



EMERGING TRENDS & Practical Challenges -TRANSFER PRICING

ICAI – Hyderabad Seminar



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OUR SCHEDULE

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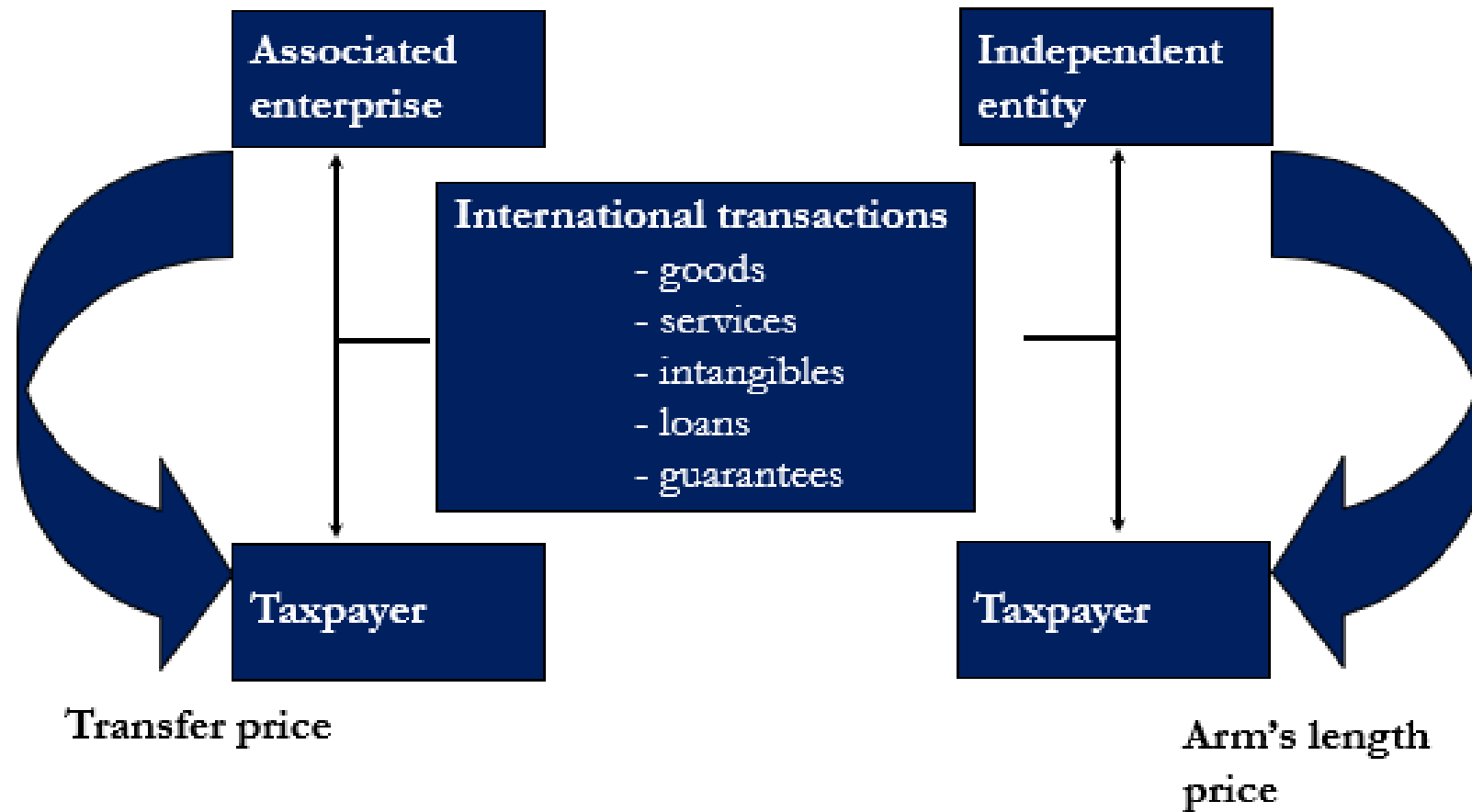
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CONCEPT OF TRANSFER PRICING



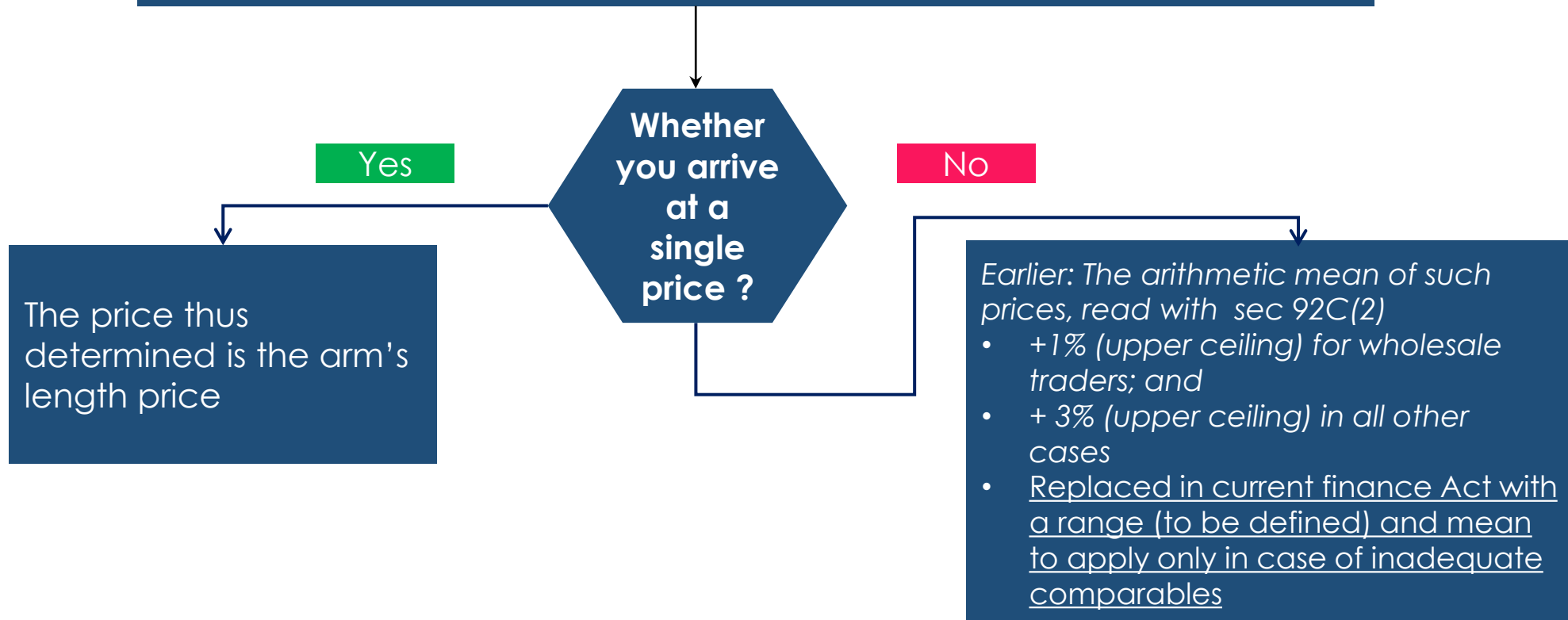
INTRODUCTION TO TRANSFER PRICING



ARM'S LENGTH PRICE

Price applied or proposed to be applied in a transaction between persons other than AEs, in uncontrolled conditions

Determination of arm's length prices using one of the Prescribed methods



APPLICABILITY

- The provisions of **Section 92 to 92F** of the Act are applicable only if:
 - There are two or more enterprises (defined in Sec 92F); and
 - The enterprises are **AEs** (defined in Sec 92A); and
 - The enterprises enter into a transaction (defined in Sec 92F); and
 - The transaction is an **International transaction** (defined in Sec 92B).
- Further w.e.f. 1 April 2012, TP provisions shall also apply to specified domestic transactions (SDTs) (defined in Sec 92BA) - where domestic related parties have claimed any special tax holiday deductions u/s 10AA/80A/80IA/favourable corporate tax rate u/s 15BAB
- Consequences of these provisions:
 - Computation of **income/ allowance of expenses** having regard to the **Arm's length price** [Section 92]
 - Maintenance of prescribed **Documentation** (Section 92D & Rule 10D)
 - Obtaining of **Accountant's report** (under Form 3CEB) (Section 92E)
 - To ensure compliance with the arm's length principle, stiff **Penalties** have been prescribed

APPLICABILITY

- **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) –**

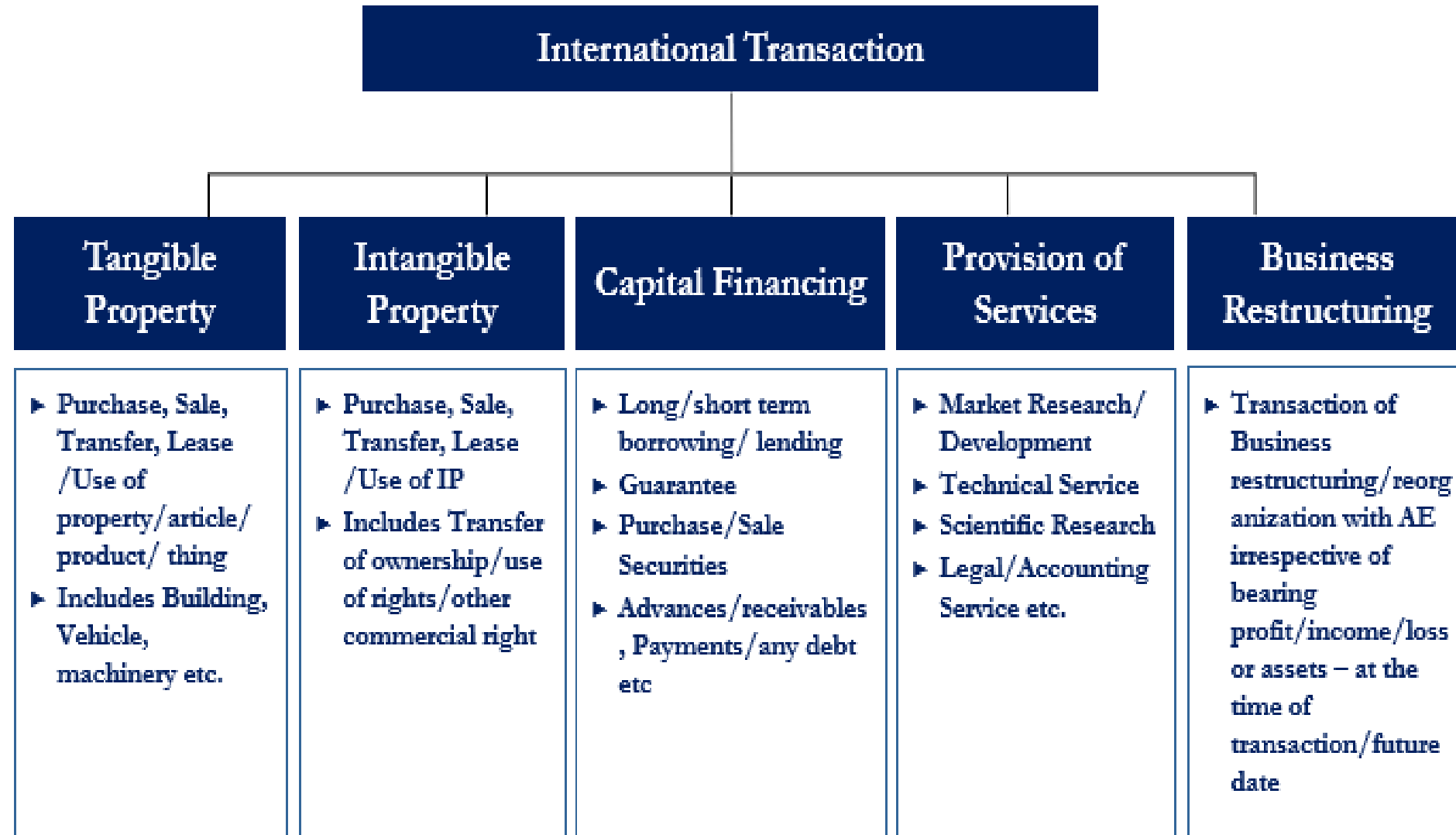
The provisions are not intended to be applied in case determination of arm's length price reduces the income chargeable to tax or increases the loss as the case may be

International transaction (Sec 92B)

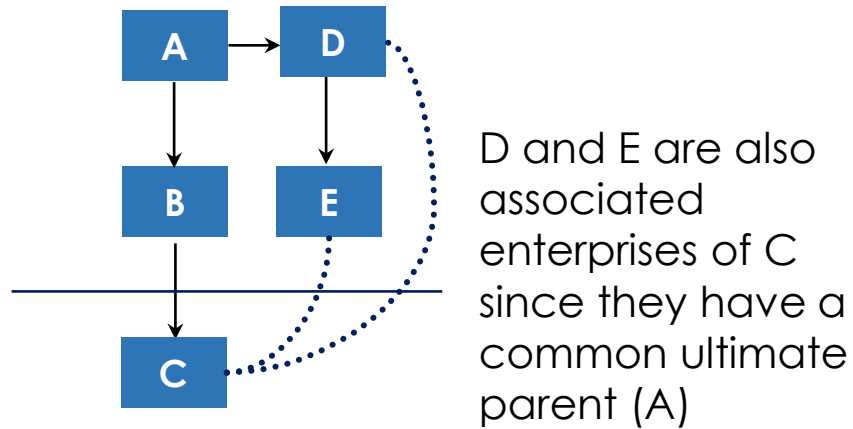
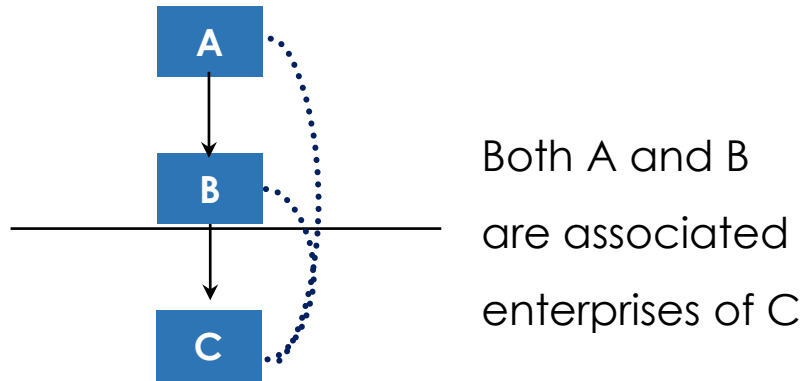
- Transactions between two or more AEs, **either or both** of whom are non-residents
- Transaction relates to:
 - Purchase, sale or lease of tangible or intangible property; or
 - Provision of services; or
 - Lending or borrowing money; or
 - Any other transaction having a bearing on the profits, income, losses or assets of the enterprises; or
 - Mutual agreements or arrangements for allocation or apportionment of, or any contribution to, any cost or expense incurred; or
 - Business restructuring or reorganization irrespective of fact that it has bearing on the profit, income, losses or assets

As per Section 92F(V):

- “transaction” includes an arrangement, understanding or action in concert –
 - (A) whether or not such arrangement, understanding or action is formal or in writing: or
 - (B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceeding.



MEANING OF ASSOCIATED ENTERPRISES (Sec 92A)

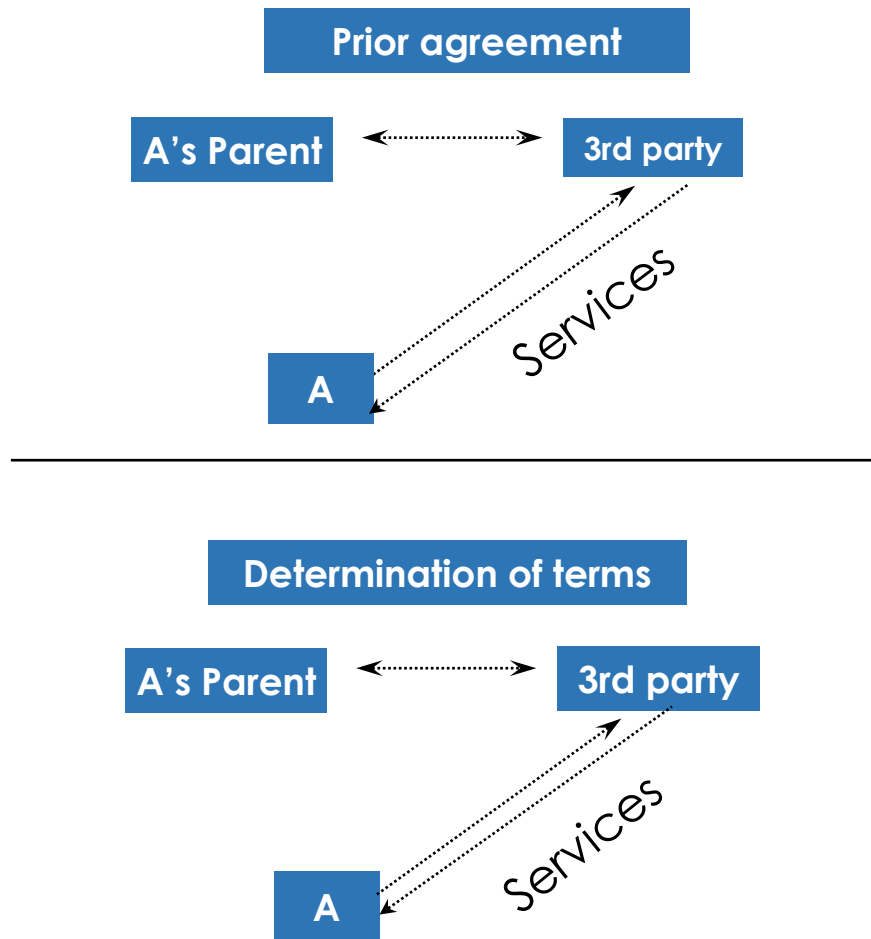


Direct or indirect participation (through one or more intermediaries) in management, control or capital

DEEMED ASSOCIATED ENTERPRISES (Sec 92A(2))

HOLDING	MANAGEMENT	ACTIVITIES	CONTROL
<p>1. $\geq 26\%$ direct / indirect holding by enterprise</p> <p><u>OR</u></p> <p>2. By same person in each enterprise</p> <p>3. Loan $\geq 51\%$ of Total Assets</p> <p>4. Guarantees $\geq 10\%$ of debt</p> <p>5. $> 10\%$ interest in Firm / AOP / BOI</p>	<p>6. Appointment $> 50\%$ of Directors / one or more Executive Director by an enterprise</p> <p><u>OR</u></p> <p>7. Appointment by same person in each enterprise</p>	<p>8. 100% dependence on use of intangibles for manufacture / processing / business</p> <p>9. Direct / indirect supply of $\geq 90\%$ Raw Materials under influenced prices and conditions</p> <p>10. Sale under influenced prices and conditions</p>	<p>11. One enterprise controlled by an individual and the other by himself or his relative or jointly</p> <p>12. One enterprise controlled by HUF and the other by</p> <ul style="list-style-type: none"> - a member of HUF - his relative or - Jointly by member and relative

DEEMED INTERNATIONAL TRANSACTION- Sec 92B(2)

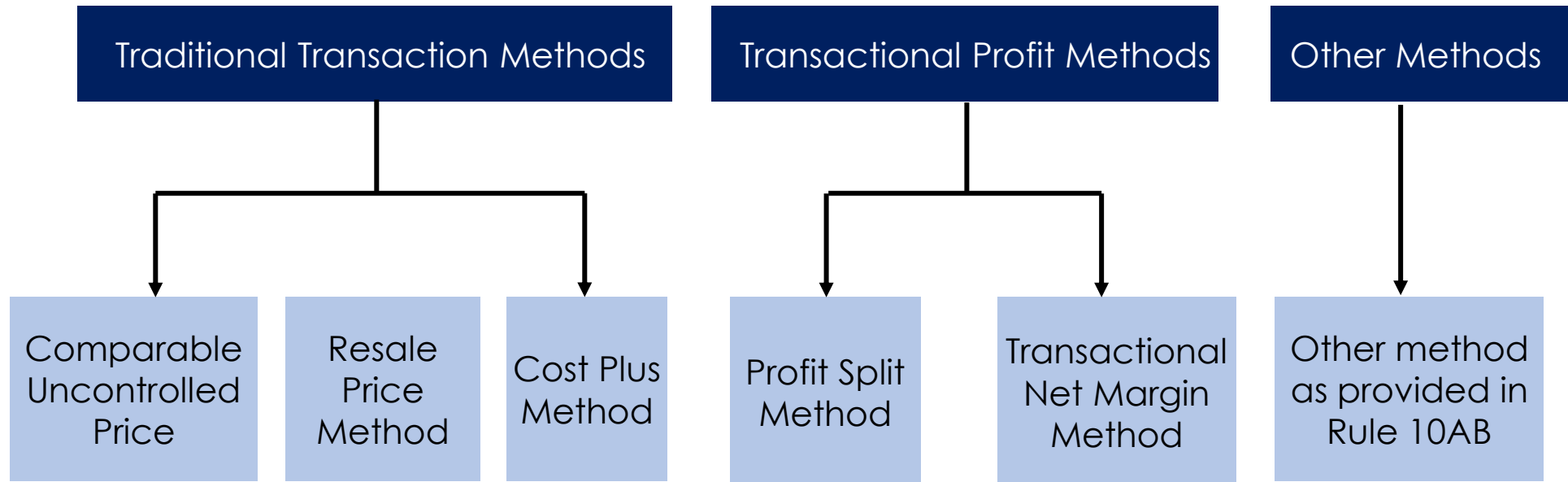


- ▶ An transaction with an unrelated company (3rd party) is deemed to be an international transaction and subject to transfer pricing regulations if
 - ▶ a **prior agreement** exists between A's AE and 3rd party in relation to services rendered by A to the 3rd party; or
 - ▶ **terms of transaction** are determined in substance by A's AE and 3rd party

SPECIFIED DOMESTIC TRANSACTION – Sec 92(2A)

- ▶ Scope of TP provisions expended w.e.f. AY 2013-14 by including “SDT” if aggregate value of such transaction exceeds INR 50 Million (INR 5 Crores) *[Finance Bill 2015 has proposed to increase this threshold to INR 20 Crores]*
- ▶ Applicability of TP regulations (including procedural and penalty provisions) to specified transactions between domestic related parties and payments made to related parties.
- ▶ Section 92BA - “**Specified Domestic Transactions**” in case of an Assessee means any of the following transactions, not being an international transaction, namely -
 - i. ~~Any expenditure in respect of which payment is made or to be made to a person u/s 40A(2)(b);~~
 - ii. Any transaction referred u/s 80A;
 - iii. Any transfer of goods/services u/s 80-IA;
 - iv. Any business transaction u/s 80-IA(10);
 - v. Any transaction under Chapter VI-A or u/s 10AA – to which provisions of Sec 80-IA (8) or (10) applies;
 - Va. Any business transacted between the persons referred to in sub-section (6) of section 115BAB;] or
 - vi. Any other transaction as may be prescribed.

PRESCRIBED TRANSFER PRICING METHODS



- Tax payer may apply any of the above methods that is considered most appropriate for a transaction. There is no preference of one method over another

COMPARABLES

- ▶ All methods require comparables
- ▶ Transfer price is set/ defended using data from comparable companies
- ▶ Comparable company should be independent and similar to an associated enterprise.
- ▶ Comparability Criteria (Rule 10C(2)):
 - nature of transactions undertaken (i.e. type of good, service etc.)
 - company functions
 - risks assumed
 - contractual terms (i.e. similar credit terms)
 - economic and market conditions



COMPARABLE UNCONTROLLED PRICE METHOD - Rule 10B(1)(a)

- The price charged or paid for property transferred or services provided in a comparable uncontrolled transaction or a number of such transactions are identified.
- Such price is adjusted for differences, if any, between the international transaction/SDT and the comparable uncontrollable transactions or between the enterprises entering into such transactions, which could materially affect the price in open market.
- The adjusted price arrived above is to be taken as the arm's length price.

