

TRANSFER PRICING 360°

Volume 3 Issue 1 | Apr-Jun 2016

Transfer Pricing remains the focal point of all the Multinational Enterprises (MNEs) during the first quarter of the financial year 2016 as many countries are racing to implement the Organisation for Economic Cooperation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) recommendations by way of legislation changes in their taxation laws. The OECD is also working at a swift pace to provide implementation packages and tools and assist countries in implementing the Action Plans.

Our *Focus Point*, continues to discuss the BEPS Action Plans. In this edition, we have brought about how Action Plans 8, 9, and 10, the most talked about action plans would impact the overall economics of operations business structure with an emphasis on its effects in India. It is important to note that it is now extremely critical to undertake the revalidation and alignment of group transfer pricing policies in light of the extensive documentation requirements as suggested in the Action Plan 13, being adopted by practically all the key developed and developing nations.

The section on *India Updates* covers the developments in India where a committee has been set up, to examine issues relating to the existing safe-harbour framework vis-à-vis APA scheme with an aim to make safe-harbour options more feasible so that taxpayers file Advance Pricing Agreements for more complex cases and other important developments.

The current Indian legislative picture covered in the *Jury's Word* brings you the key highlights of tax rulings and judiciary positions of contentious transfer pricing matters.

The *Global Developments* section summarises the list of jurisdictions which have already implemented Country-by-Country (CbC) reporting in their legislation as well as signed up for automatic exchange of information.

On 22 March 2016, the OECD has also released the CbC XML schema, which will be the standardised electronic format for filing all CbC Reports across the globe. The information forming part of the CbC Report will be collated by the country of residence of the reporting entity for the MNE group and it will be exchanged electronically between Competent Authorities, according to the Multilateral Competent Authority Agreement on the Exchange of CbC Reports, in the same XML Schema format. Fiscal year 2016 will be the first year for exchange of information which would start presumably in 2017-2018.

With the end of an impactful first quarter of the fiscal year 2016, we believe that we are in for an exciting year for transfer pricing. We will continue to keep you posted with more transfer pricing news and updates in the forthcoming quarters. We hope you find this newsletter useful and look forward to your feedback. You can write to us at skp.tp360@skpgroup.com.

Warm regards,

The SKP Transfer Pricing Team

In this issue

Focus Point	2
India Updates	6
Jury's Word	8
Global Developments	13

FOCUS POINT

Aligning Transfer Pricing and Value Creation – Impact of BEPS Action Plans 8-10

In October 2015, the OECD released the final reports on Action Plans 8-10 (aligning transfer pricing outcomes with value creation) and Action Plan 13 (transfer pricing documentation and country-by-country reporting). The Action Plans broadly aim to ensure taxes are paid where economic activities are performed and where value is created. In May 2016, the OECD Council formally adopted the recommendations set out in these Action Plans into the OECD Transfer Pricing Guidelines (TPG). The OECD is now expected to issue a revised version of the TPG once all changes are in line with BEPS Action Plans.

Action Plans 8-10 are inter-linked in terms of the objectives they intend to achieve, namely, ensuring that transfer pricing outcomes are aligned with value creation.

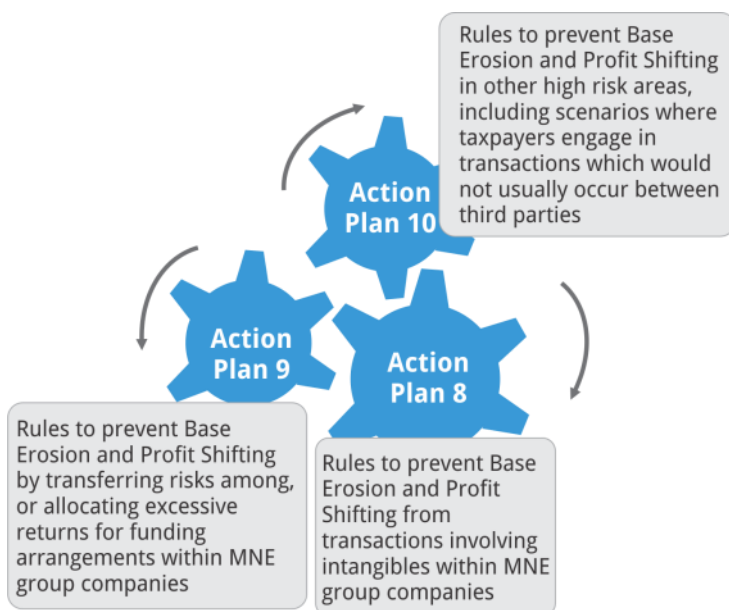
It is worthwhile to note that Action Plans 8, 9 and 10 are the most talked about, and the OECD has released the largest number of discussion drafts on these compared to any other action plans. These three action plans will

directly impact the outlook of the global transfer pricing scenario, in the near future. The OECD's work in the context of Actions 8 to 10 of the Final Report includes almost 200 pages of guidance covering several key transfer pricing areas.

These include:

1) The accurate delineation of inter-company transactions;

- 2) transactions involving intangibles;
- 3) commodity transactions;
- 4) low value adding intra-group service transactions;
- 5) cost contribution arrangements; and
- 6) future work to be completed on the transactional profit split method.



Key Takeaways from the OECD's Guidance

Some of the key takeaways from the OECD's guidelines under BEPS Action Plans 8-10 are:

Risks and Intangibles

- The group companies performing important functions, controlling economically significant risks and contributing assets in development, enhancement, maintenance, protection and exploitation (DEMPE) of intangibles will be entitled to an appropriate return reflecting the value of their contributions.
- Legal ownership alone does not necessarily generate a right to all (or in fact any) of the return that is generated by the exploitation of the intangible.
- Contractual arrangements should be respected only if supported by actual conduct of the parties. Thus, conduct of parties would override the actual contractual terms between the parties.
- Risks contractually assumed by a party that cannot exercise meaningful and specifically defined control over the risks, or does not have the financial capacity to assume the risks, will be allocated to the party that does exercise such control and has the financial capacity to assume such risks.
- The capital rich member of the group, providing funds without controlling the risks associated with its funding, will not be allocated the profits associated with the risks and will be entitled to no more than a risk-free return.
- The guidelines also provide tools in the hands of tax administrators such as, evaluation based on ex-post outcomes vis-à-vis ex-ante projections to determine the arm's length price of hard to value intangibles (HTVI) and also grants powers to disregard transactions when exceptional circumstances of commercial irrationality appear. However, the guidelines also mention necessary safeguards and protection for taxpayers before tax authorities resort to the usage of such tools.

Intra-group Services

With respect to the widely adopted transactions of management fees and head office expenses, the OECD has enumerated an elective and simplified approach for the low-value adding intra-group services. Key features of the simplified approach are:

- The guidance defines low value adding intra-group services, which include accounting and auditing, processing and managing account receivables, payables, HR matters, IT support, public relations support activities, etc.
- Activities which include all services that constitute the core business of the MNE group, research and development services, manufacturing and production services, sales, marketing and distribution activities, etc. will not be considered as low value adding intra-group services for the purpose of the simplified approach.
- Allocation of the cost pool to MNE group members which reasonably reflects the level of benefit expected by each recipient of the service.
- A standard mark-up of 5% on costs (excluding the pass-through back to back costs) to be allowed for all categories of services, which may not require a justification by way of a separate benchmarking.
- Simplified benefit test documentation for all service recipients.

Action Plans 8 to 10 – An Indian Perspective

India has always believed that transfer pricing outcomes should be aligned to value creation and that the substance of a transaction and the conduct of parties would override the form/contractual arrangement. In a sense, the BEPS Action Plan 8-10 will positively impact the Indian tax authorities and affirms their long-standing position. In fact, India has played an active role in deliberating the various positions and principles arrived in the OECD's Final Reports in the BEPS Project.

