

TRANSFER PRICING COMPLIANCE

Pitfalls and Best Practices

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Agenda

- Transfer Pricing Certification
- Transfer Pricing Documentation
- APA and Safe Harbour Compliances
- CbCR and Master File
- Case Studies
- Penalties and Avoiding Penalties

Transfer Pricing Certification

Form 3CEB

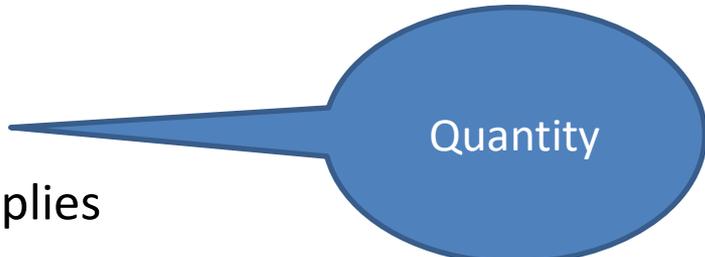
- **We have examined the accounts and records** of <<ABC>> relating to the international transaction (s) and the specified domestic transaction(s) entered into by the assessee during the previous year ending on 31st March, 20XX.
- In our opinion **proper information and documents as are prescribed have been kept by the assessee** in respect of the international transaction(s) and the specified domestic transactions entered into so far as appears from our examination of the records of the assessee.
- The particulars required to be furnished under section 92E are given in the Annexure to this Form. In our opinion and to the best of our information and according to the explanations given to us, the particulars given in the Annexure are **true and correct**.

Form 3CEB – Annexure Part A

- Name of the assessee
- Address
- PAN
- Nature of business activities of the assessee
- Status
- Previous Year Ended
- Assessment Year
- Aggregate value of International Transactions
- Aggregate value of Specified Domestic Transactions

Form 3CEB – Annexure Part B...

- List of Associated Enterprises
- Transactions in tangible property
 - Raw materials, consumables or supplies
 - Traded / finished goods
 - Any other tangible property
- Transactions in intangible property
- Providing of services
- Lending or borrowing of money
- Guarantee



Quantity



Currency and
Interest Rate



Currency

...Form 3CEB – Annexure Part B

- Purchase, sale, buy-back etc. of securities

Currency

- Mutual agreement or arrangement

- Business restructuring or reorganization

Nature,
Agreement,
Terms

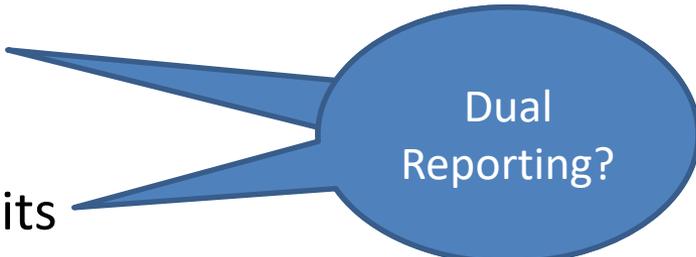
- Any other transaction

- Deemed international transaction

Details of Third
Party!

...Form 3CEB – Annexure Part C

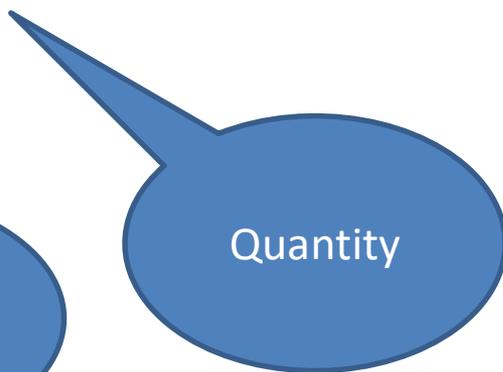
- List of AEs (including PAN)
- Inter-Unit transfer by eligible units
- Inter-Unit acquisition by eligible units
- Any business transacted – eligible business
- Any other transaction



Dual Reporting?



What to Report Here?