COMPARABLE UNCONTROLLED PRICE METHOD

► Internal CUP

Manufacturer A

Related party - B

Non-related party

► External CUP

Non-related party A

Non-related party B

RESALE PRICE METHOD- Rule 10B(1)(b)

- ▶ Compares the resale gross margin earned by associated enterprise with the resale gross margin earned by comparable independent distributors
- ▶ An arms' length gross margin should be sufficient for a reseller to cover its operating expenses and make an appropriate operating profit (in light of its functions and risks)
- ▶ Preferred method for a distributor buying purely finished goods from a group company without any value addition (if no CUP available)



RESALE PRICE METHOD- Rule 10B(1)(b) - Process

- Identification of resale price by tested party
- Resale price reduced by normal gross profit with reference to uncontrolled transaction(s)
- Such price reduced by expenses incurred (customs duty etc.) in purchase of the product/ services.
- This price may be adjusted to account for functional and other differences if any
- Adjusted price arrived above taken to be arm's length price

COST PLUS METHOD - Rule 10B(1)(c)

- ▶ Compares the gross profit on costs the associated enterprise earns with the gross profit on costs earned by comparable independent companies
- ▶ Preferred method for:
 - ▶ manufacturer supplying semi-finished goods
 - ▶ company providing services

**Manufacturer A
(Indian)**

Cost + 40%

**Related
Manufacturer
B (US)**

US Market

COST PLUS METHOD Rule 10B(1)(c) - Process

- Identification of direct and indirect costs of production incurred in tested party transactions
- Identification of normal gross profit with reference to uncontrolled transaction(s)
- Normal gross profit adjusted to account for functional and other differences if any
- Adjusted gross profit added to total costs identified in step 1
- Sum arrived above is taken to be arm's length price

PROFIT SPLIT METHOD-Rule 10B(1)(d)

- ▶ Appropriate for transactions which are not capable of being evaluated separately
- ▶ Calculates the combined operating profit resulting from a whole inter-company transaction based on the relative value of each associated enterprise's contribution to the operating profit
- ▶ The contribution made by each party is determined on the basis of a division of functions performed, valued, if possible using external comparable data
- ▶ Applicable for analyzing tangible, intangible or services issues

PROFIT SPLIT METHOD-Rule 10B(1)(d) - Process

- Determination of combined net profit of the associated enterprises arising out of international transaction
- Evaluation of relative contributions by each enterprise on the basis of functions performed, risks assumed and assets employed
- Profit thus apportioned to the tested party is used to arrive at the arm's length price
- Splitting of combined net profit amongst enterprises in proportion to their relative contributions

TRANSACTIONAL NET MARGIN METHOD-Rule 10B(1)(e)

- ▶ Examines net operating profit from transactions as a percentage of a certain base (can use different bases i.e. costs, turnover, etc.) in respect of similar parties
- ▶ Ideally, operating margin should be compared to operating margin earned by same enterprise on uncontrolled transaction
- ▶ Can compare to “comparable transactions” between independent parties
- ▶ Applicable for any type of transaction and often used to supplement analysis under other methods
- ▶ Most frequently used method in India, due to lack of availability of comparable uncontrolled prices and gross margin data required for application of the comparable uncontrolled price method/ cost plus method/ resale price method

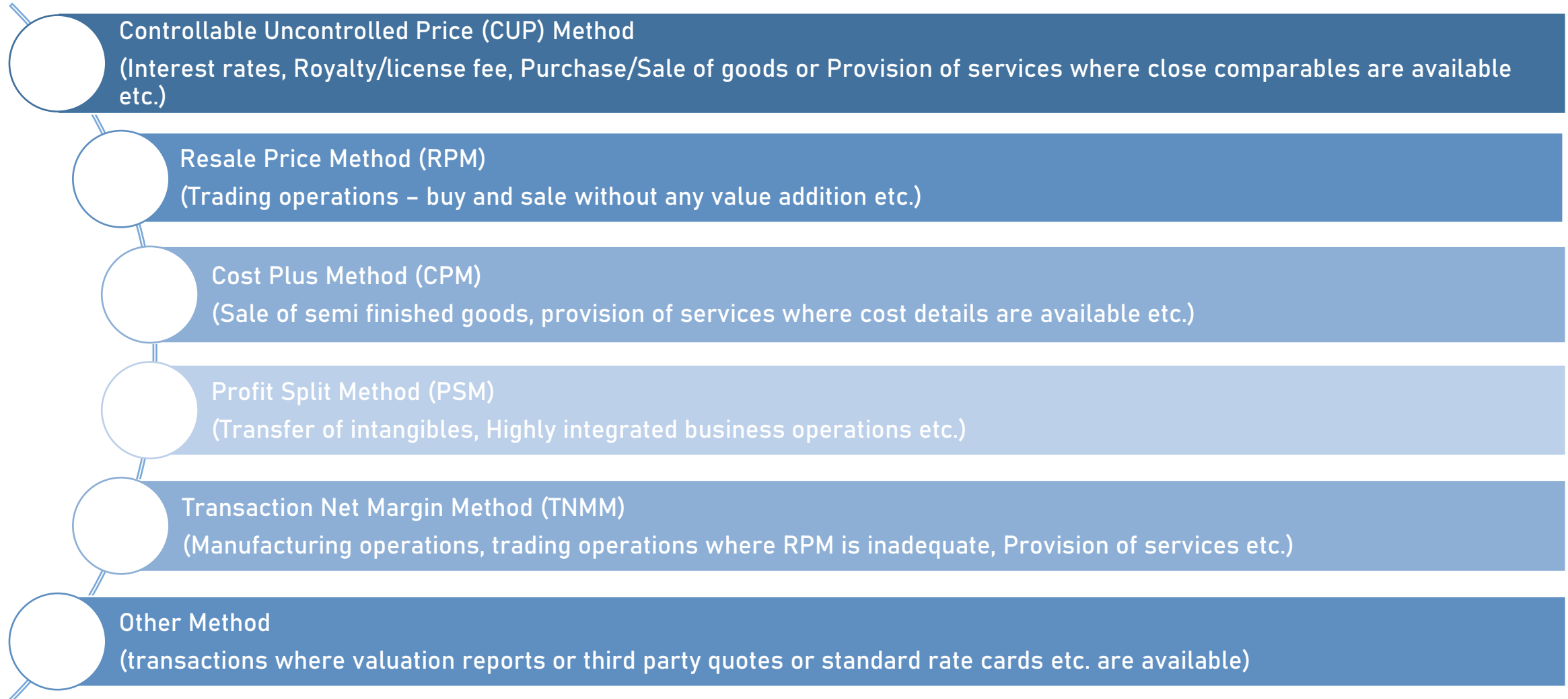
TRANSACTIONAL NET MARGIN METHOD - Process

- Computation of net profit as a percentage of a certain base realised from the international transaction.
- Computation of net profit realized by the tested party or an unrelated enterprise in a comparable uncontrolled transaction
- Net profit from uncontrolled transaction adjusted to account for differences if any
- The net profit thus established is taken into account to arrive at an arm's length price for the international transaction

OTHER METHOD : (Rule 10AB)

- Other Method or the sixth method allows the use of 'any method' which takes into account:
 - (i) the price which has been charged or paid or
 - (ii) would have been charged or paid for the same or similar uncontrolled transactions, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.
- The various data which may possibly be used for comparability purposes could be:
 - (a) Third party quotations;
 - (b) Valuation reports;
 - (c) Tender/Bid documents;
 - (d) Documents relating to the negotiations;
 - (e) Standard rate cards;
 - (f) Commercial & economic business models; etc.

Brief on TP Methods* for determining Arm's Length Price



**TP methods as prescribed in Rule 10B of Income-tax Rules, 1962 and their broad application/usage*

STEPS FOR DETERMINATION OF COMPARABLES

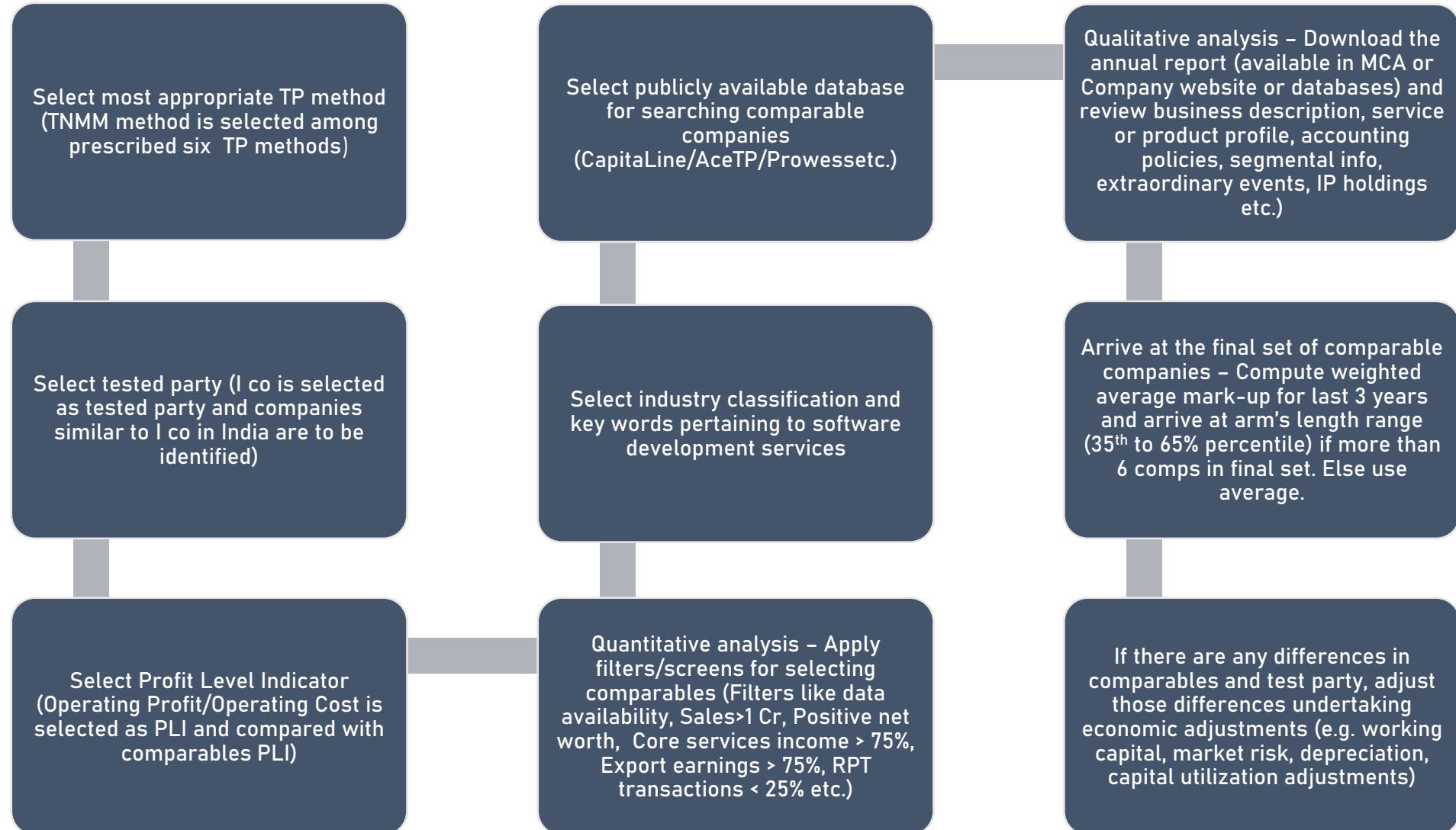
Case study:

> Indian resident entity - I co. is engaged in providing software development services to its holding company in US - F co.

> I co. is earning a mark-up of cost plus 15% for the services rendered to F co.

> We have to evaluate mark-up of 15% earned by I co from the International transaction of Provision of software development services from an arm's length stand point.

> Here are the steps involved in the benchmarking analysis undertaken to arrive at the arm's length mark-up earned by comparable companies engaged in similar software development services in India.



92 C(2) – TOLERANCE RANGE REDUCED: Notification 23/09/2014

- The Central Government notified that where the variation between the arm's length price determined under section 92C and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed:
 - **1% of the latter (TP) for wholesale traders (Explained) and**
 - **3% of the latter (TP) in all other cases,**
- The price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price for assessment year 2014-2015.

****Wholesale Trading means an international transaction or specified domestic trading in goods, which fulfils the following conditions:***

- 1. Purchase cost of finished goods is 80% or more of the total cost pertaining to such trading activities: and***
- 2. Average monthly closing inventory of such goods is 10% or less of sales pertaining to such trading activities***

INTRODUCTION OF 'RANGE' CONCEPT

- “**Range**” concept followed internationally; also propounded by OECD
- Use of inter-quartile range is amongst the globally accepted best practice and also closer to economic realities wherein prices, and or margins, are compared to those within a range and not at to a particular point.
- In order to align the transfer pricing regulations in India with the international best practices, "range" concept is proposed to be introduced for determination of arm's length price.
- However, arithmetic mean concept will continue to apply where number of comparable is inadequate
- Relevant excerpts from the FM's speech

“In order to align Transfer Pricing regulations in India with the best available practices, I propose to introduce **range concept** for determination of arm's length price. However, the arithmetic mean concept will continue to apply where number of comparable is inadequate. The relevant data is under analysis and appropriate rules will be prescribed”

CBDT Notification No S.O. 2860 (E) dated 19 Oct 2018 - 'RANGE' & 'MULTIPLE YEAR DATA'

- Budget 2014 made an announcement that 'range concept' would be introduced, where there are adequate number of comparables for determination of ALP
- Consequently, section 92C(2) was amended to prescribe for manner, in which the arm's length basis of the international or domestic transactions will be undertaken
- In light of the above announcements, the CBDT announced application of range concept and use of multiple year data

Applicable for international transaction or domestic transaction undertaken on or after April 1, 2014. (i.e. from Assessment Year 2015-16)

RANGE CONCEPT APPLICABILITY & METHODOLOGY

METHOD	Only under TNMM, RPM or CPM
COMPARABLES	Minimum 6
PERIOD	Weighted average of 3 year data of each company to construct the data set (In certain circumstances, data of 2 years could be used out of the 3 years)
PLI COMPUTATION	Numerator and denominator of the chosen PLI to be aggregated for all the years for every comparable
RANGE	Data Points lying within 35 th and 65 th percentile off the data set

If the transfer price of the tested party falls outside the range computed, the 'median' of the range would be taken as ALP and adjustment to transfer price shall be made.

USE OF MULTIPLE YEAR DATA

- Multiple year data allowed only where determination of ALP is done using TNMM, RPM or CPM.
- Data would comprise of three years including the current year.
- Data of 2 years also permitted in case of non-availability of data for 3 years for following reasons:
 - ❑ Data of the current year of the comparables not be available by the due date;
 - ❑ A comparable fails to clear a quantitative* filter in any one year; and
 - ❑ Comparable commenced operations only in the last two years or closed down operations during the current year.

Data of the current year can be used during the transfer pricing audit by both the taxpayer and the department, if it becomes available at the time of audit.

**** The notification in the present form is silent on the definition of quantitative filter. Further there is no reference to any qualitative filter.***

TRANSFER PRICING DOCUMENTATION

A detailed list of mandatory documents are given in Rule 10D(1) of the Rules.

- ▶ Ownership Structure
- ▶ Profile of multinational group
- ▶ Business description/ Profile of industry

Entity Related

- ▶ Nature and terms (including price) of international transactions
- ▶ Description of functions performed, risk assumed and assets employed (functional analysis)
- ▶ Records of economic and market analysis (economic analysis)
- ▶ Record of budgets, forecasts, financial estimates
- ▶ Any other record of analysis (if, any) to evaluate comparability of international transaction with uncontrolled transaction(s)
- ▶ Description of method considered with reasons of rejection of other methods

Price Related

TRANSFER PRICING DOCUMENTATION

- ▶ Details of transfer pricing adjustment(s) made (if, any)
- ▶ Any other information e.g. data, documents like invoices, agreements, price related correspondence etc.
- ▶ Detailed documentation not required in case aggregate transaction value is less than **INR 1 Crore**
- ▶ List of supporting documents are also provided in the law
- ▶ Contemporaneous data requirements
- ▶ Documents to be retained for a fixed period from end of the assessment year
- ▶ Need to obtain Accountant's report (under Form 3CEB) to be filed along with the return of income

Transaction Related

ACCOUNTANT'S REPORT (Form 3CEB) - Rule 10E

- Obtained by every taxpayer filing a return in India and having international transaction or SDT
- To be filed by due date for filing return of income
- Essentially comments on the following:
 - whether the taxpayer has maintained the **transfer pricing documentation** as required by the legislation,
 - whether as per the transfer pricing documentation the prices of international transactions are **at arm's length**, and
 - certifies the value of the international transactions as per the books of account and as per the transfer pricing documentation are **"true and correct"**

Form 3CEB is bifurcated into following 3 parts:

- ❑ **Part A: Details of taxpayer**
- ❑ **Part B: Details of International Transactions**
- ❑ **Part C: Details of Specified Domestic Transactions**

EVOLUTION OF TRANSFER PRICING



EVOLUTION OF TRANSFER PRICING

FY 2012-13	
S No	Particulars
1	Section 92 was amended by introducing sec 92A to 92F
2	Definition under Sec 92B was amended retrospectively w.e.f 01.04.2012
3	Sec 92BA was introduced for SDT(5CrS)
4	Sec 92CC and CD was introduced-APA
5	Safe harbour rules introduced for FY 2012-13 to 2016-17
FY 2013-14	
S No	Particulars
1.	Tolerance range of 3% was introduced w.e.f FY 2013-14
FY 2014-15	
S No	Particulars
1	APA-Rollback was introduced
2	Use of multiple year data introduced-CBDT Notification No. 83/2015 [F.No.142/25/2015-TPL]dated 19 October 2015

EVOLUTION OF TRANSFER PRICING

FY 2015-16	
S No	Particulars
1	Threshold limit for triggering the provisions of SDT increased from INR 5 Cr to INR 20 Cr from FY 2015-16 through CIRCULAR NO.- 19 /2015
FY 2016-17	
S No	Particulars
1	Sec 92BA was amended-Sec 40A(2)b was excluded
2	Adopted Action point 13 of BEPS-Introduced Master file and CBCR
FY 2017-18	
S No	Particulars
1	CBDT issued revised SHR for FY 2016-17 to 2018-19
2	Sec 94B was introduced for restriction of Interest payments
3	Sec 92CE-Secondary Adjustment was introduced
4	Introduced few clauses in Tax Audit report
	• clause 30A-Primary adjustment and repatriation of the same.
	• clause 30B-Limitation of Interest payments u/s 94B
	• clause 43(a)- CBCR

EVOLUTION OF TRANSFER PRICING

FY 2018-19	
S No	Particulars
1	Modification order for past years in case of APA
2	Clarification with respect to provisions of secondary adjustment
3	Clarification regarding definition of the "accounting year" in section 286 of the Act
4	Rationalisations of provisions relating to maintenance, keeping and furnishing of information and documents by certain persons
FY 2019-20	
S No	Particulars
1	Preponement of Form No. 3CEB compliance timeline
2	Non-residents other than FCs can file now file objections before DRP
3	Rationalizing the thin capitalization ('TC') regulations
4	Inclusion of attribution of profits to Permanent Establishment ('PE') in APA and SH
5	Penalty for false entry or omission

SECONDARY ADJUSTEMENT u/s 92CE

Secondary adjustment has been defined to mean an adjustment in the books of accounts of the taxpayer and its AE to reflect the actual allocation of profits between the taxpayer and its AE consistent with the transfer price determined as a result of primary adjustment.

- **Secondary Adjustment Provisions u/s 92CE are attracted in the following cases:**
 - Suo – Moto Adjustment by Assessee
 - Adjustment by Assessing Officer u/s 92CA
 - Safe Harbour Rules u/s 92CB
 - Advance Pricing Agreement u/s 92CC
 - Mutual Agreement Procedure (Article 25)
- **Exemptions to Secondary Adjustment:**
 - Amount of Primary Adjustment is not exceeding Rs. 1 Crore.
 - Primary Adjustment is made prior to AY 2016-17 (FY 2015-16).

Time Limit and Applicable rate of Interest

Type of Primary adjustment	Time Limit for repatriation	Consequences for imputation of delayed receipts
Adjustment made by the Indian Tax Authority and accepted by the taxpayer	On or before 90 days from the date of relevant order	For rupee denominated transactions: 1-year MCLR* + 325 basis points *MCLR of State Bank of India as of 1 April of the relevant FY
Suo-moto adjustment by the taxpayer	On or before 90 days from the due date of filing return of income under Section 139(1) of the Act or (in case of APA, the due date of filing of modified return of income)	For foreign currency denominated transactions: 6 months LIBOR* + 300 basis points *LIBOR as of 30 September of the relevant FY Or
Adjustment pursuant to APA, Safe Harbour or MAP		Additional income tax of 18% on such excess money

MASTERFILE AND CBC REPORT



MASTER FILE

- The master file (MF) is a document which contains high level information about the global business operations and TP policy of an MNE group. The MF will usually include standardized information about the group's organizational structure; significant value drivers; main geographical locations; description of the business activities of members of the group (i.e. products, services, supply chain etc.); information about the group's intangibles; financing activities within the group (including external funding); and financial and tax positions of the MNE group.
- In an attempt to achieve more transparency on the transfer pricing policies applied by MNEs, the OECD updated in 2015 the documentation requirements in Chapter V of the OECD Guidelines. Since then, MNEs are expected/required to document their transfer pricing information in the form of a Master File and a Local File.
- The Guidelines provide that the master file should be made available to all relevant tax authorities in the jurisdictions where the members of the group are resident. Further, the MF may be prepared for the group as a whole or on a line of business basis, provided all centralized functions and transactions are described thoroughly in the MF.

APPLICABILITY OF MASTERFILE

- Part A of Master File (Form 3CEAA) – Part A comprises of basic information relating to the International Group (“IG”) and the constituent entities of the IG operating in India (such as name, permanent account number and address). The final rules have clarified that Part A of the Master File will be required to be filed by every constituent entity of an IG, without applicability of any threshold;
- Part B of Master File (Form 3CEAA) – Part B comprises of the main Master File information that provides a high-level overview of the IG’s global business operations and transfer pricing policies. Every constituent entity of an IG that meets the following threshold will be required to file Part B of Master File: –
 - A. The consolidated group revenue for the accounting year exceeds INR 5,000 million and**
 - B. For the accounting year, the aggregate value of international transactions exceeds INR 500 million, or aggregate value of intangible property related international transactions exceeds INR 100 million.**
- The Master File has to be furnished by the due date of filing the income-tax return i.e. 30 November following the financial year. IGs with multiple constituent entities in India can designate one Indian constituent entity to file the Master File in India, provided an intimation to this effect is made in Form No. 3CEAB, 30 days prior to the due date for filing the Master File in India.

COUNTRY-BY-COUNTRY ('CBC') REPORT

Under BEPS Action 13, all large multinational enterprises (MNEs) are required to prepare a country-by-country (CbC) report with aggregate data on the global allocation of income, profit, taxes paid and economic activity among tax jurisdictions in which it operates. This CbC report is shared with tax administrations in these jurisdictions, for use in high level transfer pricing and BEPS risk assessments.

Requirements:

- The CbC report requires each MNE to provide key financial information on an aggregate country basis with an activity code for each member of the MNE. CbC report is a new concept for the international tax world and represents the biggest change to the existing Guidelines. The provision of the CbC report to the tax authorities is a 'minimum standard' requirement, and the report makes clear that countries participating in the BEPS project are expected to commit to and adopt this measure. It will provide tax authorities with global information for the purposes of risk assessment.

COUNTRY-BY-COUNTRY ('CBC') REPORT

- The elements relating to CbC reporting requirement shall apply in respect of an international group having consolidated revenue, based on consolidated financial statements, exceeds the threshold. The current international consensus is for a threshold of INR 6,400 Crores.
- The CbC report requires MNEs to report annually and for each tax jurisdiction in which they do business; the amount of revenue, profit before income tax and income tax paid and accrued. It also requires MNEs to report their total employment, capital, accumulated earnings and tangible assets in each tax jurisdiction. Finally, it requires MNEs to identify each entity within the group doing business in a particular tax jurisdiction and to provide an indication of the business activities of each entity.

Applicability of ('CbC') report

Rule 10DA of the Income tax Rules, 1962 ("the Rules") (as amended) provides that the provisions of furnishing of CbC Report to the Income tax department is applicable only if the consolidated revenue of International Group is more than Rs. 5,500 crores as reflected in the consolidated financial statements for the preceding accounting year.

Forms – MASTERFILE AND ('CBC') REPORT

Form	Description
Form 3CEAA (Part – A)	All CE s of International Group, Irrespective of whether Satisfying the threshold Limits or Not
Form 3CEAA (Part – B)	All CE s of International Group, Crossing the Master File threshold Limits Notified
Form 3CEAB	Subsidiaries of Designated CE i.e case more than 1 entity in India is crossing the Master File threshold limits Notified
Form 3CEAC	Intimation of the Indian CE being alternate reporting entity or that the Parent entity is filing CbCR
Form 3CEAD	Filing of CbCR by <ul style="list-style-type: none"> • Indian Parent Company • Indian Alternate reporting entity • CE resident in India satisfying 286(4) (No Agreement for Information Exchange)
Form 3CEAE	Instruction where CbCR is being Filed by Designated CE where <ul style="list-style-type: none"> • 2 or More CE s Resident of India are falling under 286(4) categories. (No Agreement for Information Exchange; or • Resident CE s of Group having Indian Parent

Forms – MASTERFILE AND ('CBC') REPORT

Form	Due dates
Form 3CEAA (Part – A)	Due date for filing of return 30 November
Form 3CEAA (Part – B)	Due date for filing of return 30 November
Form 3CEAB	30 days prior to the due date for filing form 3CEAA – 31 st October.
Form 3CEAC	2 Months prior to the due date for filing form 3CEAD – 30 th September.
Form 3CEAD	Due date for filing of return 30 November
Form 3CEAE	Due date has not been mentioned, comparatively filing could be done by March 31 of next Assessment year.

