

Transfer Pricing

CA Prerna Peshori

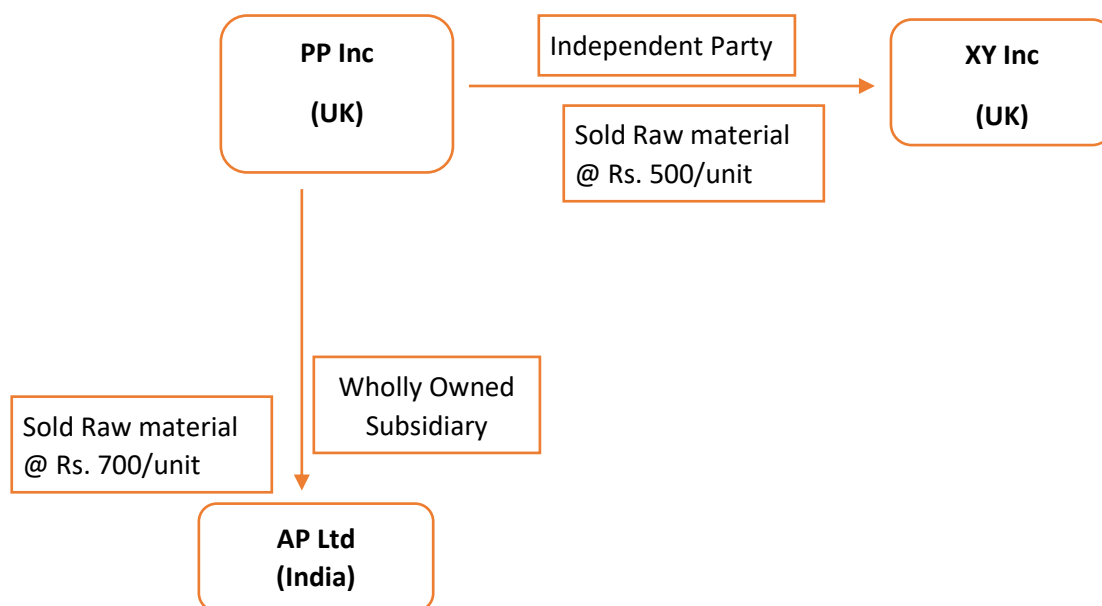
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1. What is Transfer Pricing?



PP Inc is trying to sell to AP Ltd. at a price higher than what it is charging to an independent party. Accordingly, it can claim deduction of higher expense in India, where tax rate is high (30%) and shift the profits to UK, where tax rate is low (15%). This is known as **BASE EROSION & PROFIT SHIFTING (BEPS)**. In this case, India will not allow deduction of Rs. 700 & restrict deduction to Rs. 500 (as Rs. 500 will be the Arm's Length Price).

The Finance Act, 2001 introduced Transfer Pricing Regulations for curbing tax avoidance and manipulation of intra-group transactions by abusing transfer pricing. Specifically, the memorandum to the Finance Act, 2001 stated that:

"The increasing participation of multinational groups in economic activities in the country has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, thereby, leading to erosion of tax revenues. With a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises, new provisions are proposed to be introduced in the Income-tax Act."

Transfer pricing as a concept traditionally began with the amount charged by one segment of an enterprise for a product or service that it supplied to another segment of the same enterprise. With the evolution of MNC concept, segments of the enterprise started spreading as independent entities operating in various parts of the globe. Accordingly, the term has evolved to mean **price which is charged between two or more entities of a MNC [associated enterprises (AEs)] operating in different countries**. Two enterprises are "associated enterprises" if one of the enterprises participates directly or indirectly in the management, control or capital of the other or if both enterprises are under common control. Today, transfer pricing is one of the most important issues

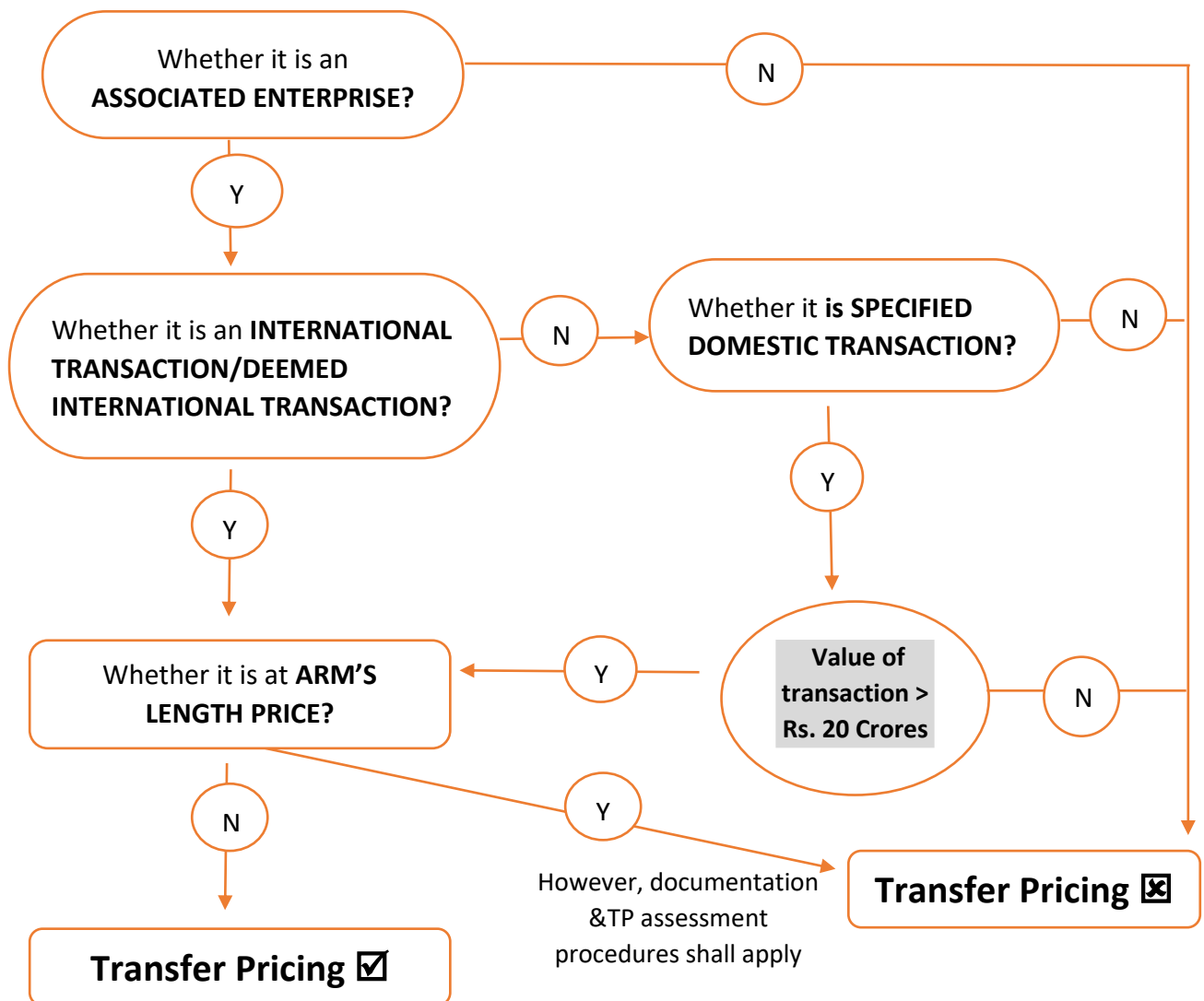
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faced by MNCs as they attempt to fairly distribute their profits amongst the companies within the group. While on the other hand, the tax authorities implement transfer pricing regulations and strengthen the enforcement in order to prevent a loss of revenue for each regime where these companies are incorporated. By structuring transactions in a way which is most beneficial to the MNC from a tax perspective, the MNC is basically able to steer and manage where it books its profits and therefore also can influence actively the tax burden.

This, the tax administrators believe is unjust. Thus, to protect each country's fair share in an MNC's total profit, the tax authorities have established principles under which it can be assumed that related parties deal with each other as if they were independent and this principle is called the arm's length principle.

2. Conditions for applicability of transfer pricing [Section 92]



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Section 92: APPLICABILITY OF TRANSFER PRICING

Section 92(1):

- Income
- Allowance for Expense
- Interest

From an **INTERNATIONAL TRANSACTION**

Section 92(2):

- In case of **INTERNATIONAL TRANSACTION + SPECIFIED DOMESTIC TRANSACTION**
- where 2 or more **ASSOCIATED ENTERPRISES** enter into a mutual agreement or arrangement
- for the **ALLOCATION/ APPORTIONMENT OF/ CONTRIBUTION TO ANY COST OR EXPENSE INCURRED**
- in connection with a benefit, service or facility provided to any one or more of such enterprises

Section 92(2A):

- Income
- Allowance of Expense
- Allocation of cost or expense
- Interest

From **SPECIFIED DOMESTIC TRANSACTION**

Shall be computed having regard to **ARM'S LENGTH PRICE**

Section 92(3): Non-applicability of TP Provisions

TP provisions **shall not apply** in case where the adoption of Arm's Length Price (ALP) shall result in:

- **Decrease in the overall Taxable Income**
- **Increase in the Loss**

It is pertinent to note that the TP provisions are intended to avoid erosion of tax base in India through claiming of expenses and losses. However, in case, where by applying ALP, there is reduction in taxable income or increase in loss, TP provisions shall not apply. **It is pertinent to note that transfer pricing adjustment cannot be made while computing book profits under MAT u/s 115JB.**

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3. Associated Enterprise [Section 92A]

A. Section 92A(1):

An **ENTERPRISE** which participates **DIRECTLY OR INDIRECTLY** or through intermediaries in:

- Management
- Control
- Capital of other enterprise.

Enterprise means person engaged in activity relating to production, supply etc. of goods, know-how, patents etc. of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights/provision of service/carrying out work/investment/loan/ business of dealing in shares etc. **Enterprise includes the term Permanent Establishment. the term "Permanent establishment" is defined in section 92F(iiiia) to include a fixed place of business through which the business of the enterprise is wholly or partly carried on.**

B. Section 92A(2):

Provides for **12 situations**, on which enterprise shall be **deemed to be associated enterprises**. Thus, Section 92A(1) is a general category with broad definition, whereas Section 92A(2), provides when enterprise shall be deemed to be associated enterprise.

It is pertinent to note that the following relationship may exist **AT ANY TIME** during the previous year:

CAPITAL BASED RELATIONSHIPS	CONTROL BASED RELATIONSHIPS	MANAGEMENT BASED RELATIONSHIPS
<p>1. ENTERPRISE OWNERSHIP:</p> <p>Any enterprise having direct or indirect ownership in shares having $\geq 26\%$ of voting power. (since the term voting power is used, preference shareholders are not covered).</p> <p>Eg.</p> <div style="display: flex; align-items: center; gap: 20px;"> <div style="border: 1px solid black; padding: 5px; text-align: center;">X US</div> <div style="font-size: 24px;">→</div> <div style="font-size: 18px;">43% stake</div> <div style="font-size: 24px;">→</div> <div style="border: 1px solid black; padding: 5px; text-align: center;">X INDIA</div> </div> <p>∴ X US & X India are AE</p>	<p>5. GUARANTOR FOR BORROWINGS:</p> <p>An enterprise guarantees $\geq 10\%$ of the total borrowings of the other enterprise.</p> <p>Eg.</p> <div style="display: flex; flex-direction: column; align-items: center; gap: 10px;"> <div style="display: flex; align-items: center; gap: 20px;"> <div style="border: 1px solid black; padding: 5px;">PP Inc</div> <div style="font-size: 24px;">→</div> <div style="border: 1px solid black; padding: 5px;">AP</div> </div> <div style="text-align: center;">Guarantee of Rs. 150 Lakhs</div> <div style="display: flex; align-items: center; gap: 20px;"> <div style="border: 1px solid black; padding: 5px;">AP</div> <div style="font-size: 24px;">↓</div> <div style="font-size: 18px;">Loan of Rs. 1000</div> <div style="border: 1px solid black; padding: 5px;">SBI</div> </div> <div style="border: 1px solid black; padding: 5px; margin-top: 10px;">AP and PP are AE as guarantee $\geq 10\%$ of total borrowings.</div> </div>	<p>11. APPOINTMENT OF BOARD:</p> <p>If one enterprise has following powers in relation to other enterprise:</p> <ol style="list-style-type: none"> appoints > HALF of BoD members; or appoint 1 or more Executive Director <p>Eg: PP Ltd. has a board composition of 7 directors including 2 executive directors. AP Inc is holding only 4%. However, AP Inc. has the right to appoint 4 directors in the Board of PP Ltd. PP Plc holds only 3%. PP Plc has the right to appoint 1 executive director in the Board.</p>

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CAPITAL BASED RELATIONSHIPS	CONTROL BASED RELATIONSHIPS	MANAGEMENT BASED RELATIONSHIPS		
		Both AP Inc. & PP Plc would be regarded as AE of PP Ltd.		
<p>2. MUTUAL HOLDING:</p> <p>Any person has direct or indirect ownership of shares having ≥ 26% of voting power, in two or more enterprises.</p> <p>Eg:</p> <div style="text-align: center;"> <pre> graph TD A[A PLC] -- 28% --> X[X Ltd.] A -- 31% --> Y[Y Ltd.] X --- B[] Y --- B B --- C[∴ Deemed AE] </pre> </div>	<p>6. DEPENDENCY ON INTANGIBLES:</p> <p>a) An enterprise which is wholly dependent for its business on the use of intangible assets like patents, copyrights, etc.</p> <p>b) Such intangible asset is <u>owned</u> by <u>another enterprise</u> or the other enterprise has exclusive right to use or exploit the intangible asset</p> <p>Eg. Fast Foods India has exclusive franchisee of Pizza Hut US and would obtain brand name, knowhow and support from Pizza Hut US. Fast Foods does not have any other business and is entirely dependent on Pizza Hut. Both the enterprises would be regarded as AE.</p>	<p>12. APPOINTMENT OF BOARD IN TWO OR MORE ENTITIES:</p> <p>Where a person has the following powers with respect to two or more enterprises:</p> <p>a) appoints > HALF of BoD members; or b) appoint 1 or more Executive Director</p> <p>Eg. Mr. Mukesh Ambani, has the power to appoint 70% of the Board of Directors of RIL & RPL. Both RIL & RPL shall be AE.</p>		
<p>3. SUBSTANTIAL LENDER:</p> <p>Loan advanced by an enterprise constitutes ≥ 51% of the BOOK VALUE of the ASSETS of the borrower.</p> <p>Eg.</p> <p>Balance Sheet of PP Ltd.</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%; text-align: center;">Liabilities</td> <td style="width: 50%; text-align: center;">Assets</td> </tr> </table>	Liabilities	Assets	<p>7. SUPPLY DEPENDENCY:</p> <p>One enterprise is engaged in manufacturing or processing of goods/articles and ≥ 90% of the raw materials or consumables:</p> <p>a) Are supplied by the other enterprise, or b) Are supplied by persons specified by the other enterprise,</p> <p style="text-align: center;">AND</p>	
Liabilities	Assets			


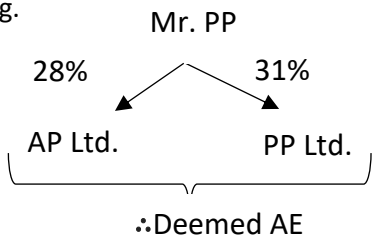

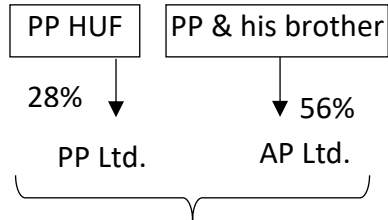
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CAPITAL BASED RELATIONSHIPS	CONTROL BASED RELATIONSHIPS	MANAGEMENT BASED RELATIONSHIPS			
<table border="1" data-bbox="161 398 552 539"> <tr> <td>Loan from AP Inc = Rs. 100 crores</td> <td>Total assets Rs. 150 crores</td> </tr> </table> <p>Since, loan from AP Inc \geq 51% than book value of assets of PP Ltd. AP Inc. & PP Ltd. are AE.</p>	Loan from AP Inc = Rs. 100 crores	Total assets Rs. 150 crores	<p>c) Prices and other conditions of supply are specified by the other enterprise. Eg. BPCL India is an oil marketing company. The company predominantly deals with Shell Petroleum of Dubai. Shell Dubai supplies almost 100% of the crude oil required by BPCL either directly or from its subsidiaries in India. Both Shell and BPCL shall be considered as AE.</p>		
Loan from AP Inc = Rs. 100 crores	Total assets Rs. 150 crores				
<p>4. MINORITY HOLDING IN A FIRM, AOP/BOI:</p> <p>Enterprise holds \geq 10% interest in a Firm, AOP/BOI.</p> <p>Eg.</p> <div data-bbox="153 1182 560 1339" style="border: 1px solid black; padding: 5px; margin: 10px 0;"> <p style="text-align: center;">12% stake</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="border: 1px solid black; padding: 5px; text-align: center;">X Ltd</td> <td style="text-align: center; padding: 0 10px;">→</td> <td style="border: 1px solid black; padding: 5px; text-align: center;">Y partnership firm</td> </tr> </table> </div> <p>∴ X Ltd. and Y are AE.</p>	X Ltd	→	Y partnership firm	<p>8. SALE DEPENDENCY:</p> <p>Where one enterprise is engaged in manufacturing or processing of goods/articles and such goods/articles:</p> <p>a) Are sold to the other enterprise, or</p> <p>b) Are sold to persons specified by the other enterprise;</p> <p style="text-align: center;">AND</p> <p>c) Prices & other Conditions of Sale are specified by the other Enterprise.</p> <p>Eg: PP Inc has entered into an agreement with AP Ltd to manufacture chemicals. PP Inc does not work for any other company. The entire produce is sold to AP Ltd. Both PP Inc. & AP Ltd. are AE.</p>	
X Ltd	→	Y partnership firm			

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CAPITAL BASED RELATIONSHIPS	CONTROL BASED RELATIONSHIPS	MANAGEMENT BASED RELATIONSHIPS
	<p>9. INDIVIDUAL – CONTROL:</p> <p>When same INDIVIDUAL/HIS RELATIVE CONTROLS  TWO ENTERPRISES</p> <p>Eg.</p> 	
	<p>10. HUF-CONTROL:</p> <p>Where one enterprise is CONTROLLED  BY A HUF, the other enterprise is CONTROLLED BY A MEMBER OF SUCH HUF OR BY A RELATIVE of a member.</p> <p>Eg.</p> 	

