

Recent Developments in Transfer Pricing in India

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Our Panelists

- **G. C. Srivastava, Former DG International Tax**
- **Kamlesh Varshney, Commissioner APA**
- **Vinod Mangotra, Senior TP Advisor, KPMG**
- **Karishma Phatarphekar, Former Head of TP, GT**
- **Rajesh Simhan, Partner, Nishit Desai & Asso.**
- **Vijay Iyer, Head of TP, EY**

Topics to be Covered

- **APA – Kamlesh Varshney**
- **Issue of shares to Parent– Rajesh Simhan**
- **Safe Harbours – Karishma Phatarphekar**
- **Location Savings – Vijay Iyer**
- **R&D Circulars – Vijay Iyer**
- **Specified Domestic Transactions – Vijay Iyer**
- **Recent Jurisprudence – Vinod Mangotra**

Advance Pricing Agreements (APA)

- **India's APA program has been progressing well**
- **146 cases filed upto March 31, 2013**
 - 29 bilaterals (mostly with UK and Japan; 2 with US)
- **20 prefiling applications in FY 13-14**
- **About 20 cases processed by the APA team and sent out to the Central Board of Direct Taxes for Approval**
- **APA team's approach is business friendly and aligned with taxpayer's objectives**
- **APA seen as a good mechanism to achieve certainty.**

Issue of Shares

- **One of the most controversial issues in recent TP audits**
- **TPO examines the valuation of shares for computation of share premium amount**
- **TPO applies DCF method of valuation and changes the cash flow assumptions and arrives at a high valuation**
- **TPO determines that for the number of shares issued, the total quantum of inward capital remittance is less**
- **Difference between the quantum of capital as determined by the TPO and the actual capital infused is treated as income**
- **Further, the fact that a portion of the capital was not received by the Indian company, an interest is also imposed (secondary adjustment).**

Safe Harbour Rules

S. No.	International Transaction	Condition
1	ITS and ITeS – Max INR 500 crores (Insignificant risk bearer)	OP/ OC \geq 20%
2	ITS and ITeS – Above INR 500 crores (Insignificant risk bearer)	OP/ OC \geq 22%
3	ITES – KPO services - (Insignificant risk bearer)	OP/ OC \geq 25%
4	Intra Group Loan to WOS \leq INR 50 crores	Base rate on 30 June of PY (SBI) + 150 bp
5	Intra Group Loan to WOS $>$ INR 50 Crores	Base rate on 30 June of PY (SBI) + 300 bsp
6	Explicit Corporate Guarantee to WOS \leq INR 100 Crores	2% or more P.A on amount guaranteed
7	Explicit Corporate Guarantee to WOS $>$ INR 100 crores (WOS rated to be of adequate to highest safety)	1.75% or more P.A on amount guaranteed
8	Contract R&D for software development (Insignificant risk bearer)	OP/ OC \geq 30%
9	Contract R&D for generic pharmaceutical drugs (Insignificant risk bearer)	OP/ OC \geq 29%
10	Manufacture and export of core auto Components	OP/ OC \geq 12%
11	Manufacture and export of non core auto components	OP/ OC \geq 8.5%

Location Savings

Arising out of India's comments in the UN TP Manual

- **TPOs in some jurisdictions have made some adjustments based on location savings**
- **Cost of manufacture in India compared with the cost of manufacture in the jurisdiction of the buyer**
- **Difference deemed to be location savings and 50% of the savings attributed to the contract manufacturer in India**
- **No cognisance to bargaining power and price charged by comparable third party manufacturers in ordinary course of business**

R&D Circulars

- **Circulars issued in July 2013 to define contract R&D**
- **Objective of the circular was to clarify the TP consequences for contract R&D.**
 - **Circular does not explicitly preempt the use of PSM for contract R&D centres**
 - **Six conditions specified for qualification of a R&D outfit as contract R&D centre**
 - **Some ambiguity in the specifications**
 - **Combination of APA with the circular would provide certainty**
 - **APA authorities following the circular to categorise taxpayers**

Recent Jurisprudence (2013)

Marketing Intangibles (AMP Expense)