CbC reporting – key definitions – section 286(9)

Term	Definition
Group	<ul style="list-style-type: none"> ▶ Group includes parent entity and all the entities in respect of which a consolidated financial reporting for financial reporting purposes is prepared or would have been prepared (if in case equity shares would have been listed on stock exchange)
International group	<ul style="list-style-type: none"> ▶ Two or more enterprises which are resident of different countries/territories or ▶ Enterprise being resident of one country/territory carrying on business through permanent establishment (PE) in other countries/territories
Parent entity	<ul style="list-style-type: none"> ▶ Entity of the group holding directly or indirectly an interest in one or more of the other entities of the group such that it is required or would have required (if in case equity shares would have been listed on stock exchange) to prepare consolidated financial statements as per laws in force/accounting standards of country/territory of which entity is resident
Constituent entity	<ul style="list-style-type: none"> ▶ Any entity of international group <ul style="list-style-type: none"> ▶ that is included in consolidated financial statement ▶ that is excluded from consolidated financial statement on the basis of size or materiality ▶ that is PE of any separate business entity and such PE prepares separate financial statement for financial reporting, regulatory, tax reporting or internal management control purposes
ARE	<ul style="list-style-type: none"> ▶ A constituent entity that has been designated to furnish CbC report in place of parent entity in country or territory in which such constituent entity is resident

OECD model CbC report template

Table 1:

Tax jurisdiction	Revenues			Profit (loss) before income tax	Cash Tax Paid (CIT and WHT)	Current year tax accrual	Stated capital	Accumulated earnings	Tangible assets other than cash and cash equivalents	Number of employees
	Unrelated party	Related party	Total							

Table 2:

Tax jurisdiction	Constituent entities resident in the tax jurisdiction	Tax jurisdiction of organization or incorporation if different from tax jurisdiction of residence	Main business activity(ies)												
			R & D	Holding or managing IP	Purchasing or procurement	Mfg or production	Sales, marketing or distri.	Admin., Mgmt or support services	Provision of services to unrelated parties	Internal group finance	Regulated financial services	Insurance	Holding shares or other equity instruments	Dormant	Other

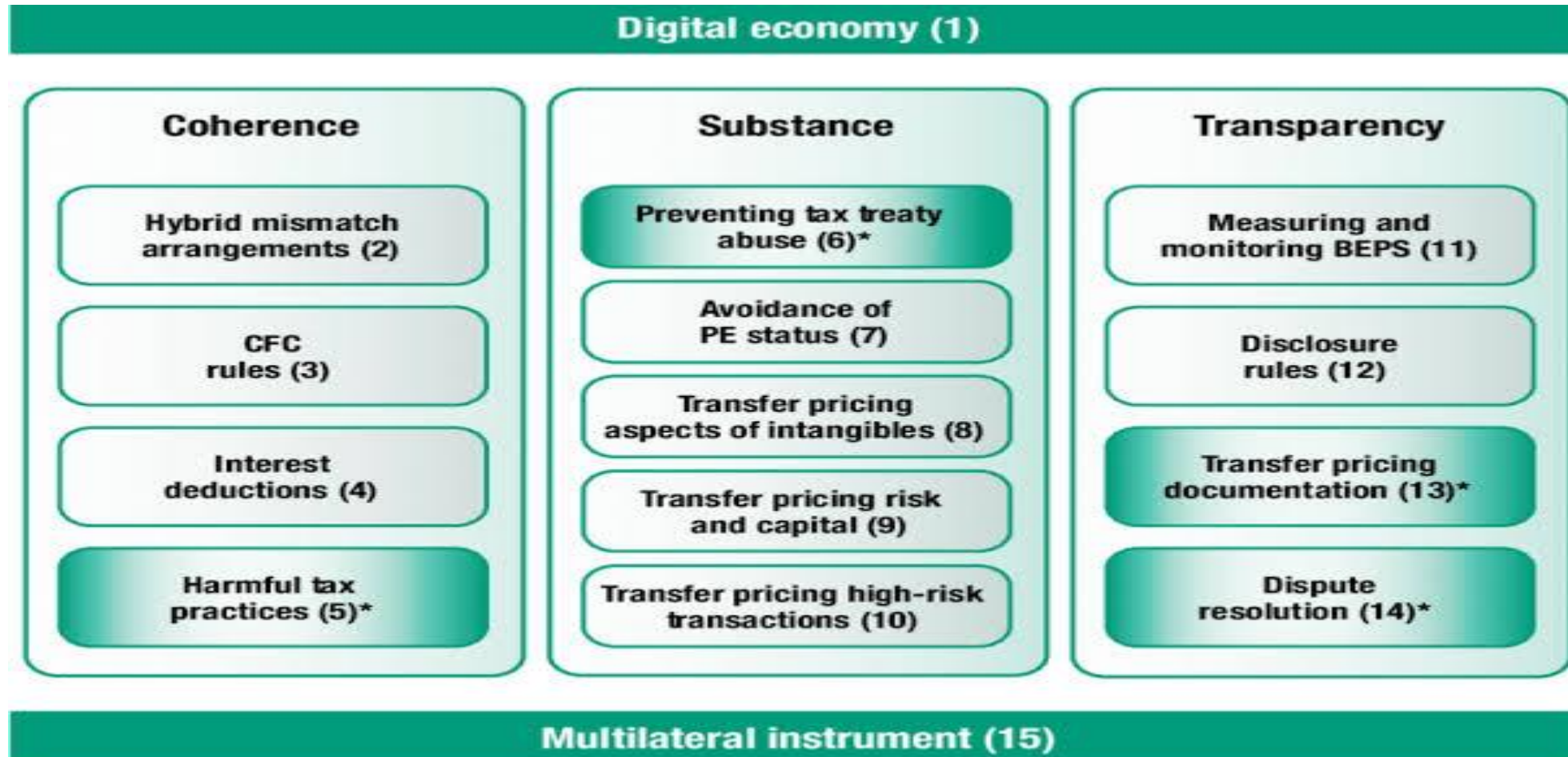
Master File – information required

Organization structure	Business description	Intangibles	Intercompany financial activities	Financial and tax positions
Structure chart:	Important drivers of business profit	Overall strategy description	Financing arrangements for the group	Annual consolidated financial statements
<ul style="list-style-type: none"> ▶ Legal ownership ▶ Geographic location 	Supply chain of: <ul style="list-style-type: none"> ▶ 5 largest products/services by turnover ▶ Products/services generating more than 5% of turnover 	List of important intangibles and legal owners	Identification of financing entities	List and description of existing unilateral Advance Pricing Agreements (APAs) and other tax rulings
	Main geographic markets of above products	List of important intangible agreements	Details of financial transfer pricing policies	
	List and brief description of important service arrangements	R&D and intangible transfer pricing policies		
	Functional analysis of principal contributions to value creation by individual entities	Details of important transfers		
	Business restructuring/ acquisitions/ divestitures during fiscal year			

BEPS - BASE EROSION & AND PROFIT SHIFTING



BEPS - Base Erosion and Profit Shifting



*Minimum standards

BEPS Action Points:

Point 4: Limit base erosion via interest deductions and other financial payments

- The goal of Action 4 is to ensure that net interest deductions are directly linked to the level of economic activity. The economic activity is determined based on taxable earnings, before deducting net interest expense, depreciation and amortization (EBITDA).
- The final report on Action 4 recommends an approach based on a fixed ratio rule which limits an entity's net interest deduction to a percentage of its EBITDA. As a minimum, this rule should apply to entities in multinational groups. The recommended approach proposes a range of possible EBITDA ratios between 10% and 30%.

BEPS Action Points:

Point 13: Re-examine transfer pricing documentation

- Action 13 contains a three-tiered standardized approach to transfer pricing documentation, including a minimum standard on CBCR.
- First, the guidance on transfer pricing documentation requires MNEs to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies in a Master File.
- Second, it requires that detailed transactional transfer pricing documentation be provided in a Local File specific to each country, identifying material related-party transactions, the amounts involved in those transactions, and the company's analysis of the transfer pricing determinations they have made.
- Third, large MNEs are required to file a Country-by-Country Report that will provide annually and for each tax jurisdiction in which they do business the amount of revenue, profit before income tax, income tax paid and accrued, and other indicators of economic activity

BEPS Action Points:

Point 14: Make dispute resolution mechanisms more effective

- It might happen that two jurisdictions seek to tax the same transactions or activities. Generally, tax treaties directly resolve most such cases. However, two jurisdictions might disagree on the interpretation or application of a tax treaty. The mutual agreement procedure (MAP) article of a tax treaty provides a mechanism to resolve these cross-border tax disputes.
- The goal of Action 14 is to address obstacles that prevent countries from solving treaty related disputes under MAP.

BEPS Action Points:

Point 15: Develop a multilateral instrument

- Most countries have Double Tax Treaties (DTT) in place with other countries. These DTT's provide clarity as to where a company has to pay taxes, if activities are spread over two or more countries.
- Although a lot of these treaties are based on the OECD Model Tax Treaty, almost all treaties are the result of bilateral negotiations. If BEPS is to be implemented correctly, these treaties have to be renegotiated one by one. This would take ages.
- Instead, Action point 15 aims to develop a Multilateral Instrument (MLI). The MLI is expected to be adopted by 100 countries. This MLI allows countries to swiftly modify their bilateral treaties to implement BEPS measures.
- The MLI, gives countries the flexibility to specify which treaties are covered. They can decide how they meet the minimum standards. If desired, they can opt out of all or part of the provisions which extend beyond the minimum standard.

Implementation of BEPS Actions in India:

Action 1	<ul style="list-style-type: none"> - Equalization Levy – Finance Act 2016 and 2020 - “Significant economic presence” from FY 18-19 	Action 13	Country by Country Reporting (CbCR) and Master File TP documentation from FY 16-17
Action 6	Bilateral re-negotiation of tax treaties to ensure greater source based taxation/ prevent treaty abuse (e.g. India – China DTAA ^[1])	Action 8-10	Tax administration and taxpayers expected to give consideration while applying ALP
Action 4	Interest deduction limitation rule (S. 94B) from FY 17-18	Action 14	Committed to minimum standards for improving effectiveness on Mutual Agreement Procedures (MAP)
Action 15	On 7 June 2017, India (along with 67 countries) signed the Multilateral Instrument (MLI) to modify existing tax treaties. India submitted ratified copy of MLI with OECD on 25 June 2019		

[1] Provisions influenced by MLI/ BEPS- Principal purpose test (PPT), competent authority rule as tie-breaker test for dual resident entities, narrowing the permanent establishment definition

RESTRICTION ON DEDUCTION OF INTEREST u/s 94B

- CBDT has introduced provisions similar to thin capitalisation in the Finance Act 2017 by insertion of Section 94B under the Act. Thin capitalisation refers to a situation in which a company is financed through a relatively high level of debt compared to equity, which significantly affects the amount of profit it reports for tax purposes
- The section is triggered when interest or similar consideration paid to the AE exceeds INR 1 crore.
- The interest amount that will be disallowed as deduction in computation of income is defined as lower of:
 - The total interest amount in excess of 30% of earnings before interest, taxes, depreciation and amortization;
 - Interest paid or payable to Associated Enterprise
- The provisions are not applicable to Indian company or PE of Foreign Company which is engaged in the business of banking or insurance
- The provisions are not applicable in respect of debt issued by lender which is PE in India of a non-resident bank
- If the interest expenditure is not wholly deducted, the balance shall be carried forward to the subsequent assessment years not more than 8 years

Applicability of IND AS

On 16 February, 2015, the MCA notified the rules which lay the Ind AS roadmap:

- **Voluntary Phase:** Early adoption of Ind AS is permitted from financial year beginning on or after 1st April, 2015.
- **Mandatory Phase I** (adoption from 1st April, 2016 with comparatives for 2015-16)
 - Listed company or Unlisted company having net worth in excess of Rs. 500 Crores or more
 - Holding, subsidiary, joint venture or associates of these companies
- **Mandatory Phase II** (adoption from 1st April, 2017 with comparatives for 2016-17)
 - All listed companies not covered under the mandatory phase I
 - Non-listed companies with net worth of INR 250 Crores or more and not covered in the mandatory phase I
 - Holding, subsidiary, joint venture or associates

APPLICABILITY OF IND AS

- Definition of related party under Ind AS 24 is broader and will cover increased number of related party relationship and has clear principles of identification of related parties.
- If, based on the Ind AS 24 definition, one party is identified as related to the second party; the definition would treat the second party as related to the first party, by symmetry.

Ind AS 24	AS -18
Includes any director	Excludes non-executive directors
Includes close members of family of KMP	Includes only relatives of KMP
An entity discloses that terms of RPT are equivalent to those that prevail in arm's length transactions, only if such terms can be substantiated	No such stipulation on substantiation of RPT when the same is disclosed to be on arm's length
KMP remuneration disclosure to include post employment benefits	Does not have such requirement

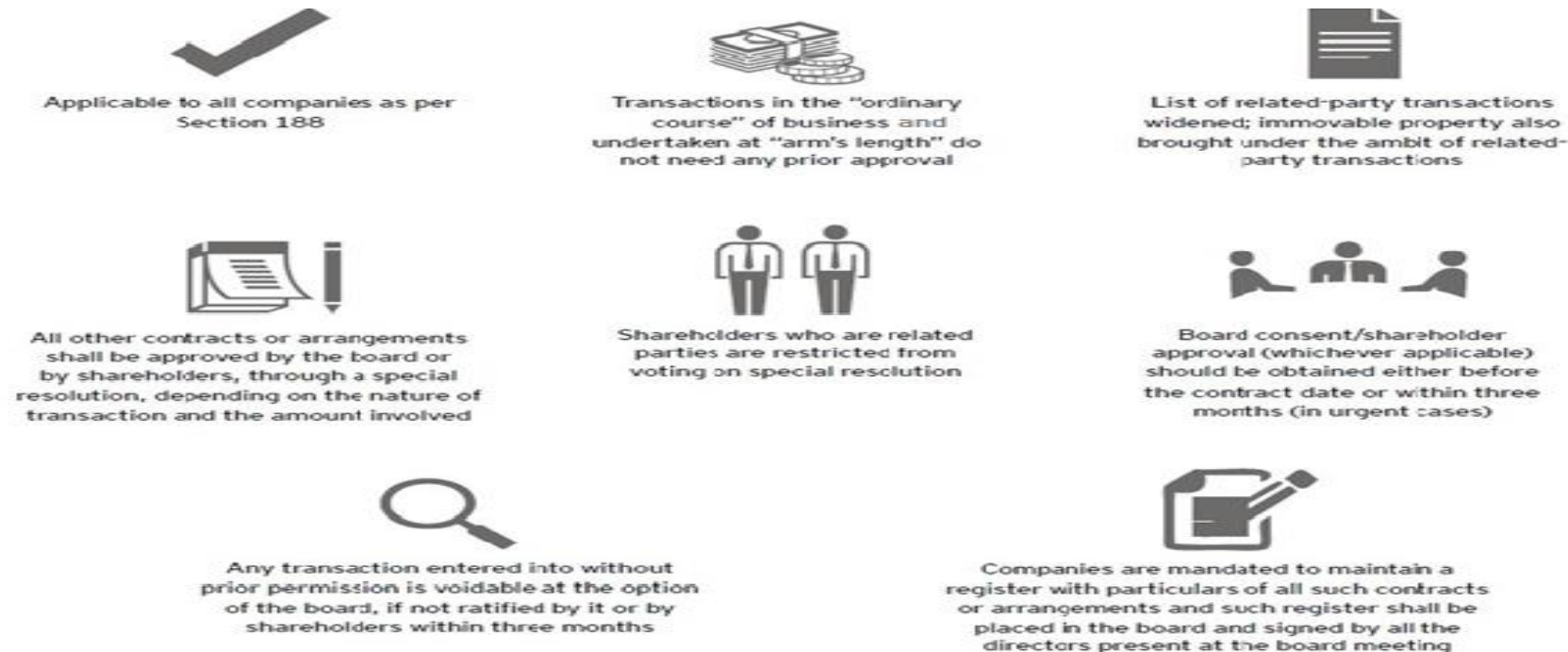
COMPANIES ACT 2013

TP INTERPLAY

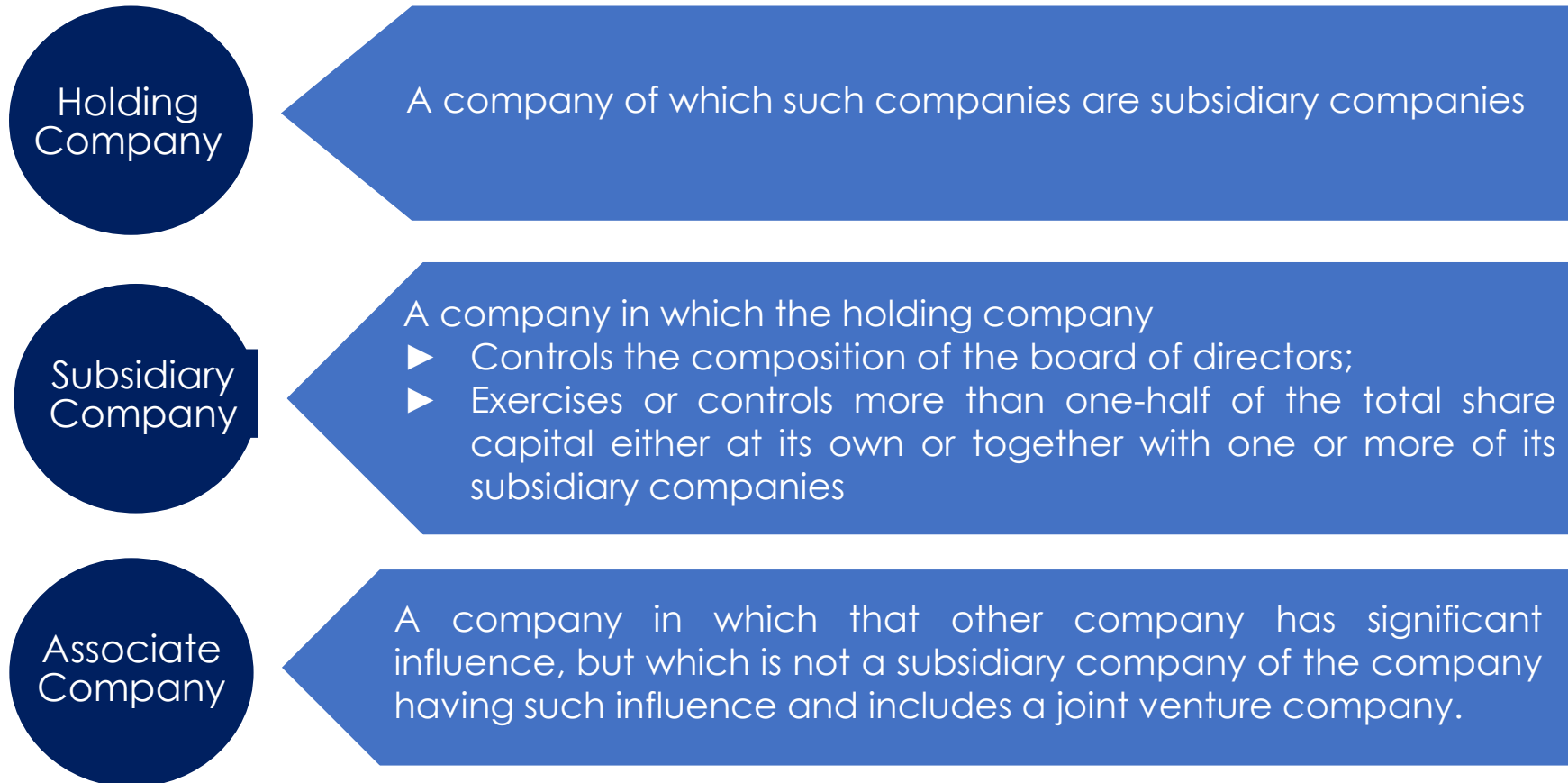


KEY COMPLIANCE REQUIREMENTS

- With the growing participation of investors and other stakeholders in companies, the question of transparency in deals with related parties has often been a topic of much debate and discussion. With the objective to usher increased degree of transparency in such transactions, section 188 has been introduced in the Act placing the onus on the Board of Directors to review, approve and explain such transactions to shareholders and in some cases seek their approval. The following are the key compliance requirements for related party transactions under the Act:



Companies Act, 2013 Definitions



Significant influence means control of at least twenty percent of the total share capital, or of business decisions under an agreement;

Companies Act, 2013 Definitions

KMP

- ▶ The Chief Executive Officer or the managing director or the manager;
- ▶ The Company Secretary;
- ▶ The Whole-time director;
- ▶ The Chief Financial Officer;
- ▶ Such other officer as may be prescribed

Relative

- ▶ Members of a HUF
- ▶ Husband and wife
- ▶ One person is related to the other in such manner as may be prescribed (includes father, mother, son, daughter, son's wife, daughter's husband, brother, sister)

Manager

An individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not.

Companies Act 2013

Related Party Transactions - Definition

The Companies Act, 2013 has laid down certain restrictions on the related party transactions if those transactions are not in the ordinary course of business or at arm's length. However, these restrictions are limited to specified transactions mentioned under section 188 of the Companies Act, 2013. These specified transactions are:

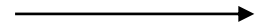
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| ▶ Sale, purchase or supply of any goods or materials; |
| ▶ Selling or otherwise disposing of, or buying, property of any kind; |
| ▶ Leasing of property of any kind; |
| ▶ Availing or rendering of any services; |
| ▶ Appointment of any agent for the purchase or sale of goods, materials, services or property; |
| ▶ Appointment of any related party to any office or place of profit in the company, its subsidiary company or associate company; and |
| ▶ Underwriting the subscription of any securities or derivatives thereof, of the company. |

Latest SEBI Update dated 22nd November 2021

1. SEBI Vide Circular No : SEBI/HO/CFD/CMD1/CIR/P/2021/662 dated 22nd November 2021 amended Vide notification dated November 9, 2021 mandating listed entities that have listed specified securities to submit to the stock exchanges disclosure of Related Party Transactions (RPTS) in the format specified by the Board from time to time.
2. Further, it has been decided to prescribe the information to be placed before the audit committee and the shareholders for consideration of RPTs.
3. Accordingly, the following provisions shall apply to entities that have listed specified securities on a Recognized Stock Exchange.

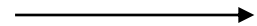
4. Information to be provided by the management of the Listed entity to the audit committee and the shareholders.
- a. Type, material terms and particulars of the proposed transaction
 - b. Name of the RPT and its relationship
 - c. Tenure of the proposed transaction
 - d. Value of proposed transaction
 - e. . The percentage of the listed entity's annual consolidated turnover, for the immediately preceding financial year, that is represented by the value of the proposed transaction (and for a RPT involving a subsidiary, such percentage calculated on the basis of the subsidiary's annual turnover on a standalone basis shall be additionally provided);
 - f. If the transaction relates to any loans, inter-corporate deposits, advances or investments made or given by the listed entity or its subsidiary:
 - Details of source of funds
 - Purpose for which the funds will be utilized
 - applicable terms, including covenants, tenure, interest rate and repayment schedule, whether secured or unsecured; if secured, the nature of security
 - g. where any financial indebtedness is incurred to make or give loans, intercorporate deposits, advances or investments
 - nature of indebtedness;
 - cost of funds; and
 - tenure

5.Audit committee



Shall review the above-mentioned information and also the status of long term (more than one year) or recurring RPTs on an annual basis before giving approval.

6.Shareholders



Shall review the above-mentioned information in addition to the requirements under the companies act 2013 as a part of explanatory statement.

7. Format for reporting of RPTs to the Stock Exchange

The listed entity shall make RPT disclosures every six months in the format provided by [Clicking here](#)

8. The Circular shall come into force with effect from April 1, 2022.

9. The Circular is issued in exercise of the powers conferred under Section 11(1) of the Securities and Exchange Board of India Act, 1992 read with Regulation 101 of the LODR.

RISK PARAMETERS



RISK PARAMETERS

CBDT vide instruction 3/2016 dated 10th March 2016 has issued guidelines for implementation of transfer pricing provisions by replacing instruction no 15/2015. The said guidelines are applicable for both IT as well as SDT. The key features of the guidelines are as under:

Selection Criteria	Action to be taken
All cases selected under Computer Assisted Scrutiny Selection (CASS) system or under the compulsory manual selection system	Mandatorily referred to the TPO by the AO after obtaining approval of the PCIT or CIT.
All cases selected under non-transfer pricing risk parameters referred to the TPO only in the following circumstances:	Where the taxpayer has entered in to and IT or SDT, however the taxpayer has not filed Form No. 3CEB or has not disclosed all the IT's or SDT's in the report so filed.
	Where there has been a transfer pricing adjustment of INR 10 crores or more in any earlier assessment year which has been upheld by the judicial authorities or is pending in appeal.
	Where, in the search and seizure or survey operations, findings have been recorded by the investigation wing or AO regarding transfer pricing issues.

Recent Developments – TP Impact



EMERGING ISSUES IN TP

1. Characterization of Comparables – Cherry picking of Comparable Companies.

A. Issue

- The crux of arm's length price determination is comparability analysis, where a controlled transaction or price is compared with the independent uncontrolled comparables. Given this, comparability, including selection of appropriate comparable is at the heart of transfer pricing analysis, and death of comparability could well mean the death of transfer pricing
- Ever since the formal transfer pricing (TP) regulations were introduced in India in 2001, the maximum amount of dispute and litigation in the field of TP have revolved around the issue of comparability or economic analysis, namely selection/ rejection of comparables.
- There was an underlying reason or logic for the genesis of such controversy i.e. profitability and functionality of any selected comparable.

EMERGING ISSUES IN TP

1. Characterization of Comparables – Cherry Picking of Comparables

B. Judicial Pronouncements

- It was held by the Delhi Tribunal in **ITW India Limited V/s ACIT 1(1), Gurgaon (2015 53 Taxmann.com 531)**, that no side (the TPO nor the assessee) can be allowed cherry-picking. The view has also been supported in the following cases:
- **Lubrizol Advance Materials India (P) Limited (2014 42 taxmann.com 263 (Ahd- Tribunal)**
- **Toshiba India Private Limited V/s ACIT (Delhi Tribunal)**
- **Phillips Software Centre Private Limited V/s ACIT (2008 26 SOT 226)**

Pr. CIT vs. M/s Softbrands India Pvt Ltd (Bangalore High Court) (AY 2006-07)

Any appeal before High court would not be entertained either by Revenue or the Assessee unless it involves substantial question of law and the exercise of fact finding or Arms Length Price determination or 'Transfer Pricing Adjustments' by ITAT is final as it is the final fact finding Authority.

EMERGING ISSUES IN TP

2. Domestic TP's deemed omission from Inception

A. Issue

- Disputed the ALP of managerial remuneration paid by taxpayer, by virtue of coverage under section 92BA(i) of ITA. The introduction of SDT caused considerable challenge to the taxpayer, in establishing the ALP of certain transactions such as managerial remuneration given that the roles/ responsibilities/ functioning of each of the directors in a particular company is unique/ different and thus may not always be comparable.
- Taxpayers had undertaken compliances in relation to SDT, such as filing of Accountant's Report in Form No. 3CEB maintenance of Rule 10D transfer pricing documentation and in certain cases, such cases also went through the rigor of transfer pricing assessments. Some cases have faced adjustments during the transfer pricing assessments and are currently in the appellate forums.

B. Judicial Pronouncements

- **Texport Overseas Private Limited Vs. Dy. CIT** (ITAT Bangalore) (Texport's case) for Assessment Year (AY) 2013-14
- Honourable Supreme Court in the case of **Kolhapur Cane sugar Works Ltd. Vs Union of India**
- Honourable Supreme Court in the case of **General Finance Co. Vs Assistant Commissioner of Income tax**
- Honourable Karnataka High Court in the case of **GE Thermometrics India Pvt. Ltd.**

EMERGING ISSUES IN TP

3. Marketing Intangibles

(a) Issues

- In case of an international transaction between taxpayer and AE under which the taxpayer incurred Advertising Marketing Promotion ('AMP') expenses towards marketing intangibles legally-owned by the AE; the issue herein pertains to allowability of such AMP expenses in the hands of the taxpayer, considering the commercial rational or the legal ownership. According to the tax Authorities, what is relevant under the transfer pricing regulations is legal ownership of intangibles.