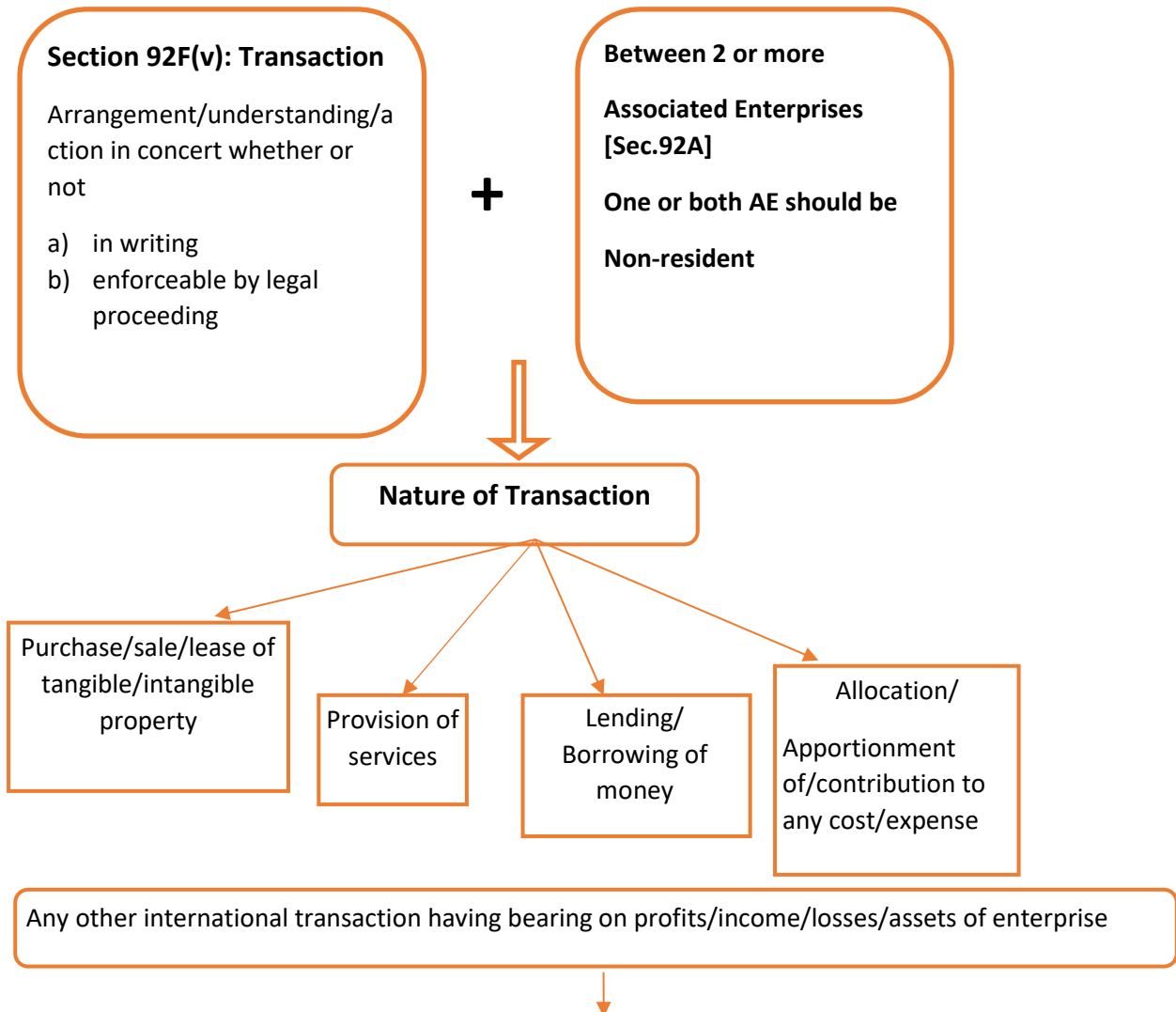
 “Control” means that an individual, either himself or along with his relatives has the power to make major decisions regarding the management of both the enterprises.

“Relative” u/s 2(41): means spouse, brother, sister or any lineal ascendant or descendant of that individual.

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4. International Transaction and Deemed International Transaction [Section 92B]



International Transaction shall include:

- Capital financing, borrowing, guarantee, sale/purchase of marketable securities/receivable & advances/ debt arising in course of business
- Transaction of business restructuring or reorganization entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date.**

Understanding the provision:

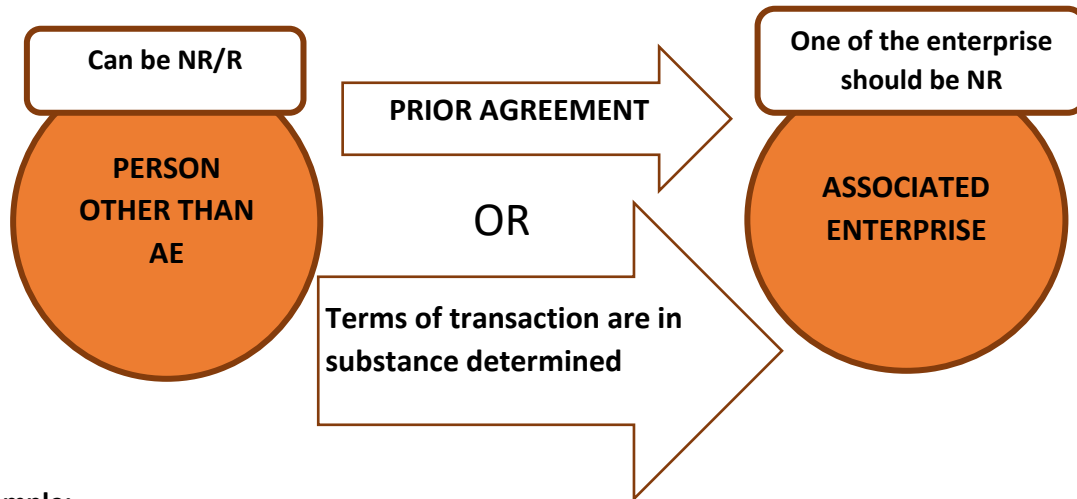
The transaction between two AE's (one or both of them should be non-resident), if relating to say purchase of goods, would get covered under the definition of international transaction. **TRANSACTION BETWEEN FOREIGN HEAD OFFICE AND INDIAN BRANCH OR PERMANENT ESTABLISHMENT SHALL BE INTERNATIONAL TRANSACTION.**

Further, if a transaction has effect on profits/losses/assets of enterprise, such transaction shall be classified under international transaction. **However, it is pertinent to note that business restructuring transaction would get classified as international transaction even if does not have any bearing on profits/losses/assets of enterprise.**

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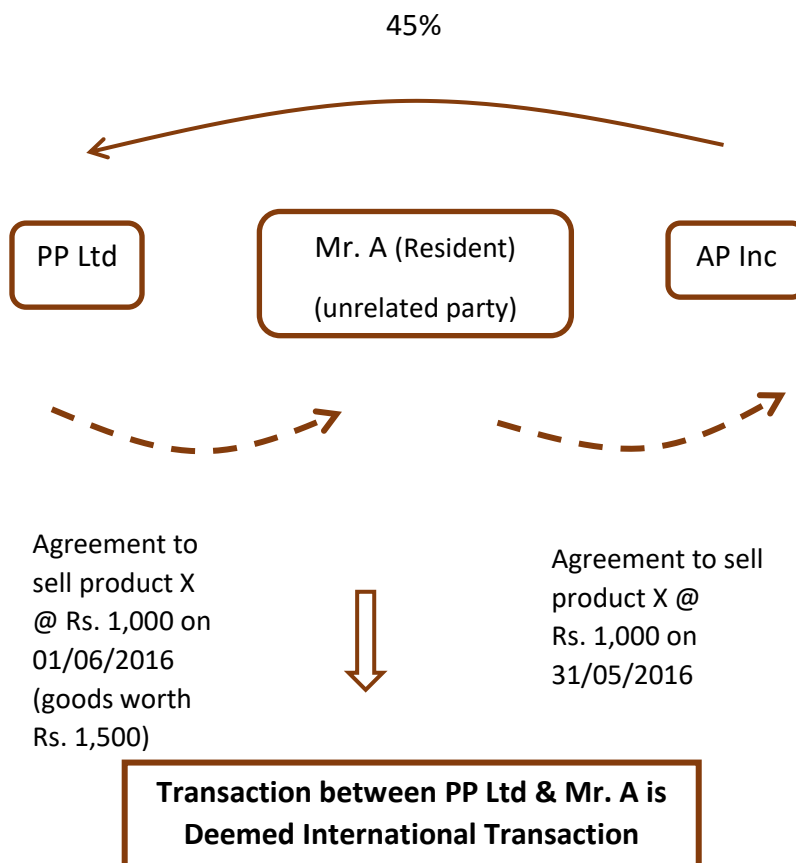
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Section 92B: Deemed International Transaction



Example:

If PP Ltd, an Indian company, has entered into an agreement for sale of product X to Mr. A (resident) an unrelated party @ Rs. 1,000 (goods worth Rs. 1,500) on 1st June, 2016 and Mr. A has entered into agreement with AP Inc, a non-resident for sale of product X @ Rs. 1,000 on 31st May, 2016. AP Inc holds 45% in PP Ltd.



If a prior agreement is entered between unrelated enterprise (say A) and AE (say B) to say sell the goods to B by making purchases from other AE (say C), then the transaction shall be deemed to be international transaction between A & C. It does not matter whether or not unrelated entity (A) is resident or non-resident. However, B/C/both should be non-resident.

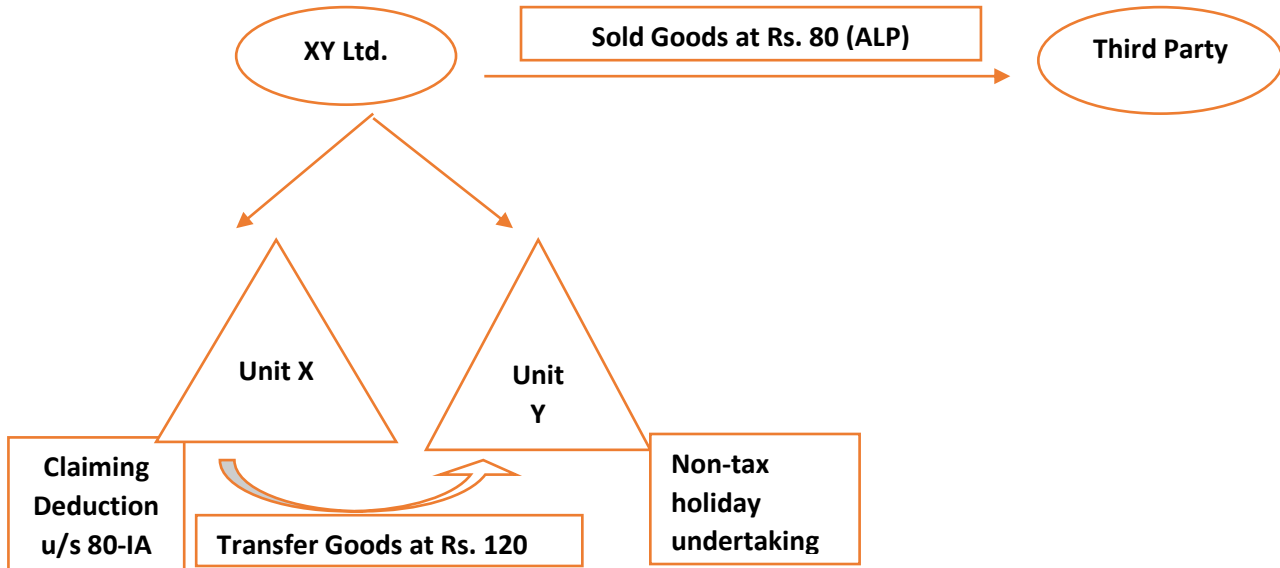
A prior agreement was entered between Mr. A & AP Inc (i.e. on 31/05/2016) to purchase goods from PP Ltd and sell to AP Inc. Accordingly, **transaction between PP Ltd & Mr. A would be deemed to be International transaction.**

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5. Specified Domestic Transaction [Section 92BA]

Intent behind Specified Domestic Transaction (SDT):

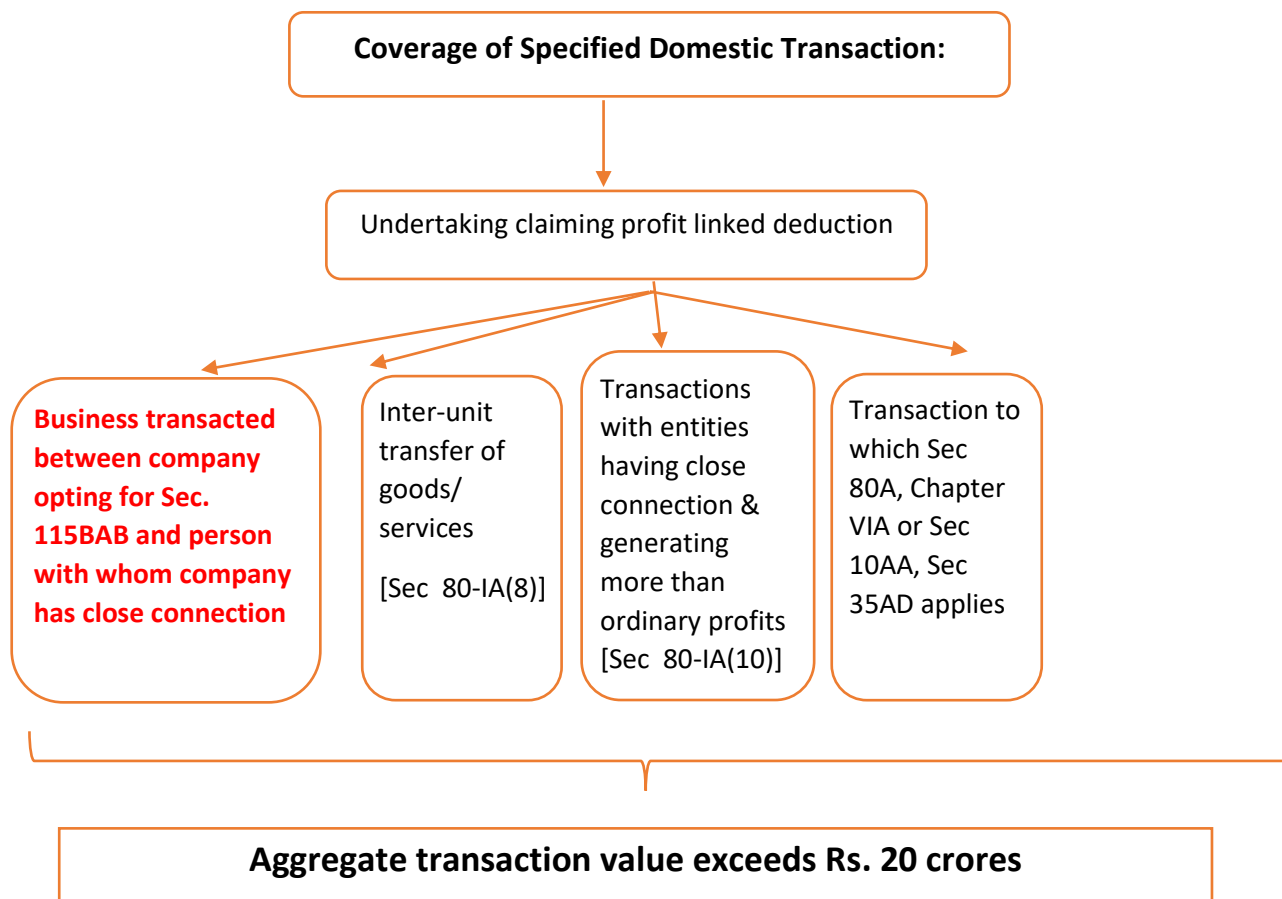


Particulars	Unit X (Tax Holiday Undertaking)	Unit Y (Non-tax Holiday Undertaking)
Income (other than related party)	100	250
Related party income	120	-
Less: Expense other than related party	(50)	(60)
Less: Related Party Expense	-	(120)
Profit/Loss	170	70
Tax Rate	0%	30%
Tax Payable	Nil	21

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It can be seen that the profits are shifted from a non-tax holiday undertaking to undertaking claiming deductions. To prevent this avoidance of tax, specified domestic transactions have been brought into scope of Transfer Pricing.



Accordingly, it can be seen that provisions of specified domestic transaction applies to:

- Section 80-IA(8): Any transfer of goods/services between various undertakings/units of the assessee.
- Section 80-IA(10): Transactions with entities having close connection & generating more than ordinary profits
- Entities claiming deductions u/s 10AA, 35AD.
- **Business transacted between company opting for Sec. 115BAB and person with whom company has close connection**

All such transactions are required to be at ARM'S LENGTH PRICE.

It is pertinent to note that transfer pricing adjustment to SDT is not required if it has the effect of increasing the loss or reducing the income. As transfer pricing mechanism is for preventing avoidance of tax and in such cases there is no avoidance of tax. In fact in such cases, a higher price is being offered to tax.

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The provisions of computation of ALP of international transaction shall mutatis mutandis apply to specified domestic transaction.

6. Computation of Arm's Length Price (ALP) [Section 92C and Rule 10B]

WHY ALP?

As per section 92(1), the income from international transaction shall be computed **HAVING REGARD TO ARM'S LENGTH PRICE**

HOW TO COMPUTE ALP?

As per section 92C, ALP shall be determined by:

- a) CUP Method
- b) RPM
- c) CPM
- d) TNMM
- e) PSM

WHAT IS ALP?

