Transfer Pricing and Documentation

J. B. NAGAR CPE STUDY CIRCLE
Online Saturday 07.11.2020

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Agenda

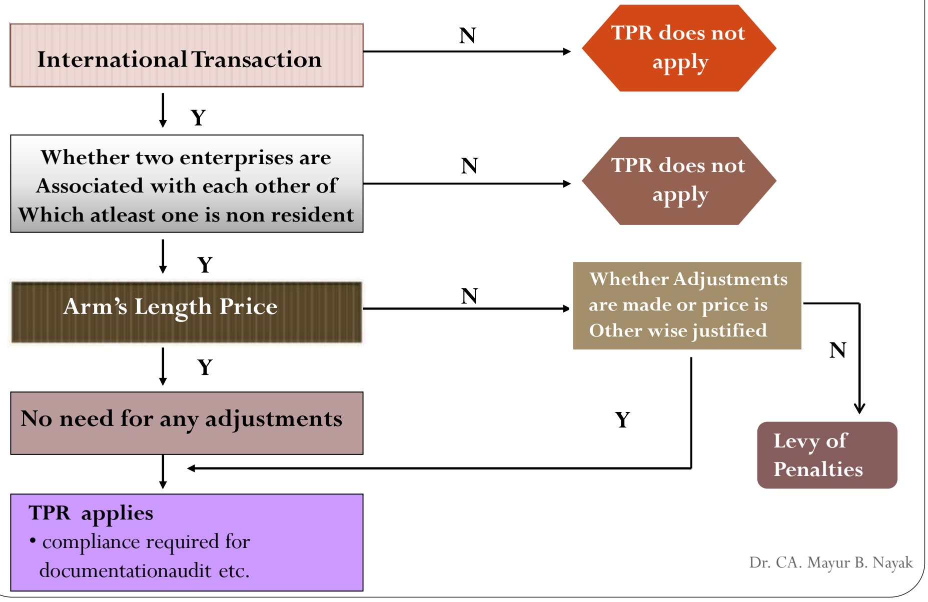
- Basic of Transfer Pricing
- Transfer Pricing Methods
- Range Concept
- Safe Harbour Rules
- **Benchmarking**
  - Debtors
  - Guarantees or Loan to an overseas Subsidiary
  - Distributors Arrangement
  - Cost plus compensation for Captive manufacturing or Service Providers
  - Cost Contribution arrangements
  - Low Risk Contract Manufacturing
- Documentation an Penalties for non-compliances
- Advance Pricing Agreement(APA) guidelines

Transfer Pricing

Meaning : The term "transfer Pricing" refers to determination of price of goods, services, and intangibles transaction between associated enterprises, entities that belong to the same business group.

The **OECD defines** "transfer Pricing" as prices at which an enterprise transfer physical goods and intangible property or provides services to associated enterprise

Checklist for Applying Transfer Pricing Regulations (TPR)



Computation of income from transaction with non-resident [Section 92]

- **Any income** arising **from an international transaction** shall be computed having regard to the **arm's length price**.

> ***Explanation***.—Allowance for any expense or interest arising from an international transaction shall also be determined having regard to the arm's length price.

- Section 92(3) provides that the **transfer pricing provisions** contained in Section 92 shall **not apply if** the same has the effect of **reducing the income chargeable to tax** or **increasing the loss** of the assessee for the year under consideration.

Meaning of associated enterprise [Section 92]

Associated enterprises are those which are owned or controlled by the same or common entity/ person.

a) an enterprise which participates, directly or indirectly, or through one or more intermediaries, in:
   - management of the other enterprise, or
   - control of the other enterprise, or
   - capital of the other enterprise.

b) If one or more persons participates, directly or indirectly, or through one or more intermediaries in:
   - management of the two different enterprises
   - control of two different enterprises
   - capital of two different enterprises

Deemed Associated Enterprises [Sec. 92A(2)]

Condition	Situation
Substantial Voting Power	➢ One enterprises ➢ holds **26% or more of the VP**, directly or indirectly, ➢ in the **other enterprises (OE).**
Substantial VP in two entities by common person	➢ Any person or enterprises ➢ **holds 26% or more** of the **VP**, directly or indirectly, ➢ **in** each of **two different enterprises**.
Advancing of substantial sum of money	➢ One enterprises advances loan to ➢ the other enterprises of an amount of ➢ **51% or more** of the book value (BV) of the **total assets of other enterprises**
Guaranteeing borrowings	➢ One enterprises guarantees ➢ **10% or more** of the **total borrowings** of ➢ the **other enterprises**.

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Deemed Associated Enterprises [Sec. 92A(2)]

Condition	Situation
Appointment of majority directors of other enterprises	➢ One Enterprises appoints **more than half (50%)** ➢ of the **Board of Directors** or members of ➢ the governing board (GB), or ➢ **one** or more **executive directors** (EDs) or ➢ **executive members** (EMs) ➢ of the GB **of other enterprises**.
Appointment of majority directors of two different enterprises by same person(s)	➢ **More than half (50%)** of ➢ the **directors or members** of the GB, or ➢ **one** or more of the **executive directors or members** ➢ of the governing board ➢ of each of the **two enterprises** ➢ are appointed **by the same person(s).**

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Deemed Associated Enterprises [Sec. 92A(2)]

Condition	Situation
Dependence on intangibles *w.r.t.* which other enterprises has exclusive rights	➢ The **manufacture or processing of goods** or articles or ➢ business carried out by one enterprises ➢ is **wholly dependent (i.e. 100%) on** ➢ **the know-how,** patents, copyrights etc., or ➢ any data, documentation, drawing or ➢ specification relating to any patent, invention, model ➢ of which the Other Enterprises is the owner or ➢ in respect of which the OE has exclusive rights.

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Deemed Associated Enterprises [Sec. 92A(2)]

Condition	Situation
Dependence on Raw Material (RM) supplied by Other Enterprises (OE)	➢ **90% or more of RMs and consumables** required ➢ for the manufacture or processing of goods or articles or ➢ business carried out by one enterprise**,** ➢ **are supplied by the Other Enterprises,** or ➢ by persons specified by the OE, ➢ where the **prices and other conditions** ➢ relating to the supply are **influenced by such OE.**

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Deemed Associated Enterprises [Sec. 92A(2)]

Condition	Situation
Dependence on Sale	➢ The **goods or articles manufactured** or processed ➢ by one enterprises, ➢ **are sold to the Other Enterprise(OE)** or ➢ to persons specified by the OE, ➢ and the **prices and other conditions** ➢ relating thereto are **influenced by such OE.**
Control by common individual	➢ Where **one enterprise** ➢ **is controlled by an individual**, ➢ the **other enterprise** ➢ is also **controlled by such individual** or his relative or ➢ jointly by such individual and his relatives

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Deemed Associated Enterprises [Sec. 92A(2)]

Condition	Situation
Control by HUF or member thereof	➢ Where one enterprise ➢ is **controlled by an HUF** and ➢ the **other enterprise is controlled** ➢ by a **member of such HUF** or ➢ by **relative of a member** of such HUF or jointly by ➢ such member and his relative
Interest in a firm, AOPs or BOIs	➢ Where one enterprise is a firm, AOPs or BOIs, ➢ the **other enterprise** ➢ **holds 10% or more** ➢ **interest** in firm/HUF/BOI.
Mutual interest relationship	➢ There exists b/w the two enterprises, ➢ any relationship of mutual interest, ➢ as may be prescribed.

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International Transactions

- A transaction between **two or more AEs** of which **either** both or any one is an **non-resident**.

