base
  - ✓ Same PLI to be adopted for both CT and CUT
  - ✓ More appropriate to use operating profit margin than profit margin (OPM would eliminate the non-operating items)
  - ✓ OPM's to be computed on the basis of financial statements
  - ✓ The accounting treatment of expenses and depreciation is also a critical factor in computing ALP.

Profit Split Method (PSM)

Steps in computing ALP (Rule 10B(1)(d)):

S. No	Particulars
1	Determine combined net profit of the AE's arising out of international transactions
2	Evaluate the relative contribution of each enterprise to the earning of combined NP on the basis of FAR
3	Split the combined NP amongst the enterprise in proportion to market returns & residual profits in proportion to their relative contribution
4	The profits so apportioned to the AE then added to the costs incurred by it in relation to international transaction would result in ALP.

Profit Split Method (PSM)

- Typical transactions where PSM may be adopted are (***As per ICAI Guidance Note***);
  - ✓ ***Integrated services provided by more than one AE*** (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***).
  - ✓ ***transfer of unique intangibles***, for e.g. two AEs contribute their respective intangibles to develop a new product or process and earn income from such product or process.
- **Determining the combined profits to be split;**
  - ✓ Identify the relevant transactions and parties to those transactions
  - ✓ Need to be put on a common basis as to accounting practice and currency and then combined *(Because accounting standards can have significant effects on the determination of the profits to be split, accounting standards should be selected in advance of applying the method and applied consistently over the lifetime of the arrangement.)*
- Combined net profit represents the profits earned from third parties due to the combined efforts of the AE's (***and not the aggregate of entire profits earned by the AE's***).
- Two approaches – ***Total profits split*** and ***Residual profit split***.

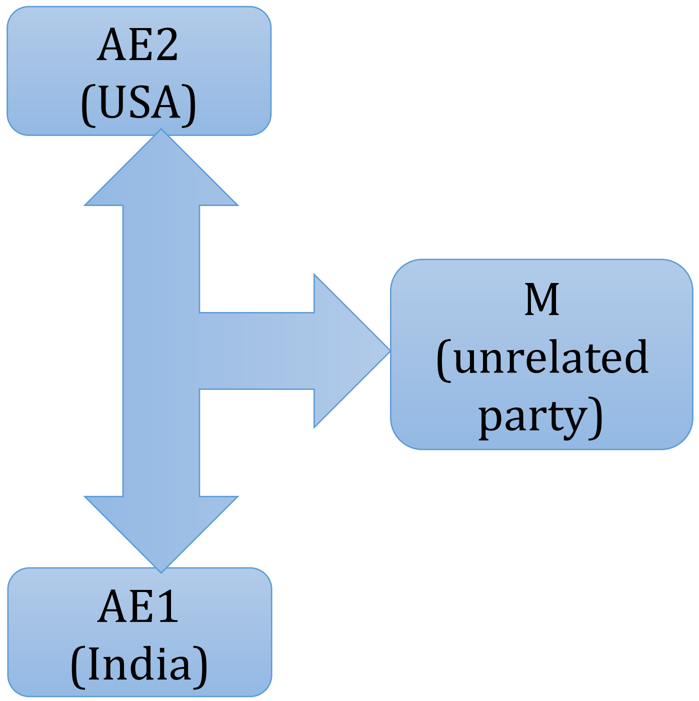
Profit Split Method (PSM)

- **Total profits split method**
  - ✓ Determine the combined net profit of the AE's arising from the international transactions (profits earned from third parties due to combined efforts of the AE's).
  - ✓ Evaluate relative contribution made by each entity on the basis of FAR analysis
  - ✓ Split the combined net profit in proportion to the relative contribution determined as above
  - ✓ ALP = Costs incurred by AE in relation to international transaction + profits so apportioned

- **Residual profits split method**
  - ✓ Determine the combined net profit of the AE's arising from the international transactions (profits earned from third parties due to combined efforts of the AE's).
  - ✓ First, based on FAR analysis, determine the basic return appropriate to the respective activities. Allocate the combined net profit on the basis of above.
  - ✓ Balance combined net profit is allocated on the basis of the relative contribution.
  - ✓ ALP = Costs incurred by AE in relation to international transaction + total profits so apportioned

Profit Split Method (PSM)

Illustration 4:



- AE1 Ltd is an investment advisory company, assists its clients with foreign acquisitions.
- AE2 Ltd based in USA has worldwide presence.
- M approached AE1 for identifying potential target companies for acquisitions in the USA.
- Both AE1 & AE2 contributed integrally for identification of potential target and assisting M with acquisition process.
- Consideration $50,000.