As per section 92F(ii), **a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions.**

METHOD	STEPS IN COMPUTATION	ILLUSTRATION	APPLICABILITY				
COMPARABLE UNCONTROLLED PRICE (CUP) METHOD	<p>① Identify the price charged for similar goods/services provided in comparable uncontrolled transaction</p> <p>② Adjust Price in ① for following:</p> <ul style="list-style-type: none"> • Quantity discount • Insurance charges • Freight cost • Warranty charges etc <p>③ ALP = ①(+)/(-)②</p>	<p>PP Ltd. supplies 50,000 engines to its holding company PP Inc @ Rs. 3,000 per engine. It also supplies 15,000 engines to XY Ltd. (unrelated party) @ Rs. 4,000 per engine. The company claims to give a volume discount of 10% for the bulk purchase by the parent company.</p> <table border="1" style="width: 100%;"> <tr> <td>Sale price per engine to XY Ltd</td> <td>Rs. 4,000</td> </tr> <tr> <td>Less: Volume Discount @ 10%</td> <td>Rs. 400 (Note)</td> </tr> </table> <p>Note: ∵ Discount is offered to parent, adjustment is required to arrive at ALP.</p>	Sale price per engine to XY Ltd	Rs. 4,000	Less: Volume Discount @ 10%	Rs. 400 (Note)	<ul style="list-style-type: none"> • Transfer of goods • Provision of services • Financial transactions like loans etc. • Transfer of intangible assets
Sale price per engine to XY Ltd	Rs. 4,000						
Less: Volume Discount @ 10%	Rs. 400 (Note)						

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METHOD	STEPS IN COMPUTATION	ILLUSTRATION	APPLICABILITY																				
		<table border="1"> <tr> <td>ALP</td> <td>Rs. 3,600</td> </tr> <tr> <td>Less : Price charged to PP Inc.</td> <td>Rs. 3,000</td> </tr> <tr> <td>Additional price</td> <td>Rs. 600</td> </tr> </table>	ALP	Rs. 3,600	Less : Price charged to PP Inc.	Rs. 3,000	Additional price	Rs. 600															
ALP	Rs. 3,600																						
Less : Price charged to PP Inc.	Rs. 3,000																						
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RESALE PRICE METHOD (RPM)	<p>① Identify property purchased or services obtained by the enterprise from an AE</p> <p>② Identify price at which such property/services is resold or are provided to an unrelated enterprise</p> <p>③ Deduct normal GP margin earned from uncontrolled transaction from ②</p> <p>④ Reduce the expenses incurred in connection with purchase of property or obtaining services</p> <p>⑤ Adjust for various factors like Qty disc/Insurance/Freight</p> <p>⑥ ALP = ② - ③ - ④ + / - ⑤</p>	<p>PP Ltd. imports Ford cars @ Rs. 12 Lakhs from its parent PP Inc for sale in India. PP Ltd resells the imported car in India @ Rs. 13.5 Lakhs and incurs expense of Rs. 1.2 Lakhs on import. XY Ltd. an Indian unrelated party, imports similar cars (Hyundai) @ Rs. 11.5 Lakhs and sells at Rs. 14 Lakhs.</p> <table border="1"> <tr> <td>Sale Price of Hyundai</td> <td>14</td> </tr> <tr> <td>Purchase Price of Hyundai</td> <td>11.5</td> </tr> <tr> <td>Gross Margin</td> <td>2.5</td> </tr> <tr> <td>Gross Margin Ratio (2.5/14)</td> <td>18%</td> </tr> <tr> <td>Sale Price of Ford</td> <td>13.5</td> </tr> <tr> <td>Gross Margin @ 18%</td> <td>2.43</td> </tr> <tr> <td>Expense on Purchase</td> <td>1.2</td> </tr> <tr> <td>Arm's length purchase price (A)</td> <td>9.87 (13.5 - 2.43 - 1.2)</td> </tr> <tr> <td>Actual Purchase Price (B)</td> <td>12</td> </tr> <tr> <td>Additional Income (B - A) per car</td> <td>2.13</td> </tr> </table>	Sale Price of Hyundai	14	Purchase Price of Hyundai	11.5	Gross Margin	2.5	Gross Margin Ratio (2.5/14)	18%	Sale Price of Ford	13.5	Gross Margin @ 18%	2.43	Expense on Purchase	1.2	Arm's length purchase price (A)	9.87 (13.5 - 2.43 - 1.2)	Actual Purchase Price (B)	12	Additional Income (B - A) per car	2.13	Distribution & Resale of goods/services
Sale Price of Hyundai	14																						
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COST PLUS METHOD (CPM)	<p>① Determine the total direct & indirect costs of production of goods/services</p> <p>② Determine normal gross profit mark-up to such costs in comparable uncontrolled transaction</p>	<p>PP Ltd. provides support services to its parent AP Inc @ USD 25/hr. PP Ltd. also provides similar service to XY Ltd. an unrelated party @ USD 36/hr. PP Inc makes immediate payment while credit period is allowed to XY Ltd of 45 days. The total direct & indirect cost of PP Ltd. is USD 15/hr and it incurs finance charges</p>	<ul style="list-style-type: none"> • Provision of services • Joint facility management • Transfer of semi-finished goods • Long term buying & 																				

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METHOD	STEPS IN COMPUTATION	ILLUSTRATION	APPLICABILITY																								
	<p>③ Adjust GP Margin for functional differences</p> <p>④ ALP = ① + ② + ③</p>	<p>of USD 2 p.m. Further, assume cost of manpower to PP Ltd is 40% more.</p> <table border="1"> <tr> <td>Hourly rate to XY Ltd.</td> <td>36</td> </tr> <tr> <td>Direct & Indirect cost</td> <td>15</td> </tr> <tr> <td>Add: Finance Chgs (USD 2p.m. x 1.5 months)</td> <td>3</td> </tr> <tr> <td>Total cost</td> <td>18</td> </tr> <tr> <td>Mark up on cost (36 – 18) (:: 100%)</td> <td>18</td> </tr> <tr> <td></td> <td>36</td> </tr> <tr> <td>Cost to PP Ltd.</td> <td></td> </tr> <tr> <td>Direct & indirect cost (40% more) [15 + 40%]</td> <td>21</td> </tr> <tr> <td>+ Mark up (100%)</td> <td>21</td> </tr> <tr> <td>ALP (A)</td> <td>42</td> </tr> <tr> <td>Less: Transfer Price (B)</td> <td>(25)</td> </tr> <tr> <td>Additional income (A – B)</td> <td>17</td> </tr> </table>	Hourly rate to XY Ltd.	36	Direct & Indirect cost	15	Add: Finance Chgs (USD 2p.m. x 1.5 months)	3	Total cost	18	Mark up on cost (36 – 18) (:: 100%)	18		36	Cost to PP Ltd.		Direct & indirect cost (40% more) [15 + 40%]	21	+ Mark up (100%)	21	ALP (A)	42	Less: Transfer Price (B)	(25)	Additional income (A – B)	17	<p>selling arrangement</p>
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Less: Transfer Price (B)	(25)																										
Additional income (A – B)	17																										
<p>TRANSACTION NET MARGIN METHOD (TNMM)</p>	<p>① Identify the net margin to the enterprise from international transaction.</p> <p>② Identify net margin from comparable uncontrolled transaction</p> <p>③ Adjust ② with factors</p> <p>④ ALP will be computed with adjusted net margin computed in ③</p>	<p>PP Ltd. procures antivirus software from its parent AP Inc in US @ Rs. 650 per pack. PP Ltd. incurs additional expense of Rs. 200 per pack on labelling. The product is sold for Rs. 1000 per pack.</p> <p>It also procures similar antivirus software from Windows @ Rs. 3,000 per pack and incurs an additional expense of Rs. 400 per pack and sells the product at Rs. 5,000 in India.</p> <table border="1"> <tr> <td>Sale Price of Windows</td> <td>Rs. 5,000</td> </tr> <tr> <td>Less: Purchase price</td> <td>Rs. 3,000</td> </tr> <tr> <td>Less: Expense</td> <td>Rs. 400</td> </tr> <tr> <td>Net margin</td> <td>Rs. 1,600</td> </tr> <tr> <td>Net margin ratio</td> <td>32%</td> </tr> <tr> <td>Sale price of software purchased from AP Inc. [A]</td> <td>Rs. 1,000</td> </tr> <tr> <td>Net margin ratio</td> <td>32%</td> </tr> </table>	Sale Price of Windows	Rs. 5,000	Less: Purchase price	Rs. 3,000	Less: Expense	Rs. 400	Net margin	Rs. 1,600	Net margin ratio	32%	Sale price of software purchased from AP Inc. [A]	Rs. 1,000	Net margin ratio	32%	<ul style="list-style-type: none"> • Provision of services • Distribution of finished goods where the RPM cannot be applied • Transfer of semi-finished goods 										
Sale Price of Windows	Rs. 5,000																										
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METHOD	STEPS IN COMPUTATION	ILLUSTRATION	APPLICABILITY												
		<table border="1"> <tr> <td>Net margin</td> <td>Rs. 320</td> </tr> <tr> <td>Total Cost (B)</td> <td>Rs. 680 (1000-320)</td> </tr> <tr> <td>Less: Additional expense</td> <td>Rs. 200</td> </tr> <tr> <td>ALP (C = A – B)</td> <td>Rs. 480</td> </tr> <tr> <td>Price charged by AP Inc (D)</td> <td>Rs. 650</td> </tr> <tr> <td>Additional Income (D – C)</td> <td>Rs. 170</td> </tr> </table>	Net margin	Rs. 320	Total Cost (B)	Rs. 680 (1000-320)	Less: Additional expense	Rs. 200	ALP (C = A – B)	Rs. 480	Price charged by AP Inc (D)	Rs. 650	Additional Income (D – C)	Rs. 170	
Net margin	Rs. 320														
Total Cost (B)	Rs. 680 (1000-320)														
Less: Additional expense	Rs. 200														
ALP (C = A – B)	Rs. 480														
Price charged by AP Inc (D)	Rs. 650														
Additional Income (D – C)	Rs. 170														
PROFIT SPLIT METHOD (PSM)	<p>① Determine the combined net profit of AE</p> <p>② Compare the relative contribution earned by each enterprise for earning combined net profit with respect to FAR & on the basis of contribution earned by unrelated enterprises in similar circumstances</p> <p>③ Split ① in proportion to ② to arrive at ALP</p>	<p>Alternative Approach</p> <p>① Partially allocate profit to each of the enterprises to arrive at a basic return appropriate to the type of the transaction</p> <p>② The remaining profits shall be allocated on the basis of relative contribution</p> <p>③ total net profit of the enterprise = ① + ②</p> <table border="1"> <tr> <td>Total cost of PP Inc</td> <td>Rs. 2 crores</td> </tr> <tr> <td>Share of PP Ltd.</td> <td>10%</td> </tr> <tr> <td>ALP (A)</td> <td>Rs. 20 Lakhs</td> </tr> <tr> <td>Price charged (B)</td> <td>Rs. 31 Lakhs</td> </tr> <tr> <td>Additional Price (B - A)</td> <td>Rs. 11 Lakhs</td> </tr> </table>	Total cost of PP Inc	Rs. 2 crores	Share of PP Ltd.	10%	ALP (A)	Rs. 20 Lakhs	Price charged (B)	Rs. 31 Lakhs	Additional Price (B - A)	Rs. 11 Lakhs	<ul style="list-style-type: none"> Integrated services provided by more than one enterprise Transfer of unique intangibles Multiple inter related transactions which cannot be separately evaluated. 		
Total cost of PP Inc	Rs. 2 crores														
Share of PP Ltd.	10%														
ALP (A)	Rs. 20 Lakhs														
Price charged (B)	Rs. 31 Lakhs														
Additional Price (B - A)	Rs. 11 Lakhs														

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METHOD	STEPS IN COMPUTATION	ILLUSTRATION	APPLICABILITY
ANY OTHER METHOD	Can be used if it results in most appropriate method and if price cannot be determined by any of the above methods. Eg. In case of share valuation, valuation report may be used.		

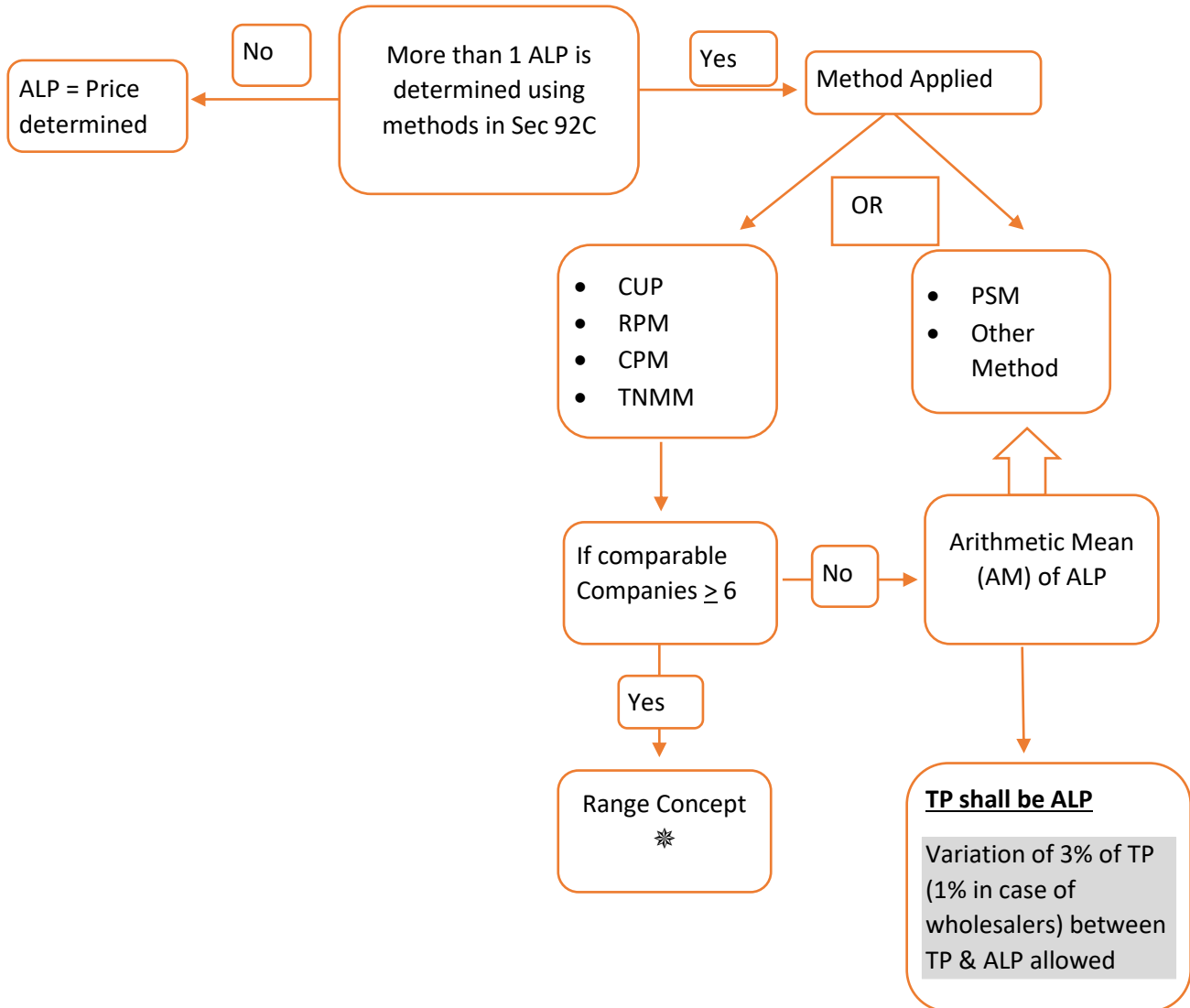
Transactions	Methods				
	Comparable Uncontrolled Price Method	Resale Price Method	Cost-plus Method	Transactional Net Margin Method	Profit Split Method
Commodities/Oil	√				
Payment of Interest	√				
Distribution of goods		√			
Provision of Services			√	√	
Contract manufacturing			√	√	
Manufacturing			√	√	
Payment of Royalty	√				
Multiple transactions involving intangibles					√
Management Charges	No Specified Method Benefit test and acceptable allocation				
Sales of shares, Intangible Assets (trademark, brand name etc.)	No Specified Method Can rely on valuation report under the other method				

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7. Range Concept and Multiple Year Data

A. Range Concept [Rule 10CA]



*STEPS FOR RANGE CONCEPT

① Calculate Weighted Average Margins or Prices for all comparables using 3 years data (including CY data) – Mostly weighted average data will be given in exam question

② Arrange the prices given in ① in **ASCENDING ORDER**

③ Obtain **35th Percentile** = Total No of comparables * 35%

④ Obtain **65th Percentile** = Total No of comparables * 65%

⑤ Find 35th & 65th percentile in data arranged in ② in ascending order. **THIS WILL BE ARM'S LENGTH RANGE. If TP is within range, TP is at ALP**

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Ⓒ If TP is not within range, obtain **MEDIAN (50th Percentile)** = Total No of comparables * 50%. Find the 50th percentile in data arranged in Ⓒ in ascending order

This shall be ALP.

If **DECIMALS** → **ROUND OFF TO NEXT HIGHER VALUE**

If **WHOLE NO** → **AVERAGE of PERCENTILE & NEXT HIGHER VALUE**

B. Multiple year data

Where the most appropriate method is the **RESALE PRICE METHOD OR COST PLUS METHOD OR TRANSACTIONAL NET MARGIN METHOD AND THE COMPARABLE UNCONTROLLED TRANSACTION** has been identified on the basis of data relating to the current year and the enterprise undertaking the said uncontrolled transaction, [not being the enterprise undertaking the international transaction referred to in sub-rule (1)], has in either or both of the two financial years immediately preceding the current year undertaken the same or similar comparable uncontrolled transaction then,-

- i. the most appropriate method used to determine the price of the comparable uncontrolled transaction undertaken in the current year shall be applied in similar manner to the comparable uncontrolled transaction or transactions undertaken in the aforesaid period and the price in respect of such uncontrolled transactions shall be determined; and
- ii. the weighted average of the prices, computed in accordance with the manner provided in sub-rule (3), of the comparable uncontrolled transactions undertaken in the current year and in the aforesaid period preceding it shall be included in the dataset instead of the price referred to in sub-rule (1).

Further, where the most appropriate method is the resale price method or cost plus method or transactional net margin method where the comparable uncontrolled transaction has been identified on the basis of the data relating to the financial year immediately preceding the current year and the enterprise undertaking the said uncontrolled transaction, [not being the enterprise undertaking the international transaction referred to in sub-rule (1)], has in the financial year immediately preceding the said financial year undertaken the same or similar comparable uncontrolled transaction then, -

- i. the price in respect of such uncontrolled transaction shall be determined by applying the most appropriate method in a similar manner as it was applied to determine the price of the comparable uncontrolled transaction undertaken in the financial year immediately preceding the current year; and
- ii. the weighted average of the prices, computed in accordance with the manner provided in sub-rule (3), of the comparable uncontrolled transactions undertaken in the aforesaid period of two years shall be included in the dataset instead of the price referred to in sub-rule (1).