- **Transactions in the Nature of** :
  - ✓ Purchase, sale or lease of tangible property or intangible property
  - ✓ Provision of services
  - ✓ Lending or borrowing of money
  - ✓ Any transaction having a bearing on the profits, income, losses or assets
  - ✓ Mutual agreement or arrangement between two or more AEs for the allocation or apportionment of any combination of any contribution cost or expense

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Section 92C – Arm's Length Price (ALP)

1. Comparable uncontrolled price method [CUP]
2. Resale Price Method
3. Cost Plus Method
4. Profit Split Method
5. Transaction Net Margin Method
6. Any Other Method as provided in Rule 10B

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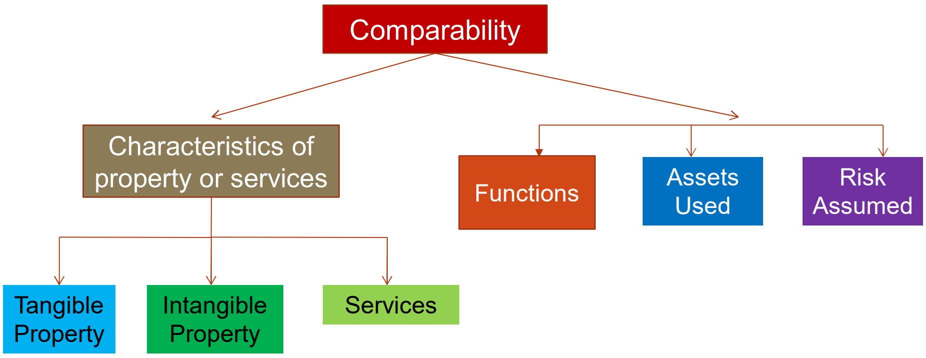
Application for ALP



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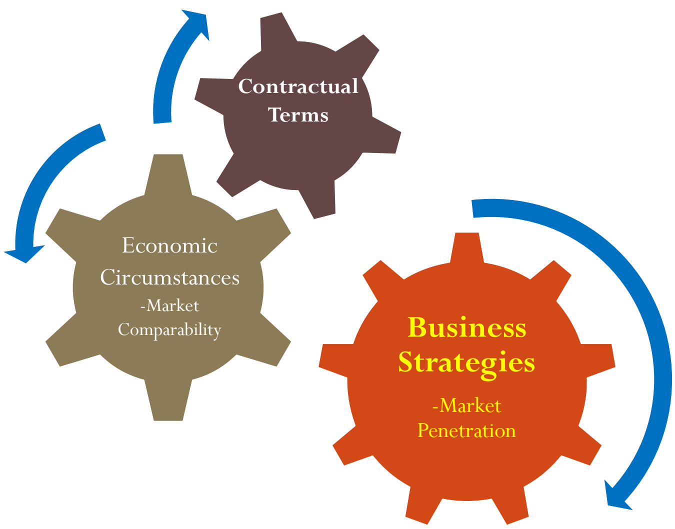
Application for ALP (contd..)



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Methods for Determination of Arm's Length Price

Comparable Uncontrolled Price Method **(CUP)**

- **Meaning**
- **Application**
  - **Internal Vs. External**
- **Rule 10 B of the Indian T.P.R.**

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Comparable Uncontrolled Price (CUP) Method

This method is applied where there are similar transaction(s) b/w unconnected parties

→ Identify price in a comparable uncontrolled transaction (CUCT)

→ Adjust the price for material differences in terms of contract, credit, transport etc.

→ Adjusted price is ALP

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Comparable Uncontrolled Price (CUP) Method

- **Difference in Source of the Product**
  - **Colombian Coffee Vs. Brazilian Coffee**
- **Difference in Terms of Sales**
  - **CIF Vs. FOB**
- **Difference in Volume (quantity)**

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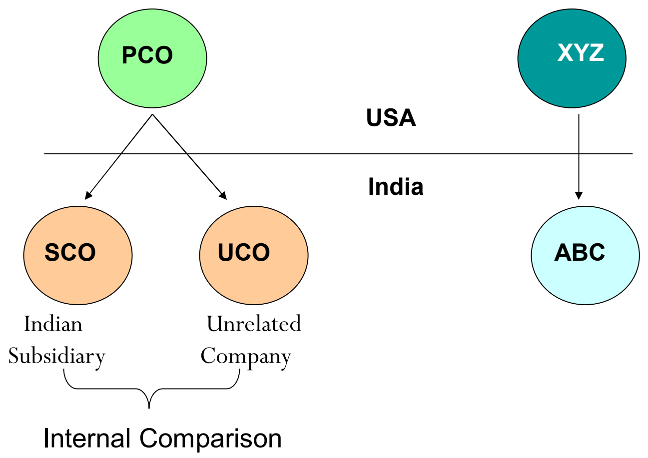
Comparable Uncontrolled Price (CUP) Method

Example



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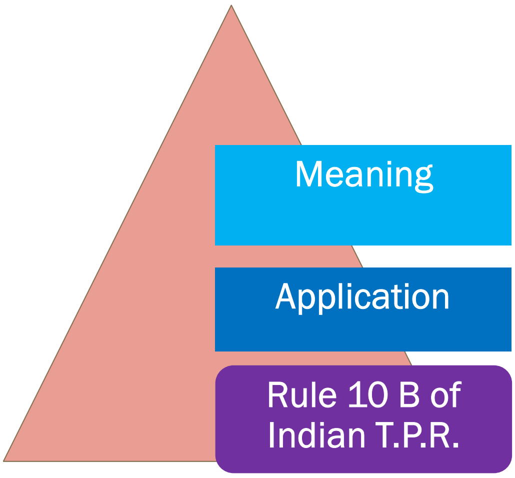
Resale Price Method (RPM)



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Resale Price Method (RPM)

1. This method is applied where item obtained from AE is resold to unrelated party
2. Identify the Resale Price(RP) at which the item is resold to unrelated party
3. Reduce the RP by the normal GP margin on CUCT expenditure incurred (customs duty) w.r.t. purchase
4. Adjust the price for functional & other differences materially affecting GP margin in open market (OM)
5. Adjusted price is ALP

E.g. = Comparison of Distributors, Brokerage Fees

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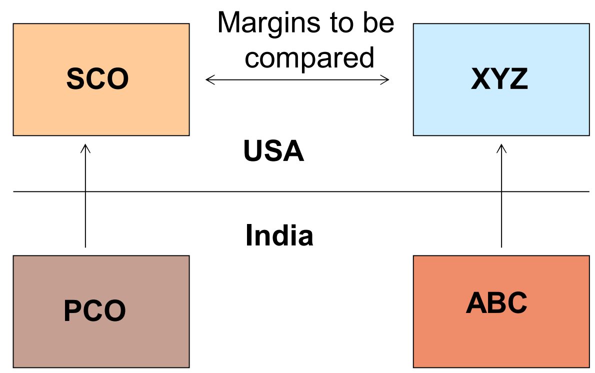
Resale Price Method (RPM)

(examples)



PCO = Parent Company
SCO = Subsidiary Company

Unrelated Parties

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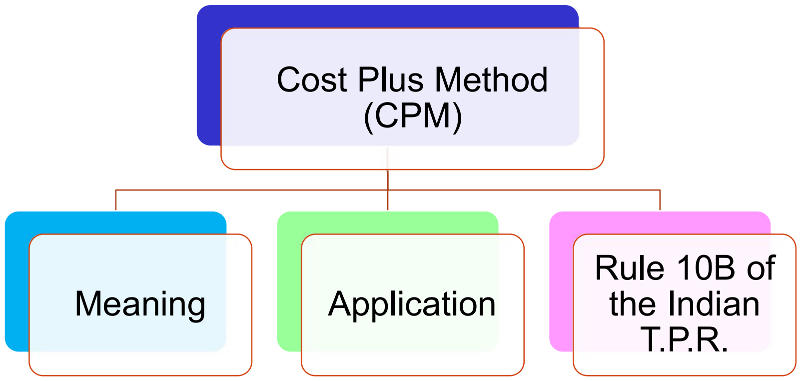
Cost Plus Method (CPM)



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Cost Plus Method (CPM)

This method is generally applied where semi-finished goods are sold to AEs

Identify direct & indirect COP incurred for property transferred or services provided to AE

Determine normal GP mark up to such costs by an unrelated enter in CUCT

Adjust the normal GP mark-up for functional and other differences materially affecting GP mark-up in OM

Total Costs increased by adjusted mark up **= ALP**

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Cost Plus Method (CPM)

Examples:

Gross Profit Margins in the household appliance industry

Contract Manufacturers

Research and Development Activity

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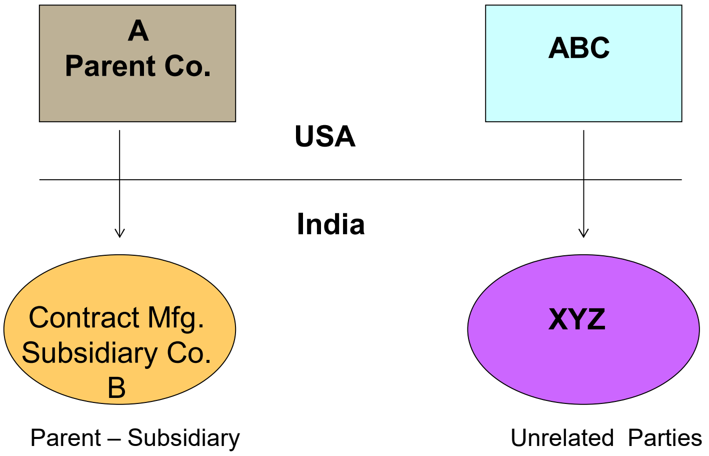
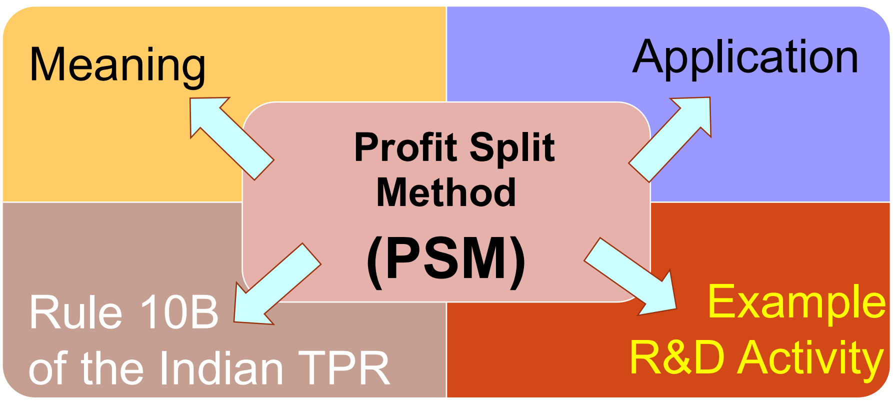
Cost Plus Method (CPM)

Examples:



Profit Split Method (PSM)



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Profit Split Method (PSM)

This method is applied where there is **transfer of unique intangibles** or in **multiple International Transaction**

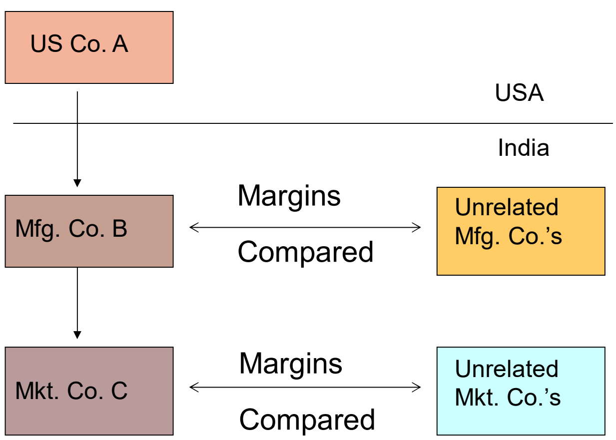
Determine combined NP of the AEs arising out of International Transaction

Evaluate the relative **contribution of each enterprise** to the earning of combined NP on the basis of FAR

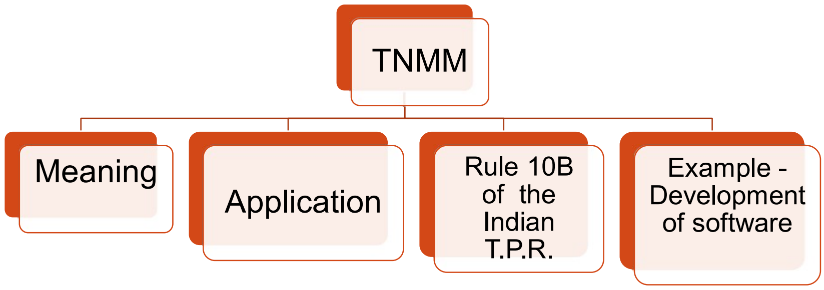
Split the combined NP amongst the enterprise in proportion to market returns; & residual profits in proportion to their relative contribution

ALP to be determined on the basis of **profit apportioned.**

Profit Split Method (PSM)



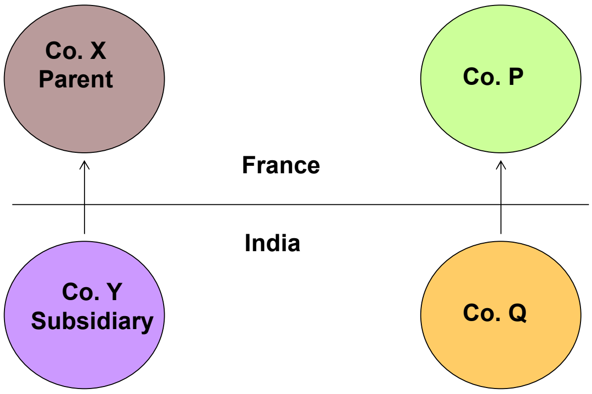
Transactional Net Margin Method (TNMM)



Transactional Net Margin Method (TNMM)

- Compute NP margin of the enterprise from International Transaction with AE having regard to cost incurred/sales effected/assets employed.
- Compute the NP margin realized by the enterprise or unrelated enterprise in a CUCT by applying the same base.
- Adjust NP margin realized from CUCT to a/c for differences affecting NP margin in the OM.
- Compare NP margin relative to costs/sales/assets of the AE with NP margin of uncontrolled party in comparable transactions.
- Adjusted NP margin taken into A/c to arrive at ALP

Transactional Net Margin Method (TNMM)



Company 'X' appoints company 'Y' its WOS for marketing
Company 'Y' charges company 'X' fees based on 5% over its net cost

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ISSUES IN APPLICATION OF TNMM

Specific factors that may affect net margins include, but are not limited to:

- Barriers to entry in the industry;
- Competitive position;
- Management efficiency;
- Individual business strategies;
- Threat of substitute products;
- Varying cost structures;

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ISSUES IN APPLICATION OF TNMM

- Difference in the working capital level;
- Difference in the import vs. domestic content;
- Difference in the capacity utilisation level;
- Difference in the business model: say outsourcing of some manufacturing processes vs. in-house manufacturing of all the processes;
- Difference in the functions: say undertaking own market / distribution channels vs. distribution through individual distributors.

Application of TNMM

Example:

AE1 Ltd., is an Indian company AE1 Ltd., manufactures compact disc (CD) writers and sells the same to AE2 Ltd., which is an AE of AE1 Ltd. As AE1 Ltd., does not have similar transaction with a non AE, no internal CUT is available. As AE1 Ltd., does not have information and data to identify a comparable company, it has used the databases in public domain for carrying out the search.

(Source: ICAI Guidelines on Transfer Pricing)

As AE1 Ltd., does not have similar transaction with a non AE, no internal CUT is available. As AE1 Ltd., does not have information and data to identify a comparable company, it has used the databases in public domain for carrying out the search. The result of the search may be summarised as follows:

	No. of companies
Search on the basis of following keywords:	
(a) Computer	800
(b) Computer hardware	250
(c) Computer peripherals	66
Sub total	1116
Elimination process :	
Companies with different activities	800
Companies with duplication when multiple database are used	75
Companies with no financials	90
Companies having significant operations like sales or purchases with related party	100
Companies reporting no operations	50
Sub total	1115
Company/companies selected – Z Ltd.	1

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Guidance Note on Report under Section 92E of the Income-tax Act, 1961

The comparison between AE1 Ltd., and Z Ltd., is carried out as follows:

Financials	AE1 Ltd. INR (in crores)	Z Ltd. INR (in crores)
Sales	130	200
Other income	5	10
Total Income	135	210
Operating expenses	85	120
Interest	5	7
Depreciation	10	12
Loss on sale of undertaking	5	0
Expenses relating to non operating income	1	3
Total expenditure	106	142
Net profits	24	58

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Operating margin	AE1 Ltd. INR(in crores)	Z Ltd. INR(in crores)
Sales	130	200
Gross revenue	130	200
Operating expenses	85	120
Interest	5	7
Depreciation	10	12
Total operating cost	100	139
Operating profit	30.00	61.00
Operating margin (before interest and depreciation)	52.94	66.67
Operating margin (after depreciation but before interest)	36.84	51.52

138

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Tested Party

The tested party is the one whose profitability is analyzed and benchmarked for establishing arm's length price of the International Transaction (or the Specified Domestic Transaction).