Quantity

Transfer Pricing Documentation

Transfer Pricing Study Report

- Documentation requirements as per Section 92D r.w. Rule 10D
- Full fledged documentation if volume of transactions > 1 Cr.
- Contents of a typical Transfer Pricing Study Report
 - About the taxpayer and group
 - About the industry
 - About the transactions
 - Functional Analysis of the parties
 - Transfer Pricing Methods and their analysis
 - Application of the selected Transfer Pricing Method

Functional Analysis = Heart of the Transfer Pricing Study

Safe Harbours

International Transactions

Form 3CEFA

- Nature of business
- Details of AE
- Whether the AE is from a no tax / low tax jurisdiction?
- Operating margins (operating transactions) / rate (financial transactions)
- Whether transfer price is as per Rules?
- Credit rating details for AE in case of guarantee

Specified Domestic Transactions

Form 3CEFB

- Nature of business
- Details of AE
- Electricity companies
 - Order of Appropriate Commission determining the tariff
- Milk Cooperative
 - Details of milk and equivalent products, rates
 - Payment at same rates to all members of cooperative society

Advance Pricing Agreements

Annual Compliance Report – Form 3CEF

- Details of assessee (incl. contact details)
- Details of transactions covered in the APA
 - Agreed vs actual, adjustment required, how is adjustment done in ITR?
- Any changes in business model of the assessee
- Any changes in functional and risk profile of the assessee / AE
- Transfer pricing methodology
 - Agreed vs actual, reason for variation
- Critical assumptions
 - Agreed vs actual, reason for not meeting critical assumptions
- Details of changes in organization structure of the group
- All other terms of APA complied or not

Country-by-Country Report (CbCR)

BEPS Action 13 Documentation

Country-by-Country Report – Statistics

Tax jurisdiction

Business activity

Number of employees

Assets | Capital

Revenues | Taxes

Master File – Articulating Global Overview

Group information

Value drivers

Global value chain

Group TP policies

Intangibles

Local File – Country Specific Information

Details of Transactions

Methods adopted

Comparability analysis

Economic adjustments

Financial information

Country-by-Country Report (CbCR)

- Applicable to large groups (MNCs with consolidated group turnover of ~INR 5,500 Cr.)
- Provides a financial overview of the group
 - Jurisdiction-wise
 - Entity-wise
- Objective – identify apparent tax-inspired mismatches of economic activity, incomes and taxes within the group
- Data to be used to assess BEPS risks (not only transfer pricing risks!)

How will the CbCR data be used?

CbCR Compliance Obligations

Inbound Entities of Foreign Parent

Intimation of Parent /Alternate Reporting Entity - Form 3CEAC

Due date – 10 months from end of Group Accounting Year

Designated Reporting Entity in case of multiple entities – Form 3CEAE

Outbound Parents / Reporting Entities

Indian Parent / Alternate Reporting Entity - Form 3CEAD

Indian entity having parent in non-cooperative jurisdiction – Form 3CEAD

Due date – 12 months from end of Group Accounting Year

CbCR - Information Template (1)

| Tax Jurisdiction | Revenues | | | Profit (Loss) before Income Tax | Income Tax paid (on cash basis) | Income Tax accrued - reportable accounting year | Stated Capital | Accumulated Earnings | Number of Employees | Tangible Assets other than Cash & Cash Equivalents |
|------------------|---------------|-----------------|-------|---------------------------------|---------------------------------|---|----------------|----------------------|---------------------|--|
| | Related Party | Unrelated Party | Total | | | | | | | |
| | | | | | | | | | | |
| | | | | | | | | | | |
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CbCR - Information Template (2)