Also, in such cases, where the use of data relating to the current year for determination of ALP subsequently at the time of assessment establishes that,-

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- i. the enterprise has not undertaken same or similar uncontrolled transaction during the current year; or
- ii. the uncontrolled transaction undertaken by an enterprise in the current year is not a comparable uncontrolled transaction,

then, irrespective of the fact that such an enterprise had undertaken comparable uncontrolled transaction in the financial year immediately preceding the current year or the financial year immediately preceding such financial year, the price of comparable uncontrolled transaction or the weighted average of the prices of the uncontrolled transactions, as the case may be, undertaken by such enterprise shall not be included in the dataset.

Rule 10CA(3) provides that where an enterprise has undertaken comparable uncontrolled transactions in more than one financial year, then for the purposes of sub-rule (2) the weighted average of the prices of such transactions shall be computed in the following manner, namely:-

	Method used to determine the prices	Manner of computation of weighted average of the prices
(i)	The resale price method	By assigning weights to the quantum of sales which has been considered for arriving at the respective prices
(ii)	The cost plus method	By assigning weights to the quantum of costs which has been considered for arriving at the respective prices
(iii)	The transactional net margin method	By assigning weights to the quantum of costs incurred or sales effected or assets employed or to be employed, or as the case may be, any other base which has been considered for arriving at the respective prices.

Rule 10B: MULTIPLE YEAR DATA (CURRENT YEAR + 1 YEAR PRIOR)

shall be used if,

- **Method = RPM/CPM/TNMM**
- the data relating to the current year is not available at the time of furnishing the return of income by the assessee, for the AY relevant to the CY:

If the data relating to the CY is subsequently available at the time of determination of ALP during the course of any assessment proceeding for the AY relevant to the CY, then, such data shall be used for such determination irrespective of the fact that the data was not available at the time of furnishing the return of income of the relevant assessment year.

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1

METHODS OF COMPUTATION OF ALP MOST APPROPRIATE METHOD

Comparable Uncontrolled Price (CUP) Method 😊

1. Price charged for similar goods/services in uncontrolled transaction
2. Adjust Qty disc, insurance, freight

Resale Price Method (RPM) 😊

1. Purchase price of similar goods/services in uncontrolled transaction
2. Resale price of such goods/services
3. Step 2-GP %
4. Adjust Qty disc, insurance, freight
ALP => (2+3+4)

Cost Plus Method (CPM) 😊

1. Total direct & indirect cost of production of goods/services
2. Total cost in an uncontrolled transaction
3. Gross margin in step 2
4. Adjust GP
ALP => (1+4)

Transaction net margin method (TNMM) 😊

1. Net margin to the enterprise from the international transaction
2. Net margin in uncontrolled transaction
3. Adjust net margin
ALP => Price + step 3

Profit Split Method (PSM)

1. Combined NP of AE
2. Evaluate relative contribution with respect to FAR
3. Split it according to step 2 to arrive at ALP

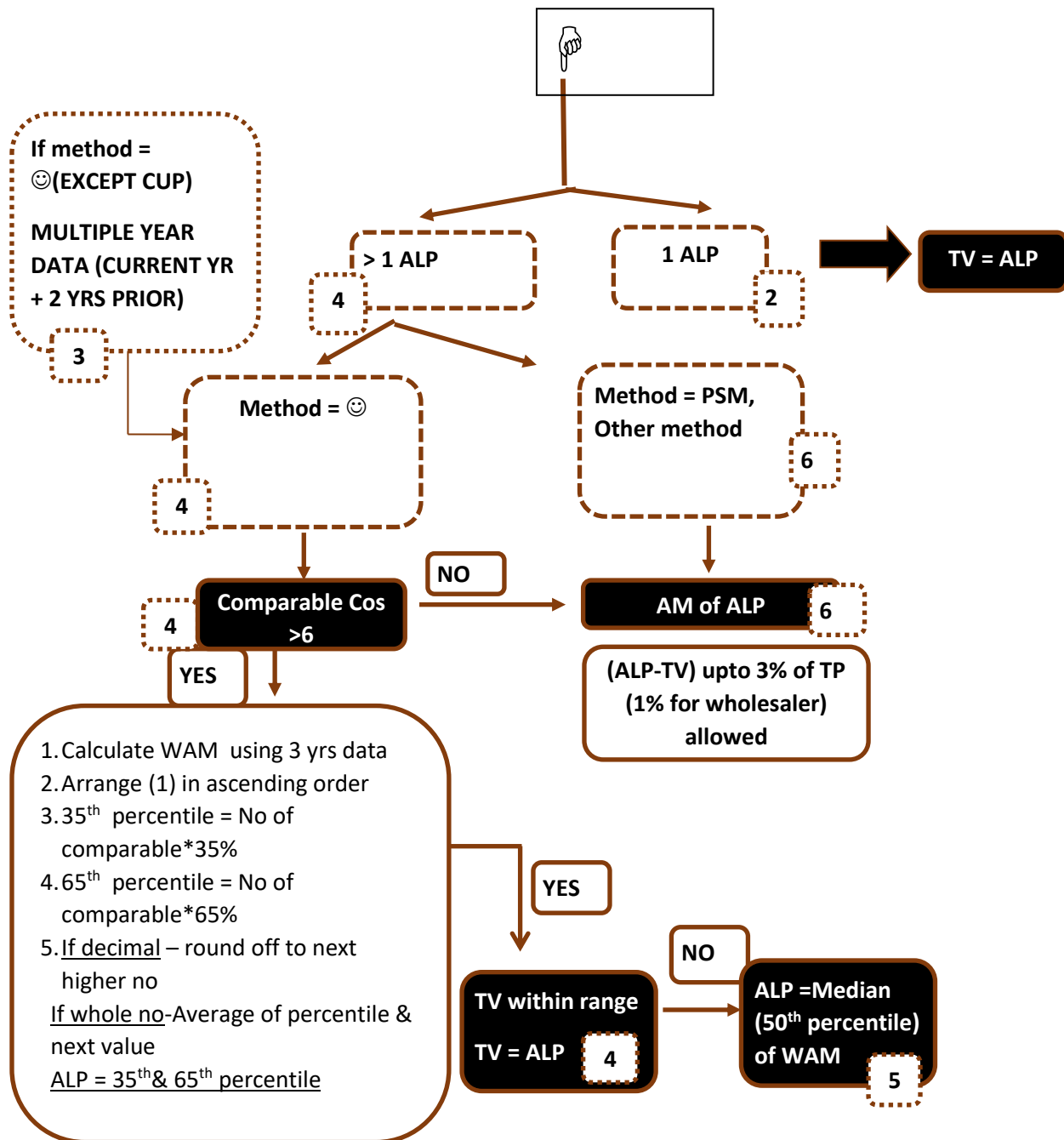
ACRONYMS

ALP = Arm's Length Price
AM=Arithmetic Mean
MAM=Most Appropriate Method
TV=Transaction value
WAM=Weighted Average Mean
FAR = Function, Asset & Risk.



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Flow of chart

1. We shall determine the MAM as mentioned ①
2. If 1 ALP, then TV=ALP
3. Multiple yr data can be used if method is CPM/RPM/TNMM
4. If MAM results in more than 1 ALP + if method is ☺ + comparable co are ≥ 6 , then check TV within range (35th & 65th percentile)
5. If not ALP = Median
6. If Method = PSM/Other Method OR comparable co < 6, then compute AM of ALP.
7. Variation between ALP & TP of 3% (1% for wholesaler) of TP shall be allowed

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8. Steps in Computing ALP

A. Functions, Assets and Risks (FAR) Analysis

Functions, Assets and Risk ('FAR') analysis is an analysis of the functions performed, taking into account assets used and risks assumed by associated enterprises (AEs) in controlled transactions.

A method of finding and organizing facts about a business in terms of the functions performed, assets used (including intangible property) and risks assumed by such business to:

- identify how they are divided among the AEs; and
- assess the importance of each function in the overall value chain.

FAR analysis is the starting point in determining the arm's length price of an international transaction.

To summarize, FAR analysis is central/core to the transfer pricing analysis. It helps in:

- Determining the nature of functions performed by the taxpayer and AE(s);
- On the basis of the above, determining true and correct characterization of the entities;
- Providing guidance on selection of most appropriate method for transfer pricing analysis; and
- Determining parameters for establishing comparability and undertaking economic adjustments.

B. Selection of tested party

The tested party will be the participant in the controlled transaction whose profitability/ pricing attributable to the controlled transactions can be verified based on the most appropriate data and requiring the fewest & most reasonable adjustments, and for which reliable data regarding uncontrolled comparables can be located.

Consequently, in most cases the tested party will be the "least complex" of the controlled taxpayers and will not own valuable intangible property or unique assets that distinguish it from potential uncontrolled comparables.

C. Selection of Profit Level Indicator (PLI)

A profit level indicator (PLI) is selected to test the profitability of tested party. PLIs are ratios that measure relationships between profits and costs incurred or resources employed. A variety of PLI's can be calculated in any given case.

It is a practice to adopt the denominator of the PLI as being un-tainted or less-tainted. A tainted income or expense would mean one that is received from an AE or paid to an AE and therefore cannot be considered to be independent or at arm's length. Untainted on the other hand would mean revenue or costs which relate to transactions with independent third parties and are therefore more reliable.

D. Most Appropriate Method

Rule 10C deals with the determination of most appropriate method. Under this Rule, the method which is best suited to the facts and circumstances and which provides the most reliable measure of an arm's length price in relation to the international transaction will be considered to be the most appropriate method.

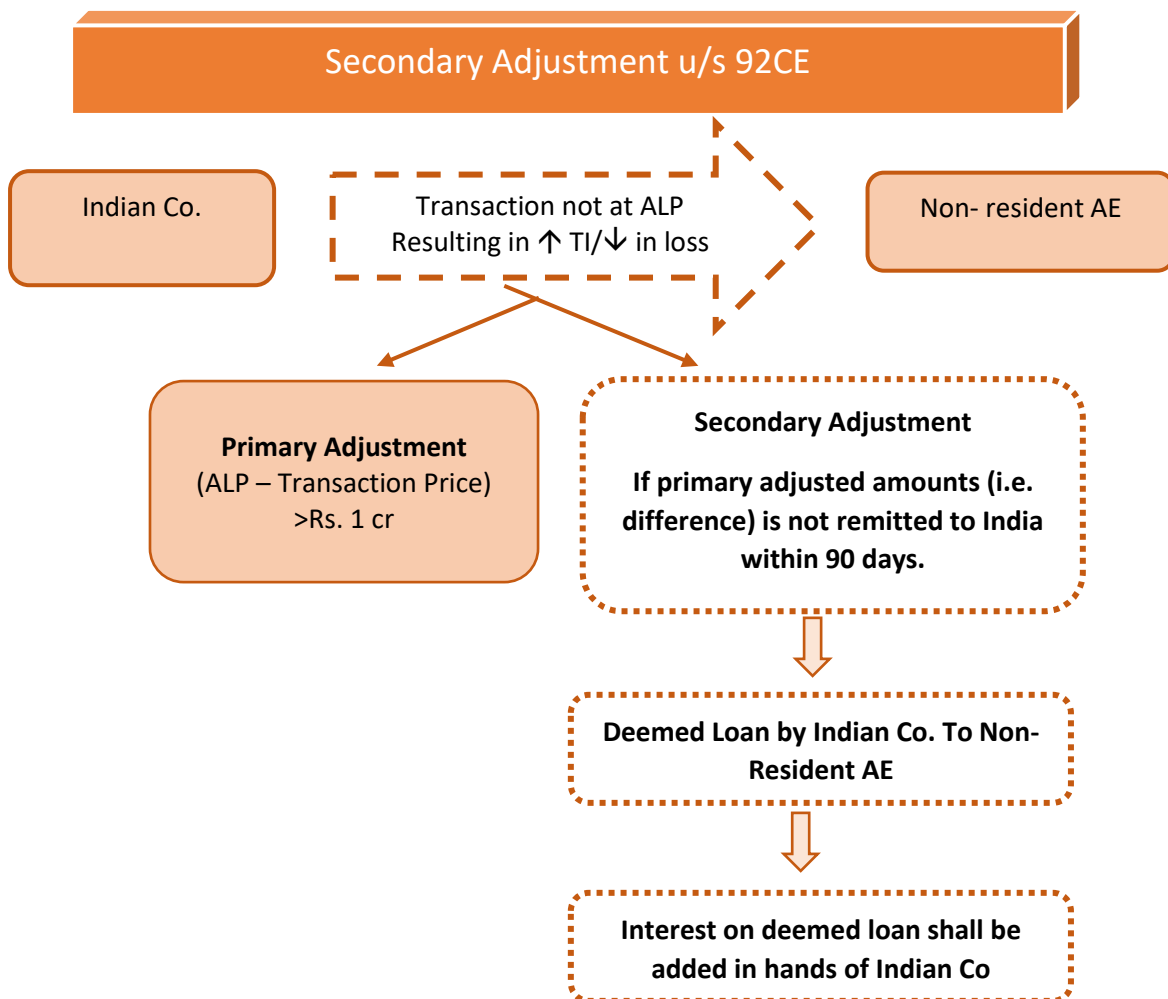
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For the purpose of selecting the most appropriate method, the following factors should be taken into account.

- i. The nature and class of the international transaction;
- ii. The class, or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;
- iii. The availability, coverage and reliability of data necessary for application of the method;
- iv. The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;
- v. The extent to which reliable and accurate adjustments can be made to account for difference, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;
- vi. The nature, extent and reliability of assumptions required to be made in application of a method.

9. Secondary Adjustment [Section 92CE]



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<p>What is primary Adjustments -</p>	<p>“Primary Adjustment” to a transfer price means the determination of transfer price in accordance with the arm’s length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the assessee.</p>
<p>What is secondary Adjustment</p>	<p>“Secondary Adjustment” means an adjustment in the books of account of the assessee and its AE to reflect that the actual allocation of profits between the assessee and its AE is consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.</p>
<p>When secondary adjustment will be applicable -</p>	<p>Secondary adjustments will be applicable in the following situations:</p> <ol style="list-style-type: none"> 1. Where a primary adjustment to transfer price has been made by <u>Suo-moto by the assessee in his return of income.</u> 2. Where primary adjustment to transfer price made by the AO has <u>been accepted by the assessee.</u> 3. Where a primary adjustment to transfer price is <u>determined by an APA entered into by assessee u/s 92CC.</u> 4. Where a primary adjustment to transfer price is made as per the <u>safe harbor rules framed u/s 92CB.</u> 5. Where primary adjustment to transfer price is arising as a result of resolution of an assessment <u>by way of the mutual agreement procedure under DTAA entered into u/s 90 /90A.</u>
<p>Threshold limit-</p>	<p>When secondary adjustment is not applicable- If the following two conditions are not satisfied, <u>secondary adjustment is NOT REQUIRED-</u></p> <ol style="list-style-type: none"> a. The amount of primary adjustment made in the case of an assessee in any previous year DOESN'T EXCEED Rs. 1 CRORE; and b. The primary adjustment is made in respect of the AY 2016-17(or any earlier assessment year)
<p>Quantification of secondary adjustment</p>	<ol style="list-style-type: none"> 1. As a result of primary adjustment to the transfer price, <u>there is an increase in the total income or reduction in the loss</u>, as the case may be, of the assessee. 2. The <u>difference between the ALP determined in Primary adjustment and the price, at which the international transaction has actually been undertaken, is “Excess Money”</u>. Such excess money may be repatriated by the non-resident assessee. Excess money means the difference between the arm’s length price determined in primary adjustment and the price at which international transaction has actually taken place. 3. <u>The excess money is not repatriated to India by the associated enterprise within 90 days(in general term, repatriation means effectively reversing the funds so that the account of the parties involved are in line with the economic intend of the primary adjustment). The excess money (which is not repatriated to India) shall be deemed to be an advance made by the assessee to such associated enterprise and the interest on such advance shall be computed as the income of the assessee in the manner as may be prescribed.</u>

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<p>The imputed per annum interest income on excess money which is not repatriated within the time limit shall be computed,—</p>	<p>(i) at the 1 year marginal cost of fund lending rate of SBI as on 1st of April of the relevant PY + 325 basis points in the cases where the international transaction is denominated in Indian rupee; or (ii) at 6 month LIBOR as on 30th September of the relevant PY + 300 basis points in the cases where the international transaction is denominated in foreign currency.</p>		
<p>Repatriation of excess money and interest on non-repatriated excess money</p>	<p>The CBDT vide Notification No.76/2019 dated 30.09.2019 has prescribed the time limit for repatriation of excess money or part thereof i.e. on or before 90 days from specified date.</p>		
	<p>Case</p>	<p>Time limit for repatriation of excess money within 90 days from</p>	<p>Date from which interest is chargeable on non-repatriated excess money within the specified time-limit</p>
	<p>Where primary adjustments are made to transfer price suo-motu by the assessee in his return of income</p>	<p>Due date of filing return of income u/s 139(1)</p>	<p>Due date of filing return of income u/s 139(1)</p>
	<p>If primary adjustments to transfer price as determined in the order of the Assessing Officer or the appellate authority has been accepted by the assessee</p>	<p>the date of the said order</p>	<p>the date of the said order</p>
	<p>Where primary adjustment has been determined by an agreement for advance pricing been entered into by the assessee E. If APA has been entered into on or before due date of filing return for relevant PY</p>	<p>Date of filing of return u/s 139(1)</p>	<p>Due date of filing of return u/s 139(1)</p>
	<p>F. If the APA has been entered into on or after</p>	<p>The end of the month in which APA</p>	<p>The end of month in which APA has been entered into</p>

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	the due date of filing of return for relevant PY	has been entered into	
	Where option has been exercised by the assessee as per the safe harbour rules under section 92CB	the due date of filing of return u/s 139(1)	the due date of filing of return u/s 139(1)
	Where agreement under the Mutual agreement procedure under a DTAA has been entered into u/s 90 or 90A	The date of giving effect by the AO to such resolution	The date of giving effect by the AO to such resolution
Option to pay additional tax, if the excess money is not repatriated	<p>In a case where the excess money or part thereof has not been repatriated within the prescribed time as mentioned above, the assessee has the option to pay additional income-tax @ 20.9664% (i.e., tax@18% plus surcharge@12% plus cess@4%) on such excess money or part thereof, as the case may be.</p> <p>Where additional income-tax is so paid by the assessee, he will not be required to make secondary adjustment and compute interest from the date of payment of such tax. This implies that he would, in any case, be required to compute interest upto the date of payment of such additional tax.</p> <p>The additional income-tax so paid by the assessee shall be treated as the final payment of tax in respect of excess money or part thereof not repatriated and no further credit would be allowed to the assessee or to any other person in respect of the amount of additional income-tax so paid.</p> <p>Further, no deduction in respect of the amount on which such additional income-tax has been paid, would be allowed under any other provision of the Act.</p>		

10. Safe Harbour

Meaning

Refers to determination of price margin which are acceptable to tax authorities. In other words, it refers to **circumstances under which the tax authorities may accept the transfer price declared by the taxpayers**

Applicability

- Applicable for period not exceeding 5 years
- Not applicable, if AE located in territory notified u/s 94A

INTERNATIONAL TRANS^N ✓

CERTAIN SDT

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Safe harbour rules relevant for A.Y.2020-21 are yet to be notified by the CBDT.