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Criteria for Selection of a Tested Party

1) The party which is least complex in terms of FAR Analysis i.e. Functions Performed, Assets Employed and Risks Assumed.
   Example:
   A choice between a Manufacturer and a Distributor
2) Reliable Information about the Tested Party is available
3) Reliable Information about the "comparables" is easily & readily available and should be capable of being verified independently.

Foreign AE as a Tested Party

No Statutory permisison nor prohibition

Tribunals are divided.

Pune Tribunal in cases of Carraro India Pvt. Ltd. [TS-124-ITAT-2019 (PUN) – TP] and in the case of Bekaert Industries Pvt. Ltd. [TS-347-ITAT-2019 (PUN) – TP] ruled against the concept of foreign AE as a tested Party as there is no Statutory sanction under the Indian Law.

USA, EU, Malaysia expressly allow Foreign Party as a Tested Party

Revenue’s stand on Comparability Adjustments

The onus to prove a “reasonably accurate comparability adjustment” is on the taxpayer.

- ➔ Capacity utilization and working capital adjustments are accepted.
- ➔ However, the Indian transfer pricing administration finds it difficult to make risk adjustments in the absence of any reliable, robust and internationally agreed methodology to provide risk adjustment.

(Source: India’s Chapter in the UN Transfer Pricing Manual, 2017 Edition)

Location Savings

Location Saving arises due to cost advantages that a Jurisdiction provides.

India provides various operational advantages to the MNEs, such as availability of low-cost labour or skilled employees, lower raw material cost, lower transaction cost, reasonably priced rental space, lower training costs, availability of infrastructure at a lower cost, various direct and indirect tax incentives, etc.

Location Specific Advantages

India provides the following Location-Specific Advantages (LSAs) to MNEs:

- ➔ Highly skilled, specialised and knowledgeable workforce;
- ➔ Access and proximity to large and growing local/regional markets;
- ➔ Large customer base with increased spending capacity;
- ➔ Superior information networks;
- ➔ Superior distribution networks;
- ➔ Various policy incentives; and
- ➔ Market premium.

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Other Method

- CBDT has notified the "Other method" vide a Notification.
- **Rule 10AB –**
  - "any method which takes into account the price which has been charged or paid, or
  - would have been charged or paid, for the same or similar uncontrolled transaction,
  - with or between non-associated enterprises,
  - Under similar circumstances, considering all the relevant facts".

*The **OECD Guidelines** also **permit the use of any other method** and state that the taxpayer retain the freedom to apply methods not described in OECD Guidelines to establish prices, **provided those prices satisfy the arm's length principle.***

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Documents used for Benchmarking under Any Other Method

Documents which may possibly be used for comparability purposes could be:

(a) Third party quotations/ invoices;

(b) Valuation reports;

(c) Tender/Bid documents;

(d) Documents relating to the negotiations;

(e) Standard rate cards;

(f) Commercial & economic business models; etc.

[Source: ICAI Guidelines on Transfer Pricing]

Transactions benchmarked using Any Other Method

- Following are the few transactions which are normally benchmarked using Any other method:

Sr. No.0	Nature of transaction	Documents used to benchmark
1	Reimbursement of Expense	- Listing of reimbursement of expense - Ledger copy - Back-to-back supporting's to show reimbursement is on cost-to-cost basis - Contract's copy
2	Recovery of Expense	- Listing of recovery of expense - Ledger copy - Back-to-back supporting's to show recovery is on cost-to-cost basis
3	Investment in share capital Or Buy back of shares	- Valuation report issued by independent valuer - Board resolution - Filing of FCGPR/ODI forms to comply with FEMA regulations - Physical share certificate issued

Examples

Transactions where Any other Method can be followed

- Sale of Registered patents to AE @ price determined based on Valuation Report obtained from Independent Valuer.
- Reimbursement of Expenses incurred on behalf of AE. which do have any bearing on profit & loss of the Entity.
- ABC Pvt. Ltd. issues CCDs to its parent company (Foreign AE) at a price higher or equal to fair value determined by Valuer.
- Interest on CCDs paid to AE @ less then Interest rate (SBI Prime Lending rate) prevailing in the market.
- Interest charged to AE @ more than Interest rate (LIBOR) prevailing in the Market
- Indian co. buys back its equity shares issued to its foreign AE at value determined in Valuation report.

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Illustrative list on Various methods

Transaction	CUP	RPM	CPM	TNMM	PSM
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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Range Concept

RANGE CONCEPT

Range Concept is applicable for international transactions undertaken on or after the 1st April 2014 (i.e., effective from assessment year 2015-16).

If six or more companies are available the Range Concept Applies otherwise Arithmetic Mean is to be applied.

Section 92C(2) *read with* Rule 10CA

Manner of computation of Arm's length price -

Whether **a single price** is arrived at?

Yes

The price thus determined is the arm's length price

NO

As per **range concept**

OR

By applying **Arithmetic Mean** * in any other case

* If the difference between Actual Transaction Price & ALP is upto **3% (1% in case of Wholesale trading)** of actual transaction price then such difference shall be ignored. Arithmetic Mean is to be applied where comparable companies available are less than six.

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Section 92C(2) *read with* Rule 10CA

How to apply Range Concept ?

Step 1

- Arrange the values in the dataset in the **ascending order**

Step 2

- Where the **actual transaction price** falls **within 35th and 65th percentile of the dataset**, the value of transaction will be accepted to be arm's length price.

Step 3

- Where the transfer price does **not fall within** the above **range**, then **median of dataset** shall be taken as the Arm's Length price

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Illustration for Range Concept

Sr. No.	1	2	3	4	5	6	7
ALP	162	158	136	145	170	152	154

Actual Transaction Price is Rs 150.
Solution:
First arrange all data in ascending order

Sr. No.	1	2	3	4	5	6	7
ALP	136	145	152	154	158	162	170

Now, 35th and 65th percentile of data shall be computed:

Total no of values in data – 7

35th percentile of data – 7*0.35 – 2.45

65th percentile of data – 7*0.65 – 4.55

Since, 2.45 and 4.55 are not whole numbers, we have to take next higher numbers i.e. 3 and 5.

ALP will be beginning at 152 (i.e. 3rd number) and Ending at 158 (i.e. 5th number) i.e. range is computed as between **152 – 158.** So if actual transaction price is within the range (152-158) then the actual transaction price shall be treated as deemed to be ALP.

But in our illustration, Actual ALP is 150 which is not falling within above determined Range, so ALP shall be median of data.

Median of data – 7* 0.50 – 3.5. Since this is not whole number, next higher value is 4 and hence the ALP is 154.

Example

AB Gems Pvt. Ltd. (PBDIT/OI): **3.49%**

Sr. No.	Comparable Companies	Profit Level Indicator (PBDIT/Operating income)
1	FD Diamond Pvt. Ltd.	2.52%
2	Khushboo Jewellers Ltd.	2.82%
3	Royal Brothers Export Ltd	3.44%
4	Rosy Pink Pvt. Ltd.	3.50%
5	Qs Diamond Ltd	4.46%
6	Maya Gems Ltd.	5.33%

Range		
35th Percentile	6*35% = 2.1	3rd Value
65th Percentile	6*65% = 3.9	4th Value

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Multiple year Data in Benchmarking

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Section 92C *read with* Rule 10B

Multiple year data Concept -

When to Apply Multiple year data Concept ?

Most appropriate method selected is
- Resale price method(RPM),
- Cost plus method(CPM)or
- Transactional net margin method (TNMM)

AND

The transaction is entered into on or after 01/04/2014.