| Tax Jurisdiction | Constituent Entities Resident in the Tax Jurisdiction | Tax Jurisdiction of Organisation or Incorporation if Different from Tax Jurisdiction of Residence | Main Business Activity(ies) | | | | | | | | | | | | | | |
|------------------|---|---|--|---------------------------|-----------------------------|----------------------------------|---|--|------------------------|------------------------------|-----------|--|---------|-------|--|--|--|
| | | | Research and Development Holding or Managing Intellectual Property | Purchasing or Procurement | Manufacturing or Production | Sales, Marketing or Distribution | Administrative, Management and Support Services | Provision of Services to Unrelated Parties | Internal Group Finance | Regulated Financial Services | Insurance | Holding Shares or Other Equity Instruments | Dormant | Other | | | |
| | | | | | | | | | | | | | | | | | |
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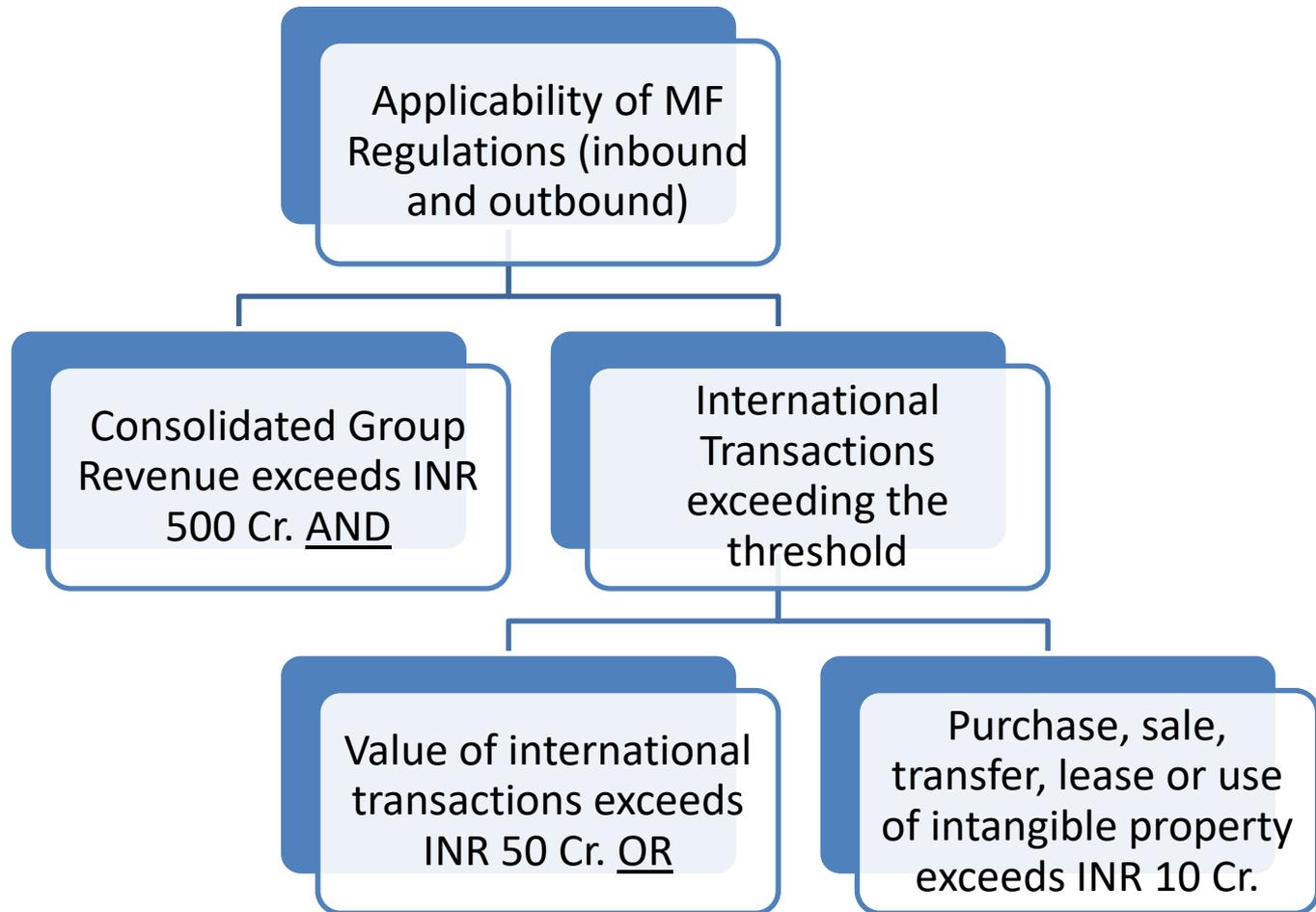
Master File (MF)