Profit Split Method (PSM)

Illustration 4:

Financial particulars of AE's in respect of international transactions

Particulars	AE1 Ltd	AE2 Ltd
Revenue	30,000	20,000
Cost	20,000	8,000
Profit	10,000	12,000

- Based on the FAR analysis, the basic return for AE1 Ltd., and AE2 Ltd., are determined to be 15% and 10% on cost respectively.
- On the basis of functions performed, risks assumed and assets employed, the relative contribution may be taken at 70%, 30% for AE1 Ltd. and AE2 Ltd., respectively.

Profit Split Method (PSM)

Solution 4:

Total profit split method

Particulars	US $
Consideration	50,000
AE1 Ltd share of revenue	30,000
AE2 Ltd share of revenue	20,000
Combined profit	22,000
Allocation of combined profit based on relative contribution	
AE1 Ltd (70%)	15,400
AE2 Ltd (30%)	6,600
Total	22,000
Total return of AE1 Ltd	15,400
Total cost of AE1 Ltd	20,000
ALP (A)	35,400
Actual Revenue (B)	30,000
TP Adjustment to be done	5,400

Residual profit split method

Particulars	US $	Particulars	US $
Consideration	50,000	Total cost of AE1 Ltd	20,000
AE1 Ltd share of revenue	30,000	ALP	35,740
AE2 Ltd share of revenue	20,000	Actual Revenue	30,000
Combined profit	22,000	TP adjustment to be done	5,740
1. Basic return			
AE1 Ltd (15% on cost)	3,000		
AE2 Ltd (10% on cost)	8,00		
Total (A)	3,800		
2. Residual return			
AE1 Ltd (70%)	12,740		
AE2 Ltd (30%)	5,460		
Total (B)	18,200		
Total return for AE1 Ltd (A+B)	15,740		

Other Method

- **Rule 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.*

- Various data which may possibly used for comparability purposes could be;
  - ✓ third party quotations/invoices
  - ✓ valuation reports
  - ✓ tender/bid documents
  - ✓ documents relating to negotiations

- Illustrations:
  - ✓ Buy back of equity shares, pricing based on valuation report from an external firm
  - ✓ Recovery of expenses where there is no service element based on third party invoices
  - ✓ Reimbursement of salary expenses of seconded employees on cost to cost basis
  - ✓ Cost allocation b/w group entities based on headcount, time spent, revenue etc.,

Computation of ALP – Sec 92C r.w Rule 10B

Methods for computing ALP [Section 92C]

CUP Method	Resale Price Method(RPM)	Cost Plus Method (CPM)	Profit Split Method (PSM)	Transactional Net Margin Method (TNMM)
This method is applied where there are similar transaction(s) b/w unconnected parties	This method is applied where item obtained from AE is resold to unrelated party	This method is generally applied where semi-finished goods are sold to AEs	This method is applied where there is transfer of unique intangibles or in multiple International Transaction	Compute Net Profit (NP) margin of the enterprise from International Transaction with AE having regard to cost incurred/sales effected/ assets employed
Identify price in a comparable uncontrolled transaction (CUCT)	Identify the Resale Price (RP) at which the item is resold to unrelated party	Identify direct & indirect Cost of Production incurred for property transferred or services provided to AE	Determine combined NP of the AEs arising out of International Transaction	Compute the NP margin realised by the enterprise or unrelated enterprise in a CUCT by applying the same base

Computation of ALP – Sec 92C r.w Rule 10B

	Reduce the RP by the normal Gross Profit (GP) margin on CUCT & expenditure incurred (customs duty) w.r.t. purchase	Determine normal GP mark up to such costs by an unrelated enter in CUCT	Evaluate the relative contribution of each enterprise to the earning of combined NP on the basis of FAR	Adjust NP margin realised from CUCT to a/c for differences affecting NP margin in the OM
Adjust the price for material differences in terms of contract, credit, transport etc.	Adjust the price for functional & other differences materially affecting GP margin in open market (OM)	Adjust the normal GP mark-up for functional and other differences materially affecting GP mark-up in OM	Split the combined NP amongst the enterprise in proportion to market returns; & residual profits in proportion to their relative contribution	Compare NP margin relative to costs/sales/assets of the AE with NP margin of uncontrolled party in comparable transactions
Adjusted price is ALP	Adjusted price is ALP	Total Costs ↑d by adjusted mark up = ALP	ALP to be detd. on the basis of profit apportioned.	Adjusted NP margin taken into A/c to arrive at ALP