11. Advance Pricing Agreement (APA)

Meaning	<p>An Advance Pricing Agreement (APA) is AN AGREEMENT ENTERED BETWEEN A TAXPAYER AND A TAXING AUTHORITY to determine ALP or specifying the manner in which ALP shall be determined, in relation to such INTERNATIONAL TRANSACTION.</p> <p>It is pertinent to note that the provisions of APA shall override the normal provisions of determination of arm's length price.</p>				
Transaction Covered	<p>INTERNATIONAL TRANSACTION <input checked="" type="checkbox"/></p> <p>SPECIFIED DOMESTIC TRANSACTION <input type="checkbox"/></p>				
Period covered under APA	<ul style="list-style-type: none"> • Not exceeding 5 consecutive previous years • Rollback mechanism is provided for period not exceeding 4 PY preceding the first of the PY for which the APA applies • [i.e. 5 future years + 4 preceding years] 				
Roll back provisions	<p>In order to reduce current pending as well as future litigation in respect of the transfer pricing matters, roll back mechanism is provided for period not exceeding 4 PY preceding the first of the PY for which the APA applies in respect of the international transaction to be undertaken. APA can be applied for the transaction undertaken in past 4 years.</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 20%;">Conditions</td> <td> <ul style="list-style-type: none"> a. International transaction is same as the international transaction to which the agreement (other than the rollback provision) applies; b. Return of income for the relevant rollback year has been or is furnished by the applicant before the due date as specified in Explanation 2 of section 139(1). c. Report in respect of the international transaction had been furnished in accordance with section 92E; </td> </tr> <tr> <td>Non-Applicability</td> <td> <ul style="list-style-type: none"> a. The determination of ALP of the said international transaction for the said year has been subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed </td> </tr> </table>	Conditions	<ul style="list-style-type: none"> a. International transaction is same as the international transaction to which the agreement (other than the rollback provision) applies; b. Return of income for the relevant rollback year has been or is furnished by the applicant before the due date as specified in Explanation 2 of section 139(1). c. Report in respect of the international transaction had been furnished in accordance with section 92E; 	Non-Applicability	<ul style="list-style-type: none"> a. The determination of ALP of the said international transaction for the said year has been subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed
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Non-Applicability	<ul style="list-style-type: none"> a. The determination of ALP of the said international transaction for the said year has been subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed 				

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	<p>an order disposing of such appeal at any time before signing of the agreement</p> <p>b. The application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year</p>
Time-limit	<p>Roll back application shall be made:</p> <p>a. before the first day of the PY relevant to the first AY for which the application for APA is made, in respect of transactions which are of a continuing nature from dealings that are already occurring; or</p> <p>b. before undertaking the transaction in respect of remaining transactions</p>

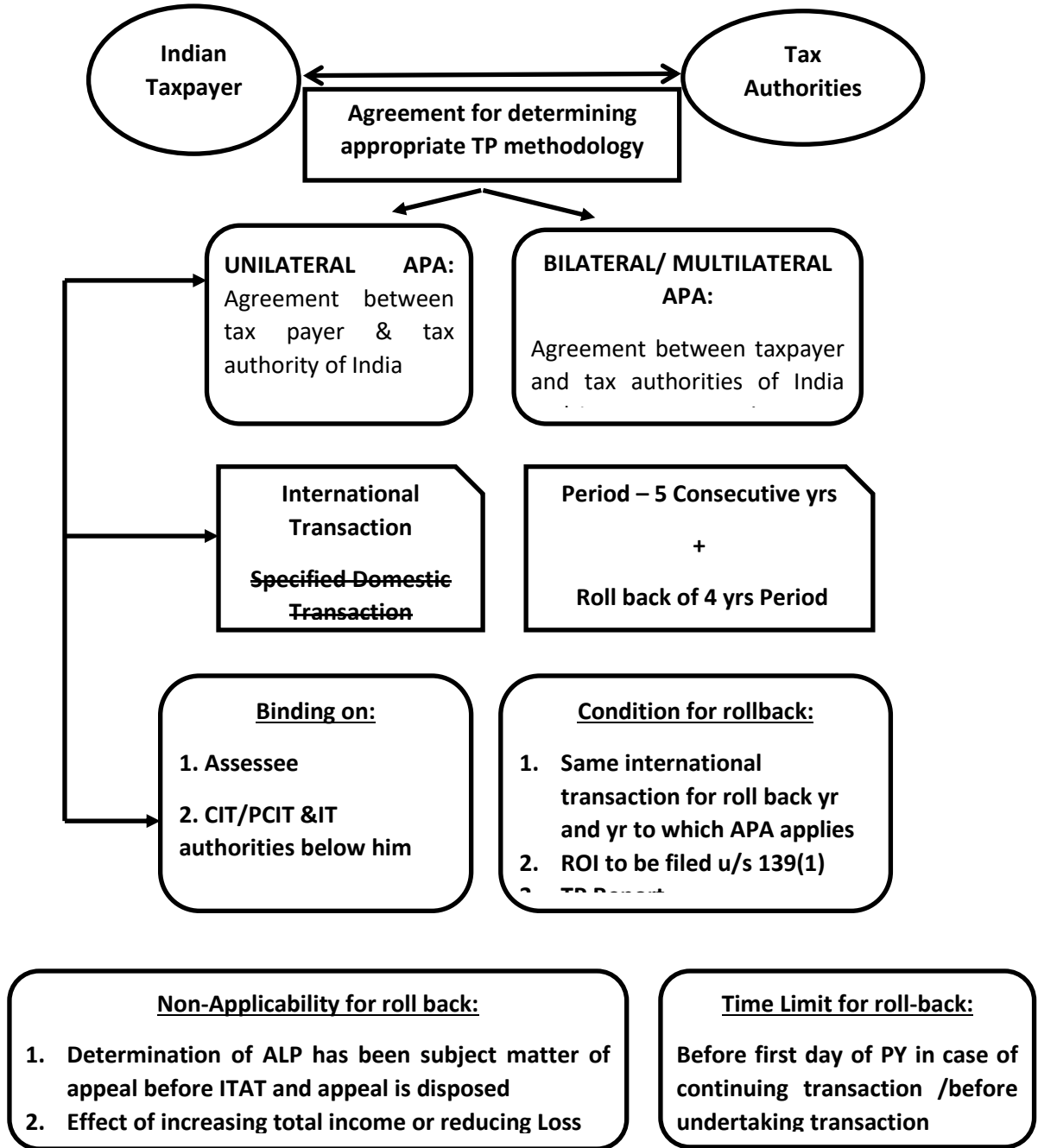
Binding on Whom

- a) the person in whose case, and in respect of the transaction in relation to which, the APA has been entered into; and
- b) the Commissioner or Principal Commissioner and the Income-tax Authorities subordinate to him, in respect of the said person and the said transaction.

Further, the APA shall not be binding if there is any change in law or facts having bearing on such APA. Accordingly, APA shall not have binding effect on the High Court.

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Question 1

Under rule 10MA(2)(ii) there is a condition that the return of income for the relevant roll back year has been or is furnished by the applicant before the due date specified in Explanation 2 to section 139(1). It is not clear as to whether applicants who have filed returns under section 139(4) or 139(5) of the Act would be eligible for roll back.

Answer

The return of income under section 139(5) can be filed only when a return under section 139(1) has already been filed. Therefore, the return of income filed under section 139(5) of the Act, replaces the original return of income filed under section 139(1). Hence, if there is a return which is filed under section 139(5) to revise the original return filed before the due date specified in Explanation 2 to sub-section (1) of section 139, the applicant would be entitled for rollback on this revised return of income.

However, rollback provisions will not be available in case of a return of income filed under section 139(4) because it is a return which is not filed before the due date.

Note – A belated return filed under section 139(4) can also be revised under section 139(5). In such a case, the revised return would replace the belated return. Therefore, an applicant would not be entitled for roll back provisions on a revised return which replaces a belated return.

Question 2

Rule 10MA(2)(i) mandates that the rollback provision shall apply in respect of an international transaction that is same as the international transaction to which the agreement (other than the rollback provision) applies. It is not clear what is the meaning of the word “same”. Further, it is not clear whether this restriction also applies to the Functions, Assets, Risks (FAR) analysis.

Answer

The international transaction for which a rollback provision is to be allowed should be the same as the one proposed to be undertaken in the future years and in respect of which the agreement has been reached. There cannot be a situation where rollback is finalised for a transaction which is not covered in the agreement for future years. The term same international transaction implies that the transaction in the rollback year has to be of same nature and undertaken with the same associated enterprise(s), as proposed to be undertaken in the future years and in respect of which agreement has been reached. In the context of FAR analysis, the restriction would operate to ensure that rollback provisions would apply only if the FAR analysis of the rollback year does not differ materially from the FAR validated for the purpose of reaching an agreement in respect of international transactions to be undertaken in the future years for which the agreement applies.

The word “materially” is generally being defined in the Advance Pricing Agreements being entered into by CBDT. According to this definition, the word “materially” will be interpreted consistently with its ordinary definition and in a manner that a material change of facts and circumstances would be understood as a change which could reasonably have resulted in an agreement with significantly different terms and conditions.

Question 3

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Rule 10MA(2)(iv) requires that the application for rollback provision, in respect of an international transaction, has to be made by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant. Clarification is required as to whether rollback has to be requested for all four years or applicant can choose the years out of the block of four years.

Answer

The applicant does not have the option to choose the years for which it wants to apply for rollback. The applicant has to either apply for all the four years or not apply at all. However, if the covered international transaction(s) did not exist in a rollback year or there is some disqualification in a rollback year, then the applicant can apply for rollback for less than four years. Accordingly, if the covered international transaction(s) were not in existence during any of the rollback years, the applicant can apply for rollback for the remaining years. Similarly, if in any of the rollback years for the covered international transaction(s), the applicant fails the test of the rollback conditions contained in various provisions, then it would be denied the benefit of rollback for that rollback year. However, for other rollback years, it can still apply for rollback.

Question 4

Rule 10MA(3) states that the rollback provision shall not be provided in respect of an international transaction for a rollback year if the determination of arm's length price of the said international transaction for the said year has been the subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement. Further, Rule 10 RA(4) provides that if any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant.

There is a need to clarify the phrase "Tribunal has passed an order disposing of such appeal" and on the mismatch, if any, between Rule 10MA(3) and Rule 10RA(4).

Answer

The reason for not allowing rollback for the international transaction for which Appellate Tribunal has passed an order disposing of an appeal is that the ITAT is the final fact finding authority and hence, on factual issues, the matter has already reached finality in that year. However, if the ITAT has not decided the matter and has only set aside the order for fresh consideration of the matter by the lower authorities with full discretion at their disposal, the matter shall not be treated as one having reached finality and hence, benefit of rollback can still be given.

There is no mismatch between Rule 10MA(3) and Rule 10RA(4).

Question 5

Rule 10MA(3)(ii) provides that rollback provision shall not be provided in respect of an international transaction for a rollback year if the application of rollback provision has the effect of

reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year. It may be clarified whether the rollback provisions in such

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situations can be applied in a manner so as to ensure that the returned income or loss is accepted as the final income or loss after applying the rollback provisions.

Answer

It is clarified that in case the terms of rollback provisions contain specific agreement between the Board and the applicant that the agreed determination of ALP or the agreed manner of determination of ALP is subject to the condition that the ALP would get modified to the extent that it does not result in reducing the total income or increasing the total loss, as the case may be, of the applicant as declared in the return of income of the said year, the rollback provisions could be applied. For example, if the declared income is ₹ 100, the income as adjusted by the TPO is ₹ 120, and the application of the rollback provisions results in reducing the income to ₹ 90, then the rollback for that year would be determined in a manner that the declared income ₹ 100 would be treated as the final income for that year.

Question 6

Rule 10RA(7) states that in case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled. It is to be clarified as to whether the entire agreement is to be cancelled or only that year for which roll back fails.

Answer

The procedure for giving effect to a rollback provision is laid down in Rule 10RA. Sub-rules (2), (3), (4) and (6) of the Rule specify the actions to be taken by the applicant in order that effect may be given to the rollback provision. If the applicant does not carry out such actions for any of the rollback years, the entire agreement shall be cancelled.

This is because the rollback provision has been introduced for the benefit of the applicant and is applicable at its option. Accordingly, if the rollback provision cannot be given effect to for any of the rollback years on account of the applicant not taking the actions specified in sub-rules (2), (3),

(4) or (6), the entire agreement gets vitiated and will have to be cancelled.

Question 7

If there is a Mutual Agreement Procedure (MAP) application already pending for a rollback year, what would be the stand of the APA authorities? Further, what would be the view of the APA Authorities, if MAP has already been concluded for a rollback year?

Answer

If MAP has been already concluded for any of the international transactions in any of the rollback year under APA, rollback provisions would not be allowed for those international transactions for that year but could be allowed for other years or for other international transactions for that year,

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subject to fulfilment of specified conditions in Rules 10MA and 10RA. However, if MAP request is pending for any of the rollback year under APA, upon the option exercised by the applicant, either MAP or application for roll back shall be proceeded with for such year.

Question 8

Rule 10MA(1) provides that the agreement may provide for determining ALP or manner of determination of ALP. However, Rule 10MA(4) only specifies that the manner of determination of ALP should be the same as in the APA term. Does that mean the ALP could be different?

Answer

Yes, the ALP could be different for different years. However, the manner of determination of ALP (including choice of Method, comparability analysis and Tested Party) would be same.

Question 9

Will there be compliance audit for roll back? Would critical assumptions have to be validated during compliance audit?

Answer

Since rollback provisions are for past years, ALP for the rollback years would be agreed after full examination of all the facts, including validation of critical assumptions. Hence, compliance audit for the rollback years would primarily be to check if the agreed price or methodology has been applied in the modified return.

Question 10

Whether applicant has an option to withdraw its rollback application? Can the applicant accept the rollback results without accepting the APA for the future years?

Answer

The applicant has an option to withdraw its roll back application even while maintaining the APA application for the future years. However, it is not possible to accept the rollback results without accepting the APA for the future years. It may also be noted that the fee specified in Rule 10MA(5) shall not be refunded even where a rollback application is withdrawn.

Question 11

For already concluded APAs, will new APAs be signed for rollback or earlier APAs could be revised?

Answer

The second proviso to Rule 10MA(5) provides for revision of APAs already concluded to include rollback provisions.

Question 12

For already concluded APAs, where the modified return has already been filed for the first year of the APA term, how will the time-limit for filing modified return for rollback years be determined?

Answer

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The time to file modified return for rollback years will start from the date of signing the revised APA incorporating the rollback provisions.

Question 13

In case of merger of companies, where one or more of those companies are APA applicants, how would the rollback provisions be allowed and to which company or companies would it be allowed?

Answer

The agreement is between the Board and a person. The principle to be followed in case of merger is that the person (company) who makes the APA application would only be entitled to enter into the agreement and be entitled for the rollback provisions in respect of international transactions undertaken by it in rollback years. Other persons (companies) who have merged with this person (company) would not be eligible for the rollback provisions.

To illustrate, if A, B and C merge to form C and C is the APA applicant, then the agreement can only be entered into with C and only C would be eligible for the rollback provisions. A and B would not be eligible for the rollback provisions. To illustrate further, if A and B merge to form a new company C and C is the APA applicant, then nobody would be eligible for rollback provisions.

Question 14

In case of a demerger of an APA applicant or signatory into two or more companies (persons), who would be eligible for the rollback provisions?

Answer

The same principle as mentioned in the previous answer, i.e., the person (company) who makes an APA application or enters into an APA would only be entitled for the rollback provisions, would continue to apply. To illustrate, if A has applied for or entered into an APA and, subsequently, demerges into A and B, then only A will be eligible for rollback for international transactions covered under the APA. As B was not in existence in rollback years, availing or grant of rollback to B does not arise.

Section 92CD provides for the following procedure for giving effect to an APA

- i. In case a person has entered into an APA and prior to the date of entering into such APA, he has furnished the return of income under the provisions of section 139 in respect of any assessment year relevant to a previous year to which the APA applies, then, such person shall, within a period of three months from the end of the month in which the said agreement was entered into, furnish a modified return, notwithstanding any contrary provision contained in section 139.
- ii. Such modified return shall be in accordance with and limited to the provisions of such APA i.e., modifications can only be made on account of such APA in the return to be filed.
- iii. All other provisions of this Act shall apply as if the modified return is a return furnished under section 139, unless anything to the contrary is provided in this section.
- iv. If the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the APA applies have been completed before the expiry of period allowed for furnishing of modified return, the Assessing Officer shall, in a case where modified return is filed in accordance with the provisions of this section, proceed to assess or reassess or re-

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compute the total income of the relevant assessment year having regard to and in accordance with the APA.

However, with effect from 1.9.2019, Assessing Officer shall pass an order modifying the total income of the relevant assessment year determined in such assessment or reassessment, as the case may be, having regard to and in accordance with the APA, instead of proceeding to assess or reassess the total income.

Such order for assessment or reassessment or re-computation of total income shall be passed within a period of 1 year from the end of the financial year in which the modified return was furnished. This shall apply notwithstanding the period of limitation contained under section 153 or 153B or 144C.