(b) Judicial Pronouncements

- **Maruthi Suzuki India Ltd Vs CIT (ITA 110/2014)** (Delhi High Court)
- **LG Electronics India Pvt Ltd v. ACIT** (Delhi-Tribunal) (SB)
- **Sony Ericsson Mobile Communications India P. Ltd Vs CIT**

(c) Precautionary Measure:

- The necessity of transfer pricing adjustment for AMP expenses may arise
- where there is influence of an AE in advertising and marketing function of the Indian affiliate. It is advisable for the taxpayer to evaluate the TP policy in light of detailed analysis of roles / responsibilities undertaken, risks borne / reward reaped. Also, a robust documentation including legal contracts etc. has to be maintained by the taxpayer.

EMERGING ISSUES IN TP

4. Issuance of Guarantee on behalf of the AE

(a) Issues

- The Indian tax authorities are of the view that the Indian entity must charge guarantee fees for the guarantee given in respect of the borrowings of AEs.
- In the absence of any guarantee fees charged to AEs, the tax authorities may take stand that Indian entities provided an intra-group service to its AE by issuing the corporate guarantee to the loans taken by their AEs abroad, the latter are obliged to pay a service charge to the Indian entity. Accordingly, Indian entity should charge guarantee fee for provision of guarantee service.

(b) Judicial Pronouncements

- **Maruti Suzuki India (ITA 110/2014)** (DELHI HIGH COURT)
- **Siro clinpharm (ITA 2618/Mum/2014)**
- **DR. Reddys Labs (ITA No. 294, 458/Hyd/2015)**
- **Rain Cements Limited v DCIT (MA No. 32 and 33/Hyd/2017)**
- **Bharti Airtel Limited Vs. ACIT [2014],**
- **Redington (India) Limited vs. JCIT (ITA No. 513/Mds/2014),**

(c) Precautionary Measure

- Considering that the chargeability of fees on corporate guarantee provided by the taxpayer to its foreign AE is a subject matter of litigation and pursuant to the amendment in section 92B to include guarantees, it is therefore advisable to charge guarantee fees on such guarantees provided, at ALP. Reference can be drawn from the rates prescribed under the SHR.

EMERGING ISSUES IN TP

5. Charging Notional Interest for Delay in Realization of Sales Proceeds from AEs

(a) Issues

- In case of excessive credit period allowed to AEs and delay in realization of sales proceeds from AEs as compared to non AEs, the tax authorities are of the view that by giving excess credit period to AEs and delay in realizing sales proceeds from AEs as compared to non AEs, the Indian entity is passing the benefits of prolonged credit to its AE. Accordingly, an adjustment should be made in respect of excess credit period allowed to AE debtors by charging notional interest from AEs on excess amount outstanding or extended credit period.

(b) Judicial Pronouncement

- PCIT-2 Vs. Bechtel India Pvt Ltd** (TS-591-SC-02017)
- CIT-9 Vs Indo American Jewellery Ltd** (TS-3-HC-2013(BOM)-TP)
- Pegasystems Worldwide India Private Limited** for FY 2009-10 (I.T.A. Nos. 1758 & 1936/Hyd/14)
- Evonik Degussa India P. Ltd** (ITA no. 7653/Mum./2011),
- M/s Avnet India Pvt. Ltd.** (ITA No .757(Bang.)/2011),
- Kusum Healthcare Pvt. Ltd.** Range 5 (ITA No.6814/Del/2014)
- BMW India** (ITA No 5354/DEL 2012)
- Indo American Jewellery Ltd vs CIT** (ITA No. 5872/Mum/2009)

CIT vs. Aurionpro Solutions Ltd (Bombay High Court)

Transfer Pricing ALP of foreign advances: If the advances are made to a AE situated abroad, the LIBOR rate has to be considered to determine the Arms Length interest and not the interest rate in India (SBI PLR). This would be reasonable and proper in applying commercial principles

(c) Precautionary Measure

- Nevertheless, in order to avoid adjustment or litigation on this account, it is advisable that there is no excess credit allowed / prolonged credit period extended to AE debtors as compared to non AE debtors. It is advisable to maintain robust documentation to prove that the excess credit, if allowed to AE debtors is due to specific business reasons and not with the intention of passing any benefits to AEs.

EMERGING ISSUES IN TP

6.Economic Adjustments

(a)Issues

- There may be certain circumstances wherein comparables identified may require adjustments for differences in working capital, risk profile of entities, capacity utilization, etc. for determining the ALP. Such adjustments are referred to as comparability adjustments or, economic adjustments in common parlance.
- Economic adjustments have been a subject matter of litigation in India.

(b)Judicial Pronouncements

- The Chennai Tribunal in case of **Mando India Steering Systems Pvt Ltd**
- The Pune Tribunal in case of **Amdocs Business Services Private Ltd.**
- The Pune Tribunal in case of **Demag Cranes & Components (India) (P.) Ltd.**
- **Srini Pharmaceuticals Ltd**, (ITA No 1851/Hyd/2012)
- **Qual core logic** (ITA No 893/ Hyd/ 2011)
- **HSBC Electronic Data Processing Pvt. Ltd** (ITA – 420/ Hyd/ 2007)
- **Mentor Graphics (Noida) Pvt. Ltd.** (2007-TIOL-382-ITAT-Del)

(c)Precautionary Measure

- In view of the above, it is advisable that the claim on account of differences should be supported with evidence. For example, claim on account of quantity should be supported with evidence such as the commercial policy of the company, etc.

EMERGING ISSUES IN TP

7. Tax authorities cannot question the commercial rationale of legitimate business expenses incurred

(a) Issue

- In certain cases, the taxpayer makes payment to its AE for the use of brand name, in spite of perpetual loss incurred by the taxpayer in its business. The Tax Authorities generally disallow such payments considering perpetual losses suffered by the Indian entity.

(b) Judicial Pronouncement

- Delhi High Court in the case of **EKL Appliance Ltd. Vs. CIT**

(c) Precautionary Measure

- The decision highlights the fact that the tax authorities per se cannot question the commercial rationale of legitimate business expenses incurred by the taxpayer.
- However, it also becomes imperative for taxpayer to demonstrate that the transaction is at arm's length by application of the prescribed methods with proper evidences/ documentation.

EMERGING ISSUES IN TP

8. Compensation for Intra Group Services – Benefit Test

(a) Issue

- Indian tax authorities take an aggressive approach while examining the TP policies in respect of intra-group services, especially when an Indian entity is the recipient of services and management fee has been charged to Indian entity.
- The Indian tax authorities mainly seek and examine the following details in this respect:
 - Need of such services to Indian entity i.e. whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in-house for itself.
 - Whether the amount charged by AE for services commensurate with the benefit derived by the Indian entity by availing such services, whether the allocation key used by AE make sense under the circumstances, etc.
 - Whether such services have given any special advantage / commercial or economic benefit to the Indian entity or the services are just in the nature of shareholder's services i.e. services rendered to protect the interest of the AE, being the shareholder and thus, not recoverable.
 - A copy of agreement between AEs and invoices/debit notes raised by AE to examine exact nature of services rendered by AE and the basis on which the payment is made to AE.

EMERGING ISSUES IN TP

9. Compensation for Intra Group Services - Benefit Test

(b)Judicial Pronouncements

- **TNS India Private Limited vs. ACIT** (ITA No.944/Hyd/2007)
- **DCIT vs. M/s Air Liquide Engineering India P Ltd** (ITA No. 1159, 1040/Hyd /2011 & ITA No. 1408/Hyd/2010)
- **Kirby Building Systems India Ltd Pashmylaram Vs ACIT** (ITA.No.1651/Hyd/2010)
- **CIT vs Ekl Appliances Ltd** (ITA Nos.1068/2011 & ITA Nos.1070/2011)
- **GOCL Corporation Limited Vs ACIT** (ITA.No.401/Hyd/2016)
- **JT International (India) Private Limited, (Presently known as Polisetty Somasundaram Tobacco Product (I) P Ltd) Vs DCIT**

(c)Precautionary Measure

- It is advisable to design a proper Group TP policy, considering the various factors such as the nature of the activity services rendered, significance of the activity to the group, functional profiling and the characterization of the intra-group transactions involved, relative efficiency of the service supplier, any advantage that the activity creates for the group, etc. Further, it is advisable to maintain robust documentation to demonstrate the actual receipt of intra-group services and fulfillment of the benefit test i.e., to demonstrate that the consideration received by the AE for services rendered to Indian entity is proper as compared to the benefit which Indian entity received from such intra group services.

EMERGING ISSUES IN TP

10. Levy of penalty under section 271G

(a) Issue

- The TPO had called upon the assessee to submit the segmental profitability for AE transactions and non-AE transactions even though the assessee had expressed its inability to furnish details in the manner for the reason that it had not maintained separate books of accounts for AE and non-AE segments.
- The TPO accordingly proposed to levy penalty under section 271G on the assessee for its failure to furnish the said requisite details.

(b) Judicial Pronouncements

- In the case of Mumbai ITAT Ruling of **ACIT V/s M/S D. Navinchandra Exports Pvt Ltd** (ITA No. 6304/Mum/2016)
- In the case of Mumbai ITAT **DCIT Vs Laxmi Diamond P. Ltd** (ITA No.2643/Mum/2017)
- In the case of Mumbai ITAT **DCIT Vs Firestone International Pvt Ltd** (ITA No. 5304/Mum/2016)
- In the case of Delhi ITAT **Bio-Rad Laboratories (India) Pvt Ltd vs. DCIT** (ITA No.1415/Del./2017)
- In the case of Jaipur High Court **CIT Vs Gillette India Ltd.** (ITA No. 104 / 2015)
- In the case of Delhi High Court **CIT Vs Leroy Somer & Controls (India) Pvt Ltd**

(c) Precautionary Measure

- The assessee should maintain robust documentation and also document the practical difficulties if any faced by the industry it operates in as no two businesses are identical which would be helpful to the TPO at the time of assessment and may avoid litigation.

EMERGING ISSUES IN TP

10. Re-imbursement of expenses

(a) Issues

- The transactions involving pure cost reimbursements also require a TP analysis (including benchmarking) for determination of ALP.

(b) Judicial Pronouncements

- Delhi High Court in the case of **Cushman and Wakefield India Pvt Ltd**
- **ADP Pvt. Ltd. Vs DCIT** (ITA No. 471/Hyd/2011)
- **AMD Research & Development Center India Private Ltd. Vs DCIT** (I.T.A. No. 86/HYD/2014)
- **M/s.Cognizant Technology Solutions India Pvt. Ltd. Vs ACIT** (ITA Nos.114 & 2100(Mds)/2011)
- **NTT DATA FA Insurance Systems (India) Private Limited Vs DCIT** (I.T(TP).A No.1311/Bang/2010)
- **NTT DATA India Enterprise Application Services P. Ltd. Vs ACIT** (ITA.No.1613/Hyd/2010)

(c) Precautionary Measure

- In view of the above, it is advisable to carefully frame the policy for re-imbursement of expenses incurred on behalf of AEs. If the expenses are administrative/routine in nature, it is advisable to maintain documentation in support of expenses incurred,
- the benefit, if any, derived by the AE, rationale for incurring the expenses by Indian entity, arrangement/agreement with the AE in respect of the same, etc.
- Further, in cases where such activities are done on regular and frequent basis and continue over a period of time, it is important to look into the substance of the transaction to find whether the activities carried on by the Indian entity amounts to service rendered by the Indian entity for which it should charge appropriate amount of service fee to the AEs.



Multilateral effects of the documentation paradigm

Revision of intercompany agreements and existing transfer pricing policies of the group to renegotiate the arrangements to be done by the AEs during the current scenario. This would have an effect on pricing, credit terms, delivery and exchange rates. The positions taken ought to be documented to face transfer pricing audits in the future.



The outcome – pressure for Taxpayers or Revenue?

Benchmarking study would not accurately measure the arm's length price for 2020 and future transactions. Adjustments can be used to assist in determining ALP. Data may not be available on public domains in real time.



More issues than solutions?

Effect on APA negotiations as the effect on critical assumptions is uncertain. The terms agreed may not reflect the COVID-19 economic situation. Impact on existing APAs needs to be considered whether to honor/ revise/ cancel. Detailed documentation is required in place to discuss with Authorities on revision of APA.



Virtual workspaces – cause for controversies?

Whether decisions made through virtual world by the personnel would trigger PE risk to the companies? Work from home option given on account of social distancing requires analysis of PE risk.

Covid-19 Impact



Addressing the conundrum

Industry wise impact is required to be assessed to understand the effects of lockdown, demand & supply, reduced margins on competitors, market players etc. and measures taken to fight the adversities.



Transition/ temporary exit?

Temporary relocation of business functions could result in diversion of work to other locations. The FAR analysis needs to be reviewed to reflect the changes with appropriate documentation in place. Impact on benchmarking analysis on account of the above is required to be carried out.



The after-effects of lockdown

Companies would incur expenditure on account of lockdowns such as retrenchment/ layoff compensation, employee benefit expenditure on treatment of infected employees office maintenance etc. Treatment of all expenses incurred during COVID 19 as operating, non-operating/ extraordinary needs careful consideration.

Covid-19 Impact



Will borrower's confidence be shattered?

Credit profile of the borrowers is impacted due to extended period of lock downs and disruption in business operations which is a key consideration for determination of interest rates. The credit rating of companies as on 31 March 2019 would be different from that of 31 March 2020 amidst the breakout though the rating has been consistent over the years.



The HARD to VALUE pain points in the economic turmoil

The licensees of intangible assets may not earn adequate profits from exploitation of assets. Therefore, the royalties and IP payments may not be made on time or payments made may not reflect the arm's length price.



Comparability adjustments – a need of the hour?

The relationship between actual output and potential output may defer as the capacity is not being utilized in the current economic scenario due to lockdowns, work from home/ leave options to employees, existence of fixed costs such as salaries, rent, maintenance, depreciation and unutilized plant and machinery. Hence, capacity utilization for comparables vis-à-vis tested party is required to be analyzed and adjustment, if any is warranted for idle capacity costs. However, this adjustment may not be feasible for risk mitigating entities operating in India.

Equalisation levy on e-commerce operators – TP?

Overview

Taking a cue from the G20 / OECD Base Erosion and Profit Shifting (BEPS) Action 1 dealing with digital economy, India introduced an Equalisation Levy ('EL') in 2016 at the rate of 6 percent on non-resident companies engaged in online advertisement and related activities.

Key features of the new EL

Applicability – Non-resident e-commerce operators who own, operate, or manage digital or electronic facility or platform for online sale of goods or online provision of services or both and derive revenues from e-commerce supply or services made or provided or facilitated by it.

Scope of e-commerce supply or services:

- Online sale of goods owned by the e-commerce operator
- Online provision of services by e-commerce operators
- Facilitation of online sale of goods or provision of services or both by e-commerce operator
- Any combination of the above

E-commerce supply or services rendered to the following:

- A person resident in India
- A non-resident in specified circumstances
- A person who buys goods or services using an IP address located in India

Levy of 2 percent imposed on consideration received or receivable by e-commerce operators from e-commerce supply or services

Effective date: 1 April 2020

- The scope of the said provision has now been expanded to include EL of 2 percent on consideration received or receivable by an 'e-commerce operator' from 'e-commerce supply or services', and is effective from 1 April 2020.

Exclusions – Cases outside the scope of EL

- Non-resident e-commerce operators who have permanent establishments in India and e-commerce supply or services are effectively connected to those establishments
- Cases where EL is leviable on online advertisement and related activities (as these are covered by different provisions)
- Sales, turnover, or gross receipts are less than INR 20 million during the financial year
- **Quarterly payment and compliance**
- **An annual statement needs to be furnished to the tax authorities on or before 30 June of the subsequent financial year.**

Exemption from applicability of normal income tax provisions on the revenues subjected to EL

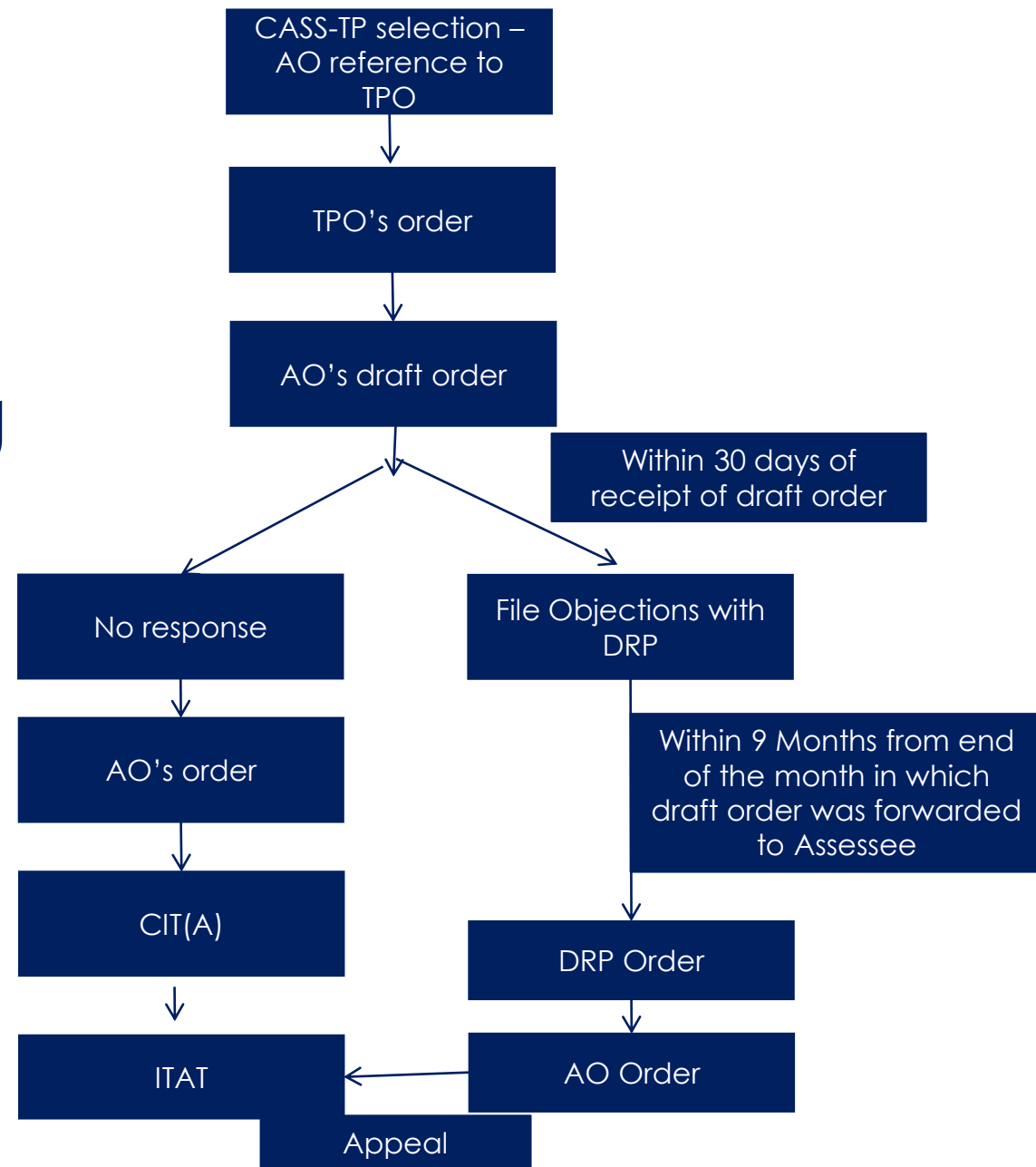
India, US reach settlement on 2% equalisation levy

1. India and the United States have reached an agreement to settle differences relating to the 2% equalisation levy imposed by New Delhi on e-commerce operators.
 2. The settlement is based on the Unilateral Measures Compromise reached among the UK, Austria, France, Italy and Spain with the US on October 21 this year.
 3. Under the agreement
 - India will continue to impose the levy till
 - a) March 31, 2024
 - (Or)
 - b) Implementation of Pillar 1 of the OECD agreement.
- } Whichever is earlier
- The liability from India's equalisation levy on e-commerce supply of services that US companies accrue in India during the interim period will be creditable against future taxes accrued under Pillar 1 of the OECD agreement
 - The US will terminate the currently-suspended additional duties on goods of India that had been adopted in the DST Section 301 investigation.
4. The India-USA agreement on a transitional approach is beneficial to India as it can carry on with the present 2% levy with certainty until Pillar 1 takes effect
 5. Once the OECD agreement rolls out, the 2% equalisation levy will have to be withdrawn. This applies to other countries as well that have imposed a similar tax

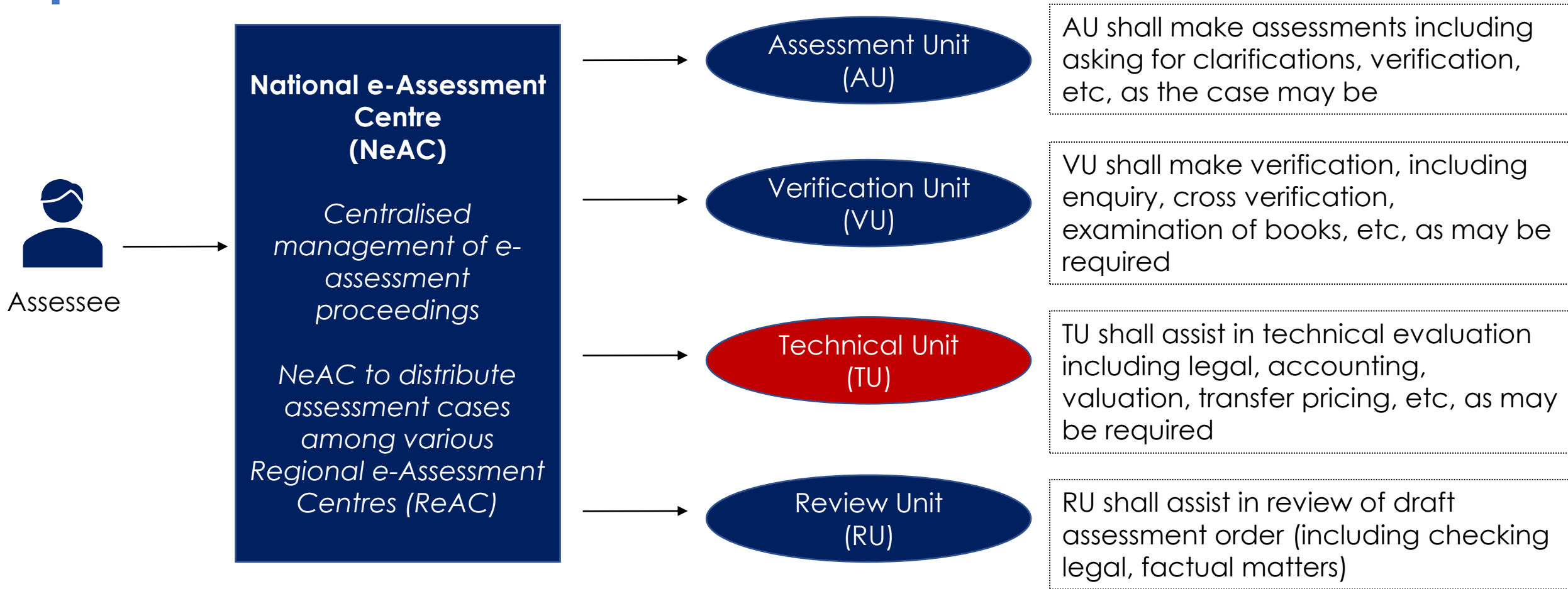


ASSESSMENT PROCEDURE

Litigation Process - Transfer Pricing



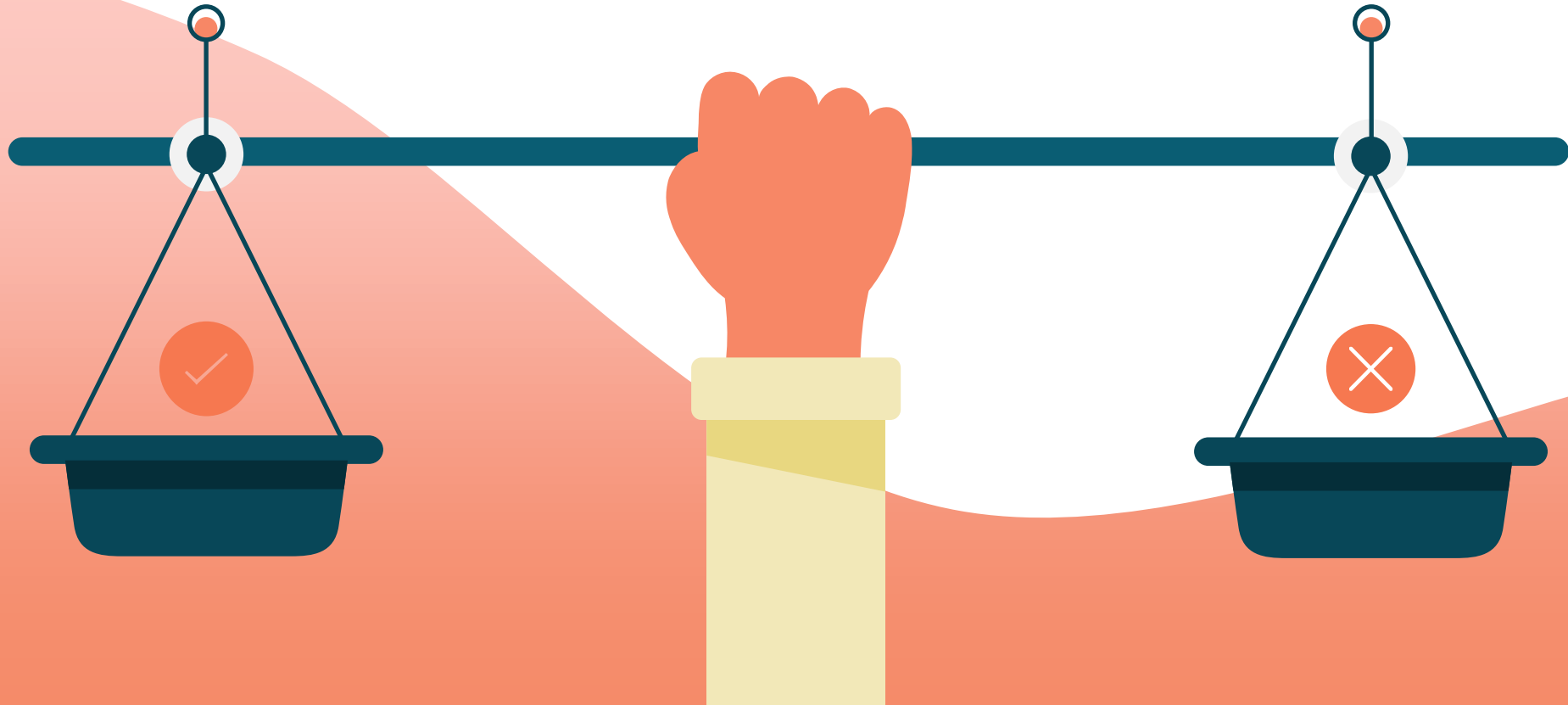
Will TP fall under Faceless Assessment?