Arm's Length Price – Multi year data & Range concept

Methods	Multi year data	Range
CUP Method	No	Yes
CPM	Yes	Yes
RPM	Yes	Yes
PSM	No	No
TNMM	Yes	Yes
Other method	No	No

Percentile	7 data set	Value to be considered	20 data set	Value to be considered
35^{th} percentile	2.45	3^{rd} value	7	Mean of 7^{th} & 8^{th}
65^{th} percentile	4.55	5^{th} value	13	Mean of 13^{th} & 14^{th}
Median	3.50	4^{th} value	10	Mean of 10^{th} & 11^{th}

- **Range concept**
- ✓ MAM – CUP, CPM, RPM & TNMM
- ✓ Comparables – 6 or more (otherwise "arithmetic mean" shall continue to apply along with tolerance range benefit (1% for whole sale traders & 3% for others)

Sl. No	Name of Company	NCP			
		31.03.2019	31.03.2020	31.03.2021	Average
1	Ace Software Exports Ltd.	-7.34%	-9.13%	-8.40%	-8.27%
2	Infomile Technologies Ltd.	9.77%	1.39%	0.00%	6.41%
3	BMC Software India Private Limited	10.06%	11.14%	0.00%	10.62%
4	Octaware Technologies Limited	3.91%	-4.08%	19.76%	11.84%
5	Maveric Systems Ltd.	19.27%	7.02%	25.09%	17.07%
6	C G-V A K Software & Exports Ltd.	31.60%	27.18%	41.26%	33.86%
Mean					11.92%
35th Percentile					10.62%
Median					11.23%
65th Percentile					11.84%

Accountant's Report (Sec 92E/Rule 10E)

Section 92E of the IT Act

*"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

*"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"*

Accountant's Report (Sec 92E/Rule 10E)

- To be obtained by every person who entered into an international transaction/SDT during the previous year
- Applies to both residents and non-residents
- Non-residents - Transactions in the nature of income to be reported
- No threshold limit for Form No.3CEB
- To be furnished 1 month prior to the due date of filing ITR
- Opinion – True and correct

FORM NO. 3CEB

[*See* rule 10E]