Master File (MF)

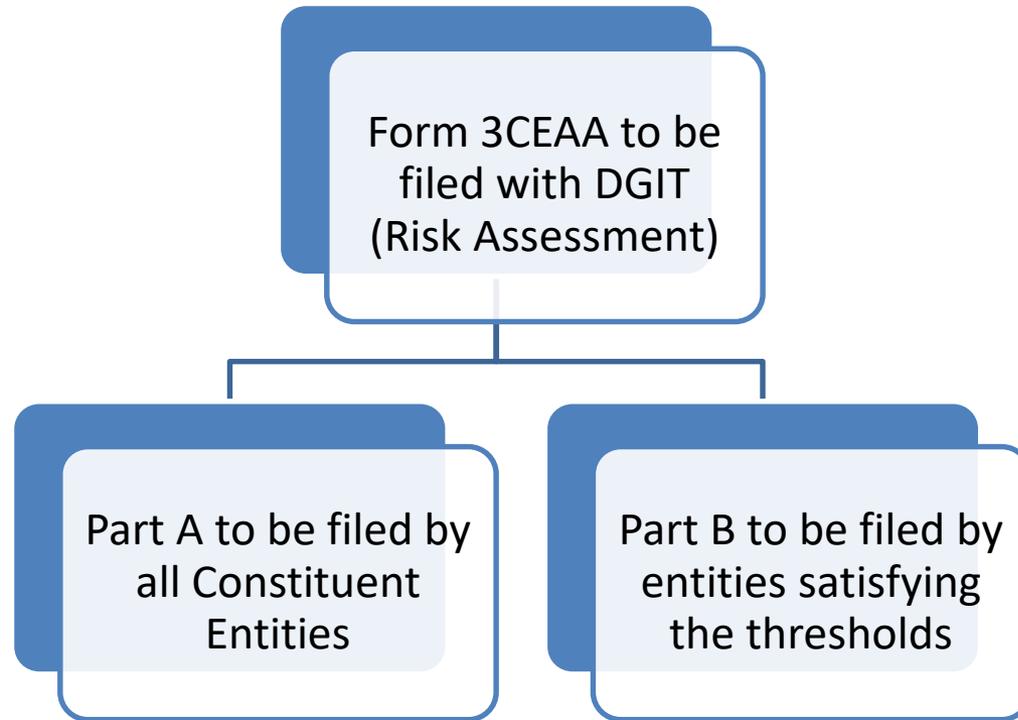
- Wider applicability than CbCR
 - Applicable to groups with consolidated group turnover of INR 500 Cr.
 - Basic intimation applicable to all Indian constituent entities
- Articulation of group's business and key components of business
 - Group level information
 - Service Agreements
 - Business Restructuring
 - Intangibles
 - Financial Arrangements
 - Information about APAs and Rulings

How will the MF data be used?

MF Applicability



MF Compliance Obligations



Master file to be filed on or before due date for furnishing income tax return.

Form 3CEAB for Designated Entities 30 days before the due date of Form 3CEAA.

MF – Information Required

Group Level Information

- Group entities; business / business lines
- Profit drivers
- Supply chain
- Markets
- Functional analysis of entities contributing > 10% to revenues, assets or profits
- Financial Statements

Service Agreements

- Description of key service agreements and capabilities of main service providers
- TP policies for allocating costs and determining prices for services

Business Restructuring

- Description of business restructuring / acquisitions / divestments

Intangibles

- IP strategy, location & management of R&D facilities
- Important IP and ownership
- Listing & description of key agreements
- Description of group TP policy on R&D and intangibles
- Description of important intangible transfers and consideration

Financial Arrangements

- Financing arrangements and top lenders
- Central finance entities; place of operation and effective management
- Description of group TP policy