- Whether TP will be falling under TU?
- Whether TP will continue under existing online/ manual assessment scenario?
- Whether TP will be taken care at AU level?



ALTERNATIVE DISPUTE RESOLUTION AND MITIGATION CHANNELS

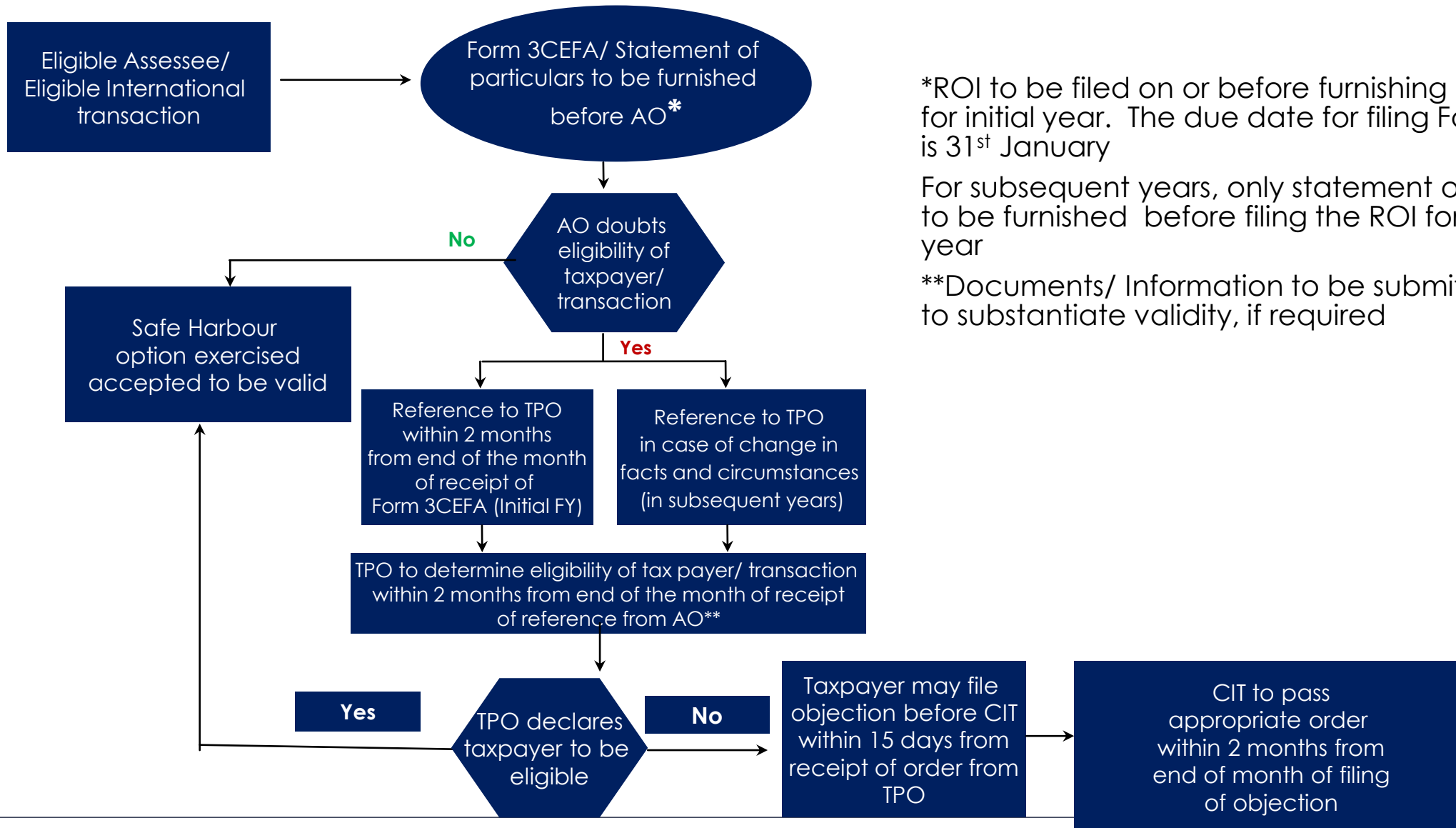


ALTERNATIVE DISPUTE RESOLUTION AND MITIGATION CHANNELS

1. Safe Harbour rules(Under Section 92CB and Rules 10TA to TG)

- A “safe harbour” is defined in the Act as circumstances in which the tax authority shall accept the transfer price declared by the assessee.
- Further, the CBDT, vide **notification 117/2021/F. No. 370142/44/2021-TPL dated 24th September 2021**, Stated that the provision of rule 10TD Is extended for AY 2021-22 (*Previously only AY 2020-21 was under the purview of this rule*).
- **Compliance Requirements:**
- **FORM 3CEFA - Safe Harbour Application (International Transactions)**
- **FORM 3CEFB - Safe Harbour Application (SDT's)**

SAFE HARBOR RULES – COMPLIANCE PROCEDURE



*ROI to be filed on or before furnishing Form 3CEFA for initial year. The due date for filing Form 3CEFA is 31st January

For subsequent years, only statement of particulars to be furnished before filing the ROI for particular year

**Documents/ Information to be submitted to TPO to substantiate validity, if required

ALTERNATIVE DISPUTE RESOLUTION AND MITIGATION CHANNELS

2. Advance Pricing Agreement (APA)

- **Finance Act, 2012** had introduced the provisions of Advance Pricing Agreement ('APA') w.e.f. **1 July 2012**.
- An APA is an agreement between the CBDT and a taxpayer, which determines in advance the ALP or specifies the manner of the determination of ALP, in relation to IT.

(A)Types:

- Unilateral APA
- Bilateral APA
- Multilateral APA

(B)Tenure:

- The tenure of APA can be up to 5 years for onward determination of ALP.
- In case of roll back mechanism, the APA can be made applicable for a period not exceeding 4 years. Hence, the total tenure applicable for APA can be 9 years.

(C)Compliance

- APA application in Form **3CED/ 3CEDA** (for period starting from FY 2020-21)

Our experience:

Basis the recent trend the APA Commissionerate is finalizing the margin at 16.75% where the value of international transactions is INR 100 crores or less than INR 100 crores per year for IT and ITeS companies

APA– OVERVIEW OF THE PROCESS



APA – Pros and Cons

Benefits	Risks
<ul style="list-style-type: none"> ▪ Proactively avoids TP controversy - Provides certainty and enhances predictability ▪ Discussion at the “right level” ▪ Solution to complex/ difficult TP issues ▪ Eliminates/reduces risk of economic double taxation ▪ Can reduce compliance cost ▪ Concerns around domestic tax law process - Preferred means of controversy management after MAP 	<ul style="list-style-type: none"> ▪ Strain on resources for taxpayers – personnel and expenses ▪ May not provide certainty in case of a unilateral APA or if an APA involves unreliable prediction on market conditions without adequate critical assumptions ▪ Fairly detailed forms/ information request during pre-filing and application stage - normally not required in an audit ▪ Confidentiality of information submitted not clear ▪ May not always result in the desired outcome

ALTERNATIVE DISPUTE RESOLUTION AND MITIGATION CHANNELS

3. Mutual Agreement Procedure(MAP)

- MAP is an alternative available to taxpayers for resolving disputes giving rise to double taxation whether juridical or economic in nature. The agreement for avoidance of double taxation between the countries would give authorization for assistance of Competent Authorities in the respective jurisdiction under MAP. In the context of OECD Model Convention for the Avoidance of Double Taxation, Article 25 provide for assistance of Competent Authorities under MAP.

➤ Recent MAP Guidance:

Resolution under MAP is arrived at following cases:

- Transfer Pricing adjustments
- Existence of a Permanent Establishment
- Attribution of profits to a Permanent Establishment
- Characterisation or re-characterisation of an income or expense

Technical Issues – Guidance Provided:

- Downward Adjustments
- Resolution of Reccuring Issues
- Secondary Adjustment
- Taxes collection
- Bilateral and Multilateral APAs

TP -Penalty provisions

Particulars	Penalties
(A) Documentation:	
Under-reporting and mis-reporting of income	50% - under-reporting; 200% - mis-reporting of income
In case of a post-inquiry adjustment, there is deemed to be a concealment of income u/s 271(1)(c)	100-300% of tax on the adjusted amount
Failure to maintain documents u/s 271AA	2% of the value of each International Transaction/SDT
Failure to furnish documents/report transaction u/s 271G	2% of the value of the International Transaction/SDT
Failure to furnish accountant's report u/s 271BA	Rs 100,000
Omission or false entry in books of accounts u/s 271AAD	Penalty equal to amount of such false entry

Penalty provisions [section 270A] - Finance Act 2016

(B) Master File:

Not maintaining and filing the required information in the master file within the due date u/s 271AA

INR 500,000/-

(C) CbCR:

Non-filing of CbC report by Indian resident parent company u/s 271GB are :

- INR 5,000 per day up to one month
- INR 15,000 per day beyond one month
- INR 50,000 per day for continuing default after service of notice

Not furnishing the information called for by the tax authority within the given time limit

- INR 5,000 for every day up to the service of the penalty order
- INR 50,000 per day for the default beyond the date of service of the penalty order

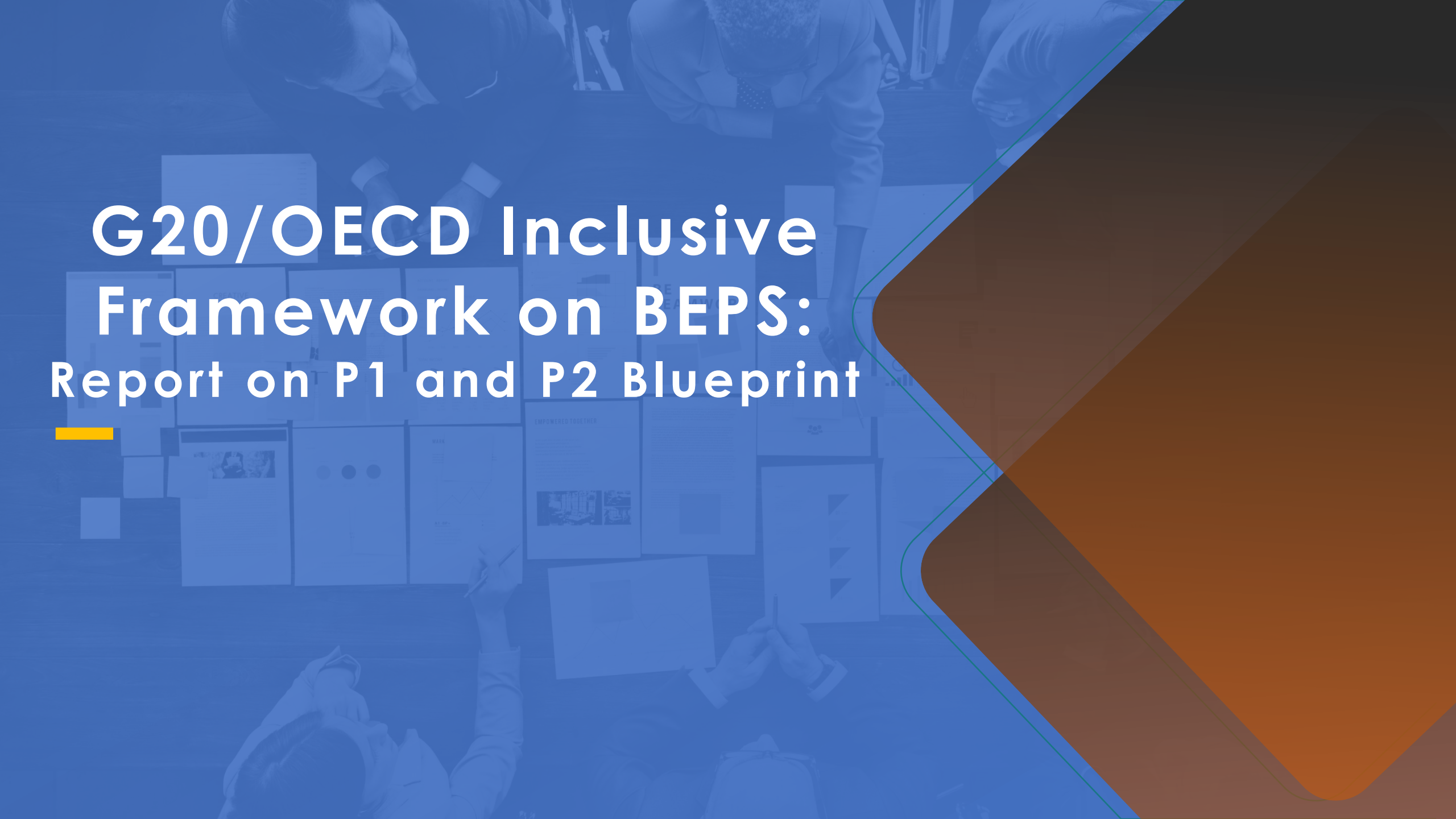
Furnishing inaccurate particulars/not filing the corrected CbC report within 15 days

INR 500,000/-


TP document, Master File and CbCR Compliances for the FY 2020-21		
Particulars	Form	Due Date
TRANSFER PRICING DOCUMENTATION		
• Maintenance of Transfer Pricing Documentation u/s 92D	-	15 February 2022
• Certification and Filing of Form 3CEB u/s 92E	Form 3CEB	15 February 2022
MASTER FILE		
• All CE s of International Group, irrespective of whatever satisfying the threshold limits or not	Part A of Form 3CEAA	15 March 2022
• All CE s of International Group, Crossing the Master File threshold Limits Notified	Part A and Part B of Form 3CEAA	
• Case more than 1 entity in India is crossing the Master File threshold limits Notified	3CEAB	13 February 2022 (30 days prior to Filing Form 3CEAA)

Due Dates - Continuation

CbCR		
<ul style="list-style-type: none">Intimation of the Indian CE being alternate reporting entity or that the Parent entity is filing CbCR	3CEAC	31 January 2022 (2 Months prior to Filing Form 3CEAD)
<ul style="list-style-type: none">This form is to specify in which country the Group is filing CbCR and ie applicable only when the Parent Company of the Group is Estd in India		
Filing of CbCR by	3CEAD	31 March 2022 (assuming Group's accounting year end as 31 March 2021)
<ul style="list-style-type: none">Indian Parent Company		
<ul style="list-style-type: none">Indian Alternate reporting entity		
<ul style="list-style-type: none">CE resident in India satisfying 286(4) (No Agreement for Information Exchange)	3CEAE	Due Date has not been notified yet CE resident in India satisfying 286(4) (No Agreement for Information Exchange)
Instruction where CbCR is being Filed by Designated CE where		
<ul style="list-style-type: none">2 or More CE s Resident of India are falling under 286(4) category. (No Agreement for Information Exchange; or		
<ul style="list-style-type: none">Resident CE s of Group having Indian Parent		



G20/OECD Inclusive Framework on BEPS: Report on P1 and P2 Blueprint



OECD Evolution and work so far

2013

Action Plans
on Base
Erosion and
Profit Shifting

2015

AP 1: FINAL
REPORT
Addressing
the Tax
Challenges
of Digital
Economy

2018

INTERIM
REPORT
OECD/G20
under
inclusive
framework;
Tax
Challenges
arising from
Digitalisation

2019

Public
consultation
document
and
Programme
of work to
develop
consensus

Oct
2020

Reports on
the Blueprints
to Pillar 1 and
2 and
invitation of
comments

Jan 21

Public
Consultation
meetings

June
21

G7
Communique

July
2021

Statement on a
Two-Pillar Solution
to Address the
Tax Challenges
Arising from the
Digitalization of
the Economy

Background of P1 and P2

- ❖ OECD and G20 countries have adopted a 15-point Action Plan to address BEPS in September 2013. The Action Plan identified 15 actions along with three key pillars:
 - Introduce Coherence in domestic rules that affect cross-border activities
 - Reinforce substance requirements in existing International Standards
 - Improve transparency as well as certainty
- ❖ The 137 members of the Framework have worked on a global solution based on a **Two-Pillar Approach**. Pillar One is focused on new nexus and profit allocation rules and ensure that the allocation of taxing rights with respect to business profits is no longer exclusively circumscribed by reference to physical presence.
- ❖ Pillar Two addresses remaining BEPS challenges and it does so via a number of interlocking rules that seek to
 - (i) ensure minimum taxation while avoiding double taxation or taxation where there is no economic profit,
 - (ii) Cope with different tax system designs by jurisdictions as well as different operating models by businesses,
 - (iii) Ensure transparency and minimize administrative & compliance costs.

Pillar 1 – Amount A

- **Amount A** is a new taxing right over a share of the residual profit of MNE groups that fall within its defined scope. The tax base is therefore determined on the basis of the profits of a group (rather than on a separate entity basis), and it is necessary to start with consolidated group financial accounts.
- A new taxing right for market jurisdictions over a share of residual profit calculated at an MNE group (or segment) level (**Amount A**)
- A fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction, in line with the ALP (**Amount B**)
- Processes to improve **tax certainty** through effective dispute prevention and resolution mechanisms.

Scope of Amount A

Global Threshold Limit:

MNE Groups with Global Turnover above **€20 B**
&
Profitability above **10%**
(PBT/ Revenue)

NEXUS: Local Revenue

1) € 1M for > €40 B GDP countries.
2) € 2.5 M for < €40 B GDP countries.

Automated Digital Services:

1. Advertisement Services
2. Sale/other Alienation of user data
3. Online Intermediation Platforms
4. Digital Content Services
5. Online Gaming

Real-Time location of User –
Based on Indicators below:

- Geolocation
- IP Address
- Other Location Information

Consumer Facing Businesses:

1. Consumer Facing goods
2. Consumer Facing Services
3. License or Franchise

Report by Licensee or Franchisee

Place of Final Delivery of the Product or use of service

Exclusions: Extractives (non-renewable resources) and regulated financial Services

Revenue Sourcing rules –

Note: 1) **Hierarchy of Indicators** should be followed. If not, MNE should justify the reason for not availing.
2) MNE must retain the **Documentation** of

- Internal Control Framework related revenue sourcing.
- Indicators used for Present category.

New Taxing Right

Profit Allocation:

- 1) Isolate the Routine profits & Residual profits. Threshold Limit = 10% of Revenue.
- 2) 25% fixed reallocation is used to allot appropriate share of residual profits to market jurisdictions.
- 3) Finally, Amount A is distributed based on the rules on Scope, Nexus & Revenue Sourcing.

Double Taxation Elimination:

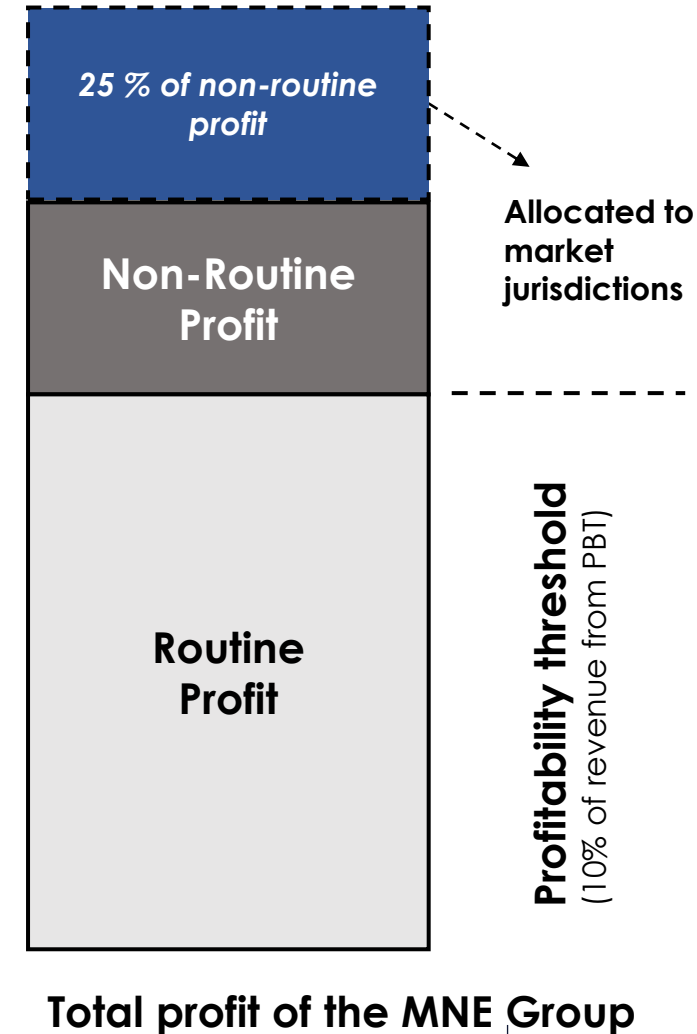
1. Identify the paying entity

- I Activities Test
- II Profitability Test
- III Market connection priority test
- IV Pro-rata allocation

2. Exemption or Credit Methods are used to eliminate double taxation.

Tax Base determination:

1. Use PBT derived from Consolidated Financial Statements.
2. Segmentation framework Threshold is yet to decide.
3. In-regime Losses can be carry forward.
4. No cross segment blending of Profits & losses are allowed



Case Study (modified as per Guidelines released by OECD in October 2021)

Facts

Group A is a large MNE group providing exclusively in-scope ADS via an online platform. It is assumed that Group A is treated as one segment for Amount A purposes and that it has the following simplified income statement:

	in million EUR
Revenue (R)	25,000
Profit before tax (P)	6,500
PBT margin (P/R)	26%

in million EUR	Local revenue (\$)	
Market 1	2,000	local subsidiary
Market 2	18,000	remote activity
Market 3	5,000	remote activity
Total	25,000	

Applying Amount A formula

Step 1: Profitability Threshold	Step 2: Reallocation percentage
Determine Group A's residual profit (W) by subtracting 10% from the PBT margin (P/R).	Determine Group A's allocable tax base (A) by multiplying residual profit (W) by 25%.
$W = P - (R * 10\%)$ $W = 6,500 - (25,000 * 10\%)$ W = 4,000	$A = 25\% * W$ $A = 25\% * 4,000$ A = 1000

10% is a threshold agreed by the IF members

25% is a threshold agreed by the IF members

Case Study (Contd)

Step 3: Allocation key

Allocation key based on the ratio of locally sourced revenue (S) to total revenue (R). This last step provides for the quantum of Amount A taxable in each eligible market jurisdiction (M), as described in the below table.

in million EUR	Local revenue (S)	Allocation Key (S/R)	Amount A (M)
Market 1	2,000	8%	$A * S/R = \mathbf{80}$
Market 2	18,000	72%	$A * S/R = \mathbf{720}$
Market 3	5,000	20%	$A * S/R = \mathbf{200}$
Total	25,000	100%	1000

Amount B – Introduced to simplify the TP Rules for tax administrations & Taxpayers -

The application of the arm's length principle to in-country baseline marketing and distribution activities will be simplified and streamlined, with a particular focus on the needs of low capacity countries. This work will be completed by the end of 2022.

Tax certainty and implementation

Tax Certainty



```
graph TD; TC[Tax Certainty] --> DPR[Dispute Prevention & Resolution]; TC --> DR[Dispute Resolution]; TC --> IA[Implementation & Administration];
```

Dispute Prevention & Resolution:

1. New mechanism Using panels.
2. Amount A allocation to be improved by panels.
3. Encourages Multilateralism in tax matters.

Dispute Resolution:

1. Mandatory binding dispute resolution mechanisms.
2. Foe countries with few MAP cases deferred from MAP peer review.

Implementation & Administration:

Implementation of Pillar 1 require action across –

1. Domestic law
2. Public International law
3. Guidance on Scope , Nexus & Revenue sourcing rules to Taxpayers & Tax Administrations.
4. Guidance could be revised & reviewed periodically

Pillar 2 – Global Minimum Tax rule

Applicability of Global Anti-Base Erosion (GloBE):

GloBE rules will apply to MNEs that meet the € 750 million threshold

Pillar 2:

Two interlocking domestic rules of GloBE –

- (i) Income Inclusion Rule (IIR): Which imposes **top-up tax** on a parent entity in respect of the **low taxed income** of a constituent entity; if that income was subject to tax at an Effective Tax Rate (ETR) that is below a minimum rate
- (ii) Undertaxed Payment Rule (UTPR): **Denies deductions** or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR i.e., **withholding tax for a payment to a related party** if that payment was not subject to tax at or above a minimum rate.

Carve Outs and Carry forward

Carve-outs:

The GloBE rules will provide for a *formulaic substance carve-out* that will exclude an amount of income that is **5% of the carrying value of tangible assets and payroll**. In a transition period of 10 years, the amount of income excluded will be 8% of the carrying value of tangible assets and 10% of payroll.

Carve-out allows countries to continue to **offer tax incentives** to promote business activity with real substance, like building a hotel or investing in a factory.

The GloBE rules will also provide for a de minimis exclusion for those jurisdictions where the MNE's revenue is less than €10 million and profits of less than € 1 million.

Carryforward:

Excess Taxes	Losses
If excess tax paid in previous year, create an Income Inclusion Rule tax credit (IIR tax credit) (Or)	Losses in jurisdiction carryforward and allowed as deduction in computation of GloBE tax base is subsequent year from profits arising in same country.
local tax carry- forward is created, 7 year look back/Carry forward period.	Carry-forward allowed Indefinitely.