Over the years, the Indian tax authorities have shifted their focus on the principal transfer pricing issues, such as aligning FAR with the

remuneration model, allocation of the location savings and the use of profit split method in case of integrated value chain models of the MNE group, etc. The tax officers are increasingly interested in studying the entire value chain of an MNE group. The transfer pricing aspects of intangibles were also debated and contested in the recent rounds of transfer pricing assessments and India has also attempted to define intangibles in an extensive manner encompassing marketing intangibles, assembled work-force, customer contracts, etc.

In the recent round of transfer pricing assessments concluded in January 2016, paragraphs from Action Plan 8-10 were widely quoted. Reliance was placed on BEPS Action Plans to address issues such as marketing intangibles, intangible ownership and remuneration to contract R&D service providers, valuation of HTVI, etc.

Furthermore, from a statutory inclusion of principles, India has already given consent to the OECD's recommendations by way of:

- Introduction of section 286 of the Income Tax Act, 1961 for implementation of Action Plan 13 and;
- Giving a consensus for adoption of Action Plan 8-10 and 13 as part of G20 summit.

This section analyses the impact of Action Plan 8-10 on various forms of inter-company transactions in the Indian context:

Indian R&D centers

Globalisation has led many MNEs to establish R&D centers in India. Most of these centers are typically set up as contract R&D service providers, not eligible for intangible related returns, and are typically remunerated on a cost plus basis. There has been a fair amount of controversy on the transfer pricing issues regarding the R&D centers.

India has already asserted the importance of economic ownership with legal ownership and has clarified its position in Circular 6/2013 addressing transfer pricing aspects regarding the development centers. The Circular states that where significant economic activity, related to the development of intangibles, takes place in India, important strategic decisions are taken by management and employees of the Indian company. Accordingly, the Indian subsidiary exercises control over operational and other risks. In this context, a routine cost plus mark-up would not reflect an arm's length price for the services rendered. The guidelines clearly follow the principle outlined in the OECD's guidance.

Indian Distributors

Indian related party distributors of MNEs typically operate exclusively for selling the group's finished products in India and are economically characterised/remunerated in one of the following ways:

A Limited Risk Distributor – implying that the Indian distributor would undertake minimal or no risk at all and is remunerated with a fixed/targeted net margin.

A full fledged distributor – implying that the Indian distributor undertakes wider selling and marketing functions as well as all market, inventory, and credit risks. Typically, the arm's length price of purchases in such a situation is tested by using either the Resale Price Method (comparison of gross margin) or TNMM (comparison of net margin) depending on the detailed functionality of the Indian distributor. The BEPS Action Plans could have the following implications for such distributors:

- **Limited Risk Distributor:** The aspect that needs to be examined is who actually manages the risks and exercises control over the functions of the distributor and in case the parent MNE does not do that, a low guaranteed margin would not adequately compensate the distributor irrespective of the contractual arrangement.
- For a **full-fledged distributor** who undertakes significant and non-routine functions especially on the marketing side, fairly independently and takes strategic decisions on local advertising and marketing

strategies, overall investments to be made, etc. the pricing policy will need to be re-evaluated. One would need to consider whether a higher share in the overall profits in the value chain corresponding to the intangibles managed and controlled by the Indian distributor is required. Also, the Indian distributor would be expected to have long term exclusive distribution rights in its territory and also be compensated for premature termination using arm's length principles.

Indian captive service providers/procurement agents/service providers

For Indian captive service providers or Indian companies acting as procurement agents, the Indian tax authorities have always contested location savings, location specific advantages and intangibles in the form of vendor/customer lists as a means to allocate higher mark-up/profitability to the Indian company. The OECD Guidance on these aspects state that while these factors may have an effect on determining the arm's length price they are not unique intangibles and they should be addressed as comparability factors. It further states that to arrive at the arm's length price where reliable local market comparables are available, specific comparability adjustments for these factors is not warranted.

India's position on these aspects is ambiguous. The Indian tax administration believes that, apart from location savings, profit from location specific factors such as skilled manpower, access to market, a large customer base, supplier information and a distribution network should result in higher remuneration to the Indian company and that the price arrived at using local comparables does not adequately address this issue. While the Indian jurisprudence is leaning towards the OECD view, we will have to wait and see if there is any formal stand taken or guidance given by the Indian tax authorities.

Intra-group services/payment of management fees

In this case the approach of the Indian tax authorities is divergent from the OECD Guidance. The OECD

has enumerated an elective and simplified approach for the low-value adding intra-group services and the simplified benefit test documentation for all service recipients. However, India has indicated that one of the major ways in which base erosion takes place is through excessive payments of management fee/service charges, royalties and interest. Thus, the Indian tax authorities consider transfer pricing of intra-group services as one of the high risk areas, which is also clearly evident from the widespread litigation in India over the same. The tax authorities in numerous cases have demanded quantification of benefit from each service received by the taxpayer and have challenged the payment on factors such as failure to demonstrate actual receipt of services, no benefits derived from the services, lack of documentation, etc.

The mark-up of 5%, as provided in the OECD Guidance for the low value adding intra-group services, is lower than the safe harbour rates prescribed by the Indian tax authorities, as well as the mark-up agreed in APA/MAP proceedings.

It would be interesting to watch out how India reconciles with OECD Guidance of this aspect. However, significant changes from the current approach cannot be expected as India has already expressed its reservation on the implementation of this specific guidance from OECD at various forums.

Valuation of Intangibles

In the case of a technological start-up entity in India that is in the process of developing an intangible. The company wishes to transfer the intangible that is still under development to its subsidiary company in Singapore. Valuation is a very difficult challenging exercise in such cases since it is extremely difficult to project the success of such an intangible. The Indian tax authorities' current approach is to scrutinise the projections used for arriving at the valuation and replace it with the actual number with the benefit of hindsight. The OECD Guidance on HTVI and the use of ex-post outcomes vis-à-vis ex ante projections to determine arm's length price would give them the much needed endorsement to look at such intangible valuations.

Currently, the judicial authorities frown upon this approach but whether the judicial thinking and approach would change is yet to be seen. Also, even after the transfer if the substantial functions, assets and risks in respect of DEMPE of intangibles carried out by the Indian parent, the tax authorities can either disregard the transfer of intangibles or allocate higher profits to India using the profit split or any other methodology.

Conclusion

All in all, the Action Plans 8-10 aims to ensure that the transfer pricing regulations across the globe are aligned to make sure that the relevant operational profits are allocated to the economic activities which actually generate them.

Considering the wide acceptance to the OECD's guidance across the globe, MNE groups must work on the immediate objective of revalidating and realigning the transfer pricing policies within the group so that the transfer pricing positions go hand in hand with the value creation within the group. It gains more importance owing to the fact that all the action plans under the BEPS Project are integrated and aligned with each other and maintain the status quo, waiting for the actual enquiry from the tax authorities, will not serve the purpose.

Moreover, with the requirements under Action Plan 13 regarding an extensive level of transfer pricing documentation (master file, local file and country-by-country report) is practically adopted by all major developed as well as developing countries. This Country-by-Country Report will make it mandatory

for MNEs to disclose, on a global basis, financial information including revenues and taxes paid, and non-financial information, including number of employees in each country. This would facilitate undertaking the first level of risk assessment by the tax authorities in India and globally and identifying areas for detailed investigations including whether entities have adequate people capabilities to perform key functions and control key risks.

Transfer pricing cannot remain a merely principle driven tax compliance activity anymore. It will touch upon the entire domain of the business, starting from the strategy to ground level operations. As a result, the entire business and operational processes may need an overhaul. It is imperative that MNE groups keep pace with the new international tax and transfer pricing scenario.