The appeal against such order shall lie to Commissioner (Appeals) [Section 246A]

- v. Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the APA applies, are pending on the date of filing of modified return, the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the APA taking into consideration the modified return so furnished.

In this case, the time period of completion of pending assessment or reassessment mentioned under section 153 or 153B or 144C shall be extended by 12 months. This shall apply notwithstanding the period of limitation contained under section 153 or 153B or 144C.

- vi. The assessment or reassessment proceedings for an assessment year shall be deemed to have been completed where -
 - (a) an assessment or reassessment order has been passed; or
 - (b) no notice has been issued under section 143(2) till the expiry of the limitation period provided under the said section.

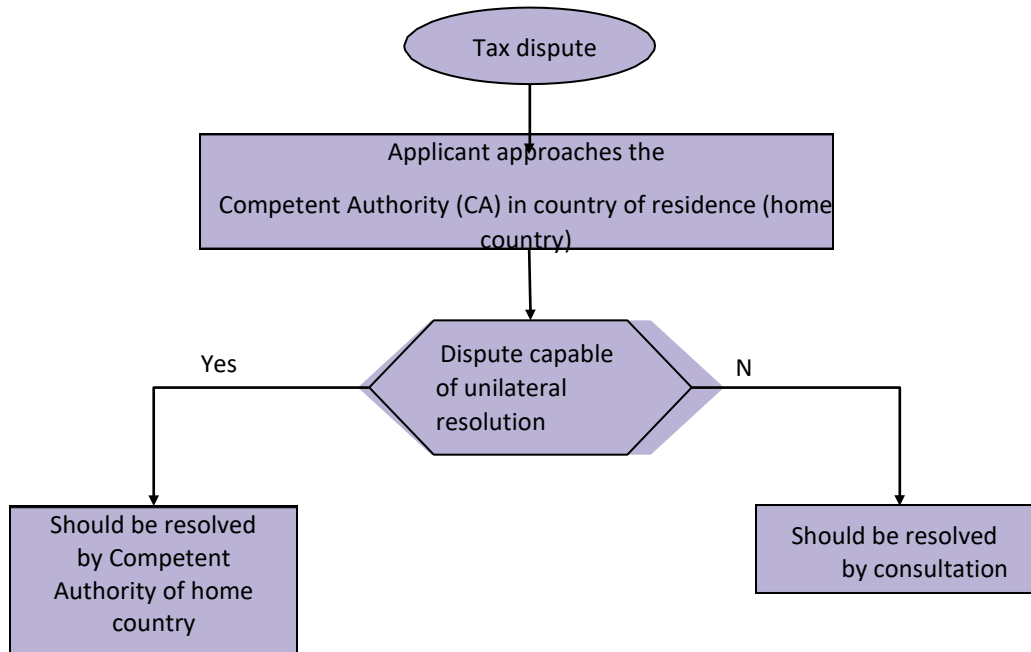
12. Mutual Agreement Procedure

The mutual agreement procedure is a well-established means through which tax administrations consult to resolve disputes regarding the application of double tax conventions. This procedure, described and authorized by Article 25 of the OECD Model Tax Convention, can be used to eliminate double taxation that could arise from a transfer pricing adjustment.

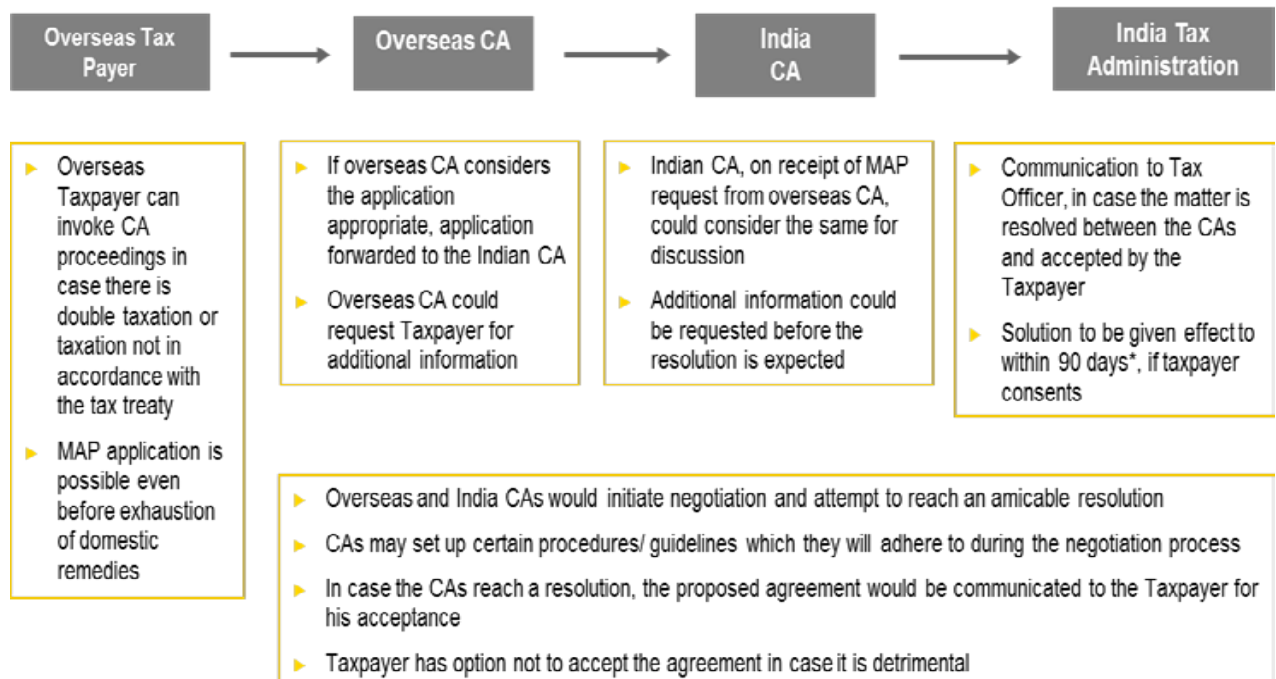
Article 25 sets out three different areas where mutual agreement procedures are generally used. The first area includes instances of “taxation not in accordance with the provisions of the Convention” and is covered in paragraphs 1 and 2 of the Article. Procedures in this area are typically initiated by the taxpayer. The other two areas, which do not necessarily involve the taxpayer, are dealt with in paragraph 3 and involve questions of “interpretation or application of the Convention” and “the elimination of double taxation in cases not otherwise provided for in the Convention”. Paragraph 10 of the Commentary on Article 25 makes clear that Article 25 is intended to be used by competent authorities in resolving not only problems of juridical double taxation but also those of economic double taxation arising from transfer pricing adjustments made pursuant to paragraph 1 of Article 9 (Article 9 – Associated enterprises).

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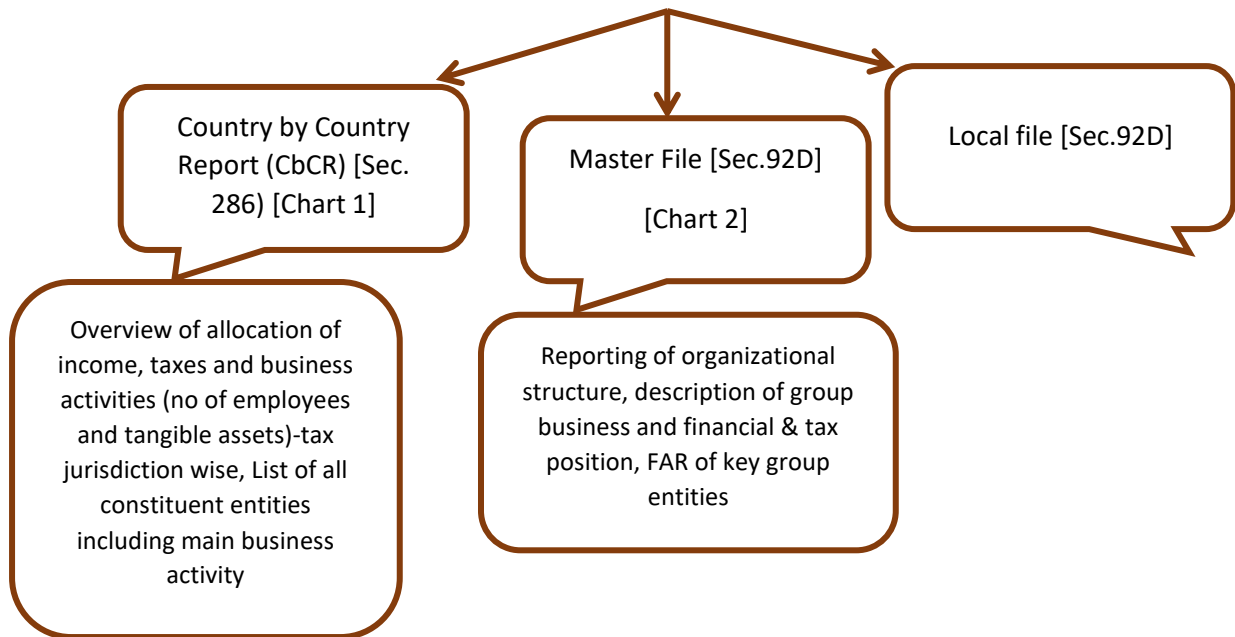
Typical MAP process in India



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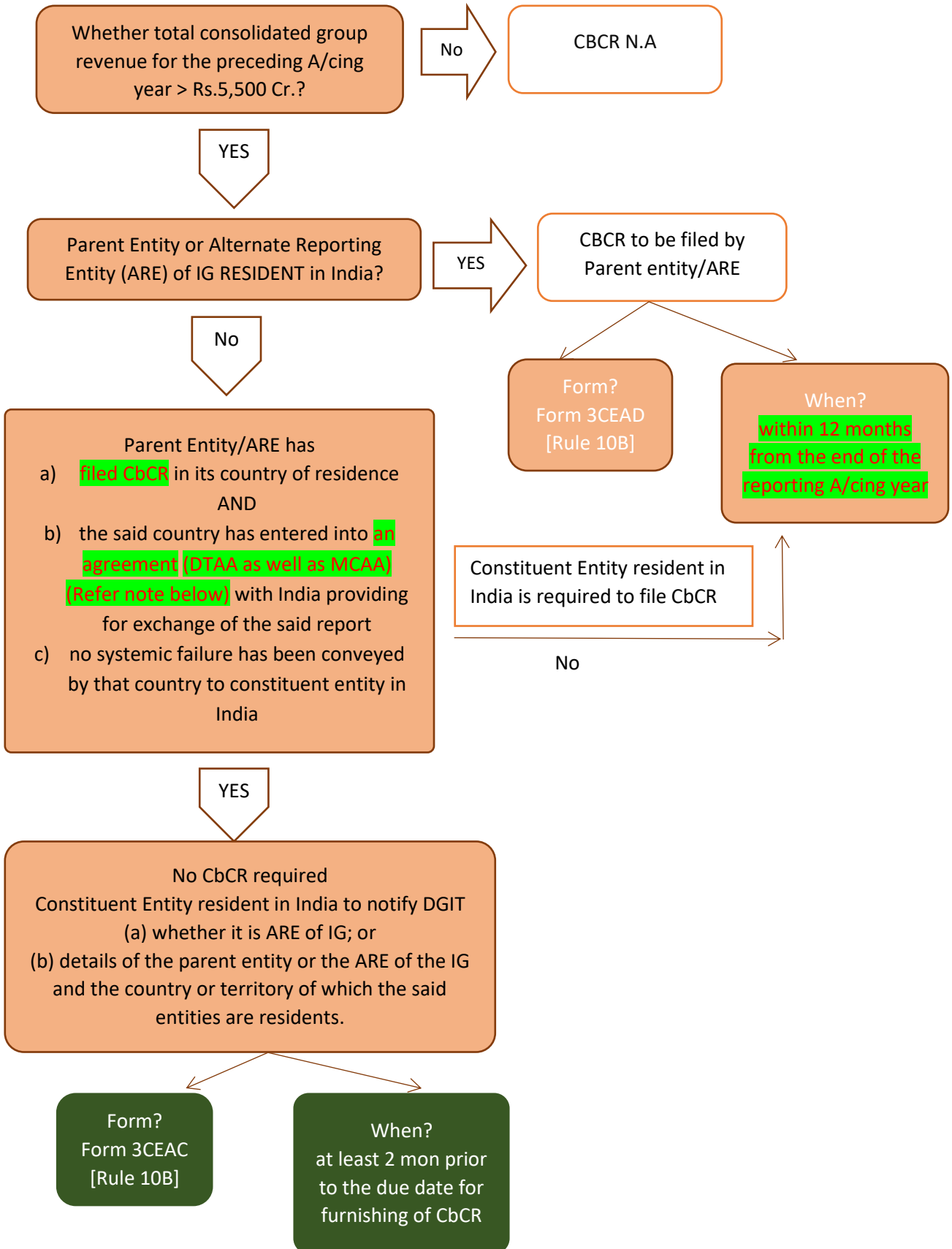
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13. Documentation and Compliances



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Country by Country Report (CbCR) [Sec.286]



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Terms:

(a) **"accounting year"** means,—

- (i) PY, in a case where the parent entity or alternate reporting entity is resident in India; or
- (ii) an annual accounting period, with respect to which the parent entity of the international group prepares its financial statements under any law for the time being in force or the applicable accounting standards of the country or territory of which such entity is resident, in any other case

b) **"agreement"** means a combination of all of the following agreements, namely:—

- (i) an agreement entered into u/s 90(1)/90A(1)[DTAA]; and
- (ii) an agreement for exchange of the report referred to in sub-section (2) and notified by the Central Government [MCAA]

As per the existing provisions for CbC reporting in India, Indian residents of foreign MNCs are required to file only a notification and not the CbC report in India provided there existed either an agreement such as the DTAA ("Direct Tax Avoidance Agreement") or a notified agreement for exchange of the CbC report (i.e. "Multilateral Competent Authority Agreement"/ "MCAA"). The definition of agreement has now been amended to include a combination of both, an agreement such as the DTAA and an agreement for exchange of CbC report (e.g. MCAA) notified by the Central Government.

This means that where there is a DTAA existing with another tax jurisdiction but no MCAA, the Indian resident of the foreign MNC would have to file the CbC report in India and not the notification i.e. for cases where the parent reporting entity/ ARE is in US, China etc. This is also applicable in a vice versa situation i.e. where the Indian Government may have a MCAA with the foreign jurisdiction but not a DTAA i.e. Uruguay and Chile.

(c) **"alternate reporting entity"** means any constituent entity of the international group that has been designated by such group, in the place of the parent entity, to furnish CbCR in the country or territory in which the said constituent entity is resident on behalf of such group

(d) **"constituent entity"** means,—

- (i) any separate entity of an international group that is included in the consolidated financial statement of the said group for financial reporting purposes, or may be so included for the said purpose, if the equity share of any entity of the international group were to be listed on a stock exchange;
- (ii) any such entity that is excluded from the consolidated financial statement of the international group solely on the basis of size or materiality; or
- (iii) any permanent establishment of any separate business entity of the international group included in sub-clause (i) or sub-clause (ii), if such business unit prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting or internal management control purposes;

(e) **"parent entity"** means a constituent entity, of an international group holding, directly or indirectly, an interest in one or more of the other constituent entities of the international group, such that,—

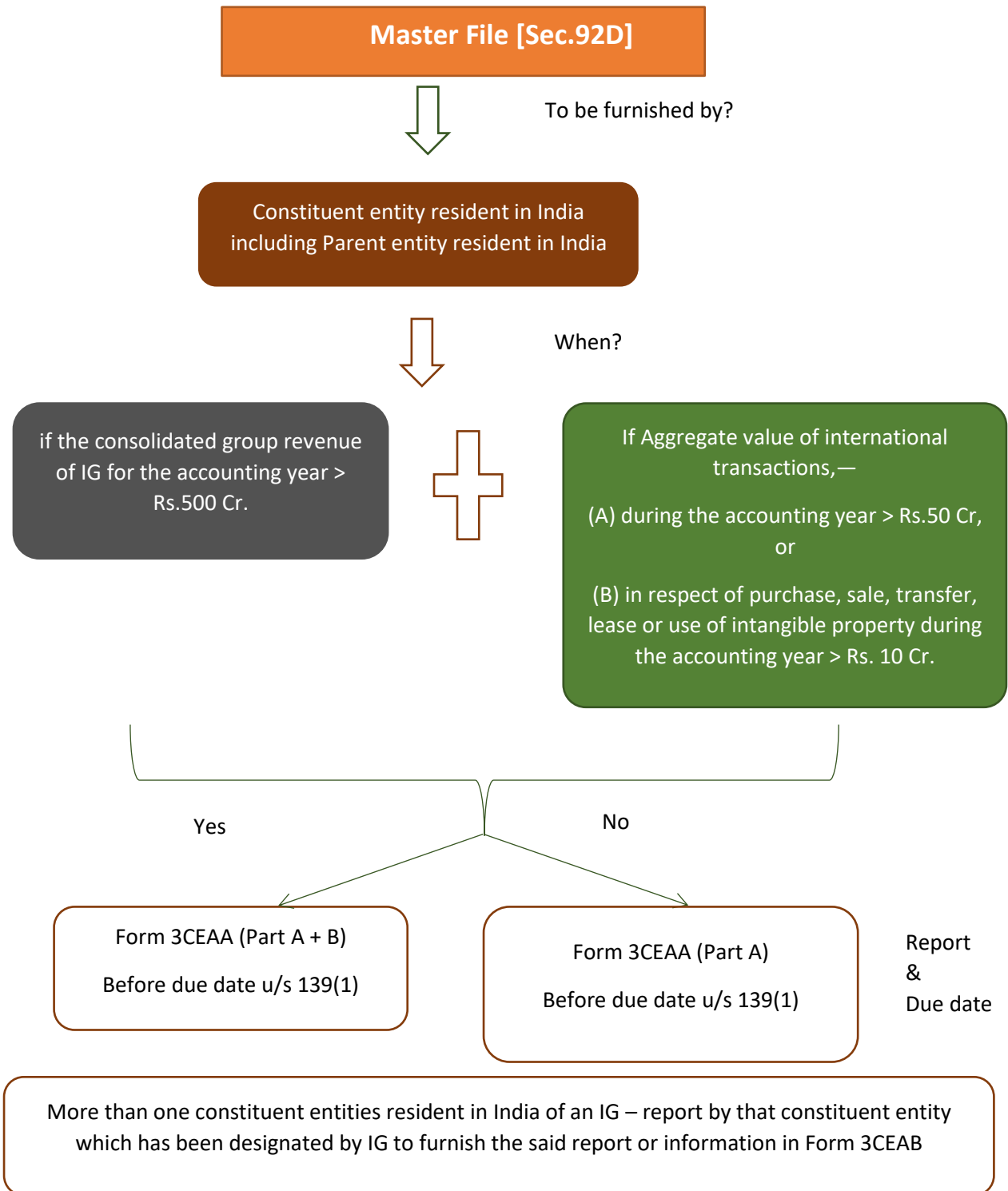
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- (i) it is required to prepare a consolidated financial statement under any law for the time being in force or the accounting standards of the country or territory of which the entity is resident; or
 - (ii) it would have been required to prepare a consolidated financial statement had the equity shares of any of the enterprises were listed on a stock exchange,
- (f) **"international group"** means any group that includes,—
- (i) two or more enterprises which are resident of different countries or territories; or
 - (ii) an enterprise, being a resident of one country or territory, which carries on any business through a permanent establishment in other countries or territories

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Local File

Every person

(a) who enters into an international transaction to keep and maintain such information and documents in respect thereof as may be prescribed by CBDT

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(b) being a constituent entity of an international group to keep and maintain the prescribed information and document in respect of an international group.