General points on P2

Entities not subject to GloBE rules:

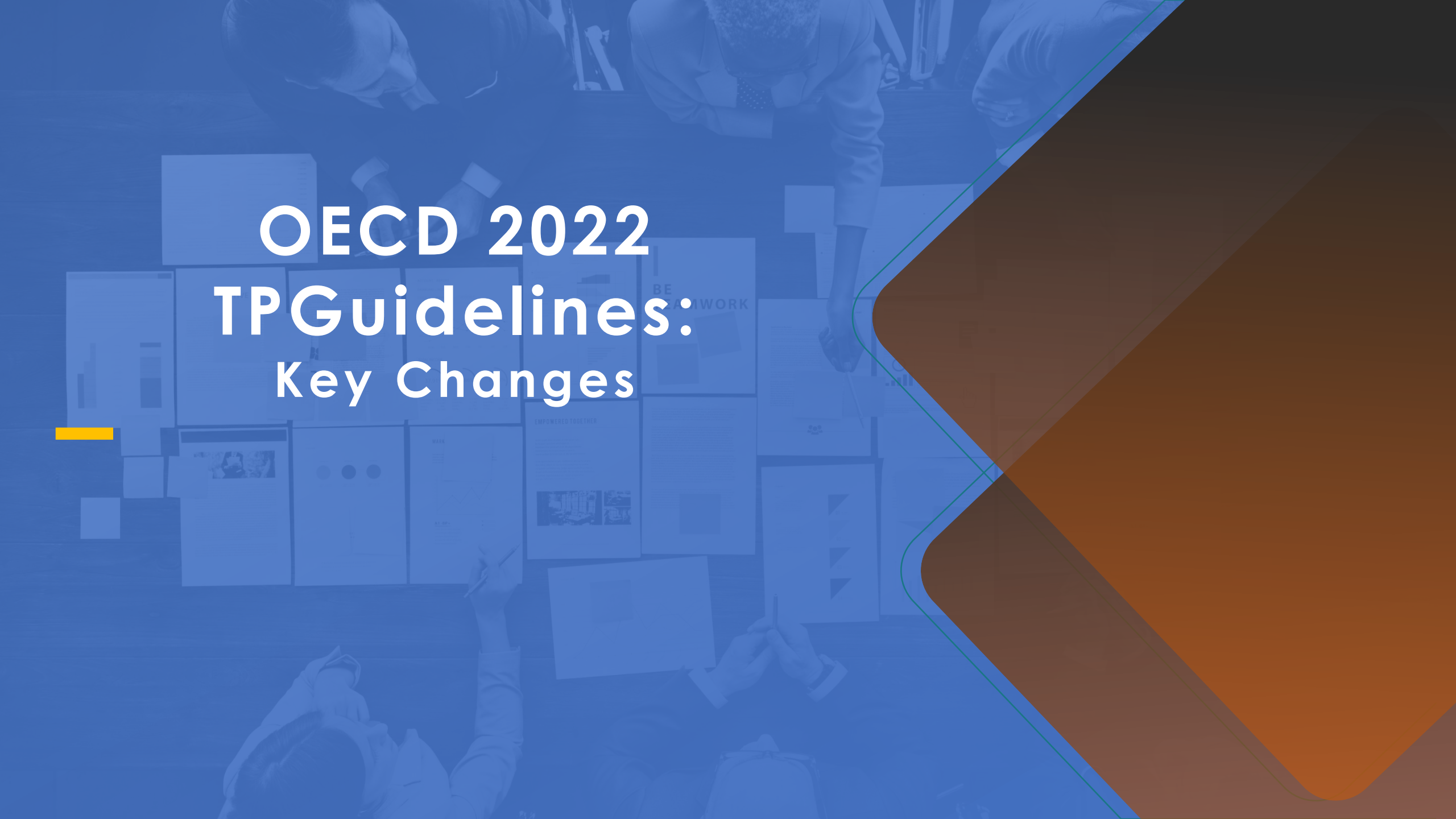
- Government entities,
- International organizations,
- NPOs,
- pension funds or investment funds that are Ultimate Parent Entities (UPE) of an MNE Group or any holding vehicles used by such entities, organizations or funds.

Switch-over rule (SOR):

Introduced into tax treaties that would permit a residence jurisdiction to **switch from an exemption** to a **credit** method where the profits attributable to a permanent establishment (PE) are subject to an effective rate below the minimum rate.

Subject to tax rule (STTR):

Treaty-based rule, that would complement the UTPR by subjecting a payment to withholding or other **taxes at source** and adjusting eligibility for **treaty benefits on certain items of income** where the **payment is not subject to tax at a minimum rate**. The STTR will be creditable as a covered tax under the GloBE rules.



OECD 2022 TP Guidelines: Key Changes

Key Changes in OECD 2022 TP Guidelines

The key amendments to earlier version of the guidelines are as follows:

- The incorporation of Transfer Pricing Guidance on Financial Transactions;
- The revision of the Guidance on the Transactional Profit Split method;
- The incorporation of the Guidance for Tax Administrations on the application of the approach to Hard-to-value Intangibles.

THANK YOU



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MHA & ASSOCIATES LLP

CHARTERED ACCOUNTANTS



MHA & ASSOCIATES LLP
CHARTERED ACCOUNTANTS

Tax Audit

Under Indian Income-tax Act, 1961

By CA Mithilesh Sai & CA Rajesh Vaishnav
(MHA & Associates LLP, Hyderabad)





Contents to be covered

- Reference Material
- Applicability
- Scope of Tax Audit
- Form 3CA vs Form 3CB
- Form 3CD - Clauses under Tax Audit
- Important Clauses in Form 3CD
- ICDS Disclosures under Tax Audit
- Other Clauses under Form 3CD
- Errors and key points to be kept in mind while preparing a Form 3CD
- Annexures





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Reference Material

Reference Material

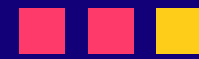


- **Income Tax Act, 1961:**
Relevant Sections – Section 44AB (Audit of accounts of certain persons carrying on business or profession)
- **Relevant Income Tax rules:**
Rule-6G (Report of audit of accounts to be furnished under section 44AB)
- **ICAI Guidance Notes – 44AB related:**
 - ICAI Guidance Note (Edition 2014)
 - ICAI Implementation Guide (Edition 2018)
 - Checklist issued by ICAI for conduct of Tax audit
- **CBDT:**
 - Circular by CBDT, dated 9th September 2021
 - Circular by CBDT by way of FAQs dated 23rd March 2017
 - Notification by CBDT dated 29th September 2016

Apart from the above, one has to consider the applicability of the Supreme Court and Jurisdictional High Court precedents on the matters where there is interpretation challenges.



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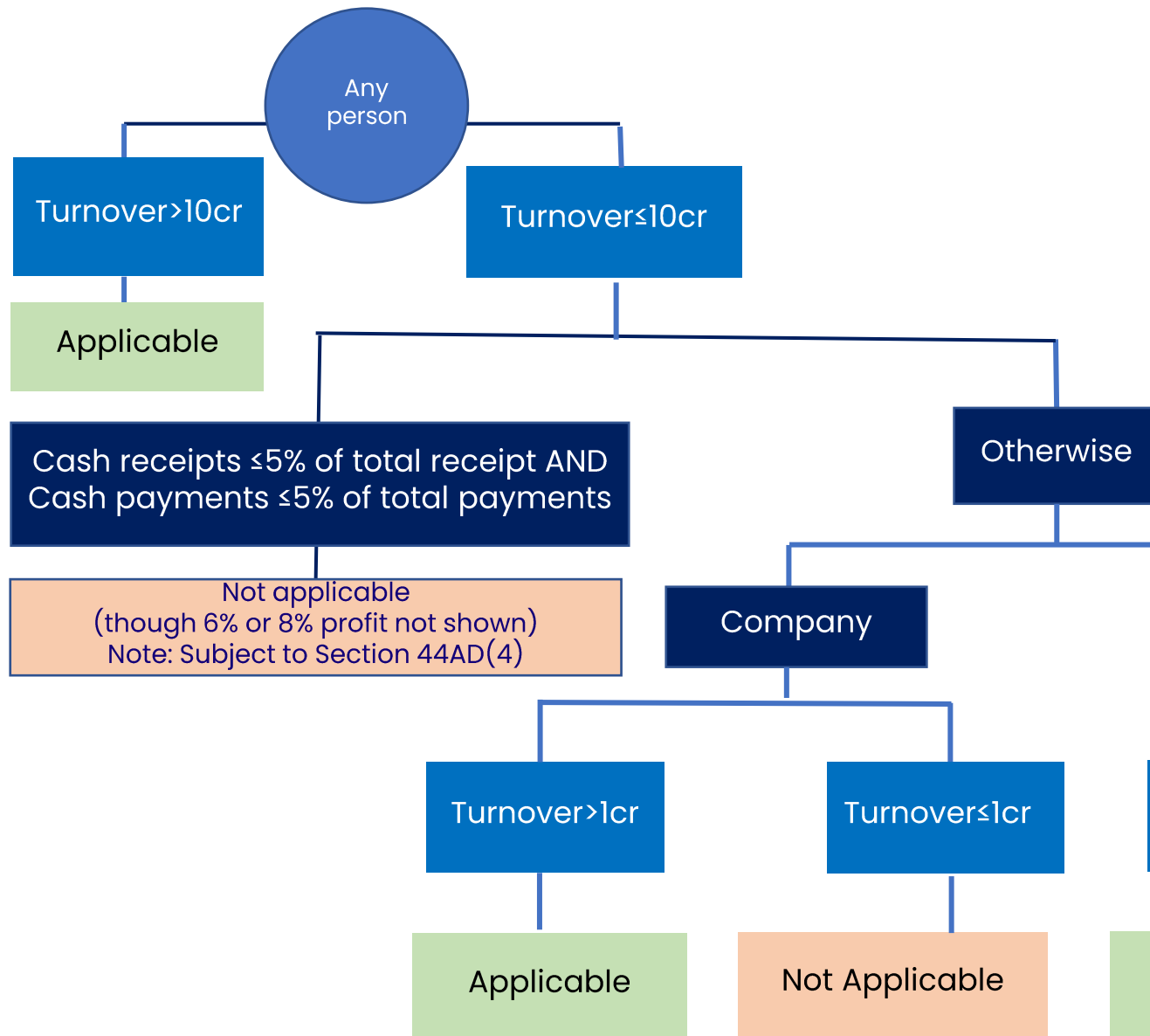


Applicability



Due dates

Particulars	Original Due date	Extended due date
Person other than companies not liable for tax audit	31-07-2021	31-12-2021
Filing Tax Audit report and other reports	30-09-2021	15-02-2022
Filing of ITRs where TP certification is not applicable and partners are subject to tax audit	31-10-2021	15-03-2022
Filing of Form 3CEB for Transfer Pricing reporting	31-10-2021	15-02-2022
Filing of ITRs where Form 3CEB is applicable	30-11-2021	15-03-2022
Revision of returns/belated tax return	31-12-2021	31-03-2022
Revision of Tax Audits	31-03-2022	31-03-2022



Applicability

Governed by Section 44AB, 44AD and 44ADA

Situation*	Situation 1	Situation 2	Situation 3	Situation 4	Situation 5	Situation 6
Status	Any person	Any person	Any person	Company	Individual/HUF/ partnership firm	Individual/HUF/ partnership firm
Turnover	11 Cr	9 Cr	9 Cr	1.5 Cr	1.2 Cr	1.5 Cr
PGBP	More/Less than 6%/8%	More/Less than 6%/8%	More/Less than 6%/8%	More than 8%	More than 6%/8%	Less than 6%/8%
Cash receipts	3%	2%	15%	20%	30%	45%
Cash payments	2%	1%	2%	25%	40%	25%
Tax Audit applicability	Yes	No	Yes	Yes	No	Yes
Remarks	As the turnover is more than 10Cr	As the cash receipts and payments are less than 5% <u>AND</u> turnover is less than 10Cr	Applicable as the cash receipts are more than 5%	Applicable as 44AD is not applicable for Companies	Can opt presumptive taxation. May not be applicable	44(a) proviso benefit not available. Also, presumptive rate not being followed

Note: Above does not capture the scenarios where presumptive tax was opted earlier and is opted out this year. The same is discussed in the ensuing slide.

Situation*	Turnover	Whether liable for a tax audit?
The assessee has opted for Section 44AD in any of the last 5 years but not opting for same in the current year	Up to Rs. 1 crore	Yes, if income is more than the maximum amount not chargeable to tax [Section 44AB(e)] The same may create anomaly, however, the same is required to prevent the abuse of the provisions
	Up to Rs. 2 crore	
	More than Rs. 2 Crore but up to Rs. 10 crore	No [Proviso to Section 44AB(a)]
	More than Rs. 10 crore	Yes
The assessee has not opted for Section 44AD in any of the last 5 years and not opting for same during the current year as well.	Upto Rs. 10 crore	No [Proviso to Section 44AB(a)]
	More than Rs. 10 crore	Yes



Whether a person opting for presumptive taxation scheme under section 44AD is required to get his accounts audited if he is opting out ?

(* Assuming cash receipt or payments does not exceed 5% of the aggregate amount received or paid during the year.)

Turnover/Gross receipts

- To be taken as per ICAI's GN on Tax Audit
- As per Para 5.10 of GN – considering that the words "Sales", "Turnover" and "Gross receipts" are commercial terms – construed in accordance with the method of accounting regularly employed
- Gross Receipts includes all receipts whether in cash or in kind which will normally be assessable as business income under the Act

Para 5.9 of ICAI Guidance Note on u/s 44AB (Revised 2014) states that:

- If sales tax/GST and excise duty are included in the sale price, no adjustment in respect thereof should be made for considering the quantum of turnover.
- If, however, the Excise duty and/or sales tax/GST recovered are credited separately to Excise duty or Sales tax Account (being separate accounts) and payments to the authority are debited in the same account, they would not be included in the turnover.

Therefore, indirect taxes should normally not be included to arrive at the limits of s. 44AB, except in the cases as stated above.

Turnover/Gross receipts

- **Inclusions (Not to be deducted for calculating Turnover)**

1. Sale of scrap/ By product
2. Sales proceeds of shares, securities, debentures etc. held as stock in trade by the assessee.
3. Cash discount other than allowed in invoice
4. Commission on sales
5. If sales tax/ Excise duty was included in sale price while accounting (Inclusive method), then the same shall form part of Turnover.

- **Exclusions (To be deducted for calculating Turnover)**

1. If sales tax/ Excise duty was not included in sale price while accounting (Exclusive method), then the same shall not form part of Turnover.
2. Sale proceeds of Fixed Assets.
3. Sale proceeds of Investment property.
4. Sale proceeds of shares, securities, debentures held as an Investment.
5. Discounts allowed in the Invoice.
6. Turnover discount (even if allowed by way of separate credit note)
7. Ancillary charges such as packing, freight and forwarding etc. provided they are separately mentioned in the Invoice. Otherwise, they will form part of Turnover.
8. Sales Returns
9. Price adjustments.
10. Special rebate (Excluding commission on sales)

Turnover/Gross receipts

In case of Share Brokers

Share Brokers buy and sell securities on behalf of their client. Thus, brokerage income received on purchase and sale of such securities shall form part of Turnover.

In case of Shares, Securities & Derivatives

Speculative Transactions

Aggregate of both positive and negative differences arising from the difference between purchase and sale transactions should be considered as Turnover.

Derivatives/ Futures & Options

In case of Derivative transactions difference between purchase and sale is settled.

Following are considered while determining turnover:

- Total of favourable and unfavourable differences.
- Premium received on sale of options.
- Differences in case of reverse trades.

received/receivable by him shall form part of his sales/turnover

Delivery based transactions

Where the transaction for the purchase or sale of any commodity including stocks and shares is delivery based whether intended or by default, the total value of the sales is to be considered as turnover.

Turnover/Gross receipts

In agency business

Amount of commission earned by the agent and not the aggregate amount for which sales are effected or services are rendered.

If the property in the goods or all significant risks and rewards of ownership of goods continue to belong to the principal, the relevant sale price shall not form part of the sales/turnover of the commission agent and/or the consignee as the case may be. If, however, the property in the goods, significant risks and reward of ownership belongs to the commission agent and/or the consignee, as the case may be, the sale price received/receivable by him shall form part of his sales/turnover



Applicability

Whether a person opting for presumptive taxation scheme under section 44AD, 44ADA and 44AE is required to get his accounts audited?

Requirement

An assessee who claims that his profits and gains from the profession are lower than the profits and gains specified

and

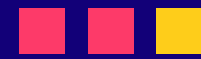
whose total income exceeds the maximum amount which is not chargeable to income-tax,

shall be required to keep and maintain such books of account and other documents as required under sub-section (2) of section 44AA and get them audited and furnish a report of such audit as required under section 44AB.





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Scope of Tax Audit

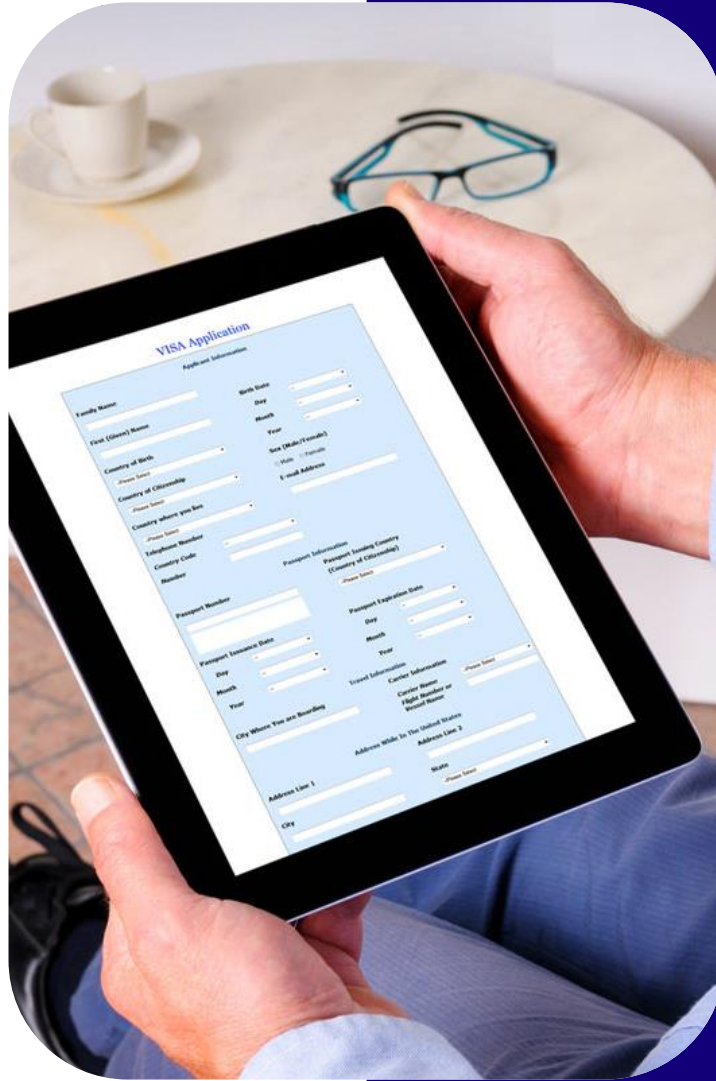
- One of the objectives of tax audit is to ascertain/derive/report the requirements of Form Nos. 3CA/3CB and 3CD.
- Therefore, the scoping of the tax Audit should revolve and serve due reporting in the above Sections.
- For entities liable for audit under any other statute, correlation of particulars given in Form 3CD with disclosures in FS is to be made and only some additional verification may be required.
- However, where there is no audit done under other statute, entire audit is to be conducted to give a true and fair view of the Financials.

Important: ICAI releases checklist for Tax Audit clause wise which helps/assists the tax auditors to avoid/minimize the risks or errors while completing the tax audit . It helps the Tax Auditors to be in conformance with the Standards of Auditing and can further assist in future for better reporting/Peer reviews etc.,

<https://www.icai.org/post/approach-to-tax-audit-under-section-44ab-of-the-income-tax-act-1961>



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Form 3CA vs Form 3CB

Sub-rule (1) of Rule 6G provides that the report of audit of accounts of a person required to be furnished under section 44AB shall –

- a) in the case of a person who carries on business or profession and ***who is required by or under any other law to get his accounts audited***, be in Form No. **3CA**;
- b) in the case of a person who carries on business or profession, but ***not being a person referred to in clause (a)***, in Form No. **3CB**.



When is Form 3CA to be used?

Form 3CA is to be used when the financial statements of the entity are audited under any other law.

For example:

- a Company audited under **Companies Act 2013**.
- A Limited Liability Partnership (LLP) audited under Limited Liability Partnership Act, 2008 if its turnover exceeds Rs. 40 Lakhs.

When is Form 3CB to be used?

Form 3CB is to be used in all other cases i.e., when financials statements of the entity are not audited under any other law.



Major Components of Form 3CA

Some of the prominent components of 3CA are mentioned below-

- Details of the Assessee i.e. Name, Address and Permanent Account Number (PAN).
- Date of the audit report.
- Annexure details (Balance sheet, Profit & Loss A/c, other documents and Form 3CD).
- A declaration by the auditor that all the filled details and the Annexure are true and correct subject to qualifications/observations if any.
- Auditor's name, address, membership number, FRN no. and signature with stamp/seal.

Major Components of Form 3CB

- Details of the Assessee i.e. Name, Address and Permanent Account Number (PAN).
- Date of the audit report.
- Annexure details (Balance sheet, Profit & Loss A/c, other documents and Form 3CD).
- **A declaration by the auditor that they have obtained all information and explanations which were necessary for the purpose of the audit.**
- Reporting of the detailed observations, comments, discrepancies, and inconsistencies (if any).
- The Form includes the declaration made by the auditor that proper books of accounts are being maintained at the branch and head offices.
- A declaration by the Chartered Accountant that all the filled details and the Annexure are true and correct subject to qualifications/observations if any.
- In the end, the Form specifies the name, address, membership number, FRN no and signature of the auditor with stamp/seal.



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Form 3CD – Clauses under Tax Audit

As per Rule 6G, the tax audit report shall be furnished in in Form 3CD

- Form 3CD is divided into 2 parts as follows:

Part	Clauses	Remarks
Part A	Clauses 1 to 8	General details of the Assessee and his business
Part B	Clauses 9 to 44	Contains specific Section wise disclosures which assists in identifying the allowances and disallowances under Indian Income-tax Act, 1961

Clause No.	Clause Name	Description
1	Name of the assessee	Basic Details of the assessee
2	Address of the assessee	Basic Details of the assessee
3	Permanent Account Number (PAN)	Basic Details of the assessee
4	Registration under Indirect Tax Laws	Whether the assessee is liable to pay indirect tax. If yes, furnish the registration no./ GSTN/identification no. allotted for the same.
5	Status of the assessee	Individual, Hindu Undivided Family (HUF), company, firm (includes LLP), Association of Persons (AOP), Body of Individuals (BOI), local authority and artificial juridical person
6	Previous year ended	Financial Year pertaining to the Audit
7	Assessment Year	Assessment Year pertaining to the Audit
8 & 8a	Clause of audit under 44AB and adoption of new tax regimes	Relevant clause and adoption of any of the new tax regimes is to be mentioned

Clause No.	Clause Name	Description
9.(a)	If firm or association of persons, indicate names of partners/members and their profit sharing ratios	Applicable to Firms and LLPs
9.(b)	If there is any change in the partners or members or in their profit sharing ratio since the last date of the preceding year, the particulars of such change	
10.(a)	Nature of business or profession (if more than one business or profession is carried on during the previous year, nature of every business or profession)	
10.(b)	If there is any change in the nature of business or profession	Mention the particulars of such change
11.(a)	Whether books of account are <u>PRESCRIBED</u> under section 44AA, if yes, list of books so prescribed.	Certain books of accounts like cash book, journal, ledger, etc. are to be maintained
11.(b)	Lists of books of account <u>MAINTAINED</u> and the address at which the books of account are kept	Location of the books of accounts to be mentioned.

S.No	Clause Name	Particulars
11.(c)	List of books of account and nature of relevant documents EXAMINED.	Mention the list of books of account examined by the auditor.
12.	Presumptive Income Relevant sections (44AD, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB, Chapter XII-G, First Schedule or any other)	The amount of profit that relates to a business subject to the presumptive scheme of taxation must be reported here. <i>(Discussed in detail in ensuing slides)</i>
13.(a)	Method of accounting employed in the previous year.	Applicable to all Assesseees irrespective of accounting method.
13.(b)	Whether there had been any change in the method of accounting employed vis-à-vis the method employed in the immediately preceding previous year.	
13.(c)	If answer to (b) above is in affirmative, give details of such change, and the effect thereof on the profit or loss.	