INDIA UPDATES

Transfer pricing litigation scenario may undergo changes in India

Transfer pricing litigation has been one of the major concerns for multi national enterprises (MNE) operating in India. However, with various measures undertaken by the Indian government to build investor confidence and to stabilise the business climate in India, the volume of transfer pricing adjustments have seen a downward trend in the last round of assessment for the transfer pricing audit year 2013-14 after it had peaked in 2012-13.

From the dispute avoidance point of view, the Indian Government had introduced two key mechanisms - safe-harbour provisions and Advance Pricing Agreements (APAs).

APAs settle the transfer pricing methodology/price for transactions to be entered into by Indian company with its overseas affiliates in advance up to five years and it can also be made applicable to the roll-back four years, after satisfying certain conditions. Under the safe-harbour mechanism, by adopting the profit margins prescribed for various kinds of outsourced services rendered by an Indian company to its overseas affiliates (such as IT, ITes, R&D), the Indian company can get the transfer pricing certainty with simplified compliances and no litigation, for a period up to five years.

However, since the prescribed profit margins were perceived to be very high in the safe harbour mechanism, many of the MNEs are opting to continue the routine transfer pricing assessment and litigation scenario or preferring the APA route. More than 600 applications for APA have been filed over the last three years.

We can expect the appellate authorities in India to take a friendlier stand with respect to the outcome of an APA. Recently, the Delhi Income Tax Appellate Tribunal has ruled in favour of the taxpayer, which has signed an APA with roll-back provisions. It is important to note that the disputed year was beyond the applicable roll-back provisions and the appellate authority stated that APA may play a vital role and will have a strong guidance value in resolving disputes even prior to the roll-back years, where functions, assets and risk (FAR) and the nature of international transactions entered between two associated enterprises remain unchanged over the period.

On a related note, it has come to knowledge that Indian Finance Ministry has set up a committee, which will examine issues relating to the existing safe-harbour framework, **including the possibility of downward movement of the prescribed profit margins for certain captive services, which would translate into a lower taxable profits and reduced tax outgo.**

The ministry is of the view that safe-harbour provisions and APA mechanism needs to go hand in hand, the aim is to make the safe-harbour option more feasible so that taxpayers file APAs for more complex cases. We need to wait and watch the actions of the Indian government with respect to the safe harbour provisions over next few months.

Transfer Pricing implications of Advertising, Marketing and Promotional (AMP) Expenses – Twists and Turns

The issue of excessive AMP expenses incurred by the Indian counterpart of the multi-national enterprise has been a hot topic for litigation in India. Over the past few years, numerous cases involving controversies around AMP expenses have been dealt with by various appellate authorities and recently, this litigious issue has reached the Supreme Court of India (the Apex adjudicating authority in India).

The Supreme Court has admitted the tax department's Special Leave Petition (SLP) against the Delhi High Court's judgement in the case of Amadeus India Private Limited, in which direct selling expenses were adjudicated to be excluded from the AMP expenses and thereby, the revenue's appeal was dismissed.

The Supreme Court also admitted the tax department's SLP against the Delhi High Court's order in the case of Honda Siel Power Products Limited, of deleting the adjustment holding that Revenue had been unable to demonstrate, with tangible material, the existence of an international transaction involving AMP expenses between the taxpayer and its foreign associated enterprise and thus the question of determining ALP did not arise.

In light of the above developments at the Apex Court, we can expect to see many more arguments and actions on this issue in the times to come.

CBDT's Action Plan 2016-17

The Central Board of Direct Taxes, the apex administrative authority in India, has published a Central Action Plan (CAP) 2016-17 meant for internal use by the income-tax authorities in India.

Along with other key areas, the CAP lays down a quarterly target for completion of time barring transfer pricing assessments as under:

Quarter Ending	% of completion of assessment
31 Jul 16	40%
30 Sep 16	90%
31 Oct 16	100%

With respect to the disposal of transfer pricing litigation cases by the Commissioner of Income Tax (Appeals) [CIT(A)], there would be a separate norm of 150 appeals per year, as may be prescribed by the Chief Commissioner of Income-tax (CCIT). In order to prioritise such appeals, suitable baskets may be created by the CCIT.

Where the CIT(A) has to decide transfer pricing cases in addition to high demand and other appeals, target for disposal of transfer pricing appeals may be allocated equating one transfer pricing appeal with two high demand appeals or four other appeals.





JURY'S WORD

KAR Therapeutics & Estates Pvt Ltd vs Deputy Commissioner of Income Tax (DCIT)¹: Investment in share capital of the subsidiary not an international transaction, mere contrary disclosure in the books of subsidiary company, without proper evidence, cannot re-characterise the transaction.

The taxpayer had infused USD 3.38 million as share capital in its Singapore subsidiary. However, during the year under consideration only shares worth USD 2.65 million were allotted and the balance share application money was pending allotment. In relation to the outstanding share application money pending allotment, the transfer pricing officer (TPO) relied on the disclosure in the financial statements of the associated enterprise (AE) which stated this amount as an unsecured interest-free loan, repayable on demand. Accordingly, the TPO re-characterised the outstanding share application money as loan and computed arm's length interest rate using prime lending rate of 12.5%.

The Income Tax Appellate Tribunal (ITAT) observed that the shares were issued against outstanding share application money in the subsequent year and it is not an international transaction. Furthermore, the ITAT also relied on the case of Prithvi Information Solutions Ltd², to state

that mere disclosures in the financial statements of the AE was not sufficient proof to warrant re-characterisation and thereby charge interest.

Mc Donald's India (P) Ltd vs DCIT:³ Actual conduct of parties and actual risk assumed can override the contractual terms, royalty received from joint venture which is remitted to an overseas AE without any value addition to be treated as 'pass through cost'.

The taxpayer had entered into a master license agreement and service agreement with its US AE for availing the right to promote and develop McDonald restaurants in India. The taxpayer was charged 5% on gross sales in India as royalty. Furthermore, the taxpayer was required to pay an initial license fee of USD 22,500 for each new restaurant it opened. The taxpayer had created two joint venture (JV) companies with two third parties who in turn were the sub-licensees and were supposed to pay the taxpayer 5% royalty and license fee.

The taxpayer benchmarked the royalty and initial license fee using the comparable uncontrolled price (CUP) method which was rejected by the TPO. Apart from the royalty and license/franchisee fee, there were

other transactions and the TPO aggregated all the international transactions and adopted the transactional net margin (TNM) method. The TPO also excluded 'franchisee fee received' from operating income as it was not remitted to McDonald US in the absence of necessary RBI approvals and as it was not recognised as expenses in the taxpayer's accounts. Accordingly, the TPO calculated the taxpayer's margins at 2.68% as against 9.89% of comparable companies and made the transfer pricing adjustment.

Furthermore, the TPO contented that royalty received from sub-licensees and paid to the US AE was not a pass through cost as the taxpayer carried the risk of cancellation of agreement in case of non-payment and had to make good the royalty amount in case of default by the franchisee. The Commissioner of Income Tax (Appeals) (CIT(A)) upheld the TPO's view.

ITAT stated that the terminology in the inter-company agreements cannot be read in isolation of the risk involved in the practical business matrix of the taxpayer. The ITAT considered the taxpayer's contention that there was no such default till date and no such risk was assumed by the taxpayer. Moreover, the fact that taxpayer has to make a payment within five days of each month shows that the benefit of retaining money is also not available

1 ITA No. 86/Hyd/2016 - AY 2011 - 2012

2 ITA No.1816/Hyd/2012

3 ITA No. 961/Del/2010

royalty and franchisee fees. The ITAT held that no significant function/risk were performed by the taxpayer and the cost which does not have any value addition should not form part of the profit level indicator (PLI) computation. The taxpayer is being remunerated at a cost plus mark up for its service activity, accordingly, royalty income received from joint ventures and passed on to the US AE should be considered as an operating item for PLI computation.