The constituent entity is required to keep and maintain the information and document irrespective of the fact whether or not any international transaction is undertaken by such constituent entity.

The constituent entity has to furnish the information and document to the authority prescribed under section 286(1), i.e., Director General of Income-tax (Risk Assessment) in the prescribed manner, on or before prescribed date

(2) Information and documents to be kept and maintained for prescribed period - The CBDT is empowered to prescribe the period for which the information and documents shall be kept and maintained.

(3) Assessing Officer & Commissioner (Appeals) empowered to require persons entering into international transaction to furnish prescribed information and documents - The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceedings under the Income-tax Act, require any person who has entered into an international transaction to furnish any such prescribed information or documents within a period of from the date of receipt of a notice issued in this regard. The requisition period may, on request, be extended further for a period not exceeding thirty days by the Assessing Officer or the Commissioner (Appeals).

Rule 10D(2) provides that in a case where the aggregate value of international transactions does not exceed Rs. 1 crore, it will not be obligatory for the assessee to maintain the above information and documents.

(4) Audit Report [Section 92E]:

Under section 92E, every person who enters into an international transaction during a previous year is required to obtain a report from a chartered accountant and furnish such report on or before the specified date on the prescribed form.

Rule 10E provides that the auditor's report shall be in Form No.3CEB. It requires the auditor to state that he has examined the accounts and records of the assessee relating to the international transactions entered into by the assessee during the relevant year. He has also to give his opinion whether the prescribed information and documents relating to the above transactions have been kept by the assessee. Further, he has to state that the particulars stated in the Annexure to his report are true and correct. The Annexure is in two parts.

In the first part of the Annexure, general information of the assessee is required to be reported. In the second part of the Annexure, the particulars about the international transactions are required to be stated. Broadly stated these particulars include list of associated enterprises, particulars and description of transactions relating to purchase, sales, provisions of service, loans, advances, etc.

“Specified date” shall have the same meaning as assigned to due date in Explanation 2 below sub-section (1) of section 139. The due date for filing of transfer pricing report under section 92E in Form 3CEB is 30th November of the assessment year.

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14. Penalties

Stringent penalties are provided in various sections for non-compliance with the above provisions. These are as under:

- 1. Penalty for failure to report any international transaction or any transaction deemed to be an international transaction:** Under section 270A, penalty@50% of tax payable on under-reported income is leviable. However, the amount of under-reported income represented by any addition made in conformity with the arm's length price determined by the Transfer Pricing Officer would not be included within the scope of under-reported income under section 270A, where the assessee had maintained information and documents, as prescribed under section 92D, declared the international transactions under Chapter X and disclosed all material facts relating to the transaction.

Failure to report any international transaction or any transaction deemed to be an international transaction to which the provisions of Chapter X applies would constitute 'misreporting of income' under section 270A(9), in respect of which penalty@200% would be attracted.

- 2. Penalty for failure to keep and maintain information and documentation [Section 271AA]:** In order to ensure compliance with the transfer pricing regulations, section 271AA provides that, the Assessing Officer or Commissioner (Appeals) may direct the person entering into an international transaction to pay a penalty@2% of the value of each international transaction entered into by him, if the person:
 - i. fails to keep and maintain any such document and information as required by section 92D(1) or section 92D(2);
 - ii. fails to report such international transaction which is required to be reported; or
 - iii. maintains or furnishes any incorrect information or document.

3. Penalty for failure to furnish information or document under section 92D [Section 271G]

Section 271G provides that if any person who has entered into an international transaction fails to furnish any such information or document as required by Assessing Officer or TPO or Commissioner (Appeals) within a period of 30 days from the date of receipt of a notice issued in this regard, then such person shall be liable to a penalty up to 2% of the value of each international transaction.

4. Penalty for failure to furnish report under section 92E [Section 271BA]

If any person fails to furnish a report from an accountant, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of Rs. 1 lakh.

Penalty for failure to comply with TP provisions : A Summary		
Section	Nature of default	Penalty
270A(9)	Failure to report any International transaction or deemed International transaction to which the provision of Chapter X applies would constitute 'misreporting of income'	200% of the tax payable on under-reported income

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271BA	Failure to furnish a report from an accountant as required under section 92E	1 lakh
271G	Failure to furnish info or doc as required by Assessing Officer or CIT(A) u/s 92D(3) within 30 days from the date of receipt of notice or extended period not exceeding 30 days, as the case may be.	2% of the value of the International transaction for each failure
271AA	(1) Failure to keep and maintain any such document and information as required by section 92D(1)/(2); (2) Failure to report such International transaction which is required to be reported; or (3) Maintaining or furnishing any incorrect information or document.	2% of the value of each such International transaction
Notes:		
<ul style="list-style-type: none"> • <i>The penalty u/s 271AA shall be in addition and not in substitution of penalty u/s 271BA.</i> • <i>If the assessee proves that there was reasonable cause for the failure, no penalty would be leviable under section 271BA, 271G and 271AA.</i> 		

(i) **Penalty for non-furnishing of the report by any reporting entity which is obligated to furnish such report [Section 271GB(1) & (3)]**

	Period of delay/default	Penalty
(a)	Not more than a month	Rs. 5,000 per day
(b)	beyond one month	Rs. 15,000 per day for the period exceeding one month
(c)	Continuing default even after service of order levying penalty either under (a) or under (b)	Rs. 50,000 per day of continuing failure beginning from the date of service of order

(ii) **Penalty for failure to produce information and documents within prescribed time [Section 271GB(2) & (3)]**

	Default	Penalty
(a)	Failure to produce information and documents before prescribed authority within the period allowed u/s 286(6)	Rs. 5,000 per day of continuing failure, from the day immediately following the day on which the period for furnishing the information and document expires.
(b)	Continuing default even after service of penalty order	Rs. 50,000 per day for the period of default beyond the date of service of order.

(iii) **Penalty for submission of inaccurate information in the CBC report [Section 271GB(4)]**

If the reporting entity has provided any inaccurate information in the report, the penalty would be Rs. 5,00,000 if,-

(a) the entity has knowledge of the inaccuracy at the time of furnishing the report but does

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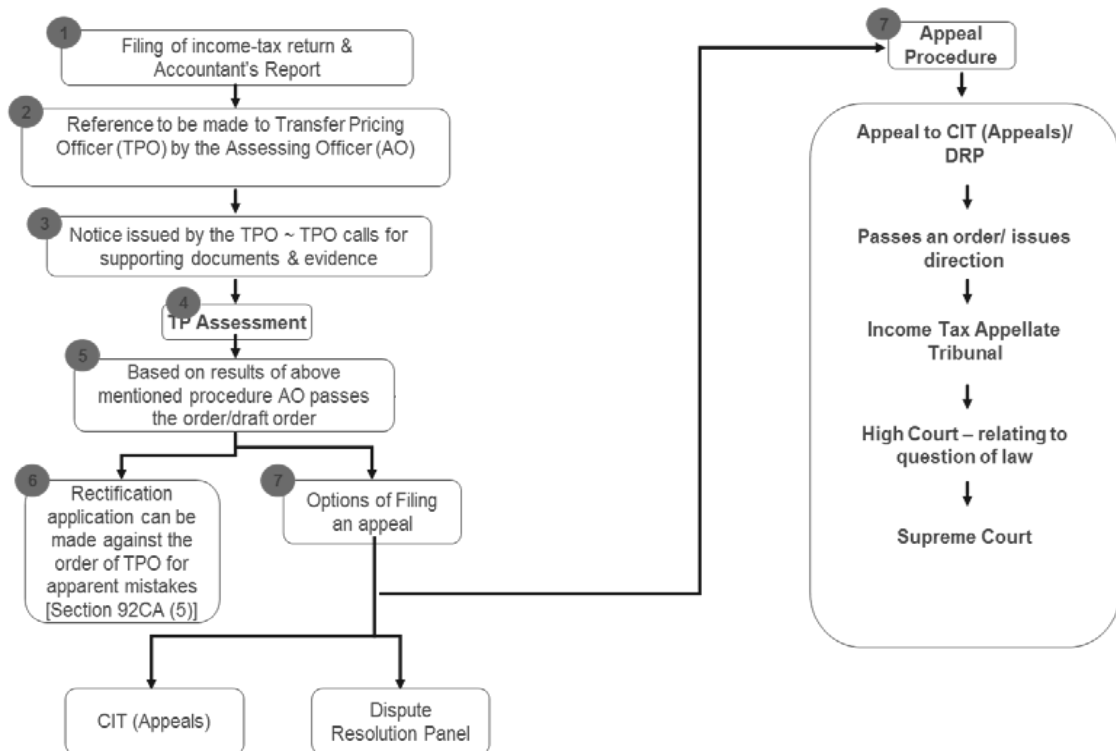
not inform the prescribed authority; or

- (b) the entity discovers the inaccuracy after the report is furnished and fails to inform the prescribed authority and furnish correct report within a period of fifteen days of such discovery; or
- (c) the entity furnishes inaccurate information or document in response to notice of the prescribed authority under section 286(6).

(iv) Non-levy of penalty if reasonable cause for failure is proved [Section 273B]

Section 273B provides for non-levy of penalty under various sections if the assessee proves that there was reasonable cause for such failure. Section 271GB has been included within the scope of section 273B. Therefore, the entity can offer reasonable cause defence for non-levy of penalties mentioned above.

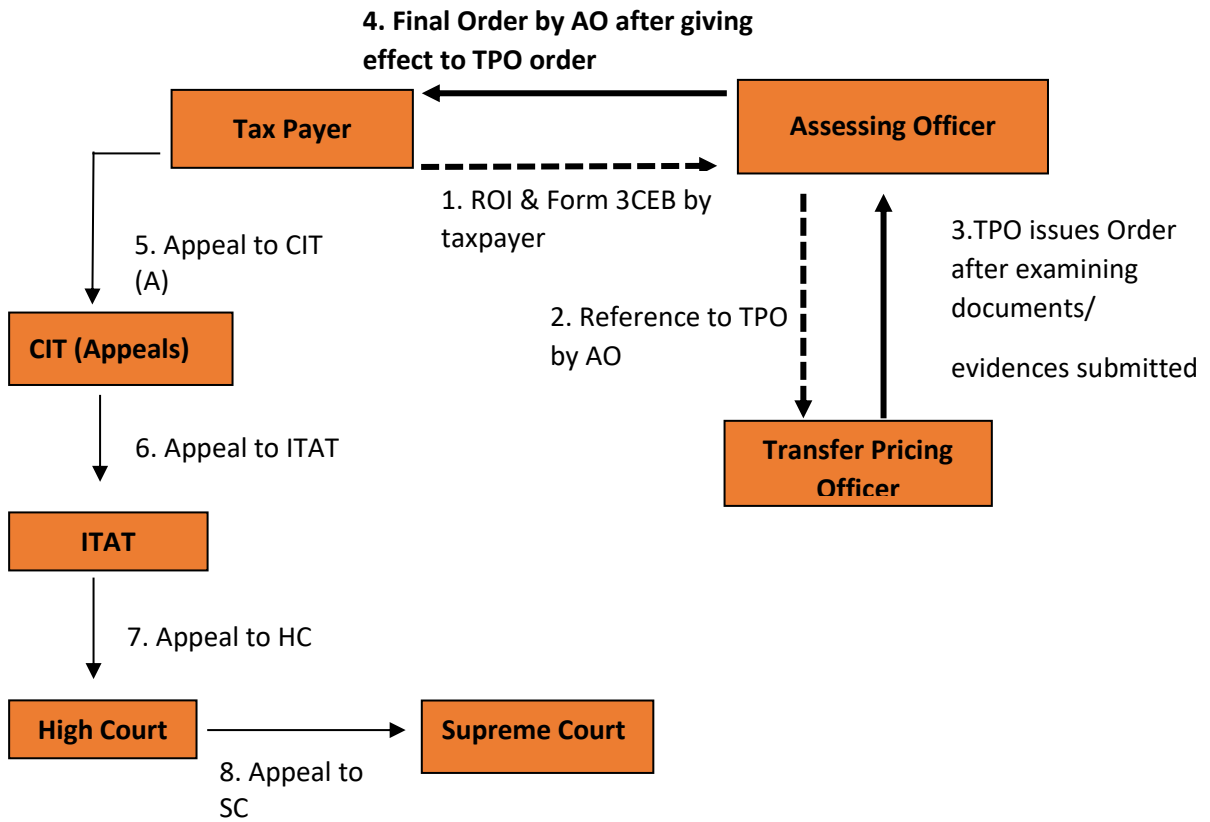
15. Transfer Pricing Assessment



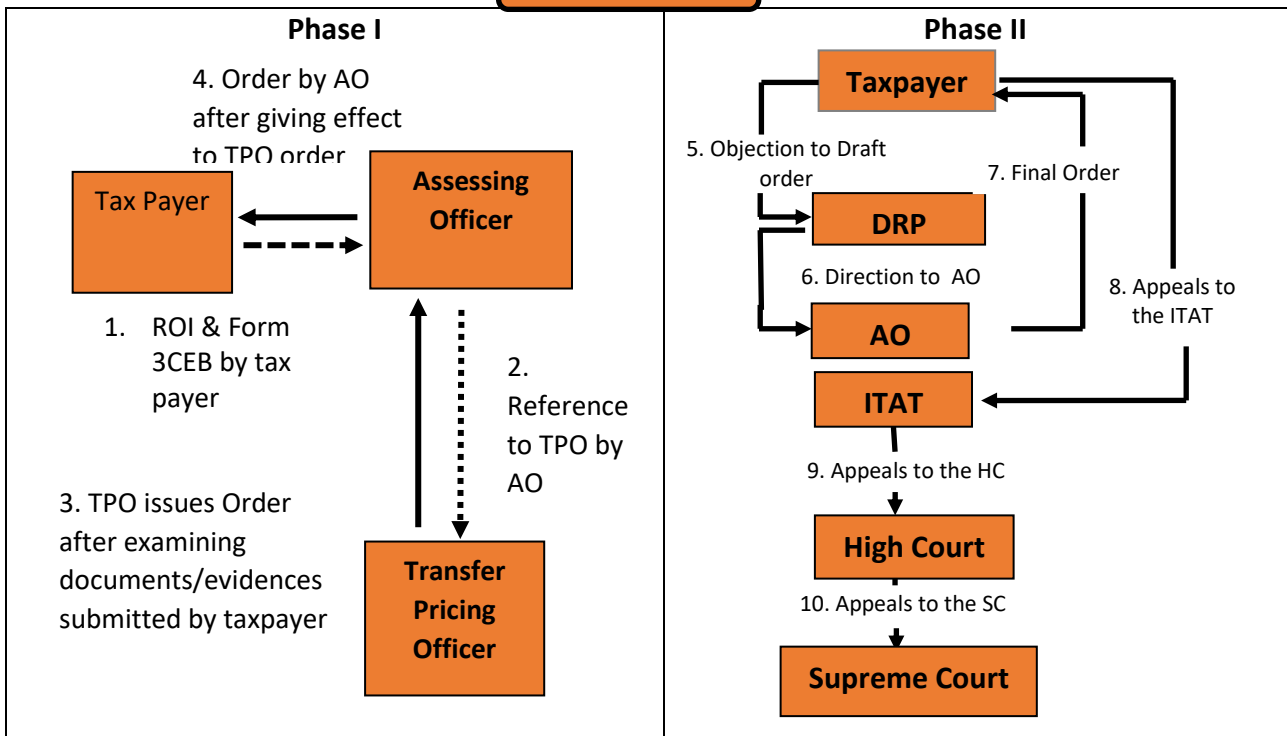
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1. TRADITIONAL ROUTE:



2. DRP ROUTE:



Earlier PCIT/CIT if he objected to directions of DRP, could direct AO to file appeal with ITAT against DRP's order within 60 days from date of passing of order. However, **NOW**

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DEPARTMENT CANNOT FILE APPEAL AGAINST ORDER OF DRP AND ONLY ASSESSEE CAN FILE APPEAL AGAINST THE SAME.