APAs and Rulings

- Listing & description of APAs and Rulings

CbCR and MF Case Studies

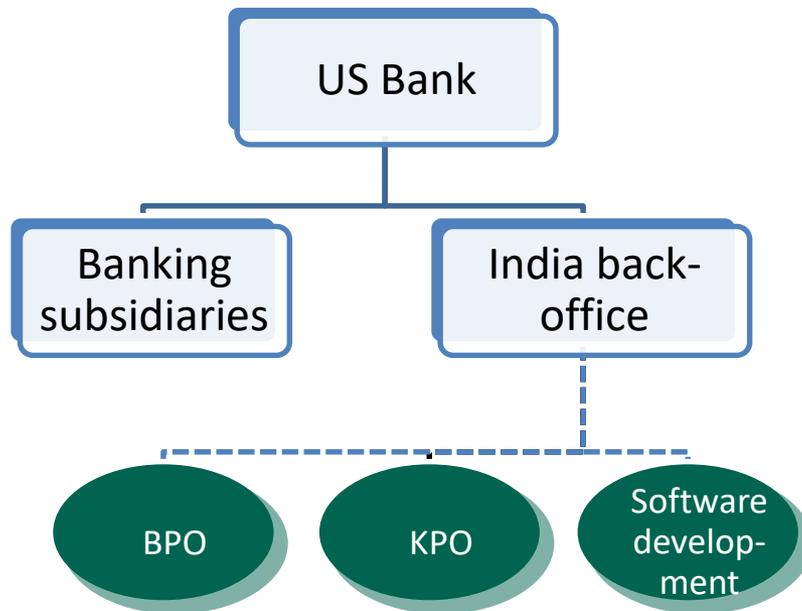
CbCR – Indian Pharma MNE

| Tax Jurisdiction | Name (Main Business) | Revenue | PBT | Head-count |
|------------------|----------------------|---------|---------------|------------|
| India | ABC HQ | 90,000 | 18,000 | 2,000 |
| India | ABC R&D | 5,000 | 1,000 | 500 |
| India | ABC Trading | 45,000 | 2,000 | 2 |
| USA | ABC Manufacture | 43,000 | -2,000 | 1,000 |
| Netherlands | ABC Finance | 25,000 | 20,000 | 6 |
| Luxemborg | ABC IP Owner | 24,000 | 18,000 | 1 |
| UAE | ABC Trading | 35,000 | 21,000 | 2 |
| Australia | ABC Services | 10,000 | 4,000 | 10 |
| Singapore | ABC e-com | 20,000 | 10,000 | 0 |
| | Consolidated | | 50,000 | |

Risk assessments

- Vastly different trading returns for India and UAE; different tax rates
- Return on R&D activities
- Return on financing; CFC rules; limit on interest deductions
- Nature of services and margins in Australia?
- Evaluating POEM exposure
- Permanent Establishment Exposure for ABC in Singapore
- Audit triggers in the US?