Furthermore, in connection with the comparable companies selected, the taxpayer contended that its risk-free business should not be compared with the TPO's set of companies which carried more risks. The ITAT accepted the above contention of the taxpayer and directed the AO to peruse the risk adjustment claimed by the taxpayer.

Assistant Commissioner of Income Tax (ACIT) vs Panasonic Energy India Co. Ltd⁴: The loss incurred on account of increase in raw material price cannot be attributed to the royalty payment.

The taxpayer is engaged in the manufacturing and trading of dry batteries, other machinery and its spares. The taxpayer had paid royalty to its AE and had incurred losses in the year under appeal. The TPO attributed the loss incurred by the taxpayer due to the payment of royalty to the AE and derived the arm's length price (ALP) to be nil, accordingly, the TPO made adjustments. Aggrieved, the taxpayer filed an appeal to CIT(A).

CIT(A) held that the TPO's action in considering royalty ALP at Nil on the basis of loss incurred by taxpayer was not supported by any of the prescribed transfer pricing methods. Furthermore, it viewed that the loss in the current year cannot be attributed to the royalty payment as it was on account of a sudden increase in the price of zinc, also there is no relationship between the zinc price and royalty. Accordingly, it deleted the addition. Aggrieved, Revenue filed an appeal before the ITAT. However, even the ITAT confirmed the actions of the CIT(A).

Ranbaxy Laboratories Ltd vs ACIT⁵: Allows selection of foreign AE as tested party placing reliance on APA signed by the taxpayer, even though the APA does not have any binding effect for the year under appeal.

The taxpayer manufactures pharmaceutical products and had entered into various international transactions with its AEs which were benchmarked using the TNM method. The taxpayer selected the foreign AE as the tested party. The TPO rejected the selection of the foreign AE as 'tested party' on grounds of a geographical difference and placing reliance on the taxpayer's own case wherein the ITAT had rejected foreign tested party. The DRP upheld the approach of the TPO.

Before ITAT, taxpayer submitted that it had an Advance Pricing Agreement (APA) signed with the Central Board of Direct Taxes (CBDT) from AY 2014-15 onwards, wherein the CBDT approved selection of foreign AEs as tested party with the TNM method as the most appropriate method (MAM) and also approved considering regional comparables. The ITAT held that, the APA entered into by the taxpayer had considered all the aspects of the manner of determination of ALP which are also similar for the current year, hence should be given the highest sanctity. Furthermore, referring to Rule 10MA wherein the methodology accepted in the APA to other years can be applied to the international transactions, provided they are similar. Accordingly, the ITAT directed the TPO to allow the foreign AE as the tested party and re-compute the ALP.

Subex Limited vs ACIT⁶: Use of loan connector database accepted and AE country's interest rate for determination of arm's length interest rate for outbound loans.

The taxpayer rendered software development services and adopted the TNM method for benchmarking. However, the TPO made adjustments

by considering the taxpayers foreign exchange income as non-operating and selected 11 companies as comparables that included two extremely high margin comparable companies. This approach of the TPO was upheld by the Dispute Resolution Panel (DRP). However, the ITAT held that foreign exchange income being related to the sales proceeds should be considered as operating in nature. Furthermore, the ITAT accepted the exclusion of the two companies (Bodhtree Consulting Ltd and Infosys Ltd) having abnormal and fluctuating profit margins and higher brand value.

In addition to the software development transaction the taxpayer had provided USD denominated loans to its AE's and charged interest at the rate of 6%. The taxpayer benchmarked the interest applying the CUP method using the 'Loan Connector' database and arriving at an arm's length interest of 3.53% (i.e. LIBOR base rate of 1% plus margin of 2.53% from loan connector). However, the TPO adopted the ALP using interest rate of 17.22% - considering Indian BB rated bonds; and made adjustments. The DRP directed to adopt the average credit risk spread from the loan connector database which the AO/TPO did not implement while passing the final order.

ITAT accepting taxpayer's contention to use the loan connector database to calculate the risk spread and directed the AO to follow the DRP order. The ITAT also held that the interest rate prevailing in the country of borrower of the loan (AE) is to be adopted in case of outbound loan transaction placing reliance on the Bombay High Court (HC) judgement in the case of Tata AutoComp System⁷.

4 ITA No.1036/Ahd/12

5 ITA No. 196/Del/2013 – AY 2008-09

6 IT(TP)A No. 223/Bang/2014

7 56 Taxman.com 206 (Bom)

Seagram Manufacturing Pvt Ltd vs ACIT⁸: Inclusion of reimbursed expenses in the cost base for marketing support services.

The taxpayer is engaged in the business of blending, bottling and trading of Indian made foreign liquor. Furthermore, the AE supplies to unrelated parties, international brands of alcoholic beverages and in this connection the taxpayer provided marketing support services such as promotion of AE's products, administrative assistance for advertising and promotional events and also collections and follow up for payments. The AE remunerated the taxpayer a fixed commission of USD 2,500 per month for the marketing services along with reimbursing the actual marketing cost on a cost to cost basis. The taxpayer had various international transactions and the TPO accepted them to be at ALP's except for the marketing support transactions which the taxpayer had benchmarked using the TNM method. The taxpayer claimed the margins earned on the marketing segment to be 13.25% on cost.

The TPO noted that the taxpayer when computing its marketing segment profitability did not properly allocate expenditure by excluding the cost to cost reimbursements from both expenses and income. Accordingly, the TPO revised the margins of the taxpayer to 4.48%. The TPO stated that the commission earned by the taxpayer was neither linked to the cost incurred nor sales made and that the taxpayer was fully involved in the functions represented by reimbursed expenses and hence should be remunerated by a mark-up on these costs. The CIT(A) upheld the TPO's view.

The ITAT observed that all risks incidental to the expenses incurred were at the taxpayer's account. The ITAT was of the view that the taxpayer played an important role in promoting AE's sales and its fixed commission model was not justified.

It directed that in order to bring all comparable companies to a level playing field, the reimbursement had to be included to compute the PLI as it could not be proved that the comparable was also being reimbursed for certain specific functions similar to the taxpayer. Consequently, the ITAT also upheld the view of the TPO and the CIT(A) and the taxpayer's transfer pricing grounds were dismissed.

Swarovski India Pvt Ltd vs DCIT⁹: CPM accepted as the MAM for a low risk contract manufacturer; however, apportionment of costs to non-existent functions that artificially increase profitability relooked.

The taxpayer is engaged in colouring raw beads imported from its AE. The taxpayer adopted the cost plus method (CPM) and compared its gross margins (30%) with comparable companies (11%). The TPO rejecting the approach of the taxpayer, sought to compare the net level profitability of the taxpayer (without specifically mentioning the TNM method). The TPO held that the taxpayer was a job worker and a 100% captive service provider and for the purpose of PLI/cost base for such transactions was neither defined in the rules nor in OECD guidelines. Accordingly, the TPO proposed an adjustment which was upheld by the CIT(A) and the CIT(A) confirmed that the TNM method was the MAM.

The ITAT held that the taxpayer was a contract manufacturer was not disputed and noted that the United Nations (UN) guidelines provide an application of CPM as the MAM for a contract manufacturer. The ITAT also observed that the CPM was accepted even in the previous years as the MAM for the transaction of receipt of job work charges.