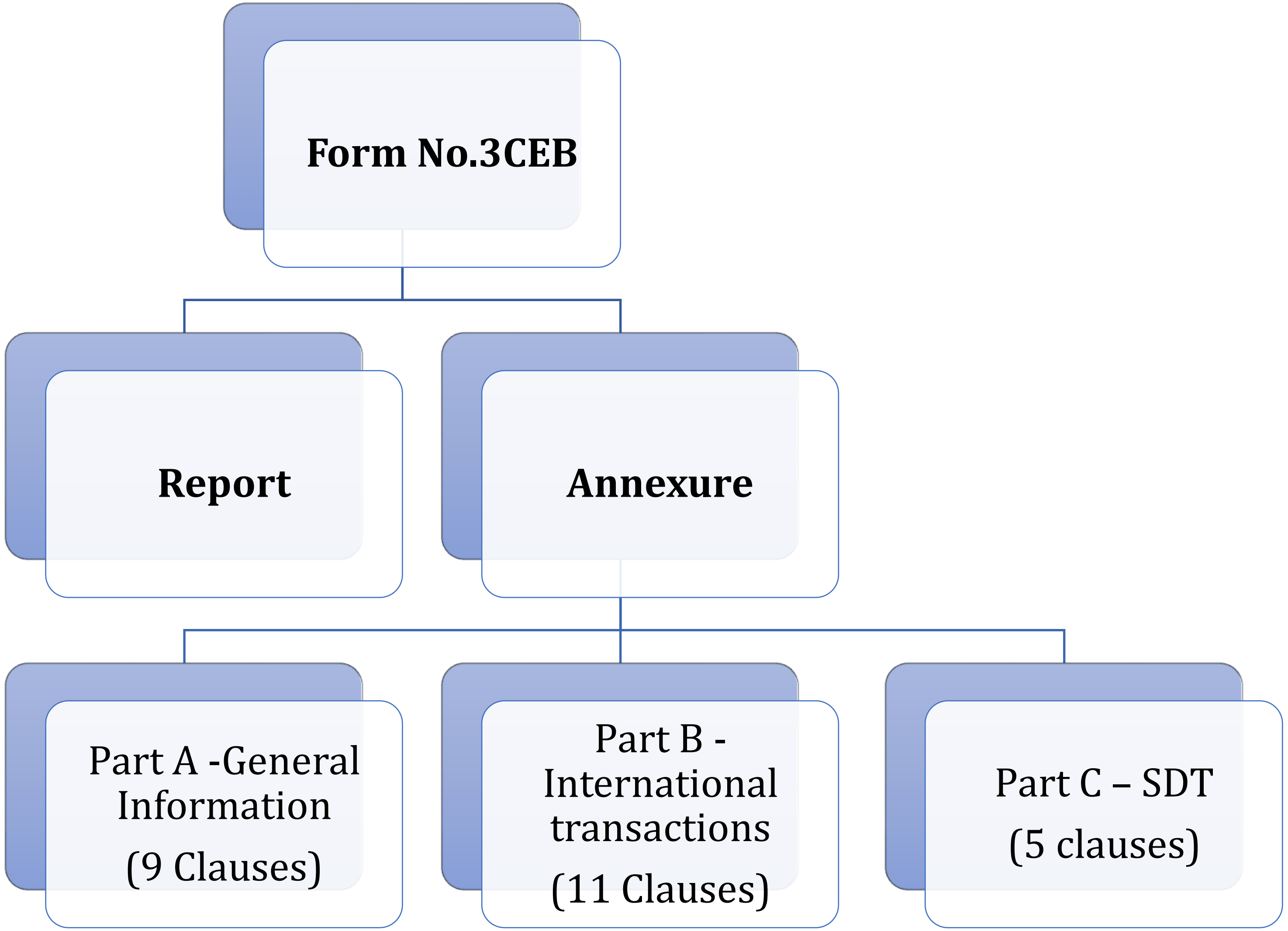
Report from an accountant to be furnished under section 92E relating to international transaction(s) and specified domestic transaction(s)

1. *I/We have examined the accounts and records of...(name and address of the assessee with [*Permanent Account Number or Aadhaar Number*]) relating to the international transaction(s) and the specified domestic transaction(s) entered into by the assessee during the previous year ending on 31st March, ...
2. In *my/our opinion proper information and documents as are prescribed have been kept by the assessee in respect of the international transaction(s) and the specified domestic transactions entered into so far as appears from *my/our examination of the records of the assessee.
3. The particulars required to be furnished under section 92E are given in the Annexure to this Form. In *my/our opinion and to the best of my/our information and according to the explanations given to *me/us, the particulars given in the Annexure are true and correct.

Place:................ *Date:*................

***Signed*..
Name:..
Address:..
....
Membership No.:....................................

Form No.3CEB - Overview



Form No.3CEB – Part A – General Information

Clause No.	Particulars	Remarks
1	Name of the assessee	Full name as per PAN/Aadhaar
2	Address	Address same as per ITR (in case of foreign company, foreign address)
3	PAN/Aadhaar	Get copy of PAN/Aadhaar
4	Nature of business/activities of the assessee	In line with ITR
5	Status	As per ITR & Sec 2(31)
6	Previous Year ended	
7	Assessment Year	
8	Aggregate value of international transactions as per books of account	Book value
9	Aggregate value of specified domestic transactions as per books of account	Book value

Form No.3CEB – Part B – International transactions

10. List of AE's with whom transactions entered into during the year	Name of the AE
	Nature of relationship
	Brief description of the business carried on by the AE
11. Transactions in relation to Tangible Property	11A – Purchase/sale – Raw materials/consumables/any other supplies for ***assembling/processing/manufacturing*** of goods/articles
	11B – Purchase/sale – Traded/finished goods
	11C – Purchase/sale/transfer/lease/use of any other tangible property
12. Transactions in relation to Intangible Property	Purchase/sale/transfer/lease/use of any intangible property
	Includes trademarks, trade names, customer related intangibles (customer lists, customer contracts), human capital related (trained and organised work force), location related intangibles (leasehold interest), ***any other similar item that derives its value from its intellectual content rather than its physical attributes***.