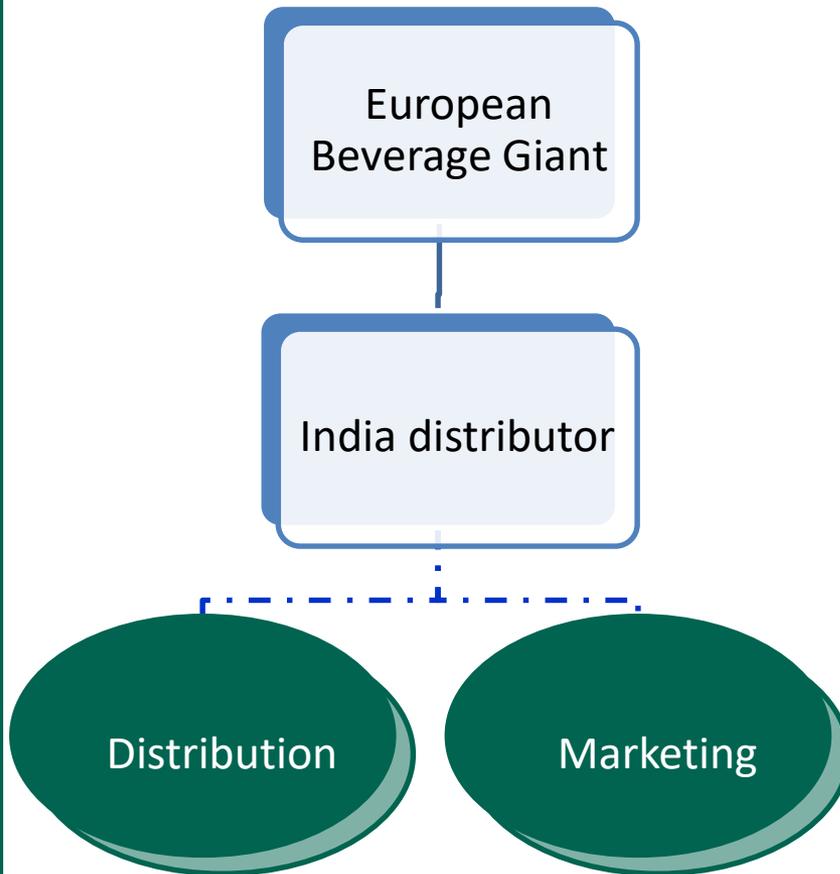
MF – Large US Bank



- Master File of US Bank (value drivers):
 - Financial strength
 - Brand name
 - Diversified business
 - Human intangibles
 - Proprietary software
 - Innovation and process improvement
- Characterisation of India back-office in TP study?

Consistency is the key!

MF – European Beverage Giant



- Master File of European Beverage Giant (value drivers):
 - Product formula
 - Brand name
 - Proven marketing concepts
 - Local implementation of marketing concepts
 - Distribution network
- Characterisation of Indian distributor in TP study?

Consistency is the key!

Closing Remarks!

Transfer Pricing Penalties

| Default | Penalty |
|---|-------------------------|
| Failure to furnish Form 3CEB | INR 100,000 |
| Failure to keep and maintain Transfer Pricing Documentation | 2% of transaction value |
| Failure to report transactions required to be reported | 2% of transaction value |
| Maintaining / furnishing incorrect information / document | 2% of transaction value |
| Failure to furnish information / document called for by AO / TPO / CIT(A) | 2% of transaction value |
| Adjustment based on under-reported income (insufficient documentation / disclosure) | 50% of additional tax |
| Failure to report transactions required to be reported | 200% of additional tax |

Additional CbCR and MF Penalties

| Default | Period of default | Penalty (INR) |
|--|--------------------------------|----------------|
| Non-furnishing of CbCR | upto 1 month | 5,000 per day |
| Non-furnishing of CbCR | beyond 1 month | 15,000 per day |
| Non-furnishing of CbCR | after imposing above penalties | 50,000 per day |
| Non-submission of information / documents called for in relation to CbCR | upto imposition of penalty | 5,000 per day |
| Non-submission of information / documents called for in relation to CbCR | after imposing above penalty | 50,000 per day |
| Furnishing inaccurate information / document in CbCR / in relation to CbCR | | 5,00,000 |
| Failure to furnish Master File | | 5,00,000 |

FAQs on Compliances

- Does transfer pricing apply to transactions between Branch and Head Office?
- Does transfer pricing apply to foreign companies?
- Does transfer pricing apply to individual taxpayers?
- Taxpayer has only made investments and not entered into other transactions. Does transfer pricing apply?
- Does transfer pricing apply to dividends?
- Does transfer pricing apply to payment to non-resident Directors?
- How does transfer pricing apply if the parties are Associated Enterprises for part of the year?

Some Best Practices

- Accountant vis-à-vis Transfer Pricing?
- Communication with outgoing auditor
- Ledger Scrutiny
- Management Representation Letter
- Involvement of right personnel of the taxpayer
- Whenever in doubt, write a Note!
- Timing of transfer pricing documentation?
- Documentation for 'soft' transactions
- Documentation for losses
- Documentation for market trends
- Documentation for spot pricing of commodities

QUESTIONS?