However, in relation to the computation of the ALP the ITAT observed that while computing the

PLI the taxpayer had allocated its cost under different activity heads such as coating of raw beads, trading, transfers and corporate. The taxpayer had income from the activity of coating of raw beads and had apportioned the total expenses to other activity heads that were non-existent and merely created them to increase profit artificially. The matter was remanded back to the file of the TPO/AO to re-examine the case in light of observations of ITAT.

SI Group India Limited vs DCIT-LTU:¹⁰ RBI approved royalty rate held valid comparable; private database held valid for CUP analysis in case of export transactions.

The taxpayer was engaged in manufacturing organic chemicals and phenolic resins and was incurring operating losses for the year under consideration.

Issue 1: The taxpayer paid royalty at the rate of 2% of the net selling price of goods manufactured and benchmarked the transaction using CUP method placing reliance on the Reserve Bank of India's (RBI) approval. The TPO rejected the benchmarking analysis as the taxpayer had incurred operating losses and determined the ALP of royalty payment as nil. The DRP confirmed the transfer pricing additions. The ITAT held that in the absence of any correct mechanism and scientific method adopted for computing/determining ALP by TPO, RBI approval could be regarded as a reasonable CUP. Reliance was placed on Hyderabad ITAT ruling in the case of Owens Corning Industries (India) Pvt Ltd¹¹ Based on the above submission, the ITAT deleted the adjustment.

8 ITA No. 4783/Del/2007 & 4784/Del/2007 - AY 02-03 and AY 03-04
9 ITA No. 3472/Del/2012 - AY 02-03

10 ITA No. 9197/Mum/2010 - AY 2006-07
11 ITA No.549 & 595/Hyd./2014

Issue 2: In addition to the above, the taxpayer had also imported a generic product from its AE that constituted only 0.13% of the total purchases. Taxpayer adopted CUP method and compared freight on board (FOB) value of products sold by the AE to third party customers in China with FOB value of products sold to the taxpayer. The TPO rejected the CUP analysis due to difference in market conditions (Indian vs Chinese market), geographical location, and volume (560 MT to Chinese entity vs 84 MT to taxpayer) and in the absence of concrete documentary evidences, the TPO determined the ALP of import product as nil. The DRP provided partial relief and rejected the nil ALP determined by the TPO. The ITAT also upheld the CUP analysis and held that the differences in the market, size and geographical location could not be a valid reason to reject the comparable data in the absence of any factual analysis reflecting any influence of such factors on the transactions. The ITAT further held that the exact product comparison in case of a generic product is not warranted.

Issue 3: The taxpayer has also exported certain generic chemical products to its AE and it was incurring an operating loss on the export of such products. The taxpayer adopted the CUP method to benchmark the transaction and extracted the customs data pertaining to all the exports of such products from India that were provided by a third party service provider (International Business Information Services). The TPO rejected the CUP analysis and adopted TNMM, thereby proposing an adjustment that was confirmed by the DRP. However, the ITAT relied on the case of Tilda Riceland Pvt Ltd¹² and held that the database built on inputs like customs data is reasonably acceptable when the ALP was determined on the basis of CUP, it was immaterial whether the taxpayer had earned profit or incurred a loss from such a transaction. Accordingly, the ITAT deleted the transfer pricing adjustment.



DCIT vs Software AG Bangalore Technologies Pvt Ltd:¹³ Negative working capital adjustment rejected by the ITAT in case of captive service providers.

The taxpayer was a captive service provider and had entered into international transactions with its AEs. During the course of transfer pricing proceedings, the TPO suo moto proposed and worked out a negative working capital adjustment; thereby, increasing the margins of comparable companies. A negative working capital adjustment indicates that the comparable companies manage their working capital (i.e. payables, receivables and inventory) efficiently as compared to the taxpayer. However, working capital adjustment was not claimed by the taxpayer while determining the ALP. CIT(A) directed that if the negative working capital adjustment is considered then the taxpayer should also be granted risk adjustment.

Aggrieved, revenue preferred an appeal before the ITAT and argued that the taxpayer had not submitted the working of risk adjustment and hence, CIT(A) was not justified in directing the TPO to compute the same. Since the TPO had suo moto worked out the working capital adjustment, the ITAT by applying the principle of consistency directed the TPO to consider the claim of risk adjustment.

As regards working capital adjustment, the taxpayer had filed cross objections. The taxpayer relied on judicial precedence and submitted that the working capital adjustment was not warranted in its case. The taxpayer submitted that being a captive service provider, it did not bear any working capital risk. The ITAT noted that the taxpayer had neither used any borrowed funds for working capital nor was there any risk on account of credit period provided to customers. Based on the submissions of the taxpayer, the ITAT rejected the suo moto negative working capital adjustment proposed by the TPO.

¹² (2014) 64 SOT 61 (Delhi)

¹³ IT(TP)A No. 1628/Bang/2014 and CO No. 72/Bang/2014 [in IT(TP)A No. 1628/Bang/2014] for AY 2010-11



DCIT vs Phillip Morris Services India (S.A.) India Branch Office¹⁴: Rejected revenue's approach of considering the taxpayer's overall group profitability and affirmed the taxpayer's functional profile along with the benchmarking analysis adopted in its study report.

The taxpayer was a branch office (permanent establishment) in India engaged in trading cigarettes of a world-known brand along with other tobacco products. It also rendered marketing support services to its AEs. The taxpayer had entered into transactions of purchase of cigarettes for resale and provision of marketing support services to its AEs. It had also incurred an operating loss on account of initial years of operation. The taxpayer had benchmarked the transaction of purchase of cigarettes for resale using resale-price method (RPM). The TPO rejected RPM and applied TNMM and rejected the comparable companies selected by the taxpayer since neither of them incurred a net loss in trading transactions like the taxpayer. Furthermore, the TPO also rejected the transfer pricing study report stating that brand royalties being an important feature with regard to the sale of a particular brand of

cigarettes, comparison should be made with the group companies dealing in the same brand of cigarettes i.e. with Marlboro Cigarettes brand and not with companies trading products of other brands. Thus, the TPO proposed an adjustment by comparing operating profit of the group with that of the taxpayer. Aggrieved, the taxpayer appealed before the CIT(A). The taxpayer filed a fresh Transfer Pricing Study Report (TPSR) with additional comparable companies and justified the arm's length nature of international transactions based on which the CIT(A) deleted the adjustment. Aggrieved, the revenue preferred an appeal before the ITAT.

The ITAT in its detailed ruling held/ viewed:

- that fresh TPSR submitted by the taxpayer during the course of appellant proceedings before CIT (A) cannot be relied upon without providing an opportunity of being heard before the TPO since the fresh transfer pricing study adopted by the taxpayer was in favour of the revenue and hence rejected the argument.
- the loss incurred by the taxpayer was obvious on account of initial years of operation and trading being carried out for merely five months.

- the AO's remark of brand loyalty being a vital factor was baseless and inaccurate because the economic and market conditions were not considered while performing the comparability analysis.
- FAR and gross margins of the taxpayer cannot be compared with the group as there were significant differences in the functional profile of the taxpayer as compared to the group. Especially in light of the fact that group companies were into maintaining warehouses, carrying out research and development or manufacturing activities or owning trademarks, etc. Based on the comparison of the functional profile, the comparison with the group is not appropriate.
- The ALP for similar transactions was accepted by the TPO in subsequent assessment years.

Thus, the ITAT upheld the application of RPM as the most appropriate method since the taxpayer was merely functioning as a distributor and the gross margins, as adopted in the fresh TPSR, were at an arm's length after considering the tolerance range of +/-5%.



Global updates on the BEPS project

The 13 countries which have signed an agreement to exchange information automatically for CbC reports under the BEPS project during this quarter are given in table 1¹.