S.No	Clause Name	Particulars
13.(d)	Whether any adjustment is required to be made to the profits or loss for complying with the provisions of income computation and disclosure standards notified under section 145(2).	Applicable to Assessee's following Mercantile Accounting system. The 'Income Computation and Disclosure Standards' (ICDS) ranging from ICDS I to ICDS X are to be followed for computation of income and disclosures to be made.
13.(e)	If answer to (d) above is in the affirmative, give details of such adjustments	
13.(f)	Disclosure as per ICDS	
14.(a)	Method of valuation of closing stock employed in the previous year.	The method of valuation should be in accordance with AS 2 'Valuation of Inventories'. Valuation shall be made at lower of actual cost or net realisable value(NRV).
14.(b)	In case of deviation from the method of valuation prescribed under section 145A, and the effect thereof on the profit and loss	

S.No	Clause Name	Particulars
15	Give the following particulars of the capital asset converted into stock-in-trade:	An asset held as a capital asset would attract income under the head capital gains at the time of its sale and an asset held as stock-in-trade would attract income under the PGBP. When it is decided to treat a capital asset as part of the stock of the business, it will attract capital gains subject to certain conditions.
15.(a)	Description of capital asset;	
15.(b)	Date of acquisition;	
15.(c)	Cost of acquisition;	
15.(d)	Amount at which the asset is converted into stock-in-trade.	
16	Amounts not credited to the profit and loss account, being –	<i>(Discussed in detail in ensuing slides)</i>
16.(a)	The items falling within the scope of section 28;	Sub Clauses (a), (d) and (e) will apply to all assessee' s. (b) And (c) will not apply to the assessee following cash basis of accounting.
16.(b)	The proforma credits, drawbacks, refund of duty of customs or excise or service tax, or refund of sales tax or value added tax where such credits, drawbacks or refunds are admitted as due by the authorities concerned;	

S.No	Clause Name	Particulars
16.(c)	Escalation claims accepted during the previous year;	The tax auditor is required to report the amounts which have not been credited to the P&L account.
16.(d)	Any other item of income;	
16.(e)	Capital receipt, if any.	
17.	Land or Building or both transferred at less than Stamp Duty	<p>If the sale consideration of an immovable property is less than the stamp duty value of such property, the stamp duty value shall be deemed to be the sale consideration for the purpose of tax computation.</p> <p><i>(Discussed in detail in ensuing slides)</i></p>
18.	Particulars of depreciation allowable as per the Income Tax Act, 1961 in respect of each asset or block of asset, as the case may be, in the following form:-	<p>The Income Tax Act prescribes depreciation to be charged as per the 'block of assets system' subject to certain conditions. This clause checks that the depreciation has been arrived at correctly.</p> <p><i>(Discussed in detail in ensuing slides)</i></p>
18.(a)	Depreciation of asset/block of assets	
18.(b)	Rate of depreciation	

S.No	Clause Name	Particulars
18.(c)	Actual cost of written down value, as the case may be	
18.(d)	Additions/deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustment on account of: (i) Central Value Added Tax credits claimed and allowed under the Central Excise Rules, 1944, in respect of assets acquired on or after 1st March 1994, (ii) change in rate of currency, and (iii) subsidy or grant or reimbursement, by whatever name called.	
18.(e)	Depreciation allowable	
18.(f)	Written down value at the end of the year	
19.	Amounts deductible under sections: 32AC, 32AD, 33AB, 33ABA, 35(1)(i), 35(1)(ii), 35(1)(iia), 35(1)(iii), 35(1)(iv), 35(2AA), 35(2AB), 35ABB, 35AC, 35AD, 35CCA, 35CCB, 35CCC, 35CCD, 35D, 35DD, 35DDA, 35E;	The tax auditor checks whether the assessee has complied with all the necessary conditions to claim a deduction under these sections. The amount debited to P&L as well as admissible as deduction to be disclosed (<i>Discussed in detail in ensuing slides</i>)

S.No	Clause Name	Particulars
20.(a)	Any sum paid to an employee as bonus or commission for services rendered, where such sum was otherwise payable to him as profits or dividend	The assessee would be allowed a deduction in respect of a payment made to an employee in the nature of a bonus.
20.(b)	Details of contribution received from employees for various funds as referred to in section 36(1)(va)	The contributions made by the employer to such funds shall be allowed as a deduction only if they are made within the due date.
21.(a)	Please furnish the details of amounts debited to profit and loss account, being in the nature of capital, personal, advertisement, expenditure, etc.	The nature of these expenses are such that they may either be fully disallowed or only allowed subject to certain conditions. <i>(Discussed in detail in ensuing slides)</i>
21.(b)	Amounts inadmissible under section 40(a)(i), 40(a)(ia), 40(a)(ic), 40(a)(iia), 40(a)(iib), 40(a)(iii), 40(a)(iv), 40(a)(v)	These sections broadly relate to disallowances made in respect of an expenditure or a part of an expenditure where tax was required to be deducted at source but the assessee failed to do so. <i>(Discussed in detail in ensuing slides)</i>

S.No	Clause Name	Particulars
21.(c)	Amounts debited to profit and loss account being, interest, salary, bonus, commission or remuneration inadmissible under section 40(b)/40(ba) and computation thereof;	This is applicable to firm, AOP or BOI assesseees where payments are made to the partners/members in the nature of salary, remuneration, interest, etc. <i>(Discussed in detail in ensuing slides)</i>
21.(d)	Disallowance/deemed income under section 40A(3)	Any expenditure incurred by any mode other than an account payee cheque or through a bank account using ECS if they exceed Rs. 10,000 in a day. <i>(Discussed in detail in ensuing slides)</i>
21.(e)	Provision for payment of gratuity not allowable under section 40A(7);	The deduction is allowed for payment of contribution to an approved gratuity fund. <i>(Discussed in detail in ensuing slides)</i>
21.(f)	Any sum paid by the assessee as an employer not allowable under section 40A(9);	<i>(Discussed in detail in ensuing slides)</i>
21.(g)	Particulars of any liability of a contingent nature;	Such a liability usually relates to ongoing legal disputes <i>(Discussed in detail in ensuing slides)</i>

S.No	Clause Name	Particulars
21.(h)	Amount of deduction inadmissible in terms of section 14A in respect of the expenditure incurred in relation to income which does not form part of total income;	An amount of expenditure which will be disallowed as it is deemed to be incurred towards earning exempt income. <i>(Discussed in detail in ensuing slides)</i>
21.(i)	Amount inadmissible under the proviso to section 36(1)(iii)	Where the assessee borrows a loan for business purposes, the interest thereon would normally be allowed as a deduction. However, if such loan was used to acquire an asset, the interest shall not be allowed <i>(Discussed in detail in ensuing slides)</i>
22.	Amount of interest inadmissible under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006.	The MSME act prescribes an amount of interest that would not be allowed as a deduction .
23.	Particulars of payments made to persons specified under section 40A(2)(b)	This section basically disallows expenditure incurred by way of payment to relatives in excess. <i>(Discussed in detail in ensuing slides)</i>

S.No	Clause Name	Particulars
24.	Amounts deemed to be profits and gains under section 32AC or 32AD or 33AB or 33ABA or 33AC.	These sections allow for a special deduction to certain assessees subject to certain conditions. In case of a breach of these conditions, the whole or a part of the deduction allowed earlier would be included as deemed income.
25.	Any amount of profit chargeable to tax under section 41 and computation thereof.	A deduction has been allowed in respect of an expenditure but the assessee has received some benefit whether by cash or by reduction in actual liability in the current year, Where an asset has been sold by an assessee engaged in the power generation and distribution and such sale consideration exceeds the written down value.

S.No	Clause Name	Particulars
25.	Any amount of profit chargeable to tax under section 41 and computation thereof.	<p>A bad debt that was allowed earlier is subsequently recovered.</p> <p>Where an amount has been withdrawn from a special reserve created by a financial company on which deduction was earlier allowed</p> <p>Where such amounts/benefits as above have been received even after the closure of business.</p>
26.	Sums covered by Section 43B	
26.(a)	Pre-existed on the first day of the previous year but was not allowed in the assessment of any preceding previous year and was (a) paid during the previous year; (b) not paid during the previous year;	<p>This section allows certain expenditure like cesses, taxes, duties, interest to bank, etc. to be claimed only on actual payment of the same if it is made before the due date of filing the return for the respective assessment year.</p> <p><i>(Discussed in detail in ensuing slides)</i></p>
26.(b)	Was incurred during the previous year and was (a) paid on or before the due date for furnishing the ROI.	

S.No	Clause Name	Particulars
27.(a)	Central Value Added Tax Credits(CENVAT)/ Input Tax Credit	The details of the CENVAT or input tax credit carried forward from the previous year, its utilization and the balance left needs to be provided along with the treatment of the same in the accounts of the assessee. <i>(Discussed in detail in ensuing slides)</i>
27.(b)	Prior Period Items	Applicable only for the assessee's following the mercantile system of accounting. <i>(Discussed in detail in ensuing slides)</i>
28.	GIFTS of Unlisted Shares Received by LLP's/Firms/Companies	Where the assessee receives certain shares of a private limited company where the Fair Market Value of such shares minus the amount paid to acquire such shares exceeds Rs. 50,000, such excess shall be chargeable to tax under the head 'Income from other sources' <i>(Discussed in detail in ensuing slides)</i>

S.No	Clause Name	Particulars
29.	Share Premium received by closely held companies in excess of Fair Market Value u/s 56(2)(viib)	Such excess premium shall be chargeable to tax under the head 'Income from other sources'. <i>(Discussed in detail in ensuing slides)</i>
29A.	a. Amount chargeable u/s 56(2)(ix). Advance received on capital asset forfeited. b. Furnish the nature of income and amount.	Advances received in relation to the transfer of a capital asset are shown as income from other sources where the advances are forfeited and the capital asset is not ultimately transferred. <i>(Discussed in detail in ensuing slides)</i>
30	Hundi Transactions	Details of any amount borrowed on hundi or any amount due thereon repaid, otherwise than through an account payee cheque
30A	Whether primary adjustment to transfer price, as referred to in sub-section (1) of 92CE, has been made during the previous year? (Yes/No)	The transfer pricing provisions under the Income Tax Act in general aim to value transactions with associated enterprises at an arm's length price. <i>(Discussed in detail in ensuing slides)</i>

S.No	Clause Name	Particulars
30B.	Limitation of interest deduction for borrowings from Associated Enterprises up to 30% of EBITDA	<p>Where an Indian Company borrows a sum of money from an associated enterprise, the deduction in respect of interest payable on such borrowed amount under the Income-tax Act shall be restricted to 30% of EBITDA (Earnings before interest, tax, depreciation and amortisation). The interest in excess of 30% shall be allowed to be set off in subsequent years subject to certain conditions. This clause places a check for compliance in this regard.</p> <p><i>(Discussed in detail in ensuing slides)</i></p>
31.	Loans/ Deposits/ Receipts and Payments under Section 269SS/269ST and 269T	<p>Specific disclosures required for each aspect for receipts and payments in detail and person wise</p> <p><i>(Discussed in detail in ensuing slides)</i></p>

S.No	Clause Name	Particulars
32(a).	Details of brought forward loss or depreciation allowance	Such amounts need to be revised for any change arising out of a rectification order, assessment order <i>(Discussed in detail in ensuing slides)</i>
32(c).	Change in the shareholding of the company has taken place during the previous year due to which the losses incurred prior to the previous year cannot be allowed to be carried forward in terms of section 79	This provision is applicable to a private limited company with the following exceptions: Less than 51% of the voting power only has changed hands Change in shareholding is due to death of a shareholder Change in shareholding is due to shares gifted by a shareholder to a relative Where the holding Company is a foreign company and the change in shareholding is due to amalgamation/demerger where less than 51% of the shareholding has changed <i>(Discussed in detail in ensuing slides)</i>

S.No	Clause Name	Particulars
32(c).	Details of speculation loss	A loss in speculation business will be allowed to be carried forward for only 4 years and can set off against income from speculation gain only. <i>(Discussed in detail in ensuing slides)</i>
32(d).	Details of loss in respect of specified business	Details to be provided
32(e).	Details of loss in respect of deemed speculation business	Details to be provided
33.	Section-wise details of deductions, if any, admissible under Chapter VIA or Chapter III (Section 10A, 10AA).	The tax auditor will have to verify whether the assessee has fulfilled the conditions necessary to claim the section-wise deductions. <i>(Discussed in detail in ensuing slides)</i>
34(a).	Deductions/ collections of tax – chapter XVII-B or XVII- BB	These sections broadly relate to compliances in respect of TDS payable on certain expenses. The tax auditor reports the expenditure on which tax was required to be deducted, whether such tax was actually deducted and paid to the government on time. If not, penalty is to be mentioned. <i>(Discussed in detail in ensuing slides)</i>
34(b).	Furnishing of tax deducted or collected statement	
34(c).	Whether the assessee is liable to pay interest under section 201(1A) or section 206C(7).	

S.No	Clause Name	Particulars
35(a)	Quantitative Details of a trading concern	In the case of a trading concern, give quantitative details of principal items of goods traded
35(b).	Quantitative Details of a manufacturing concern concern	Give quantitative details of the principal items of raw materials, finished products and by-products
36A.	Details of deemed dividend	The provisions of deemed dividend are attracted when a private limited company advances an amount to a shareholder (or to a concern in which he has a substantial interest) having more than 10% voting power in the company subject to certain conditions. Details of deemed dividend received and date of receipt to be disclosed
37 to 39.	Details of cost, excise and service tax audits	If yes, give the details, if any, of disqualification or disagreement on any matter/item/value/quantity as may be reported/identified

S.No	Clause Name	Particulars
40.	Accounting Ratios	Following are the ratios/key details required for the clause Turnover Gross Profit Ratio Net Profit Ratio Stock in trade/Turnover Ratio Material Consumed/Finished Goods
41.	Details of Demands raised or Refunds issued under Tax laws	The details of orders received from tax authorities other than Income Tax and Wealth Tax need to be provided in this clause. <i>(Discussed in detail in ensuing slides)</i>
42.	Details of forms furnished in Form No.61, 61A and 61B	These forms relate to Specified Financial Transactions in respect of certain prescribed transactions when they are entered into by such assesseees as prescribed in Sec.285BA

S.No	Clause Name	Particulars
43.	Furnishing of Country by Country Report (CBCR) under section 286	The report mentioned in this clause relates to providing information in respect of the international group of entities of which the assessee is a part and where the parent entity of such international group is not resident in India.
44.	Break-up of total expenditure of entities registered or not registered under the GST	Provide a break-up of the total expenditure from the GST point of view like expenditure in relation to exempt goods / services under GST, payments to entities under the Composition Scheme, Payments to entities not registered under GST etc. A similar schedule is available as a part of the Income Tax return forms to be filled up by those not liable for tax audit. Currently the same is put under abeyance till 31-03-2022



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Important Clauses in a Tax Audit

The following are the important clauses in a Tax Audit where extra efforts and care is to be taken by the Tax Auditor before putting forth his observations:

- a) Clause 12 – Presumptive income applicability
- b) Clause 16 – Amounts not credited to Profit and Loss account
- c) Clause 17 – Details of land/building to confirm compliance with Section 43CA and 50C
- d) Clause 18 – Depreciation (Adjustments as per recent amendments)
- e) Clause 19 & 33 – Amounts admissible under incentive related Sections and Chapter VIA
- f) Clause 21 – Amounts debited to P&L but attracting disallowance
- g) Clause 23 – Related party payments
- h) Clause 26 – Section 43B related payments
- i) Clause 27 – Prior period expenditure
- j) Clause 28, 29, 29A – Disclosure for under clauses (viia),(viib) and (x) of Section 56(2)
- k) Clause 30A & 30B – Primary adjustment u/s 92CA and Disallowance under Section 94B
- l) Clause 31 – Section 269SS, 269ST and 269T related disclosures
- m) Clause 32 – Details of b/f depreciation and losses
- n) Clause 34 – TDS related compliance and disclosures
- o) Clause 41 – Details of demand/refunds under any other laws

Clause 12: Presumptive Income



Whether the profit and loss account includes any profits and gains assessable on presumptive basis? if yes, indicate the amount and the relevant section :

Section	Description
44AD & 44ADA	Eligible Business (Individual, HUF, firm – excluding LLP). For 44AD once the assessee opts out of presumptive taxation – presumptive provisions cannot be resorted to for a period of 5 years after the year of opting out. Profession referred to in Section 44AA
44AE	Transport Business
44B	Shipping business of a non-resident
44BB	Non resident providing services in prospecting or extraction of mineral oils
44BBA	Operation of aircraft by non-resident
44BBB	Civil construction in turnkey power projects by non-residents
Chapter –XII-G	Shipping Business
First Schedule	Insurance Business

Issues in presumptive taxation:



- Deduction (OR) disallowance under section 40(a)/ 43B presumed to have been given effect to.
- Set off of brought forward losses, business losses (from same business when presumptive provision were not opted for or different business) – likely to be permissible.
- Set off of unabsorbed depreciation –not likely to be permissible since overriding effect over sections 30 to 38 (including unabsorbed depreciation).

Sub-clause (a):

Section 28 shall also include any sum received for not carrying on any activity under an agreement in relation to any business or profession. (w.e.f. 01/04/2017).

Sub-clause (b):

The words 'admitted by the concerned authorities' would mean 'admitted within the relevant previous year'. However, if the assessee follows cash basis of accounting the admittance of claim without actual receipt will have no significance.

Sub-clause (c): Escalation Claims –

- Where assessee follows cash basis of accounting, whether details of escalation claims accepted without actual receipt is to be reported?
- Whether the following escalation claims constitute claims accepted?
 - Claims merely made by the assessee
 - Claims under negotiations
 - Claims which are sub-judice

(Ref: CIT v. Hindustan Housing & Land Development Trust Ltd.)

Clause 16(d)&(e): Amounts not credited to Profit & Loss Account



Sub-clause (d): Any Other Income –

- Does 'any other income' include even 'income from other sources'? – Yes

Sub-clause (e): Capital Receipt

- Does the phrase 'Capital Receipts, if any' includes capital contribution like gifts, share capital etc.? – The receipts in the nature of income/profits may be required to be reported
- Should interest on Fixed Deposits or Other Incomes (like rentals) which are reduced from cost of fixed assets / Capital WIP be mentioned? – Ideally Yes

Clause 17: Details of land/building to confirm compliance with Section 43CA and 50C



- Land or Building or both transferred for consideration less than value adopted by any authority of a State Government (Section 50C or 43CA)
- Section 43CA or Section 50C provide for tolerance band of 10% and the same was briefly increased to 20% for the period 12-11-2020 to 30-06-2021 in respect of primary sale of residential units of values up to Rs. 2 Crores. The same relief is provided to the buyers u/s 56(2)(x) for the same period.
- Applicability of the additional tolerance would be required to be reported specifically by the Tax Auditor.

Clause 18: Depreciation (Adjustments as per recent amendments)

Relevant issues

- Determine Rate of depreciation as per Appendix I of Income Tax Rules
- Obtain a depreciation schedule from the client showing opening block, additions and deletions to fixed assets, depreciation rate applied, amount of depreciation claimed, etc.
- Verify the opening written down value from the computation enclosed with the previous year's return and the Form 3CD of the previous year. Enquire if there are disputes with respect to classification or rate of depreciation for the assessee raised by the Income tax authorities.
- In cases where additional depreciation is being claimed, ensure that the conditions specified in the section have been complied with for the assets in respect of which such additional depreciation is being claimed.
- The tax auditor must take care on the applicability of STCG on sale of depreciable assets and would specifically be required to make adjustments to the WDV as per Section 43CA.
- Date of put to use may require certificate from relevant technical person or expert in the field to substantiate the claim of depreciation from such date

Clause 18: Depreciation (Adjustments as per recent amendments)

Relevant issues for current AY 2021-22

- Adjustments to written down value of block of depreciable assets for taxpayers opting for tax regimes under section 115BAC (individuals and HUFs) and 115BAD (cooperative society) and other taxpayers opting for other regimes in the current AY.
- Rule 5 amended by Notification No. 610(E) dated 1 October 2020 which provided for adjustment of opening WDV as on 01.04.2020 to the extent depreciation under section 32(1)(iia) brought forward from past years which could not be set off under new regime
- Adjustment only if the new regimes are adopted from AY 2021-22
- Adjustment to WDV on opting for new regime needs to be specifically reported.
- Where new regime for companies under section 115BAA is opted for in AY 2021-22 – no adjustment in opening WDV permissible for unabsorbed depreciation which is likely to lapse on opting for new regime
- Finance Act 2021 provided that Goodwill will be no longer a depreciable asset. Goodwill would be required to be disclosed as notified by CBDT.

Clause 19 – Auditor should Consider the followings:



The Tax Auditor should indicate the amount debited to the Profit & Loss Account and the amount actually admissible in accordance with the said sections.

- The Tax Auditor should ensure eligibility of the expenditure/payment for deduction and compliance of conditions prescribed in the said sections.
- The Amounts not debited to Profit & Loss Account but admissible under any sections mentioned in the clause have to be stated. [Example : Section 33AB and Section 33ABA –Depositing amounts in designated accounts]

Clause 19 – Relevant issues:

- In case where audit is required under certain sections to claim deduction and separate auditor is appointed for this purpose, is it enough to rely on such auditor's report ?
- How will the auditor rely on the work done by such other auditors / experts for the work done by them?
- What should be the extent of reliance to be placed?
- What would be the stand of a Tax Auditor in case such report is unavailable?
- Where auditors have changed, can the auditor rely on previous year's computation and audit report with respect to sec 35D, 35DD, 35DDA etc. or should scrutinize expenses incurred in earlier years?

Clause 19 & 33 : Amounts admissible as deductions from 32AC to 35E



Clause 33 – Relevant Issues



- Can Tax auditor rely on certificates issued by professionals other than CAs?
- Where payments qualifying for deduction u/s. 80D etc. might not have been paid out of business income but personal income, should same be disclosed?
- Where in preceding P.Y, admissibility of deductions claimed u/ss. 80-I, 80-IA, etc. are not questioned & allowed from return of income, is required to verify allowability of same?

Clause 21 – Amounts debited to P&L but attracting disallowance



- Expenditure in nature of capital, personal, advertisement expenditure etc.
- Amounts admissible under 40(a).
- Amounts debited to Profit & Loss Account being interest, salary, bonus, commission or remuneration inadmissible under 40(b)/40(ba)
- Disallowance under 40A(3).
- Provision for gratuity not allowed under 40A(7) .
- Sums paid by an assessee as an employer not allowed under 40A(9) .
- Particulars of contingent liability.
- Amounts of deductions inadmissible in terms of Section 14A
- Amounts inadmissible under proviso to 36(1)(iii)

Clause 21 – Amounts debited to P&L but attracting disallowance

Furnish the details of amounts debited to the profit and loss account, being in the nature of capital, personal, advertisement expenditure etc.

Nature	Sr. No.	Particulars	Amount in Rs.
Capital Expenditure			
Personal Expenditure			
Advertisement expenditure in any souvenir, brochure or the like published by a political party			
Expenditure incurred at clubs being cost for club services and facilities used.			
Expenditure by way of penalty or fine for violation of any law for the time being force			
Expenditure by way of any other penalty or fine not covered above			
Expenditure incurred for any purpose which is an offence or which is prohibited by law			

Clause 21 – Amounts debited to P&L but attracting disallowance



- Club membership fees typically not in the nature of capital expenditure – may not be reported as capital expenditure. Leads to uncalled adjustment by CPC.
- Sub-point (3) – Advertisement expenditure in any souvenir, brochure, tract, pamphlet or the like published by a political party. Expenditure relating to general advertisements are not be disclosed.

Penalty and amount paid for violation of law:



- Tax auditor while reporting under this clause is not required to express any opinion as to the allowability or otherwise of the amount of penalty or fine for violation of law.
- This clause covers only penalty or fine for violation of law and not the payment for contractual breach or liquidator damages.
- Details are to be given under this clause if the penalty, etc. are debited to profit & loss account, even if the assessee is contesting before the higher authorities.
- Any fees, charges, interest payable for compensation for delay in payment, etc. not in the nature of penalty/ payment for violation of law – may not be reported

Clause 21 – Amounts debited to P&L but attracting disallowance



- Amounts inadmissible under sec 40(a)(i) and 40(a)(ia) –Details of payments on which tax is not deducted or where amount is deducted but not paid within due date of filing return.
- Details of taxes deducted and paid in subsequent year are not separately reported here. Taxpayers may be advised to maintain appropriate scheduled along with documentary proof for disallowances made in section 40(a)(i)/(ia) and tax withholding and deduction claims in subsequent years.
- Ensure that the disclosure corresponds to Clause 34 (a)
- Amounts inadmissible under sec 40(a)(ib) to 40(a)(v)
- Amounts disallowable under clause (iv) –any payment to provident fund or other fund established for benefit of the employees is to be disallowed, unless the assessee has made effective arrangements to secure that tax shall be deducted at source from any payments made from such fund from payments chargeable under the head salaries.
 - May be advisable to examine PF Trust Deed/ obtain representation to ensure that there are adequate provisions for TDS on payments made out of PF fund –particularly in view of the fact that provisions relating to exemption of PF contribution have undergone significant change due to amendment in section 17 (employer's contribution to PF, superannuation fund and NPS in excess of INR 750,000 and interest accruing thereon) and 10(11)/10(12) (interest on employees' contribution to PF in excess of INR 250,000).

Other issues

1. Provision for Payment of gratuity not allowable under sec 40A(7) – unless provision is made for the purpose of contribution to approved gratuity fund.
2. Includes only provision for payment of gratuity to employees on their retirement or termination of their employment. Does not include any contribution to approved gratuity funds. Contributions to approved gratuity funds are covered under section 43B (clause 26)
3. Important to report unfunded gratuity correctly under section 40A(7) or section 43B – depending on whether provision is for contribution to approved/ unapproved gratuity fund
4. If there is no approved gratuity fund – provision for gratuity to be disallowed under section 40A(7) itself.
 - Provision for contribution to approved gratuity fund although not affected by section 40A(7) is allowable only on payment basis under section 43B
5. If the amount is reported under one clause in TAR but disallowed in other clause in ITR – CPC may consider both the disallowances resulting in double disallowance

Clause 21 – Amounts debited to P&L but attracting disallowance



Clauses	Description
Clause 21	<ul style="list-style-type: none">- Expenditure related to exempt income u/s 14A- Whether disallowance to be made in case of no exempt income in the relevant year? – View supported by various High Court decisions – SLP dismissed- Not applicable for dividend income which are now taxable in the hands of the shareholders- Considerations for 14A may be equally applicable for deduction under section 80M- Amount inadmissible under the proviso to Sec 36(1)(iii)- Interest on capital borrowed from the date on which capital was borrowed till the date on which the capital asset is first put to use not to be allowed as deduction- For the purpose of identification of qualifying assets and calculation of borrowing cost to be capitalized provisions of ICDS IX to be applied- ICDS IX contains provisions for capitalization of borrowing costs in case where capital is borrowed specifically for an asset or where the borrowing is general- In case of ready to use capital assets which can be immediately put to use – motor car, certain equipments, shares held as investment etc. arguably no borrowing costs to be capitalised

Clause 23 : Payments to Related parties



40A(2)(b)	Where the assessee is	Persons referred to in clause (b)
(i)	Individual	any relative of the assessee;
(ii)	Company, firm, AOP, HUF	any director, partner, or member or any relative of such director, partner or member;
(iii)	Carrying on business or profession	any individual who has a substantial interest in the business or profession of the assessee, or any relative of such individual;
(iv)	Carrying on business or profession	<ul style="list-style-type: none"> - a company, firm, AOP or HUF having a substantial interest* in the business or profession of the assessee - or any director, partner or member of such company, firm, AOP or HUF - or any relative of such director, partner or member or any other company carrying on business or profession in which the first mentioned company has substantial interest*;
(v)	Carrying on business or profession	a company, firm, AOP or HUF of which a director/ partner / member, has a substantial interest* in the business or profession of the assessee; or any director/ partner / member of such company, firm, AOP or HUF or any relative of such director, partner or member;
(vi)	Any person who carries on a business or profession	All of the above

Matters to be considered

Whether payments made to related parties of capital nature are covered in reporting ? – Yes

How can a tax auditor ascertain details regarding persons covered in the said section and how can such transactions be verified ? – Obtain the list from Management, compare with RPT, TP certificates etc.,. Further, where the transactions are multifold, necessary MRL and observations may be required

Note: The definition of related parties are different under Companies Act, Ind As, AS and Income-tax Act, 1961. Therefore, the auditor must exercise professional judgement and applicability for reporting from an Income-tax Act perspective.