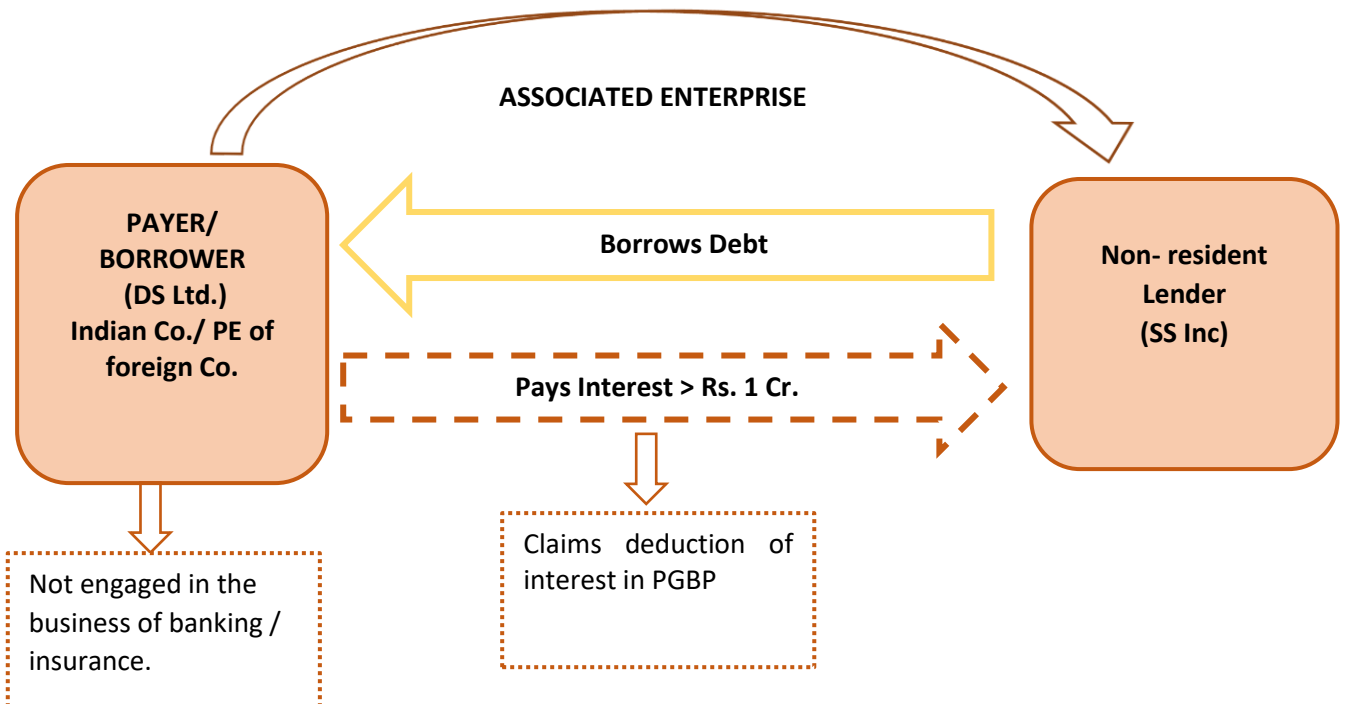
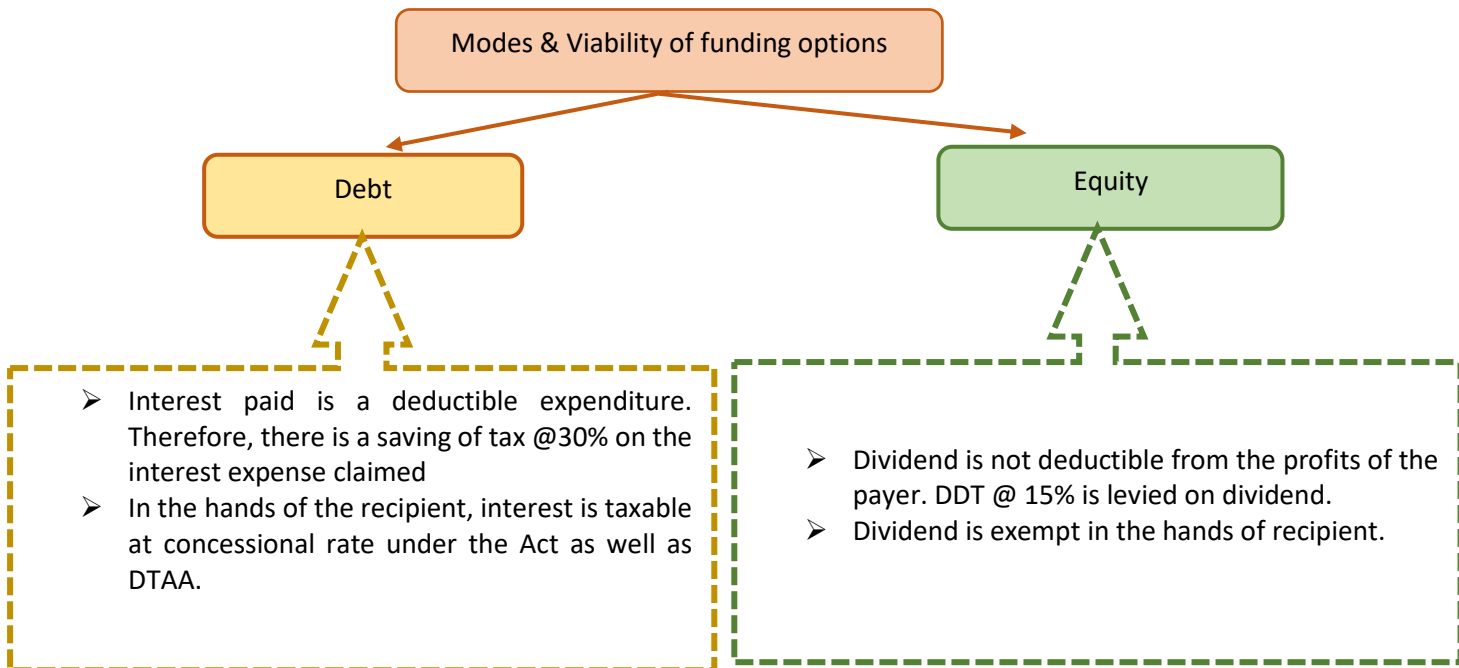
***Time limit for completion of assessment where reference is made to TPO:**

Provision	Existing	Revised
• Completion of assessment u/s 143(3) or u/s 144	30 months	24 months
	From end of AY in which income was first assessable	
• Reassessment u/s 147	24 months	21 months
	From the end of FY in which notice u/s 148 is served	
• Completion of fresh assessment in pursuance of order passed u/s 254/263/264	24 months	21 months
	From the end of FY in which order u/s 254 is received by CC or CIT or order is passed u/s 263/264 by CIT	

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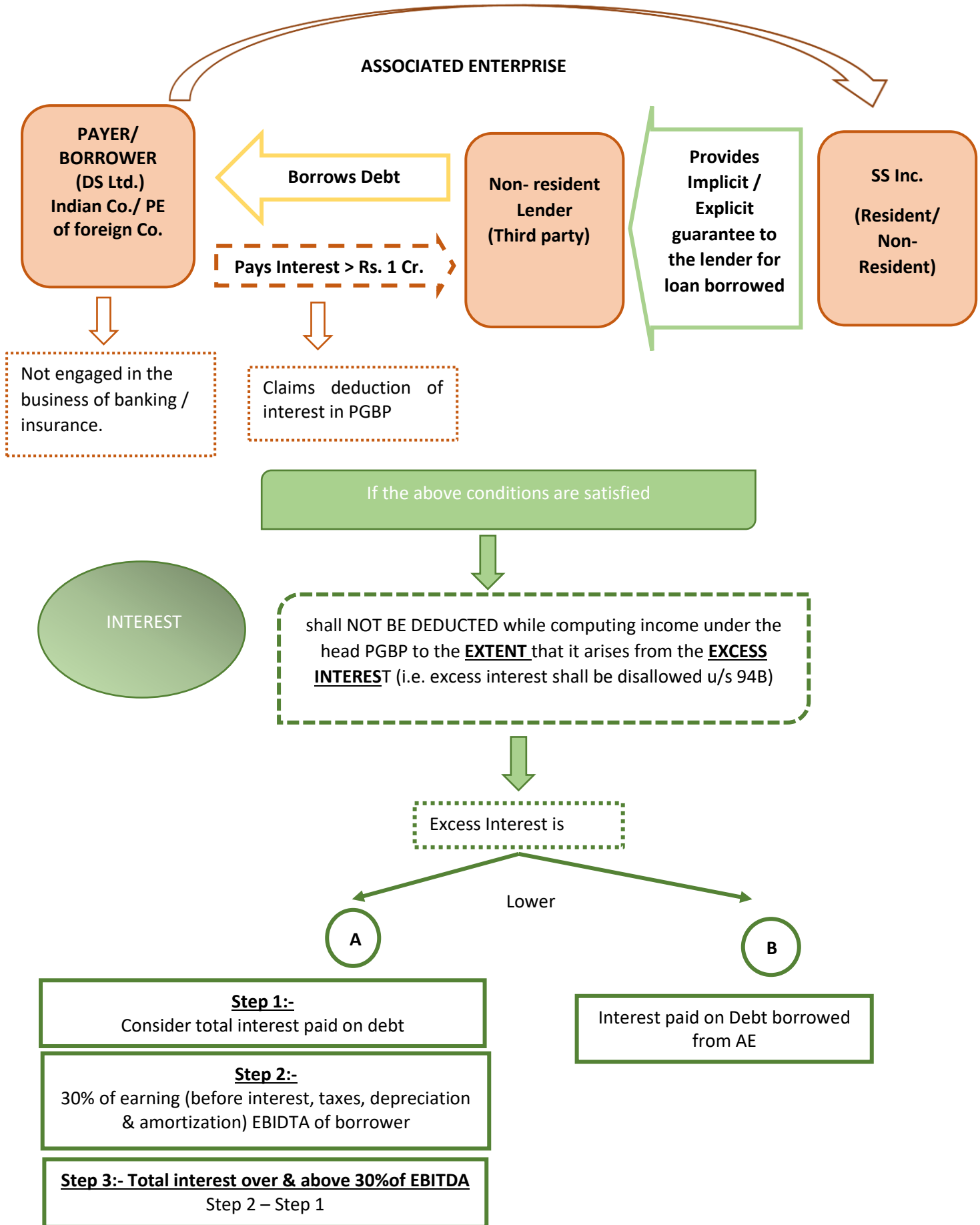
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16. Thin Capitalisation Rules [Section 94B]



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Borrower	Lender	Guarantor	94B Applicable?
Indian Company / PE	Non-resident AE	No guarantee	Yes
Indian Company / PE	Resident AE	No guarantee	No
Indian Company / PE	Non-resident	Resident AE	Yes
Indian Company / PE	Resident	Non-resident AE	No (since debt not from non-resident)
Indian Company / PE	Resident	Resident AE	No (since debt not from non-resident)
Foreign company (with a POEM in India)	Non-resident AE	No guarantee by AE	No
Foreign company (with a POEM in India)	Non-resident	Guarantee by AE	No

17. Notified Jurisdictional Area [Section 94A]

The Central Government (CG) is empowered to notify any country or territory outside India as a notified jurisdictional area in relation to transactions entered into by any assessee, if such country lack effective exchange of information with India. Cyprus was notified as NJA by CG.

Circular 15/2017

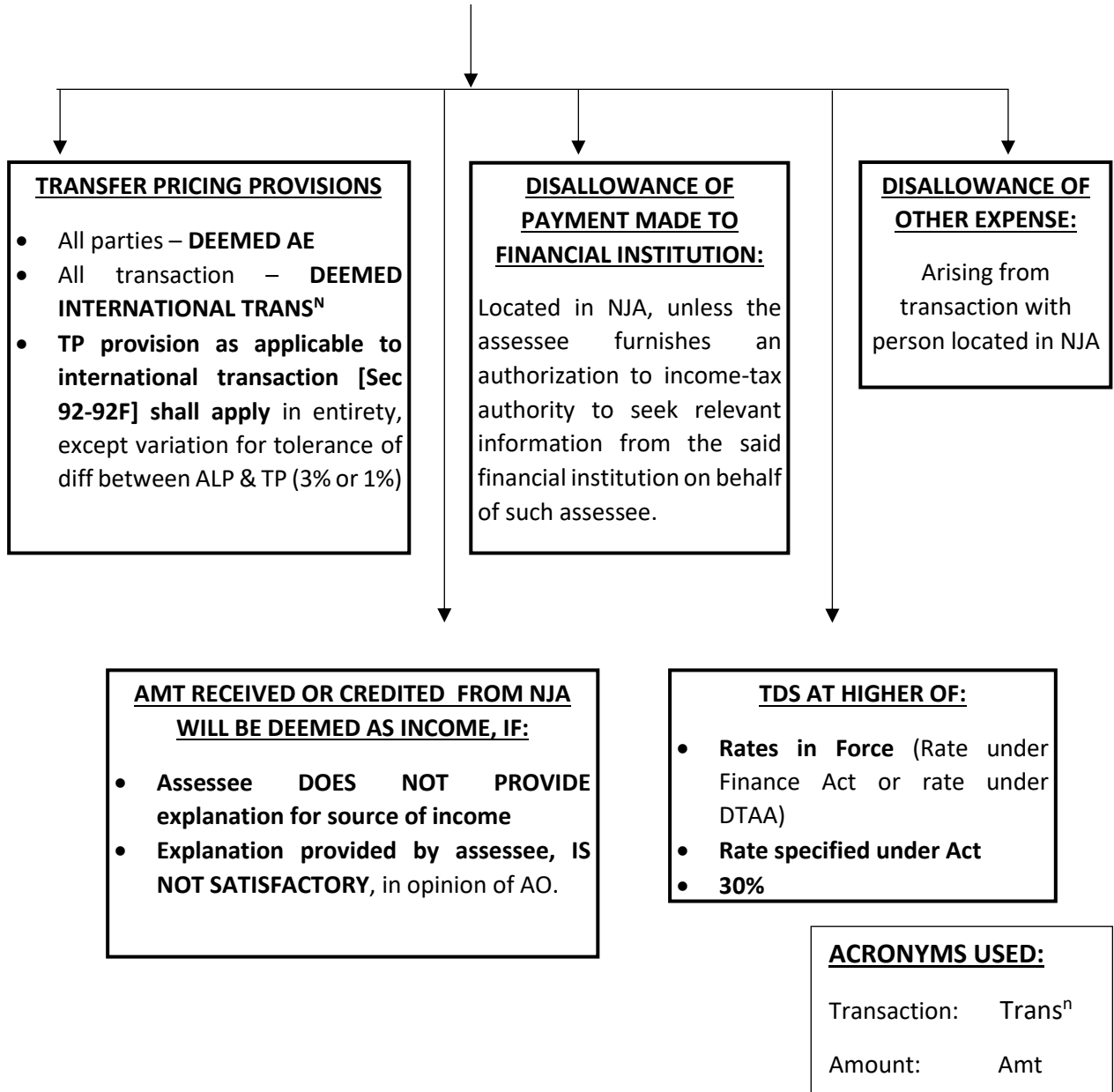
Cyprus has been removed from the list of "Notified Jurisdictional areas" under section 94A of the Income

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➤ Section 94A(2): Applicability of Transfer Pricing Regulations:

If an assessee enters into a transaction where one of the parties to the transaction is a person located in a NJA then following implications arises:-



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18. Transfer of Income to Non-residents [Section 93]

Section 93 hits at transactions which are effected with a view to avoiding liability to taxation. For the purpose, the word “non-resident” also includes a person who is not-ordinarily resident. In order to attract the provisions of this section, all the following conditions must be satisfied:

- a) There is a transfer of assets - whether movable or immovable and whether tangible or intangible.
- b) The transfer is made by any person in India or outside irrespective of his residential status or citizenship.
- c) The transfer is made either alone or in connection with associated operations.
- d) The assets transferred directly yield income chargeable to tax under this Act.
- e) The transfer of assets is effected in such a manner that the income becomes payable to a person outside India who is either a non-resident or a not ordinarily resident in India.
- f) The transferor acquires any right by virtue of which he gets the power to enjoy the income whether immediately or in future.
- g) The Assessing Officer is satisfied that avoidance of liability to tax in India is the purpose of the transfers.

In particular, this section deems any income of a non-resident person which, if it were the income of a resident person, would be chargeable to tax in India (in the absence of this Section), as the income of the resident person in India for all purposes of the Act provided that all the conditions stated above are satisfied. This section also covers a variety of transactions constituting a transfer including cases where assets are transferred to a non-resident person and the transferor indirectly derives income under the guise of obtaining loans or repayment of loans. If the aforesaid conditions are fulfilled, the income from the assets transferred should be treated as the income of the transferor and would accordingly be taxable in his hands. Therefore, where assets are transferred to a body corporate outside India, in consideration of shares allotted by it to the transferor, he (the transferor), will become assessable under this section in respect of the income of the company derived by it from those assets. This section will not, however, apply to cases where it is shown to the satisfaction of the Assessing Officer that (i) neither the transfer nor any associated operation had for its purpose or for one of its purposes the avoidance of liability to taxation or (ii) it is provided to the satisfaction of the Assessing Officer that the transfer was effected for bonafide commercial purpose and with no intent to avoid tax.

The income which is deemed to be that of the transferor under this section may also arise as a result of the transfer in connection with associated operations. However, in this case also, the treatment of the income would be the same.

Meaning of “associated operation”: The expression ‘associated operation,’ in relation to a transfer, means an operation of any kind effected by any person in relation to:

- (i) any of the assets transferred;
- (ii) any assets representing, whether directly or indirectly, any of the assets transferred;
- (iii) any income arising from such assets;
- (iv) any assets representing, whether directly or indirectly, the accumulation of income arising from such assets.

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Meaning of “Assets”: It includes property or rights of any kind.

Meaning of “transfer”: In relation to rights, transfer includes the creation of those rights.

Meaning of “benefit”: It includes a payment of any kind.

In order to determine the liability of the assessee in respect of the deemed income it is immaterial if the income or benefits from the transfer (i) are actually received or not or (ii) are received or are receivable in cash or kind or (iii) are receivable directly or indirectly. For purposes of this section, a person is deemed to have the power to enjoy the income of a non-resident if:

- i. the income, in fact, so dealt with by any person as to be calculated at some point of time to enure for the benefit of the transferor, whether in the same form of the income or otherwise;
- ii. the receipt or accrual of the income operates to increase value of any assets held by the transferor or for his direct or indirect benefit;
- iii. the transferor receives or is entitled to receive at any time any benefit out of the income or out of any money available for the purpose by reason of the effect or successive effects of the associated operations on that income and the assets which represent that income;
- iv. the transferor is in a position to obtain for himself the beneficial enjoyment of the income by exercising any power of appointment or power of revocation or otherwise, whether with or without the consent of any other person, or
- v. the transferor is able to control directly or indirectly the application of the income in any manner whatsoever.

However, in determining whether a person has the power to enjoy the income due regard shall be had to the substantial result and effect of the transfer and any associated operations must be taken into consideration irrespective of the nature or form of the benefits.

It may be noted that where an assessee has been charged to tax in respect of a sum deemed to be his income under this section, the subsequent receipt of that sum by the assessee, whether as income or in any other form, shall not be liable to tax in his hands at the time of receipt.