Continue…..

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Multiple Year Data

If Most Appropriate Method
- RPM/CPM/TNMM
  - Multiple year data can be used
- CUP/PSM/Other Method
  - Multiple year data can not be used

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Multiple Year Data

- For Each comparable selected, the data of current year is to be considered.
- In case such data is not available at the time of furnishing the return of income

↓

Data pertaining to - upto 2 Preceeding F.Y. may be used.

- Rules provides that - in the event current year data becomes available during course of Assessment proceedings, then

↓

the same shall be used by TPO for the purpose of the analysis

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Multiple Year Data

Weighted Average: While using Multiple year data, the Profit Level Indicator should be weighted average.

Eg.

	Yr.0	Yr.1	Yr.2	Total	
Operating Profit	250	300	350	900	OP/OR for comparable would be 900/5400= 16.7%
Net Operating Revenue	1700	1800	1900	5400	

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Summary of Use of Multiple Year Data (MYD)

At the time of compliance

- MYD considered irrespective of the Range applicability.
- MYD entails use of data for the year under consideration ('current year') and data for up to two preceding financial years;
- Data for the current year, if available is compulsorily to be considered unless not comparable on qualitative or quantitative reasons.

At the time of transfer pricing assessment

- At the time of transfer pricing assessment, data for the current year, if available, must be used
- If such updated data for the current year cannot be used due to qualitative / quantitative filters, then such a comparable cannot be used irrespective of the fact that the data for previous years remains to be comparable;
- A fresh comparable not appearing in the benchmarking set at the time of compliance can be used at the time of assessment.

Safe Harbour Rules

Section 92CB

"safe harbour" means circumstances in which the income-tax authorities shall accept the transfer price or income, deemed to accrue or arise under clause (i) of sub-section (1) of section 9, as the case may be, declared by the assessee.

Taxpayers opting for the Safe Harbour Rules for FY 2019-20 will need to file **Form 3CEFA** with the Assessing Officer, on or **before the due date of furnishing return of income for FY 2019-20**, i.e.**, *by 31st January, 2021***

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Safe Harbour Rules

S. No.	Eligible International Transaction	Circumstances
	[Rule 10 TC]	**[Rule 10TD]**
1	**Provision of software development services** **does not include any R&D services**	The **operating profit margin** declared by the eligible assessee from the eligible international transaction in relation **to operating expense** incurred is – **Not < the prescribed %** / **Value of International Transaction** 17% / Upto Rs. 100 Crore 18% / Between Rs.100 crore to Rs. 200 Crore

Not < the prescribed %	Value of International Transaction
17%	Upto Rs. 100 Crore
18%	Between Rs.100 crore to Rs. 200 Crore

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Safe Harbour Rules

S. No.	Eligible International Transaction	Circumstances
	[Rule 10 TC]	[Rule 10TD]
2	**Provision of information technology enabled services** does not include any R&D services	The **operating profit margin** declared by the eligible assessee from the eligible international transaction in relation **to operating expense** incurred is –

Not < the prescribed %	Aggregate value of International transaction during PY
17%	Upto Rs. 100 Crore
18 %	Between Rs.100 Crore to Rs. 200 Crore

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Safe Harbour Rules

S. No.	Eligible International Transaction	Circumstances
	[Rule 10 TC]	[Rule 10TD]
3	**Provision of Knowledge process outsourcing (KPO) services** does not include any R&D services	The Value of International Transaction does **not exceed Rs.200 crore** & the ***operating profit margin declared*** by eligible assessee from eligible international transaction in relation ***to operating expense is –***

Not < the Prescribed %	Employee Cost in relation to the Operating Expense
24%	at least 60%;
21%	40% or more but less than 60%;
18%	does not exceed 40%

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Safe Harbour Rules

S. No.	Eligible International Transaction	Circumstances
	[Rule 10 TC]	**[Rule 10TD]**
4	**Advancing of intra-group loans** where the amount of loan is denominated in Indian Rupees **(INR)**	The **interest rate declared** in relation to the eligible international transaction is **not less than** the 1 yr marginal cost of funds **lending rate** of **SBI as on 1st April** of the relevant previous year **plus-**

%	CRISIL rating of Associated Enterprise or its equivalent
1.75%	Between AAA to A
3.25%	BBB-, BBB, BBB+
4.75%	Between BB to B
6.25%	C to D
4.25%	No Credit rating & loan upto Rs.100 Crore

Safe Harbour Rules

S. No.	Eligible International Transaction	Circumstances
	[Rule 10 TC]	**[Rule 10TD]**
4	**Advancing of intra-group loans** where the amount of loan is denominated **in Foreign currency**	The **interest rate declared** in relation to the eligible international transaction is **not less** than the **6 month LIBOR** of the relevant foreign currency as on **30th September** of the relevant **previous year** plus-

%	CRISIL rating of Associated Enterprise or its equivalent
1.50%	Between AAA to A
3 %	BBB-, BBB, BBB+
4.50%	Between BB to B
6 %	C to D
4 %	No Credit Rating & loan upto Rs.100 crore as on 31st March of the relevant P.Y

Safe Harbour Rules

S. No.	Eligible International Transaction	Circumstances	
	[Rule 10 TC]	[Rule 10TD]	
5	**Providing corporate guarantee**	**Where the amount guaranteed**	**The commission or fee declared in relation to the eligible international transaction is at the rate not less than -**
		Not Exceed Rs.100 crore	1% p.a. on the amount guaranteed
		Exceed Rs.100 crore & Credit rating of AE is done by agency register with SEBI	

Safe Harbour Rules

S. No.	Eligible International Transaction	Circumstances
	[Rule 10 TC]	[Rule 10TD]
6	**Provision of contract R & D services wholly or partly relating to software development**	The **operating profit margin declared** by the eligible assessee from the eligible international transaction in relation to operating expense incurred is **not less than 24%,** where the **value of the international transaction does not exceed a sum of Rs. 200 crore**.

Safe Harbour Rules

S. No.	Eligible International Transaction	Circumstances
	[Rule 10 TC]	[Rule 10TD]
7	**Provision of contract R & D services wholly or partly relating to generic pharmaceutical drugs**	The **operating profit margin declared** by the eligible assessee from the eligible international transaction in relation to operating expense incurred is **not less than 24%,** where the **value of the international transaction does not exceed a sum of Rs. 200 crore**.

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Safe Harbour Rules

S. No.	Eligible International Transaction	Circumstances
	[Rule 10 TC]	[Rule 10TD]
8	**Manufacture and Export of Core Auto Components**	The **operating profit margin declared** by the eligible assessee from the eligible international transaction in relation to operating expense incurred is **not less than 12 %.** **i.e. OP/OE at least 12%**

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Safe Harbour Rules

S. No.	Eligible International Transaction	Circumstances
	[Rule 10 TC]	[Rule 10TD]
9	**Manufacture and Export of Non-Core Auto Components**	The **operating profit margin declared** by the eligible assessee from the eligible international transaction in relation to operating expense incurred is **not less than 8.5 %.** **i.e. OP/OE at least 8.5 %**

Safe Harbour Rules

S. No.	Eligible International Transaction	Circumstances
	[Rule 10 TC]	[Rule 10TD]
10	**Receipt of low value-adding intra group services**	The **entire value** of the international transaction, including a **mark-up not exceeding 5%,** does **not exceed a sum of Rs. 10 crore.**

FINANCIAL TRANSACTIONS

In India, the transfer pricing approach for inter-company loans and guarantees revolves around:

➔ examination of the loan agreement;

➔ a comparison of terms and conditions of loan agreements;

➔ the determination of credit ratings of lender and borrower;

➔ the identification of comparable third party loan agreements; and

➔ suitable adjustments to the comparables to enhance comparability.

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Benchmarking

Guarantees to an Overseas Subsidiary

Borrower / payer of Guarantee Fees	Guarantor / receiver of Guarantee Fees	Comments
Indian assessee	Associated Enterprise	Arm's length guarantee fee has to be determined. Indian Tax Authorities would be not be convinced of arm's length nature if there is "nil" guarantee fee charged.
Associated Enterprise	Indian assessee	Arm's length guarantee fee has to be determined.

