

OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations *Condensed version* and Transfer Pricing Features of Selected Countries 2009

Sample excerpt

INDIA

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1. Tax Authority and Law

The tax administration agency in India is the Central Board of Direct Taxes (CBDT). Section 92 of the Income Tax Act 1961 (ITA) contains the transfer pricing provisions. Rule 10 of the Income Tax Rules (ITR) provides further guidance on application legislation.

India has attained an observer status in the OECD with enhanced engagement. It therefore endorses the OECD Transfer Pricing Guidelines to the extent such guidelines are not inconsistent with the domestic regulations.

2. Rulings and Guidelines

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2.2. Arm's Length Principle

Section 92 of ITA relates to the computation of income from an international transaction and provides that any income arising from an international transaction shall be computed having regard to the arm's length price. Further, it clarifies that the allowance for any expense or interest arising from an international transaction is also required to be determined having regard to the arm's-length price.

Also, where in an international transaction, two or more associated enterprises enter into a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided to any one or more of such enterprises, the cost or expense allocated or apportioned to, as the case may be, contributed by, any such enterprise shall be determined having regard to the arm's length price of such benefit, service or facility, as the case may be.

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4. Comparability Analysis

4.1. Comparable Data

The Indian regulations replicate the conditions and procedures of the OECD Transfer Pricing Guidelines in respect of application of the arm's length principle and determination of arm's length price. Rule 10B of the ITR provides that the comparability of one transaction with another should be judged with reference to:

- the specific characteristics of the property or services transferred in either transaction;
- the functions performed, taking into account assets employed or to be employed and the risks assumed by respective parties of the transactions;
- the contractual terms (whether or not those terms are informal or in writing) of the transactions that lay down explicitly or implicitly how the responsibilities, risks, and benefits are divided between the parties to the transactions; and
- conditions prevailing in the markets in which the parties to the transactions operate, including the geographical location and size of the markets, costs of labour and capital in the markets, overall economic development and level of competition, and whether the markets are wholesale or retail.

However, there are no specific guidelines on how to search for comparable data. Taxpayers are increasingly relying on the OECD's draft notes for comparability in this regard.

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4.4. Use of Range

Provided that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices, or, at the option of the assessed, a price which may vary from the arithmetical mean by an amount not exceeding 5%, of such arithmetical mean.

Use of arithmetical mean as opposed to inter-quartile range is unique to India and has been criticized on many occasions. Further, the language for usage of 5% range is ambiguous and a subject matter of litigation. Indian Tax Tribunals have differing views on the same and the final position is not settled.

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6. Mutual Agreement Procedures (MAP)

Most of the tax treaties concluded by India provide for transfer pricing adjustments in relation to transactions between associated enterprises, if such transactions are not priced at arm's length. This is typically captured in Article 9(1) of the tax treaties. Article 9(2) of the tax treaties provides for a mechanism to resolve economic double taxation which would arise pursuant to a transfer pricing adjustment in one country. However, in certain cases (such as Germany, Korea (Rep.), Singapore, etc.), Article 9(2) is absent. This is increasingly becoming a big issue in resolution of transfer pricing disputes with these countries.

The Indian Competent Authority has been taking a strict view on applicability of MAP relief for residents of such countries. Given that transfer pricing is relatively new to India and not many MAP cases have been resolved, there is no finality on the view taken by the Indian Competent Authority.

Rules 44G and 44H of the ITR explain the manner in which MAP is to be initiated in India.

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9. Transfer Pricing Audits

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9.2. Statute of Limitation

The time limit for completion of a transfer pricing audit is approximately 3 years from the date of furnishing the accountant's certificate. As an illustration, for the financial year ended 31 March 2009, the following are the compliance timelines that taxpayers need to bear in mind:

- 30 September 2009: Deadline for maintaining documentation, filing tax return and accountant's report;
- 30 September 2010: Limitation for initiating a transfer pricing audit by the tax administration (same as for regular tax audit);
- 31 October 2012: Limitation for completion of the transfer pricing audit (scrutiny by the Transfer Pricing Officer);
- 31 December 2012: Limitation for completion of tax audit (scrutiny by the Assessment Officer);
- 31 March 2014: Limitation for reassessment (where income escaping assessment is less than INR 100,000);
- 31 March 2016: Limitation for reassessment (where income escaping assessment is equal to or greater than INR 100,000); and
- 31 March 2019: Date till which documentation is required to be maintained.

9.3. Desk and Field Audits

Transfer pricing audits in India have generated tremendous controversy partly due to an exponential increase in audit activity and partly due to the resulting transfer pricing adjustments. There has been an increase in the number of government personnel exclusively dealing with transfer pricing matters.

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10. Penalties

With an objective to ensure compliance with the arm's length principle, the Indian legislation has prescribed civil penalties for various non-compliances.

Section 271(1)(c) of ITA: Concealment of income

As a general principle, if the tax officer in-charge or the Commissioner of Income Tax (Appeals) is satisfied that any person has concealed the particulars of income or furnished inaccurate particulars of income, he may direct to pay (by way of penalty), a sum ranging from 100% to 300% of tax payable on such adjusted amount.

Specifically in relation to transfer pricing adjustments, Explanation 7 to Section 271(1)(c) of the ITA states that the amount so added or disallowed (adjustment) shall be deemed to represent the income in respect of which particulars have been concealed or inaccurate particulars have been furnished, unless the taxpayer proves that the price charged or paid in such transaction was computed in accordance with the provisions contained in Sec. 92C of the ITA and in the manner prescribed under that Sec. 92C, in good faith and with due diligence.

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