Payments to persons specified in 40A(2)(b)

- Ensuring compilation of details from ledger and reconciliation with Financials
- Payment made to persons specified under section 40A(2)(b) – may not always be same as that reported in financials under Related Party Transactions (Different definitions under The Companies Act 2013, AS, Ind-AS)
- Reconciliations with AS 18/ Ind-AS 24 Disclosures/ Transfer Pricing Certificate
- Whether the details required to be furnished should be in respect of gross figures or net of GST?
 - To be considered net of taxes as only relates to expenditure claimed. In case where amounts in financials are inclusive of taxes, to prepare appropriate reconciliations
- Whether to be disclosed as Gross / Net of TDS?
 - Clause 23 of the Form No. 3CD requires only actual payments to persons specified in section 40A(2)(b) to be reported and not the amounts claimed in or debited to profit and loss account.

Payments to be kept in mind (Refer Section 43 B for details):

- Tax, duty, cess or fee
- Contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees; Bonus or commission for services rendered and Leave encashment
- Interest on loan or borrowing from financial institutions/NBFC etc.
- Indian Railways for use of railway assets

Details of payments of sums referred to in clauses (a) to (g) of Sec 43B

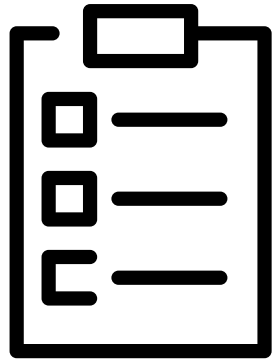
- Pre-existed on the first day of the previous year but was not allowed in the assessment of any preceding previous year
- Was incurred in the previous year

Allowability of Expenditure

- If pre-existing, then it has to be paid during the previous year
- If during the year, it can be paid till the due date of filing of return

Note: State whether sales tax, customs duty, excise duty or any other indirect tax, levy, cess, impost, etc., is passed through the profit and loss account.

Points to be kept in mind



- Separate year wise reconciliation has to be maintained as per provisions of income tax on allowability basis.
- Also, it has to be reconciled with previous year TAR & ITR
- Provision/ Liability which pre-existed on the first day of the previous year may not match with opening balance of liability in the financials especially in cases where the liability was settled before return filing in the previous financial year
- Issues where provisions are reversed in each year
- Outstanding liabilities are to be reviewed & review any impact of adjustments due to IT Assessment

Points to be kept in mind

- Should be matched with financials, other indirect tax filings. If there are any discrepancies, the auditor may qualify his remarks or provide his observations as may be required.
- Recognition of prior period items may require the Tax Auditor to peruse the records thoroughly in case no statutory audit is done previously which identified the same.

Clause 28, 29, 29A – Disclosure for under clauses (viia),(viib) (ix)and (x) of Section 56(2)



S.	Clause	Remarks
1	56(2)(viia)	Not applicable for FY 2020-21
2	56(2)(viib)	Applicable to shares issued at a premium and not applicable to shares issued at a face value Premium received on shares issued to non- resident not covered in ambit of section 56(2)(viib) Exception: Shares issued by a Startup during the year – {Notified class of persons under clause (ii) of proviso to section 56(2)(viib)}
3	56(2)(ix)	Any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if,— such sum is forfeited; and the negotiations do not result in transfer of such capital asset Nature of the sum and amount to be disclosed Whether any token money provided to builder which is forfeited taxable under section 56(2)(ix)
4	56(2)(x)	Where any person receives, in any previous year, from any person or persons any sum of money, without consideration, the aggregate value of which exceeds fifty thousand rupees any immovable property, without consideration, SDV> INR 50000 or for consideration and SDV > consideration and such excess is more than INR 50000 and amount equal to 10% of the consideration any property, other than immovable property, without consideration or with consideration less than FMV by an amount exceeding INR 50000

Clause 28, 29, 29A – Disclosure for under clauses (viia),(viib) (ix) and (x) of Section 56(2)

Points to be kept in mind

- For Section 56(2)(viib) – As per rule 11UA, the assessee can opt for NAV or DCF method of valuation. The assessee may also substantiate any other value before the assessing officer based on the value of the assets including intangible assets such as goodwill, patents, trademarks, copyrights, licenses or any other commercial rights of similar nature
- As per Finance Act, 2021 it is provided to increase the safe harbour from 10% to 20% under section 43CA for the period from 12th November 2020 to 30th June 2021 in respect of the only primary sale of residential units of value up to Rs. 2 crores. Also, relief by increasing the safe harbour from 10% to 20% was allowed to buyers of these residential unit's u/s 56(2)(x) for the same period.
- Whether the issue of shares due to loan covenants/ similar binding obligations taxable u/s 56(2)(x) ACIT v Subodh Menon (ITA No. 2776/M/2015)(ITAT Mumbai) –Bonafide business transaction cannot be taxed U/s. 56(2)
- Whether issue of shares by way of rights issue/ bonus issue taxable under section 56(2)(x) – Sudhir Menon HUF (ITA No. 4887/M/2013)(ITAT Mumbai)? – for pro rata allotment of shares to the existing shareholders and receipt of fresh shares by way of bonus issue, as there is no additional gain derived by the shareholders in such scenarios. However, disproportionate right issues may be taxable.
- Waiver of loan – Whether subject to section 56(2)(x)? – If the waiver is supported with consideration (commercial conditions) then the same may not be taxable. However, otherwise the same may be taxable.

Points to be kept in mind

What is Primary adjustment? Is it applicable for the Assessee?

If Primary adjustment is made, then things to be reported

- (a) under which clause of sub-section (1) of section 92CE primary adjustment is made?
- (b) amount (in Rs.) Of primary adjustment:
- (c) 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)
- (d) if yes, whether the excess money has been repatriated within the prescribed time (Yes/no)
- (e) if no, the amount (in Rs.) Of imputed interest income on such excess money which has not been repatriated within the prescribed time

Impact of Primary adjustment



- (a) Addition of adjustment to income
- (b) If adjustment relates to AY 2016-17 or earlier or if adjustment below Rs. 1 crore, No further impact
- If (b) not applicable, imputed interest (As per Rule 10CB – Fund lending rate of SBI + 3.25% if international transaction is in Indian Rupee as on 01-Apr of previous year or at 6-month LIBOR as on 30-09 of the previous year plus 3%, if in Foreign currency)
- (c) If excess money available with the associated enterprise repatriated within prescribed time, No further impact
- (d) If not, compute the interest

Provisions:

- Where an Indian Company or PE of foreign company has taken any debt from non-resident being an associated enterprise and interest on such loan exceeds Rs.1 crore then **Excessive Interest** shall be disallowed.
- The excess interest means total interest paid/payable in excess of 30% EBDITA or total interest payable whichever is less.
- Not Applicable to Indian Company or PE of foreign company engaged in the business of banking or insurance.
- Remaining can be carried forward to next 8 years.

The above provision shall not apply to interest paid on loan taken from lender who is PE in India of Non-Resident being engaged into the banking business. (Amendment by Finance Act, 2020, w.e.f 01-04-2021)

Disclosures required:

- a) Amount of interest incurred
- b) EBIDTA
- c) Amount that exceeds 30% of EBIDTA
- d) Amount b/f and c/f under Section 94B

Clause	Remarks
Clause 31(a)	Details of all loans or deposits accepted during the year exceeding limit in sec 269SS i.e. INR 20,000
Clause 31(b)	Details of amounts received for transfer of immovable property (whether transfer takes place or not) in excess of limit as per sec 269SS i.e. INR 20,000
Clause 31(b)(a)	Details of all amounts received in aggregate in excess of limit in sec 269ST i.e. INR 2,00,000 <ul style="list-style-type: none">• from a person in a day or• in respect of a single transaction or• in respect of transactions relating to one event or occasion from a person, where such receipt is otherwise than through a bank account (cheque/draft/ECS, etc.)
Clause 31(b)(b)	Details as required in Clause 31(b)(a) where receipt is by cheque or bank draft, not being an account payee cheque or an account payee bank draft

Clause	Remarks
Clause 31(b)(c)	Details of all amounts paid in aggregate in excess of limit in sec 269ST i.e. INR 2,00,000 <ul style="list-style-type: none">• to a person in a day or• in respect of a single transaction or• in respect of transactions relating to one event or occasion to a person, where such receipt is otherwise than through a bank account (cheque/draft/ECS, etc.)
Clause 31(b)(d)	Details as required in Clause 31(b)(c) where receipt is by cheque or bank draft, not being an account payee cheque or an account payee bank draft
Clause 31(c)	Details of each repayment of loan or deposit or any amount received for transfer of immovable property where amount exceeds limit specified in sec 269T i.e. INR 20,000
Clause 31(d)	Details of repayment of loan or deposit as mentioned above otherwise than through a bank account (cheque/draft/ECS, etc.)
Clause 31(e)	Details of repayment of loan or deposit as mentioned above by a cheque or bank draft which is not an account payee cheque or account payee bank draft

Points to be kept in mind

- In case of change in shareholding, provide details for the same and examine applicability of section 79
- Whether the assessee has incurred any speculation loss referred to in section 73 or any loss referred to in section 73A in respect of any specified business during the previous year
- In case of a company, please state that whether the company is deemed to be carrying on a speculation business as referred in explanation to section 73
- Amounts should be matching with previous ITR and TAR
- Adjust amounts as per latest assessments/appeal effect orders v returned losses
- What if the amount of returned losses are subsequently restored in appellate proceedings – whether such increased losses could be claimed by way of rectification? – Yes, the same can be taken
- New tax regimes (Section 115BAA, Section 115BAC and section 115BAD) does not allow some specific deductions. Brought forward losses need to be modified to the extent they are related to such restricted disallowed deductions.
- DTVSV settlements – Care should be taken to adjust the brought forward losses/ unabsorbed depreciation on account of any appeals which are settled under DTVSV. Where the option of payment or reduction of losses/ UAD etc exercised by the taxpayer etc., the amounts should be disclosed accordingly.

- Section-wise details of deductions, if any admissible under Chapter VIA or Chapter III (Section 10A, Section 10AA)
- Deductions likely to be available under new regime u/s 115BAA
 - Section 80JJAA
 - Section 80M
- Deductions likely to be available under new regime u/s 115BAC
 - Section 80CCD(2) – contribution to NPS
 - Section 80JJAA
- Whether reporting under this clause is required if the audit is carried for in respect of proprietary business of an assessee? – Particulars of deductions admissible under Chapter VIA will have to be given with reference to the items appearing in the books of accounts of the business/profession which is subject to audit under section 44AB. Any deductions which are not relating to the business, the disclosure by Tax Auditor may not be mandatory.

Clause	Remarks
Clause 34(a)	<p>Details of all expenses on which TDS/TCS is required to be deducted/collected and details of whether TDS/TCS is deducted/collected at specified rates</p> <p>Key points:</p> <ul style="list-style-type: none"> Reconciliation with books Matching with ITR and Clause 21 Lower deductions limits and certificates to be checked TDS made on the basis of payments TDS on year end provisions TDS applicability and legal positions
Clause 34(b)	<p>Details of TDS/TCS returns to be furnished</p> <p>Key points:</p> <ul style="list-style-type: none"> Disclose filing dates for all forms 24Q,26Q etc. (Check with TRACES) Provide confirmation on inclusion of all transactions in the original return Details of any other transactions not forming part of TDS returns
Clause 34(c)	Interest liability u/s 206(1A)/206C(7)

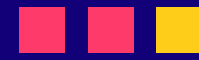
Clause 41 – Details of demand/refunds under any other laws



- The tax auditor should obtain a copy of all the demand/ refund orders issued by the governmental authorities during the previous year under any tax laws other than Income Tax Act and Wealth Tax Act.
- Normally, the Indirect tax laws such as Central Excise Duty, Service Tax, Customs Duty, GST, Value Added Tax, CST, Professional Tax etc. would be covered as other tax laws.
- However, the auditor should exercise his professional judgment in determining the applicability to relevant tax laws for reporting under this clause.
- It may be noted that even though the demand/refund order is issued during the previous year, it may pertain to a period other than the relevant previous year. In such cases also, reporting has to be done under this clause.
- The tax auditor should verify the books of account and the orders passed by the respective Department for ascertaining whether any such demand has been raised or refund order has been issued under any other tax law and accordingly report the same.
- If there is any adjustment of refund against any demand, the auditor shall also report the same under this clause.



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ICDS Disclosures in a Tax Audit

- As per Section 145 any assessee having taxable income under the heads
 - “Profits and gains from business or profession” or
 - “Income from Other Sources”
- has to compute their taxable income in accordance with cash or mercantile system of accounting.
- The Central Government has notified ICDS in this regard.
- ICDS are guidelines used by taxpayers and the Income Tax Department for calculating the taxable income obtained by an assessee in a financial year.
- The purpose of the ICDS is to govern the computation of income in accordance with the pertinent tax provisions.
- Most of the ICDS are in parlance with the IGAAP subject to few exceptions.
- Where there is any inconsistency between Income-tax Act, 1961 and ICDS, the Act shall always prevail.

List of ICDS notified under the Income Tax Act, 1961

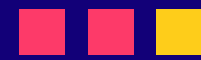
The details of disclosures are made available in Annexures

ICDS No.s	ICDS
I	Accounting Policies
II	Valuation of Inventories
III	Construction Contracts
IV	Revenue Recognition
V	Tangible Fixed Assets
VI	The Effects of changes in Foreign Exchange Rates
VII	Government Grants
VIII	Securities
IX	Borrowing Costs
X	Provisions, Contingent Liabilities and Contingent Assets





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Other clauses in a Tax Audit

The following are the general clauses where there is relatively less efforts involved:

Basic details of business and other related clauses:

- Clause 1 to 8 – General details pertaining to the Assessee
- Clause 10 – Nature of business (Refer the list stipulated by the Income-tax department)
- Clause 11 – Details of books of accounts, their address and list examined
- Clause 13 – Details of method of accounting and deviations arising therefrom
(including ICDS adjustments and disclosures as discussed before)
- Clause 14 – Method of valuation of closing stock etc.,
- Clause 20 – Sum paid as bonus/ commission otherwise payable as profits or dividends and
Details of EPF, ESI employee contributions **(Note: Finance Act 2021 has mandated the disallowance of employees contribution. Therefore the same is to be disallowed in the ITR)**
- Clause 35 – Details of stock (RM, FG, Trading goods) – Requires disclosure of principal items only
- Clause 40 – Details of turnover, GP, NP, stock in trade etc., (Note: Table and detailed calculation must be maintained year-wise)

Applicable only to one class of persons or specific transactions:

Clause 9 – Specific to Partnership firms and AOP

Clause 15 – Capital asset converted into stock

Clause 22 – Amount of interest admissible u/s 23 – MSME

Clause 36A – Whether the assessee has received any amount in the nature of dividend u/s 2(22)(e)

Details of reporting/audits are required in the following clauses:

- a) Clause 37, 38 and 39 – Details of cost, central excise and service tax audit
- b) Clause 42 – Details of reports in Form 61, 61A and 61B
- c) Clause 43 – Report under Section 286 and related details

Note: Clause 30C (GAAR) and Clause 44 (break-up of expenditure GST/Non-GST wise) – The disclosure in these two clauses has been kept in abeyance till 31-03-2022.



**Errors and key points
to be kept in mind
while preparing a
Form 3CD**

- Many of the Tax Audit reports do not have the paragraphs relating to Assessee's responsibility and Tax Auditor's responsibility as required by the Guidance Note in respect of SA 700 Forming an Opinion and Reporting on Financial Statements.
- Some of the tax audit reports contained a reference about the attached physically signed tax audit reports which mention these Paragraphs thereby complying with the requirement of SA 700. However, as per the Guidance Note on Tax Audit the same are specifically required to be mentioned / reported under clause (3) of Form No.3CA or Clause (5) of Form No.3CB, as the case may be.
- In certain tax audit reports that were examined, it has been observed that the qualification paragraph i.e. clause (3) of Form No.3CA or Clause (5) of Form No.3CB, as the case may be, contained a reference to Notes to Form No. 3CD. These notes did not mainly contain the qualifications but also contain general additional information. As per the Guidance Note (paragraphs mentioned above) only qualifications/ observations should be reported in the space provided in the form No. 3CA/3CB itself while the additional information which are not in the nature of qualification could be attached as notes.
- While issuing the tax audit report under section 44AB of the Income tax Act, 1961, the Auditor should generate appropriate UDIN and refer the same in its Report.

Errors and key points to be kept in mind while preparing a Form 3CD

- Information in Form No. 3CD should be based on the books of account, records, documents, information and explanations made available to the tax auditor for his examination.
- Where a particular item of income/expenditure is covered in more than one of the specified clauses in the statement of particulars, a suitable cross reference to such items at the appropriate places.
- In computing the allowance/disallowance, the law applicable in the relevant year should keep in view, even though the form of audit report may not have been amended to bring it inconformity with the amended law.
- The tax auditor may qualify his report on matters in respect of which information is not furnished to him and state in his report that the relevant information has not been furnished by the assessee.



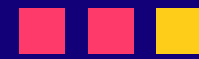
- Assessee is having business as well as professional income. How would the tax audit be applicable? – Business and profession as covered by 44AA must be looked into separately
- Assessee is having more than one business, how will the tax audit be applicable? Businesses (unless any of them being presumptive must be clubbed)
- Whether a person opting for presumptive taxation scheme under section 44AD is required to get his accounts audited? – Where the conditions given are not satisfied or in the case of opting out of presumptive taxation
- Whether tax audit shall be applicable to Non-residents? – Yes, as the provisions are applicable to every person
- Can Tax Audit be revised? Is there a limit for the revision? Whether UDIN can be revised? **(Amendment vide Finance Act 2021 in the Rule 6G)** – Revision should be before 31-03-2022 for Section 40 and 43B related disallowance changes. Further, UDIN can be created for revision.

- Other Information Schedule under ITR is normally tallied by CPC line by line with 3CD (Specifically the Clause 21 and 26 of the 3CD)
- Where there is any disagreement for any clause with the Assessee document the same
- Each allowance and disallowance should correspond to ITR under the same clause/provision
- Bifurcation of Gratuity u/s 40A (7) or 43B
- Correlation of TDS disallowance clause 21 v/s Clause 34(a)
- Depreciation Calculation and addition of more than 180 and less than 180 are not properly bifurcated.
- Unabsorbed depreciation and business loss amount should be cross tallied with ITR

- Support disclosure for every clause with a backup/documentation
- Obtain Management Representation Letter to support the disclosures wherever required.
- Where test check/audit techniques are applied mention them specially in the qualifications/observations
- If there are any positions taken basis any favourable judicial pronouncements, mention them specifically in the observations as the same are generally disallowed/added back by tax authorities. Further, the same may assist the Assessee to support his position at appellate level and for any likely penalty proceedings.
- Related party transactions should be accurately disclosed



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Annexures

Specified Financial Transactions (SFT)

Rule 114E – Relevant clauses applicable generally to companies are as under for which Form 61A filing is required:

Transaction Code	Particulars	Reporting Requirement	Reporting Limit per transaction	Details per the Notification(s) issued
SFT- 007	Purchase of debentures	Company or Institution issuing bonds or debentures (excludes renewal)	INR 10,00,000 or more	Receipt from any person of an amount aggregating to ten lakh rupees or more in a financial year for acquiring bonds or debentures issued by the company or institution (other than the amount received on account of renewal of the bond or debenture issued by that company)
SFT- 008	Purchase of shares	Company issuing shares (including share application money)	INR 10,00,000 or more	Receipt from any person of an amount aggregating to ten lakh rupees or more in a financial year for acquiring shares (including share application money) issued by the company.
SFT- 009	Buy back of shares	Companies listed on recognised stock exchange	INR 10,00,000 or more	Buy back of shares from any person (other than the shares bought in the open market) for an amount or value aggregating to ten lakh rupees or more in a financial year.
SFT- 013	Cash payment for goods and services	Any person liable to furnish tax audit report	Cash payment of INR 2,00,000 or more	Receipt of cash payment exceeding two lakh rupees for sale, by any person, of goods or services of any nature
SFT-015	Dividend Income – Dividend distributed during the financial year.	A company paying dividend	Any amount	The information is to be reported for all dividend distributed during the financial year. Dividend will be the total amount of dividend distributed during the financial year.

ICDS I – Accounting Policies



The ICDS, in contrast to Accounting Standards (AS), does not consider the aspects of prudence and materiality in the selection and application of accounting policies. ICDS only permits a change in accounting policies on the existence of solid grounds for the same.

Disclosures:

- All Significant accounting policies adopted
- Any change in such accounting policies having material effect in current year or expected to have in future years along with the amount by which any item is affected by such change.
- Disclosure or change in policy is not a justification for wrong or inappropriate treatment of item.
- If the fundamental accounting assumptions of going concern, consistency and accrual are not followed, the fact shall be disclosed.

ICDS II – Valuation of Inventories



ICDS II shall be applied for valuation of inventories, except:

- Work-in-progress arising under construction contract, dealt with by the ICDS III on construction contracts
- Work-in-progress which is dealt with by any other ICDS
- Shares, debentures and other financial instruments held as stock-in-trade, dealt with by the ICDS VIII on securities
- Producers' inventories of livestock, agriculture and forest products, mineral oils, ores and gases to the extent that they are measured at net realisable value
- Machinery spares dealt with by ICDS V on tangible fixed assets.

Disclosures:

- The Accounting Policies adopted in measuring inventories including the total carrying amount of inventories.

ICDS III – Construction Contracts

ICDS III deals with the determination of income earned from construction contracts.

Construction contracts are classified under fixed-price contracts and cost-plus contracts:

1. Fixed Price Contract– The contractor agrees to receive fixed rate per unit of output or fixed price for the whole contract.
2. Cost Plus Contract – The cost with a defined percentage markup on the cost is reimbursed to the contractor.

Disclosures:

- The amount of contract revenue recognized as revenue in the period,
- The method used to determine the stage of completion of contracts
- Contracts in Progress Disclosures
 - Amount of cost incurred & recognised profits
 - The amount of advances received
 - The amount of retentions (amount billed for work done but still not received to the satisfaction of the conditions specified in the contract)

ICDS IV – Revenue recognition



ICDS 4 is associated with the recognition of revenue. In this case, the basis for recognition of revenue which results from the sale of goods, royalties, dividend, and so on can be determined.

Disclosures:

- The transaction involved in sale of goods; amount not recognized as revenue due to lack of a reasonable certainty.
- Amount of revenue from rendering of service, recognized as revenue in the reporting period
- The method used to determine the stage of completion of service
- For service transactions that are in progress at the end of the year:
 - Amount of costs incurred and recognized profits at the end of the year
 - The amount of advances received
 - The amount of retentions

ICDS V – Tangible fixed assets



ICDS 5 is associated with the specified tangible fixed assets such as land, building, machinery, etc.

An item is considered as a tangible fixed asset if it is held for the purpose of producing or providing goods or services and is not held for sale in the normal course of business.

Disclosures:

- Description of asset or block of assets
- Rate of depreciation; Depreciation allowable
- Actual cost or written down value; Additions or deductions during the year
- Put to use date of asset
- Adjustments, if any, on account of CENVAT claimed or allowed
- Changes in rate of exchange of currency, if any
- Subsidy or grant, if any

ICDS VI – Effects of Changes in Foreign Exchange rates



ICDS VI deals with the treatment of:

- I. Transactions in foreign currencies;
- II. Treatment of foreign currency transactions in the nature of forward-exchange contracts.
- III. Translating the financial statements of foreign operations.

Disclosures:

ICDS-VI stipulates no disclosure requirements. Hence, Item No. (f) of Clause 13 of Form No. 3CD also requires no specific disclosures in respect of ICDS-VI.

Kindly note the principles as laid down in Section 43A would always prevail for any inconsistency arising.

ICDS VII – Government Grants



ICDS VII deals with the accounting treatment of Government grants, subsidies, duty drawbacks, waiver, concessions, incentives, reimbursements, etc.

Disclosures:

- Nature and extent of Government grants recognized by way of deduction from the actual cost of the asset and/or as income during the year
- Nature and extent of Government grants not recognized by way of deduction from the actual cost of the asset and/or as income during the year and reasons thereof.

ICDS VIII – Securities



ICDS VIII deals with securities held as stock-in-trade and securities held by a scheduled bank or public financial institutions.

It is recognized as follows:

- Security on acquisition is recognized at an actual cost which consists of the purchase price and acquisition charges.
- With respect to security acquired in exchange for other security or another asset, the cost of acquisition is the fair value of the security or asset acquired.
- In the case of cum-interest securities, the accrued interest is deducted from the actual cost of securities.

Disclosures:

- Compliance with the recognition may be disclosed

ICDS IX – Borrowing Costs



ICDS IX deals with the treatment of borrowing costs and other costs which are incurred in relation to borrowing of funds.

ICDS has specified the formula for capitalization of borrowing costs which involves allocating the total general borrowing cost incurred in the ratio of the average cost of qualifying assets on the first day and last day of the previous year. As stated by ICDS, capitalization of borrowing costs should begin with the date of borrowing (if it is a specific borrowing), and the date of the utilization of funds (if it is a general borrowing).

Disclosures:

- The accounting policy adopted for borrowing costs
- The amount of borrowing costs capitalized during the year

ICDS X – Contingent Liabilities and Contingent Assets

ICDS 10 relates to provisions, contingent liabilities and contingent assets, except the following:

- Arising out of financial instruments, whether the same is carried at fair value or not.
- Arising out of executory contracts.
- Arising in insurance business from contracts with policyholders.
- Covered by other ICDS.

Disclosures:

- Brief description of the nature of the obligation / asset and related income
- The carrying amount at the beginning and at the end of the year
- Additional provision made/ asset and related income recognized during the year
- Amount used and charged against the provision
- Amount of provision/ asset and related income reversed during the year.

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