The simplest way to benchmark the guarantee fees is to follow **"opportunity cost approach"**, also known as "interest savings approach".

Continue…..

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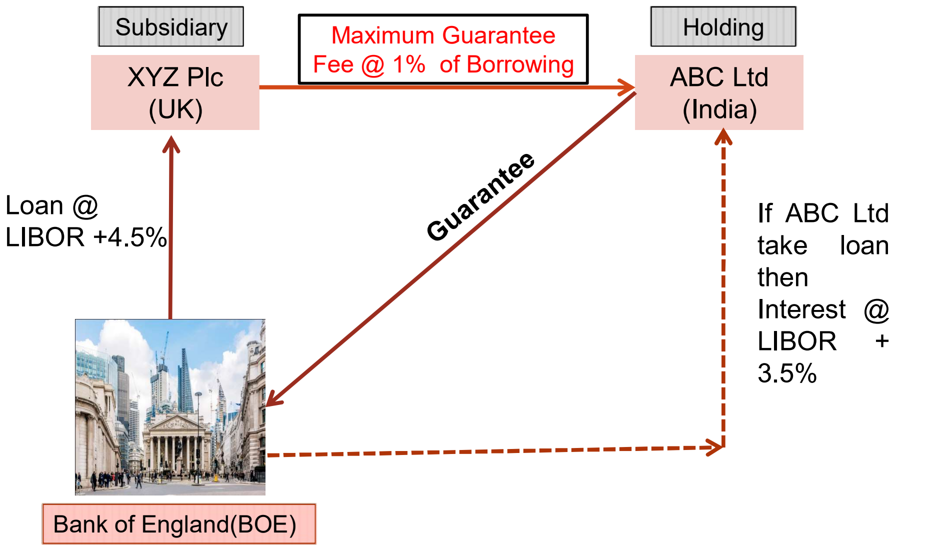
Benchmarking

Example



Benchmarking

Loan to an Associated Enterprises:-

There are several possibilities to determine ALP :-

- Internal comparable loan, if any
- Benchmark Prime Lending Rate (BPLR) of Indian banks
- Base Rate of Indian banks
- LIBOR plus “x” basis points, where “x” is determined by a benchmarking exercise
- EURIBOR plus “x” basis points, where “x” is determined by a benchmarking exercise

Recently, **various Tribunals** have been applying **“LIBOR plus”** as an indicator of arm’s length prices.

Cost Contribution Arrangements(CCA)

OECD Transfer Pricing Guidelines 2017 define the term CCA -

- as "a **contractual arrangement** among business enterprises to
- **share the contributions and risks** involved **in the joint development,** production or the obtaining
- **of intangibles, tangible assets or services** with the understanding that the aforesaid are expected to created benefits for the individual businesses of each of the participants"

CCAs are most common in relation to research & development (R&D) and development of intellectual property (IP) including IP use & ownership.

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Cost Contribution Arrangements(CCA)

Legal provision as per Sec.92 (2) :-

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

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Cost Contribution Arrangements(CCA)

Reporting Requirement

Master File
(Form 3CEAA)

Local File
(Form 3CEB)

important agreements related to intangibles, including CCAs.

important service arrangements

transactional information

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Distributor Arrangements

Marketing Intangibles

Limited Risk Distributors		Full Fledged Distributor (Marketer/Distributor)	
Functions	Risks	Functions	Risks
Sales & Distribution, Monitoring Inventories, Monitoring Credit Risk	Limited Inventory Risks, Limited Credit Risks	Sales & Distribution, Marketing	Market Risk, Inventory Risks, Credit Risks

Continue…..

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Distributor Arrangements

LG Electronics India Pvt Ltd. V/s ACIT [2013] 29 taxmann.com 300(Delhi) (SB)

The Tribunal held that TP adjustments in relation to the Advertising Marketing & Promotion **(AMP) expenses** incurred by the Indian taxpayer for creating and improving the **marketing intangible** for and **on behalf of the foreign parent** company is **permissible.**

***RayBan Sun Optics India Limited** v. **DCIT** (ITA No. 5933/Del/2012)*
***Canon India Pvt. Ltd. v. DCIT** (ITA Nos. 4602/Del/2010, 5593/Del/2011 & 6086/Del/2012)*

Distributor Arrangements

illustrative functions / risk / asset, the **distributor** could be characterized as follows:

Parameters	Commission agent	Limited risk distributor	Normal risk distributor	Entrepreneur distributor
Takes title	No	Yes	Yes	Yes
Credit risk	No	Limited	Yes	Yes
Inventory risk	No	Limited	Yes	Yes
Marketing responsibilities	No	Limited	Limited	Yes
Foreign exchange risks	No	No	Yes	Yes

Manufacturers

Parameters	Full Fledge Manufacturer	Licensed Manufacturer	Contract Manufacturer	Toll Manufacturer
Produces on	Own behalf	Own behalf	Principal	Principal
Intellectual Property	Owns the IP	Does not own the IP but uses the IP owned by Principal on license basis	Does not own	Does not own
Materials	Owns	Owns	Owns	Does not own
Production Scheduling	Does not own	Does not own	Done by Principal	Done by Principal
Selling and distribution function	Performs	Performs	Does not Perform	Does not perform

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Continue.....

Manufacturers

Parameters	Full Fledge Manufacturer	Licensed Manufacturer	Contract Manufacturer	Toll Manufacturer
Bears Market Risk	Yes	Yes	Limited	Limited
Bears Inventory Risk	Yes	Yes	Limited	No
Bears Capacity-utilization Risk	Yes	Yes	No	No
Bears Credit Risk	Yes	Yes	No	No

Sun Pharmaceutical Industries Limited vs ACIT, TS-596-ITAT-2017 (Ahd)-TP

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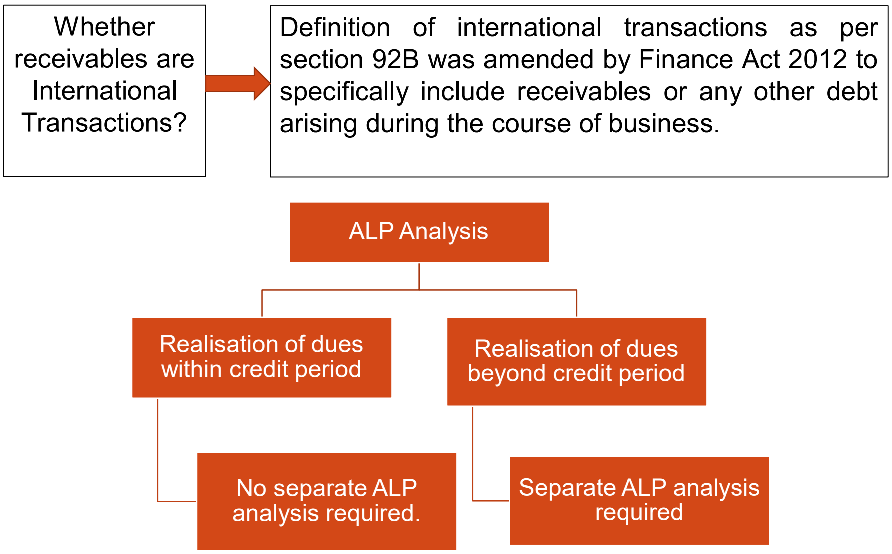
Benchmarking of Receivables



Outstanding Receivable – Is it a separate International Transaction??

- Overdue outstanding receivables has been under constant litigation in India.
- In the event the actual receipt is beyond what has been agreed between parties then typically such extended credit period is viewed as an advance of loan that warrants a charge
- Various courts have provided relief by allowing for working capital adjustment and acknowledging the practical and commercial situations
- However, recently in the case of **Bharti Airtel Services Ltd**[1], the Delhi Income Tax Appellate Tribunal (ITAT) has provided a contrary view and dismissed the taxpayer's appeal against a transfer pricing adjustment of interest on outstanding receivables.

[1] ITA No. 161/Del/2017 (AY 2011-12)

Outstanding Receivable – Is it a separate International Transaction??