- Higher than Brightline Advertisement, Marketing and Promotion (AMP) spend by brand licensee in India implies tacit understanding with licensor AE for brand promotion service through such spend.
- High net profit of licensee does not necessarily imply that compensation was received for excess AMP spend through cheaper purchases from the licensor AE. Fact of cheap purchases to be independently proved *de hors* the overall higher net profit rate. **LG Electronics India Pvt Ltd - 23 Jan 2013 (Delhi Tribunal Special Bench)** (Contrary view in **BMW India Pvt Ltd -16 Aug 2013 - Delhi Tribunal – Next slide**)

Marketing Intangibles (AMP Expense)

- **There is no provision under the Indian Income tax Act which requires that the excess AMP spend by the brand licensee in India ought to be compensated by licensor through direct compensation only.**
- **Licensee is free to get indirect compensation from licensor AE in any manner, for example by way of purchases from AE at a price which leaves the licensee with profits higher than comparables.**

BMW India Pvt Ltd - Delhi Tribunal -16 Aug 2013

BPO/KPO

- **KPO Services are not distinct from BPO services. Both fall under the category of ITES. Even in the 15 products and services notified by the CBDT in SO 890(E) dated 26.9.2000 for sections 10A,10B,80HHE; KPO is not recognized as a separate service. Willis Processing Services (I) Pvt. Ltd, ITAT Mumbai – 1.3.2013 and RAMPgreen Solutions Private Limited, ITAT Delhi – 22.3.2013**
- **KPO services, e.g. highly technical and specialized engineering services, are distinct from BPO services. Capital IQ Information Systems (India) Pvt Ltd, ITAT Hyderabad - 23.11.2012.**
- **KPO Services require application of knowledge and advanced analytical and technical skills - Safe Harbour Rules 18.9.2013. Also Mumbai Special Bench Tribunal hearing fixed on 6.1.2014**

Foreign Tested Party ?

- Comparing profit of the foreign AE with profit of comparables to determine the ALP of transaction between the assessee and its foreign AE, misses the wood from the tree by making the substantive section 92 otiose. **Onward Technologies Ltd – ITAT Mumbai -30.4.2013**
- Considering the views expressed in majority of Tribunal decisions and the United Nation’s Practical Manual on Transfer Pricing, the tribunal viewed that ‘tested party’ can be local or foreign party. **General Motors India Pvt Ltd - ITAT Ahmedabad- 2.8.2013**

Combined Transaction Approach

- **Assessee's activities of manufacturing of cars and trading of finished goods are intertwined and inter-related. Therefore its profits need to be benchmarked at entity level only instead of benchmarking manufacturing and trading segments separately. Toyota Kirloskar Motors Pvt Ltd. – ITAT Bangalore – 22.11.2012**

Whether loss making or abnormally high profit making companies valid comparables

- A functionally comparable company which had incurred losses in 2 out of 3 years, including the year under consideration, cannot be rejected as a comparable **Goldman Sachs (India) Securities Pvt Ltd – ITAT Mumbai- 23.1.2013**
- Special Bench of Tribunal constituted at Mumbai for hearing on 6.1.2014 for deciding on comparability of abnormally high profit making companies (and BPO/KPO comparability issue). **Maersk Global Service Centres India Pvt Ltd – Mumbai – 21.11.2013**

Other Decisions

- Tribunal held that Japanese 'soga soshisa' subsidiaries (general trading intermediaries) are trading companies and not commission agents / brokers, because Purchases / Sales recorded in books and title to goods also taken. Significant functions and risks relating to products not considered. **Mitsubishi Corporation India Pvt Ltd – ITAT Delhi – 23.8.2013**

Other Decisions

- **When the overseas principal company has issued power of attorney to Director of its PE in India to manage the branch operations in India, the entire management and control in regard to operations in India is situated in India only and hence the PE is a Resident for applicability of TP provisions. IJM (India) Infrastructure Ltd – ITAT Hyderabad – 22.8.2013**

Other Decisions (contd.....)

- When primary intent of the license is to transfer technology to the Indian AE and not trademark usage, no portion of royalty is attributable to the brand name. **Maruti Suzuki India Ltd – ITAT Delhi – 2.8.2013**
- For a transaction between two non-AEs to be deemed as an international transaction on account of a prior agreement, or determination of terms in substance, between one party and the AE of other party, one of the two parties need to be non-resident . **Kodak India Pvt Ltd – ITAT Mumbai – 30.4.2013**

Q&A