Following are the 13 countries which have adopted/proposed to adopt Country-by-Country (CbC) reporting under the Base Erosion and Profit Shifting (BEPS) project during this quarter.

Table 1

Argentina	Iceland	China
Bermuda	India	Senegal
Canada	Israel	Uruguay
Curacao	Korea	
Georgia	New Zealand	

Table 2

Sr. No.	Name of country	Applicability date of CbC reporting	Threshold limit		Signed multilateral agreement for automatic exchange of CbC reports
1	Belgium	1 January 2016	EUR	750 million	Yes
2	Germany	1 January 2016	EUR	750 million	Yes
3	Canada	1 January 2016	CAD	1 billion	Yes
4	Austria	1 January 2016	EUR	750 million	Yes
5	Norway	1 January 2016	NOK	6.50 billion	Yes
6	India	1 April 2016	INR	53.95 billion	Yes
7	Russia	1 January 2017	RUB	50 billion	No
8	Sweden	1 January 2017	SEK	7 billion	Yes
9	Singapore	1 January 2017	SGD	1125 million	No
10	Switzerland	1 January 2018	CHF	900 million	Yes
11	China	To be notified	CNY	5 billion	Yes
12	Liechtenstein	To be notified	To be notified		Yes
13	US	First day of the taxable year of the ultimate parent entity that begins on or after the date of publication in the Federal Register.	USD		No

¹ List of countries covered in the previous quarter (Jan to March 2016)
http://www.skpgroup.com/data/resource/skp_transfer_pricing_360_january_march_2016_.pdf

OECD's public guidance on CbC reporting

The Organisation for Economic Co-operation and Development (OECD) issued common public guidance for consistent and swift implementation of CbC reporting.

The guidance covers the following issues:

- Transitional filing options for multinational enterprises (parent surrogate filing)
- The application of CbC reporting to investment funds
- The application of CbC reporting to partnerships
- The impact of currency fluctuations on the agreed EUR 750 million filing threshold.

Parent Surrogate filing

OECD introduced parent surrogate filing on voluntary basis to address 'transition' issues arising in case of jurisdictions not able to implement CbC reporting with respect to the fiscal period commencing from 1 January 2016. Parent Surrogate filing would allow the ultimate parent entities of a Multinational Enterprises (MNE) Group resident in their jurisdiction to voluntarily file their CbC report for the fiscal periods commencing on or after 1 January 2016 in their jurisdiction of tax residence. Accordingly, where surrogate filing is available, it will mean that there will be no local filing obligations for that particular MNE in any jurisdiction, subject to a few conditions:

- Ultimate parent entity has filed the CbC report in conformity with Action Plan 13 with the tax authority of its residence;
- By the first filing deadline i.e. 31 December 2017, the jurisdiction of the ultimate parent entity must have its laws in place to require CbC reporting;
- By the first filing deadline, the Qualifying Competent Authority Agreement must be in effect between the jurisdiction of tax residence of the ultimate parent entity and the local jurisdiction;
- There is no systematic failure of intimation by jurisdiction of the ultimate parent entity to the local jurisdiction;
- The tax jurisdiction of the ultimate parent entity and the local jurisdiction are intimated about the parent surrogate filing.

OECD states that the US, Japan and Switzerland, in their respective jurisdiction, have so far confirmed the availability of 'parent surrogate filing' in accordance with the above guidelines with respect to fiscal periods commencing on or after 1 January 2016.

Application of CbC reporting to investment funds and partnerships

The OECD states that there is no general exemption for investment funds. Furthermore, for investment funds and partnerships, the governing principle to determine whether they are a part of an MNE Group is to follow the accounting consolidation rules. Accordingly, if the consolidation principles apply to partnerships and investment funds, then they may be a constituent entity of an MNE group subject to CbC reporting.

Impact of currency fluctuations on the agreed EURO 750 million filing threshold

There is no requirement for a jurisdiction using a threshold denominated other than in Euros to revise this periodically in order to reflect currency fluctuations. The conversion of Euro 750 million to local currency for determining threshold as on January 2015, would hold till Year 2020.

OECD releases standardised electronic format for the exchange of CbC under BEPS

On 22 March 2016, the OECD released its standardised electronic format (XML Schema) as well as the related user guide for the exchange of CbC report between jurisdictions.

According to the release, CbC reports are to be electronically transmitted between the Competent Authorities in accordance with the CbC XML Schema. It will assist tax administrations in obtaining a complete understanding of the way in which MNE's structure their operations. CbC reports will be filed annually which will provide the tax administrations with key information on the global allocation of income and taxes paid, together with other indicators of the economic activity within the group.

OECD releases discussion draft on the development of a multilateral instrument to implement tax-treaty related BEPS measures

On 31 May 2016, the OECD released a discussion draft seeking input on the multilateral instrument to be developed under OECD BEPS Action Plan 15. The main objective of the multilateral instrument is to implement the tax treaty-related BEPS measures by modifying existing bilateral tax treaties in a rational manner. The instrument will include OECD BEPS recommendations on hybrids, treaty abuse, Permanent Establishments (PE) and dispute resolution. Comments are invited on certain technical issues and questions related to the implementation of the treaty-related BEPS measures (though not on the scope or substance of the BEPS outputs), as well as on the development of a provision on mandatory binding arbitration within the Mutual Agreement Procedure (MAP). The timeline for the comments is 30 June 2016. A public consultation is scheduled for 7 July 2016.

A multilateral instrument will implement agreed measures in a reasonably short period while safeguarding the bilateral nature of tax treaties.

US: Introduces CbC Reporting

On 30 June 2016, Internal Revenue Service (IRS) released final regulations on CbC reporting.

CbC report is to be filed along with the income-tax return. CbC reporting applies to US corporations, partnerships and business trusts that have foreign operations. CbC reporting applies to US persons that have a consolidated annual revenue of US \$ 850 million (approximately to EUR 750 million). The CbC report is to be filed with the tax authorities for fiscal year beginning on or after the first day of a taxable year of the ultimate parent entity that begins on or after the date of publishing in the Federal Register. Federal Register should be published on 30 June 2016.

The US intends to enter into competent authority arrangements for the automatic exchange of CbC report with jurisdictions with which the US has an income tax treaty or tax information exchange agreement.

If a foreign tax jurisdiction fails to meet the confidentiality requirements, data safeguards, and appropriate use restrictions set forth in the competent authority arrangement, the US will cease the exchange of all reports with that tax jurisdiction.

US MNE groups, whose ultimate parent entity's taxable year begins before the applicability date, will not have a CbC report filing requirement for the year 2016. The final regulations do not provide a specific waiver of penalties for US MNE groups whose ultimate parent entity's taxable year begins on or after the applicability date. The penalty rules would generally apply, including the reasonable cause relief for failure to file.

Australian CbC reporting implementation – Local file format finalised

The Australian Taxation Office (ATO) has finalised the design of the local file whereby every reporting entity is required to file a report in standardised electronic form within 12 months from the end of the financial year.

The ATO has designed two types of local files:

- A short form local file, which will be applicable to taxpayers having less than USD 2 million related party dealings and who do not undertake international transactions as mentioned in the short form exceptions list;

- A (full) local file, which all other taxpayers in the CbC regime will have to be maintained.

The short form of the local file will require the following information:

- An organisational structure, including the names and role description of individuals in the Australian entity and their reporting hierarchy, etc;
- A description of the organisation's business and strategy;
- Details of business restructuring that occurred in the current year and earlier years;
- Details of intangible transfers in the current year and prior years;
- A list of key competitors.