- The department representative ('DR') distinguished the facts of various cases relied upon by the assessee and the facts of instant case as:
  - It is not shown that the sale price included the outstanding credit period beyond the agreed credit period. DR submitted that had the sale price included the outstanding receivable beyond the specified period for payment and that there was no need to mention 15 days in the agreement;
  - In the case laws relied upon by the assessee, the taxpayer made the working capital adjustment in its transfer pricing analysis;
  - The tax authorities also alleged that the working capital adjustment working submitted by the assessee was not reliable.

Outstanding Receivable – Is it a separate International Transaction??

- Accordingly, ITAT categorically noted that the, *"service agreement mandated payments by the AE to the taxpayer within 15 days. The agreement clause clearly shows that if the payment is beyond 15 days, it does not include the cost of service for withholding the payment beyond 15 days by the AE. This shows that in the service cost, the cost of outstanding which remains overdue is not factored. Further, as the working capital adjustment was denied in the absence of reliable data, the* ***ITAT concluded that the outstanding debtors beyond an agreed period are a separate international transaction of providing funds to its AE, for which the taxpayer must have been compensated in the form of interest at LIBOR + 300 BPS."***

Documentation & Penalties

TP Documentations

Section 92D *read with* rule 10D

- Section 92D imposes responsibility on **every person** who enters into an international transaction to keep and maintain such information and documents in respect thereof as may be prescribed in Rule 10D.
- **Every person**, being a **constituent entity** of an international group, shall keep and maintain such information and document in respect of an international group as may be prescribed.

TP Documentations

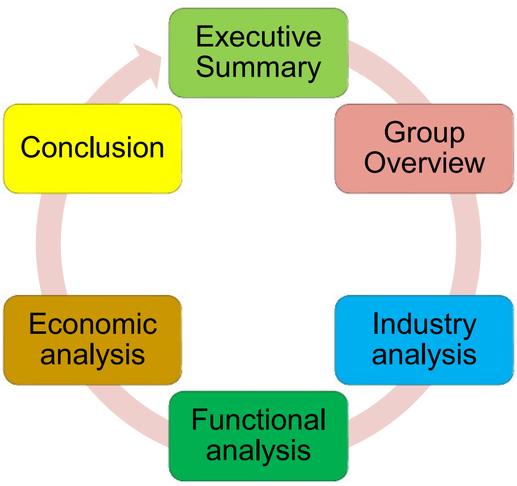
Section 92D *read with* rule 10D

Need for TP Documentation –

- Self review of intercompany transfer pricing
- Penalty Protection
- Basis for the selecting method in Form 3CEB
- To be prepared for transfer pricing audit

TP Documentations

Structure of Transfer Pricing documentation



TP Documentations

BEPS Action Plan 13	TP Study Report	Form 3CEAA	Form 3CEAD
Types of Document	**Local File**	Master File	Country-by-Country (CbC) report

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TP Documentations

Document	Information
Local file	Specific reference to material transactions of the local taxpayer
Master File (Form 3CEAA)	Standardized information relevant for all multinational enterprises (MNE) group members
Country-by-country (CbC) report (Form 3CEAD)	Information relating to the global allocation of the MNE's income and taxes paid; and Indicators of the location of economic activity within the MNE group

Documents are required to be **kept for 8 years** from the end of relevant A.Y.

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TP Documentations

Applicability of Local File & Form 3CEB

Local file (TP Study Report)	If Value of International Transaction is **> Rs. 1 Crore**
Form 3CEB (TP Audit Report)	➢ There no threshold limit for Form 3CEB. ➢ Time limit for furnishing Form No. 3CEB – On or **before 31st October** of the relevant A.Y.

Due date for furnishing FORM 3CEB for F.Y. 2019-20 has extended to

Applicability of Master File (Form 3CEAA)

AS per Rule 10DA :–Every Person , being a constituent entity of an international group ,if

Form 3CEAA

Part A

Compulsory irrespective of the value of International Transaction

Part B

Aggregate value of international transactions

In case of **Intangible property** exceeds Rs. 10 Crore

OR

exceeds Rs. 50 Crore

AND

Consolidated group revenue **exceeds** Rs. 500 Crore

Continue…..

Master File (Form 3CEAA)

Due Date

The **FORM 3CEAA** shall be furnished on or before the due date for furnishing the return of income specified under Section 139(1) i.e. **30th November each year.**

In case of More than one Constituent entity

- Furnishing of **Form 3CEAB** by that constituent entity which has been designated by the international group to furnish the FORM 3CEAA.
- Such intimation shall be made **at least 30 days before** the due date of filling **FORM 3CEAA *i.e 31st October each year.***

Penalties

Section	Default	Penalty
271AA	▪ Failures to **keep & maintain** information & document as per Sec 92D. ▪ Fails to report transactions ▪ Fails to maintain/furnish correct information/document	2% of transactions value
	▪ Fails to furnish **Master File** (Form 3CEAA)	**Rs. 5,00,000**
271G	Fails to furnish information & documents u/s 92D	2% of transactions value
271BA	Failure to furnish **FORM 3CEB**	**Rs.1,00,000**
270A	Failure to report any transactions would constitute '**Misreporting of income**'	200% of Taxes

Country-by-Country(CbC) [Form 3CEAD]

- The Country-by-Country (CbC) report has to be submitted by parent entity of an international group to the prescribed authority in its country of residence.
- This report is to be based on consolidated financial statement of the group.
- **Applicability in India –**

If **Total group revenue** as per CFS is **Rs.5500 crore or more** in previous accounting year.

Due Date within 12 months from the end of reporting accounting year. i.e. for the FY 2019-20 due date is 31st March 2021

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Country-by-Country(CbC) [Form 3CEAD]

Content of CbC Report –

- MNEs have to report annually and for each tax jurisdiction in which they do business:
  (1) the amount of revenue;
  (2) profit before income tax; and
  (3) income tax paid and accrued
- MNEs have to report their total employment, capital, accumulated earnings and tangible assets in each tax jurisdiction.
- MNEs have to identify each entity within the group doing business in a particular tax jurisdiction and provide an Indication of the business activities each entity engages in.

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Country-by-Country(CbC) [Form 3CEAD]

Form	Applicability
Form No. 3CEAC	CE resident in India, which is part of an international group and whose parent is a non-resident .
Due Date At least 2 months prior to the due date of furnishing Cbc report	
Form No. 3CEAE	The designated entity, where there are multiple CEs resident in India that are part of the same international group and whose parent is non-resident.
Due date of filling Form 3CEAE has not been prescribed.	

CE = Constituent entity

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Penalties

Sec 271GB :- Penalty for Not Furnishing CbC report

	Period of delay	Penalty
a	Upto 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

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Secondary Adjustments

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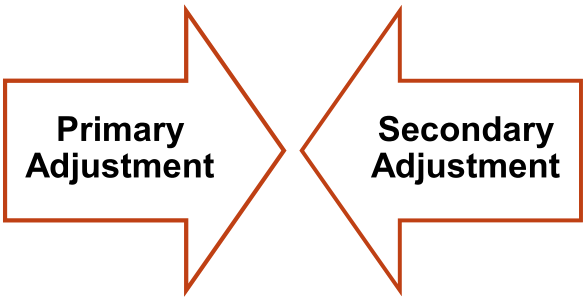

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Primary Adjustment

What is Primary Adjustment ?

- "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

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Secondary adjustment – Section 92CE

- **"Secondary adjustment"** means an **adjustment**
- **in** the **BOAs** of the assessee and its associated enterprise
- to reflect that the **actual allocation of profits**
- **between** the **assessee** and **its associated enterprise**
- are 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.

Non- Applicability :- where the **amount of primary adjustment** made in any previous year does **not exceed Rs. 1 Crore**; or the primary adjustment is **made** in respect of an AY commencing **on or before 1st April, 2016.**

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Background

- TP adjustments (i.e., primary adjustment) impacted the taxable profits which resulted in imbalance of cash account;
  - No accounting entries were passed in the books for the money receivable on account of excess paid or short charged to AE.
- OECD TP guidelines have advocated the approach of aligning actual intercompany transactions to reflect the arm's length standard. OECD TP guidelines defines:
  - **Secondary Adjustment ('SA')** - adjustment that arises from imposing tax on a secondary transaction in transfer pricing cases;
  - **Secondary Transaction** - a constructive transaction that countries will assert under their domestic legislation after having proposed a primary adjustment in order to make the actual allocation of profits consistent with the primary adjustment.