Form No.3CEB – Part B – International transactions

SI. No.	Issues	Disclosure
1	AE only for a part of the year – whether to be reported and what value?	
2	Sale of raw materials not utilized for processing/manufacturing	To be reported in clause 11(A) (As per ICAI Guidance note)
3	Multiple/lack of availability of quantitative details	Practically, one could mention 'numerous' in quantity column
4	Goods in transit	Based on books of accounts
5	Foreign exchange loss capitalised on import of capital goods?	Depending on the method and differences b/w INT and CUT

Form No.3CEB – Part B – International transactions

13. Transactions in respect of services	
14. Transactions in relation to lending/borrowing of money	Lending or borrowing of money including any type of advance, payments, deferred payments, receivables, non convertible preference shares/debentures or any other debt arising during the course of business
	Nature of financing arrangements – Term loan, project finance, working capital arrangement, fixed asset financing facility, trade advances etc.,
	Issue – 94B Vs. TP Provisions in respect of interest expense? & Whether to report principal amount of loan?
15. Transactions in the nature of guarantee	Nature of guarantee – Corporate Guarantee or Letter of credit etc.,
	No separate disclosure for reporting the amounts as per books of accounts Vs. ALP **Reporting required – Compensation/fees charged/paid**

Form No.3CEB – Part B – International transactions

16. Transactions in relation to purchase/sale of marketable securities, issue/buyback of equity shares, optionally/partially/compulsorily convertible debentures/preference shares

- No separate disclosure for reporting the amounts as per books of accounts Vs. ALP
- **Issue – Do we need to report issue/allotment of equity shares including at premium post Bombay HC ruling - Vodafone India Services (P.) Ltd. V. UOI [2014] 50 taxmann.com 300?**

17. Transactions in relation to mutual agreement/arrangement

- Intra group services in nature of management charges or cost allocation within group companies

18. Business restructuring/reorganizations

- **Issue – Whether value/consideration (exit charge/consideration) paid or received is to be disclosed?**

Form No.3CEB – Part B – International transactions

SI. No.	Issues	Disclosure
1	Issue/allotment of equity shares	May not be required to be reported (as per ICAI Guidance note)
2	Sale of equity shares	Requires disclosure, may give raise to capital gains
3	Issue/redemption/conversion of OCD/CCD – every year or at the time of issue	
4	Principal repayment of loan – every year or at the time of loan	

Form No.3CEB – Part B – International transactions

19. Any other international transactions

- Residuary clause (not covered in above clauses covered here)
- Typical transactions – reimbursement/recovery of expenses (free of cost services/goods)
- Dividend paid/received?

20. Deemed international transaction

- Centralized MSA for procurement of materials and sale of goods
- Centralized MSA for rendering of services
- Transfer of business/assets pursuant to global restructuring arrangement
- Centralized agreements – Logistic services, global advertisement arrangements etc.,
- **CIT vs. Kodak India Private Limited (ITA No. 15/2014) Mumbai ITAT – Quadrangular agreements does not amounts to DINT though there is a prior agreement but terms and conditions are dictated by the tax payer independently.**

Form No.3CEB – Part C – SDT

21. List of AE's with whom SDT entered into during the year	Name of the AE
	Nature of relationship
	Brief description of the business carried on by the AE
22. Inter-unit transfer (eligible business to other business – 80IA(8))	22A – Transfer of goods/services from eligible business (Sec 80A(6), 80IA(8), Sec 10AA) to another business
	22B – Acquisition of goods/services by eligible business (Sec 80A(6), 80IA(8), Sec 10AA) from another business
23. Any SDT which has resulted in more than ordinary profits to eligible business u/s 80IA(10) or Sec 10AA	Income & expense transactions covered under this clause
	Reporting is required where the eligible unit has generated "***more than ordinary profits***"

Form No.3CEB – Part C – SDT

24. Any SDT which has resulted in more than ordinary profits to eligible business u/s 115BAB	115BAB – Concessional tax regime @15% for new domestic manufacturing companies (Applicable from FY 2019-20 onwards)
	Income & expense transactions covered under this clause
	Reporting is required ***only if evaluation of profits leads to conclusion that it is not at arm's length***