In addition to above, the full local file will require the following information:

- **Part A** - Details of all inter-company transactions in the year, including the details of transactions, dollar value, country of residence, transfer pricing method relied upon and whether transfer pricing documentation maintained or not.
- **Part B** – For all material transactions, except transactions defined in the exclusion list:
 1. A copy of the underlying agreements;
 2. A copy of the relevant foreign Advance Pricing Agreement (APA) or ruling relevant to the transaction;
 3. The transfer pricing method used by the foreign related party;
 4. The audited financial statements.

Taxpayers who fail to adhere to their tax disclosure will be exposed to stringent penalties.

The ATO has acknowledged that Part A of the above overlaps the requirements of Section A of the International Dealings Schedule of the tax return. Accordingly, to avoid this duplication, an administrative solution is being developed by the ATO whereby taxpayers may choose to voluntarily file Part A of the local file—in place of Section A of the international dealings schedule.

Additionally, the ATO has provided for the following:

- Taxpayers who have entered into an APA would not have to resubmit information/documents submitted at the time of the APA (like agreements, etc).

- Controlled transactions between a reporting entity and its branch are out of the scope of local file.
- An extension on the time limit of filing would be available for the first year by requesting the ATO.

Australia: Amends regulations to incorporate OECD changes

In the 2016 Federal Budget, the implementation of the modified OECD transfer pricing guidelines from 1 July 2016 was announced. These guidelines implement BEPS Action Plan 8-10 i.e. aligning transfer pricing outcomes with the global value chain impacting profit attribution and provides guidance on what are considered to be high risk related party dealings. Furthermore, these modified guidelines are focussed on the economic substance in a global value chain.

Taxpayers with the following intra-group arrangements may be significantly impacted by the regulations from 1 July, 2016, in the following ways:

Risk allocation

Allocation of risk to a group member without actually performing activities merely by way of a contractual agreement will need to be aligned. There should be actual performance of functions and financial ability to bear risks.

Commodity transactions

Will be governed by the commodities pricing guideline which would consider the use of Comparable Uncontrolled Price (CUP) as the most appropriate method and allow publicly quoted prices to be used.

Intellectual property (IP)

- Transfers: In case of a transfer of IP in MNE structures where central IP ownership exist and when used up to five years, the transfer value of the IP needs to be consistent with actual profits attributed to such IPs.
- Attribution of profits: IP related profit entitlement will depend on the activities actually performed and the functions undertaken. It should be consistent with the development, enhancement, maintenance, protection, exploitation (DEMPE) activities.

Other Global Happenings

US: Bilateral APA's with India

The US Treasury Department and the Indian Ministry of Finance issued a joint statement following the conclusion of the Sixth Annual US - India Economic and Financial Partnership (EFP) which stated that the tax authorities of the US and India, have resolved a significant portion of bilateral tax disputes between the two countries. In addition, the governments have started to accept bilateral Advance Pricing Agreement applications by companies in both jurisdictions in order to strengthen the commercial ties.

Ireland – Guidelines for Bilateral APA formalised

On 23 June 2016, the Irish Revenue published eBrief No. 60/16, which contains the guidelines for a formal bilateral APA programme which would be effective from 1 July 2016. Before this, Ireland accepted requests for bilateral APA's on an ad hoc basis with treaty partners when invited to do so by the other country. This programme has been introduced in response to Action Plan 14 of the BEPS initiative.

This programme would apply to APA applications made to the Irish Revenue on or after 1 July 2016 by a company which is a tax-resident in Ireland for the purpose of the relevant double tax treaty and or by a PE in Ireland of a non-resident company in accordance with the provisions of the relevant treaty.

According to the guidelines, an application may be made by a taxpayer for an APA to the Irish Revenue in respect of the following two types of transactions:

- transactions between separate business enterprises; or
- transactions between parts of the same business enterprise operating in different countries (e.g. between a head office and a PE or between two separate PEs), subject to the provisions of the relevant double tax treaty.

A pre-requisite to a bilateral APA application is that there must be a double tax treaty in place in order to consider a bilateral APA application.

The bilateral APA programme is intended for transaction(s) where the transfer pricing issues involved are

complex or where there is a high likelihood of double tax arising. Some of the cases that may be covered in an APA include:

- doubts on the applicable transfer pricing methodology;
- bespoke and/or complex transfer pricing methodologies; and
- absence of reliable comparables/significant or complex adjustments required.

The terms that will typically be agreed on as part of a bilateral APA process include the nature of the covered transaction, term of the APA (including rollback), transfer pricing methodology, compensating adjustments, critical assumptions and annual reporting requirements.

The APA process shall comprise of the following five phases:

- Pre-filing (or pre-application);
- Formal APA application;
- Evaluation of APA application and negotiation;
- Formal agreement; and
- Annual reporting.

APA's will be granted for a fixed term, usually three to five years, and may be revoked, revised or renewed. Information contained in an APA shall be treated as confidential by the tax authorities. There would also be no fees payable to the Irish Revenue for the application made.

Where the transfer pricing issues involve more than two tax jurisdictions, of which Ireland is one, the Irish Revenue will effectively conclude a multilateral APA (via a series of Bilateral APA's) by conducting multilateral meetings with other tax administrations, subject to the terms of the relevant double tax treaties. The programme, however, does not cover unilateral APA's.

Greece - Transfer pricing obligations of acquiring company in case of merger

The Public Revenue Authority of Greece published a document on 2 June 2016 which provides clarifications with respect to the transfer pricing obligations of the acquiring company in the case of a merger. The following are the clarifications:

- In the case of a merger, the acquiring company is responsible for the submission of the relevant transfer pricing documentation with respect to transactions that have taken place after the

preparation of the merger balance sheet and the final registration of the merger decision in the Business Register – Geniko Emboriko Mitroo (General Electronic Commercial Registry);

- Only transactions of the acquired company with its related companies fall under the transfer pricing obligation and not the transactions of the acquired company with the acquiring one; and
- The acquiring company is required to submit the transfer pricing documentation within four months from the preparation of the merger balance sheet.

Belarus: Updates in the transfer pricing regulation

Belarusian Tax Code introduced more detailed and stricter transfer pricing rules, with effect from 1 January 2016. Although these changes are aimed to align the Belarusian transfer pricing regulation with the OECD transfer pricing guidelines, many changes impose more restrictive rules on taxpayers. The amendments are as under:

Controlled transactions

Initially, the transfer pricing regulations were applicable to transactions involving goods, works and services. The amended regulations also include the transactions involving intellectual property, leases and loans.

Real estate transactions

Initially, the transfer pricing rules were applicable to transactions involving only the sale of real estate and not to the purchase of real estate or sale/purchase of housing bonds. The amended regulations also include the purchase of real estate and the sale/purchase of housing bonds if the transaction price deviates by 20 % or more from the market price. Furthermore, it also states that, the entities entering into the transaction should be under common control.

Cross-border transactions

The transactions list as per the amended regulations is shortened and it includes:

- Transactions with related non-residents where the transaction value exceeds BYR 1 billion (approximately EUR 49,000 as on 1 January 2016);
- Transactions with non-residents registered in low tax jurisdiction where the transaction value exceeds BYR 1 billion;
- Transactions exceeding BYR 1 billion with the above two, if independent intermediaries with no substantial functions are involved;
- Transactions involving strategic goods if the transaction value exceeds BYR 10 billion;
- Transactions by large taxpayers provided the transaction value exceeds BYR 10 billion.

Transactions within Belarus

Initially, the domestic transactions were not covered within the scope of transfer pricing rules. However, from 2016 the transactions between related parties are considered controlled if the entity entering into a related party transaction has a corporate income tax exemption which:

- Falls under certain categories of taxpayers which are not subject to corporate income tax or
- Applies specific taxation regimes (eg. unified tax regime) or
- Operates in the specified territories like free economic zones, high technology park, etc.