Background

- Prior to 2017, SA was attempted by tax authorities by re-characterizing the TP adjustments in the case of PMP Auto Components Pvt. Ltd. [TS-263-ITAT-2014 (Mum) - TP].
  - ITAT ruled in favour of taxpayer holding that SA is not permissible as per the then existing TP provisions of the Act.
- To provide statutory backing and to be in line with OECD / international best practice, **India vide Finance Act, 2017** has introduced SA provisions by **insertion of Section 92CE** in the Income Tax Act ('the Act').

Secondary adjustment – Section 92CE

Forms of Secondary Adjustment

- Constructive dividends
- Constructive Equity Contributions
- Constructive loans.

Secondary adjustment – Section 92CE

Cases where secondary adjustment has to be made

- (a) Suo motu by the assessee
- (b) by the Assessing Officer
- (c) Advance pricing agreement (Sec.92CC)
- (d) Safe harbour rules (Sec. 92CB)
- (e) Mutual agreement procedure (MAP)

Secondary adjustment – Section 92CE

- Non-repatriation of **excess money** by the associated enterprise **deemed to be an advance**

Excess Money = ALP's in primary adjustment − Actual value of international transaction

Excess money or part thereof may be **repatriated from any of the associated enterprises** of the assessee which is not a resident in India

Continue…..

Secondary adjustment – Section 92CE

Excess money or part thereof should be repatriate within -

Type of primary adjustment	Time limit for repatriation	Applicable interest rate for delayed receipts	
		Transaction in INR	Transaction in Foreign currency
Adjustment made by the **Indian Tax Authority** and accepted by the taxpayer	On or before 90 days from the date of relevant Order	1 year Marginal cost of fund lending rate of SBI as of 1st April of the relevant FY + 3.25%	6 month LIBOR as of 30th September of the relevant FY + 3 %

Continue…..

Secondary adjustment – Section 92CE

Excess money or part thereof should be repatriate within -

Type of primary adjustment	Time limit for repatriation	Applicable interest rate for delayed receipts	
		Transaction in INR	Transaction in Foreign currency
Suo-moto adjustment by the taxpayer	On or before 90 days from the due date of filing return of income (or modified return as may be applicable in case of an APA)	1 year Marginal cost of fund lending rate of SBI as of 1st April of the relevant FY + 3.25%	6 month LIBOR as of 30th September of the relevant FY + 3 %
Adjustment pursuant to, **Safe Harbour Rules**			

Continue…..

Secondary adjustment – Section 92CE

Excess money or part thereof should be repatriate within -

Type of primary adjustment	Time limit for repatriation	Applicable interest rate for delayed receipts	
		Transaction in INR	Transaction in Foreign currency
Adjustment pursuant to MAP	On or before 90 days from the date of giving effect by the Assessing Officer under rule 44H to the resolution arrived at under MAP	1 year Marginal cost of fund lending rate of SBI as of 1st April of the relevant FY + 3.25%	6 month LIBOR as of 30th September of the relevant FY + 3 %

Continue…..

Secondary adjustment – Section 92CE

Excess money or part thereof should be repatriate within -

Type of primary adjustment	Time limit for repatriation	Applicable interest rate for delayed receipts	
		Transaction in INR	Transaction in Foreign currency
Adjustment pursuant to APA	➢ 90 days from the date of filing of ROI u/s 139(1) if APA has been entered into on or before the due date of ROI u/s 139(1) of that PY. ➢ 90 days from the end of the month in which APA was entered into after due date of ROI for relevant PY.	1 year Marginal cost of fund lending rate of SBI as of 1st April of the relevant FY + 3.25%	6 month LIBOR as of 30th September of the relevant FY + 3 %

Advance Pricing Agreement (APA)

Advance Pricing Agreements (APA)

- An Advance Pricing Agreement (APA) is a **mechanism to resolve transfer pricing issues in advance**, i.e., before the cross-border related party transaction actually takes place or, at least, before a dispute arises in respect of such cross-border transaction.
- The APA has the potential **to reduce litigation** for the taxpayer and provide certainty for a longer period of time
- **Types of APA :-**
  - Unilateral APA
  - Bilateral APA
  - Multilateral APA

Advance Pricing Agreements (APA)

Advantages

- Provide certainty with regard to determination of ALP of the international transaction
- Impart flexibility for complex transfer pricing issues
- Reduce the risk of potential double taxation
- Reduce compliance costs
- Reduce the burden of record keeping.

Disadvantages

- High upfront cost
- No time limit to finalise agreement prescribed under the APA rules.
- Onerous details required in Pre-filing / APA application

Sec.92CC – Applicability of APA

- The CBDT with the approval of Central Govt, may enter into APA with **any person for determination**;
  - **arm's length price(ALP)** in relation to an international transaction to be entered into by that person
  - **income referred to in Sec.9(1)(i)** or specifying the manner in which said income is to be determined, as is reasonably attributable to the operations carried out in India by or on behalf of that person, being a non-resident.
- APA is applicable for **maximum 5 consecutive years**.

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Continue…..

Sec.92CC – Applicability of APA

- The APA shall be binding on -
  - The **Person** who entered into APA
  - The **IT Authority** till level of CIT/PCIT
- APA shall not be binding if there is changes in law/facts
- With the approval of CG, CBDT may declare on APA to be **void-ab-initio,** if it find that the APA has been obtained by **fraud or misrepresentation of facts**
- APA may apply for any period **maximum 4 years** preceding the first of P.Y. referred in APA **(Roll back provision)**
- If APA apply then provision of **sec. 92C & 92CA** does **not apply**.

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Process Involved in APA

The APA Scheme involves the following Process :-

- Pre-Filing Consultation (Form 3CEC)
- Furnishing of APA application (Form 3CED)
- Acceptance/rejection of an APA appliction
- Action by the taxpayer, the AO and the TPO while the APA is processed or negotiated
- Amendment to an APA application
- Assignment to APA application to APA team
- Examination & analysis of an APA application
- Conversion of a unilateral APA into bilateral APA
- Entering into a unilateral APA
- Negotiation by the competent authority in bilateral/multilateral APA & entering into an APA
- Action by the taxpayer & the AO on entering into an APA
- Annual Compliance Report
- Compliance Audit for the APA term
- Cancellation & revision of APA

Roll-Back Provision (Rule 10MA)

Conditions for applying :-

- The international transaction is same as the international transaction to which the agreement (other than the rollback provision) applies;
- The return of income for the relevant rollback year has been or is furnished by the applicant before the due date as specified in of Sec .139(1).
- The report (form 3CEB) in respect of the international transaction had been furnished in accordance with section 92E
- The applicability of rollback provision, in respect of an international transaction, has been requested by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant;
- The applicant has made an application seeking rollback in form 3CEDA

APA Filling Fees

Statutory fee for filing an APA application (Form 3CED)	
Amount of International Transaction	**Fee**
Upto Rs. 100 Crore	10 lakh
Rs. 100 Crore to Rs. 200 Crore	15 lakh
Above Rs. 200 Crore	20 lakh

- The request for rollback provision in **form no. 3CEDA** with proof of payment of an additional **fee of Rs.5 lakh.**
- However, there is **no fee** prescribed **for** the **pre-filing consultation** process(Form 3CEC).

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FORM's under APA Scheme

Stage	FORM	Authority for filing
Pre-filing consultation	Form 3CEC	DGIT (International taxation)
Formal APA application	Form 3CED	DGIT(International taxation) in case of Unilateral. Competent Authority of India in case of bilateral/multilateral.
Application for Rollback of an APA	Form 3CEDA	DGIT (International taxation)
Withdrawal of APA application	Form 3CEE	DGIT(International taxation) in case of Unilateral. Competent Authority of India in case of bilateral/multilateral
Execution & monitoring of agreement	Form 3CEF	DGIT(International taxation) in case of Unilateral.

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Questions
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Thanks !

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Andheri, Mumbai