Form No.3CEB – Check list

SI. No	Information required
1	NOC from previous auditor in case of new client
2	Audited accounts with notes, tax audit report & director's report for the relevant year
3	Detailed summary of related party schedule
4	Detailed schedule of debtor and creditor
5	Inter-company agreements & ledger extracts
6	Sample invoices/debit notes/credit notes/vouchers
7	Group transfer pricing policy
8	Discussions with assessee to identify unreported transactions such as deemed international transactions, free of cost services/goods provided/received, guarantees etc.
9	Master file & CbCR
10	Last year Form No.3CEB
11	TP documentation (as per Sec 92D r.w Rule 10D)
12	Management representation letter
13	Impact of COVID-19 on the business and industry as a whole

Form No.3CEB – Accountant's review

SI. No	Accountant's responsibility
1	***Reconciliation of nature & value of international transactions/SDT*** with audited accounts (AE ledger extracts, notes to accounts - related party schedule, earnings/expenditure in foreign currency etc.,)
2	***Test-check*** agreements, invoices, negotiations, cost plus workings etc.,
3	***Compare last year's Form 3CEB*** with current year's to ensure no regular international transactions is missed out
4	***Classify appropriately*** the transactions under relevant clauses of Form 3CEB
5	***Documenting the positions taken*** relying on judicial precedents, Accounting Standards, Auditing standard or Guidance note issued by ICAI.
6	***Prepare notes to Form 3CEB*** and file a ***hard copy*** before the Assessing Officer within 15 days of online filing

Secondary Adjustment – Sec 92CE

- Inserted by Finance Act, 2017 and applicable from AY 2018-19 onwards
- **Sec 92CE(3)**

  *"**Secondary adjustment**" means an* **adjustment in the books of account of the assessee and its associated enterprise** *to reflect that the **actual allocation of profits** between the assessee and its associated enterprise are consistent with the transfer price determined **as a result of primary adjustment**, thereby removing the **imbalance between cash account and actual profit** of the assessee.*

- No secondary adjustment is required if;
  - ✓ Primary Adjustment (PA) <= Rs. 1 crore; or
  - ✓ PA made with respect to AY 2016-17 or earlier years

- ***Excess money*** available with its AE as a result of primary adjustment, ***if not repatriated to India*** within the prescribed time (90 days), to be ***treated as interest bearing advance***.

- **Rate of interest to be charged (as per Rule 10CB)**;
  - ✓ 1 year SBI marginal cost of funds lending rate (MCLR) as on 1st April of the relevant PY + 325 basis points, if currency of international transaction is in INR
  - ✓ 6 month's LIBOR as on 30th Sep of the relevant PY + 300 basis points, if currency of international transaction is in foreign currency

Reporting in Form 3CD

30A. (a) Whether primary adjustment to transfer price, as referred to in sub-section 1) of section 92Ce, has been made during the previous year? (Yes/No)

(b) If yes, please furnish the following details:—

(i) Under which clause of sub-section (1) of section 92CE primary adjustment is made?

(ii) Amount (in Rs.) of primary adjustment:

(iii) Whether the excess money available with the associated enterprise is required to be repatriated to India as per the provisions of sub-section (2) of section 92CE? (Yes/No)

(iv) If yes, whether the excess money has been repatriated within the prescribed time (Yes/No)

(v) If no, the amount (in Rs.) of imputed interest income on such excess money which has not been repatriated within the prescribed time:

TP Documentation

- **Sec 92D**

  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*

Entity related	Price related	Transaction related
• Ownership structure • Profile of multinational group • Business description of the assessee, AE & the industry	• Contractual terms • FAR analysis • Economic analysis (method selection, PLI, comparable benchmarking) • Forecasts, budgets, estimates	• Details of TP adjustments, if any • Any other information e.g. agreements, invoices, exchange of e-mails on price negotiations et..,

- *Above documentation as per Rule 10D & to be maintained if aggregate value of international transactions > Rs.1 crores*
- *Documentation to be retained for 8 years from the end of relevant AY*
- *Failure of the same will attracts stringent penal provisions*

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THANK YOU
QnA's