Also, the above would be applicable to transactions involving independent intermediaries (agents, etc.) with no substantial functions. The threshold for the domestic transactions is BYR 1 billion.

Amendment in the definition of related parties

According to the new rules, in the following instances the companies shall be considered as related parties:

- A party has direct/indirect participating interest of at least 20% in other entities;
- At least 50% of the executive bodies or board of directors of the two entities are same individuals.

Transfer pricing documentation

Earlier, the maintenance of the documentation report was not mandatory. However, amended regulations require taxpayers to

prepare the documentation report. Furthermore, the taxpayers are required to maintain and file the following:

- Documentation report for controlled transactions over BYR 10 billion;
- For real estate transactions and foreign/domestic transactions over BYR 1 billion: Economic justification of the applied price; and
- Notifying the tax authorities of each transaction by sending electronic invoices with specific information prescribed

Also, the taxpayers are required to provide the necessary documents during desk and field tax audits within 5/10 working days.

Transfer pricing methods

The amended regulations introduced the profit split method which will be applied in accordance with the OECD guidelines.

Extension in the rights of tax authorities

The tax authorities have the right to obtain all the necessary information required to determine the comparability of commercial and financial conditions from all the sources including the state authorities.

Australia: Transfer pricing adjustments with customs implications

The ATO released a Practice Statement (PS LA 2016/1) on 14 April 2016 that deals with transfer pricing adjustments with potential customs implications. The statement provides guidance to the ATO staff when making transfer pricing adjustments in cases where a taxpayer purchases imported goods on which customs duty has been levied.

The objective of the guidance is to provide relief to the taxpayers in cases where the ATO makes a transfer pricing adjustment and does not attribute the adjustment to individual components of purchases, in which case, taxpayers experience difficulties in obtaining refund/determine additional liability of custom duty.

The guidance provides that where a transfer pricing adjustment is made by the ATO in respect of imported goods, the affected taxpayer may request assistance from the ATO in determining a revised amount of customs value of duty paid on the import of the goods. When the

taxpayer makes such a request, the ATO will check and confirm whether it has sufficient and appropriate documentation to identify the component of transfer pricing benefit related to the imported purchases, or may even request for further information. On providing sufficient documentation, it would allow the ATO to populate an adjustment table that would attribute the transfer pricing adjustment to the appropriate cross-border transactions. Accordingly, the taxpayer can then approach the Australian Border Force with the relevant documentation along with any adjustment table to claim a refund or pay the additional duty.

World Custom Organisation: Customs Authorities placing reliance on transfer pricing documentation

The World Custom Organisation (WCO) released an important new agreement on transfer pricing and customs valuation. In the release it states that over the years, the World Trade Organisation (WTO)'s valuation agreement sets out various methods for establishing the customs value used as the basis for calculating customs duties. It also states that customs authorities examine transactions between related parties when they are of the opinion that the price has been influenced owing to the close connection between the related parties.

The WCO confirmed the fact that over the years for similar objectives different methods have been followed for transfer pricing and customs valuation and thus, transfer pricing business documentation may contain useful information for customs administration. The release provides a case study wherein custom officials make use of the transfer pricing information based on the transactional net margin method, on the basis of which the customs officials accept the sale price as not being influenced by the relationship. Both the WCO and the OECD recommend closer co-operation between custom and tax administrations in order to identify the correct tax and duties legally due and enhance trade facilitation for the compliant business sector.

Hong Kong – Joins as an Associate to the framework for the implementation of measures against BEPS

On 20 June 2016, the Hong Kong Government announced that it will join the inclusive framework for the implementation of the package of measures against (BEPS) as an associate, along with the OECD and other G20 countries. This shall include implementing minimum standards – Action Plan 5, Action Plan 6, Action Plan 13 and Action Plan 14.

It was announced by the Hong Kong Financial Services and the Treasury Bureau that by joining the BEPS implementation package, the legislative amendments would be carried out in a phased/timely manner. Also, for the purpose of arriving at the time/stage for making such amendments, the government would consult the industry.

Singapore – Joins as an Associate to the framework for implementation of measures against BEPS

On 16 June 2016, the Singapore Government announced that it would join the inclusive framework for the global implementation of the package of measures against BEPS along with OECD and G20 countries.

Clarity pertaining to the issue of guidelines or changes to be brought by the Singapore Government for making these measures effective is awaited.

Winner of India Tax Firm of the Year at Asia Tax Awards 2016

We are extremely proud to announce that SKP has won 'India Tax Firm of the Year' at the International Tax Review's Asia Tax Awards, 2016. We are honoured to have our efforts recognised by International Tax Review, one of the world's leading publications on cross-border tax, providing international news and updates, surveys and interviews with leading tax executives and officials around the world.

About SKP

SKP is a long established and rapidly growing professional services group located in seven major cities across India. We specialise in providing sound business and tax guidance and accounting services to international companies that are currently conducting or initiating business in India as well as those expanding overseas. We serve over 1,200 active clients including multinationals, companies listed on exchanges, privately held and family-owned businesses from 50 countries.

From consulting on entry strategies to implementing business set-up and M&A transactional support, the SKP team assists clients with assurance, domestic and international tax, transfer pricing, corporate services, and finance and accounting outsourcing matters, all under one roof. Our team is dedicated to ensuring clients receive continuity of support, right across the business lifecycle.

Our Offices

Mumbai

19, Adi Marzban Path
Ballard Estate, Fort
Mumbai 400 001
T: +91 22 6730 9000

New Delhi

B-376
Nirman Vihar
New Delhi 110 092
T: +91 11 4252 8800

Bengaluru

312/313, Barton Centre
Mahatma Gandhi Road
Bengaluru 560 001
T: +91 80 4277 7800

Pune

VEN Business Centre
Baner-Pashan Link Road
Pune 411 021
T: +91 20 6720 3800

Gurgaon

German Centre for Industry and Trade
Building No. 9, Tower B
Level 12, DLF Cyber City Phase III
Gurgaon 122 002
T: +91 124 463 6000

Canada

269 The East Mall
Toronto
ON M9B 3Z1
Canada
T: +1 647 707 5066

Hyderabad

6-3-249/3/1 SSK Building
Ranga Raju Lane
Road No. 1, Banjara Hills
Hyderabad 500 034
T: +91 40 2325 1800

Chennai

3, Crown Court
128 Cathedral Road
Chennai 600 086
T: +91 44 4208 0337

www.skpgroup.com

Connect with us



skp.tp360@skpgroup.com



www.linkedin.com/company/skp-group



www.twitter.com/SKPGroup



www.facebook.com/SKPGroupIndia



plus.google.com/+SKPGroup

Subscribe to our alerts



DISCLAIMER

This newsletter contains general information which is provided on an "as is" basis without warranties of any kind, express or implied and is not intended to address any particular situation. The information contained herein may not be comprehensive and should not be construed as specific advice or opinion. This newsletter should not be substituted for any professional advice or service, and it should not be acted or relied upon or used as a basis for any decision or action that may affect you or your business. It is also expressly clarified that this newsletter is not intended to be a form of solicitation or invitation or advertisement to create any adviser-client relationship.

Whilst every effort has been made to ensure the accuracy of the information contained in this newsletter, the same cannot be guaranteed. We accept no liability or responsibility to any person for any loss or damage incurred by relying on the information contained in this newsletter.

SKP Business Consulting LLP is a member firm of the "Nexia International" network. Nexia International Limited does not deliver services in its own name or otherwise. Nexia International Limited and the member firms of the Nexia International network (including those members which trade under a name which includes the word NEXIA) are not part of a worldwide partnership. For the full Nexia International disclaimer, please [click here](#).