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Transfer Pricing Practices in India: Emerging Issues and Challenges

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1. Introduction

Transfer pricing (TP) provisions were introduced in the Income-tax Act in 2001. The provisions were broadly aligned with the OECD guidelines[1] on transfer pricing. Over the last 20 years, transfer pricing audits in India have thrown up a number of issues and challenges. Administration of the transfer pricing law has also resulted in a number of disputes and protracted litigation. With a view to reducing transfer pricing disputes, a number of initiatives have been introduced by the tax administration in the recent past. Some of the initiatives have included the introduction of an Advance Pricing Agreement (APA)[2] Scheme, inclusion of Safe Harbor provisions, utilization of the Mutual Agreement Practice (MAP)[3] provision in bilateral tax treaties to resolve TP disputes, migration from a quantum of transaction based selection to risk-based selection of TP cases for audit, and issuance of various circulars and instructions on transfer pricing matters to provide clarity on TP issues, etc.

Due to these initiatives, there has been an impact on the number of cases under audit as well as the number of disputes arising from such audits which have both shown a downward trend. Transfer pricing tax administration can now focus on high risk cases and at the same time provide a reasonable degree of

[1] This 2017 edition of the OECD Transfer Pricing Guidelines incorporates the substantial revisions made in 2016 to reflect the clarifications and revisions agreed in the 2015 BEPS reports on actions 8-10 aligning transfer pricing outcomes with value creation and on action 13 Transfer Pricing Documentation and Country by Country Reporting. It also includes the revised guidance on safe harbours approved in 2013 which recognizes that properly designed safe harbours can help to relieve some compliance burdens and provide taxpayers with greater certainty. Finally, this edition also contains consistency changes that were made to the rest of the OECD Transfer Pricing Guidelines. The OECD Transfer Pricing Guidelines were approved by the OECD Council in their original version in 1995.

[2] Advance Pricing Agreement (APA) is an agreement between a taxpayer and the tax authority specifying the Transfer pricing methodology (TPM) for pricing the tax payer's transactions for future years. The objective of the Advance Pricing Agreement is to provide much-needed tax certainty to multinational enterprises (MNEs) operating in India, particularly on their intra-group transaction and in the process, adopt global best practices. APAs gives certainty to taxpayers, reduce disputes, enhance tax revenues and make the country an attractive destination for foreign investments. The Finance act, 2012 introduced sections 92 CC and 92CD to provide for a framework for APA with effect from July 1, 2012 the salient features APA available at https://www.incometaxindia.gov.in/Lists/Latest%20News/Attachments/360/FINAL_ANNUAL_REPORT_29_11_19.pdf

[3] A MAP is a mechanism for competent authorities (tax authorities or representatives of the Ministry of Finance or similar) to discuss cross-border taxation of specific transactions or situations with a view to coordinate their approach for the benefits of the taxpayers involved. This process is available under a tax treaty entered into by two or more countries so that the treaty partners are able to resolve cases involving their taxpayers where they have been disputes concerning' cross border transactions in their countries.

certainty to low risk taxpayers. The new approach is expected to raise the quality of transfer pricing audits without creating an environment of tax uncertainty and protracted litigation

2. What is transfer pricing?

Transfer pricing, for the tax purposes, is the pricing of inter – company transactions that take place between affiliated businesses. The transfer pricing process determines the amount of income that each party earns from that transaction.

OECD defines "Transfer Pricing" as the pricing at which an enterprise transfers physical goods and intangible goods and provides services to Associated Enterprises, Since the Transfer Price within the group may not necessarily be driven by market forces and the Group's Interest may precede over market consideration, it is possible that the Transfer Pricing may differ from the prices that would have ordinarily fetched in similar transaction from an independent enterprise under similar circumstance. Transactions between Associated Enterprises (AEs) is referred to as "Controlled" transactions as distinct from "uncontrolled" transactions between companies that are not associated and can be assumed to operate independently on Arm's Length Basis in arriving at the prices of such transactions.

3. Background of Transfer Pricing in India

Indian started attracting interests of Multinational Enterprises (MNEs), similarly, several Indian companies also steadily emerged as global players by either making offshore acquisitions or by setting up overseas subsidiaries, Standing Committee in March 1991 – the existing provisions of the act were inadequate to deal with tax minimization through transfer pricing.[4] The Expert Group constituted by Central Board Of Direct Taxes (CBDT) recommended complete revision of existing section 92 of the Income Tax Act, 1961.

The Indian Transfer Pricing Regulations are based on the Arm's Length Principle. The regulations came into effect from 1 April 2001. The regulations provide that any income arising from an international transaction between Associated Enterprises (AE's) shall be computed having regard to the Arm's Length Price (ALP). The concept of associated enterprises has been defined in detail in the regulations.

The regulations prescribe mandatory annual filing requirements as well as maintenance of contemporaneous documentation by taxpayers if international transactions between associated enterprises cross a threshold, and they contain penalty implications in case of non-compliance. The primary onus of proving the arm's length price of a transaction lies with the taxpayer. In most cases, the Indian entity is taken as the tested party and Indian comparable are used. If the foreign associated enterprise is the lesser complex entity it is taken as the tested party.

[4] V Sridharn, "*Transfer of Pricing in India*" National Judicial Academy, available at http://www.nja.nic.in/Concluded_Programmes/2018-19/P-1148_PPTs/2.Transfer%20Pricing.pdf

In order to provide uniformity in the application of transfer pricing law, there are specialized Commissionerates under the supervision of a Principal Chief Commissioner of Income-tax (International Taxation) at Delhi and two Chief Commissioners of Income-tax (International Taxation) stationed at Mumbai and Bangalore. Transfer Pricing Officers (TPO) are vested with powers of inspection, discovery, enforcing attendance, examining a person under oath, on-the-spot enquiry/verification and compelling the production of books of account and other relevant documents during the course of a transfer pricing audit. The mechanism of the dispute resolution panel (DRP) is also available to taxpayers to resolve disputes relating to transfer pricing.

This area of operation is manned by various Directorates of Transfer Pricing, and caters to determination of arm's length price of international transactions pertaining to transfer of goods, services, intangibles, etc., between two or more Associate Enterprises (AE) under chapter –X of the Income Tax Act, 1961.

4. Computation of income from international transaction having regard to arm's length price (ALP)

The first Indian attempt at transfer pricing regulations was in 2001, when the Finance Act was amended the Income Tax Act, 1961 by the amendment of section 92 and insertion of new sections 92A to 92F providing for determination of proper income arising from international transactions where either or both the parties involved happen to be non-residents. Any income arising from an international transaction shall be computed having regard to the arm‘s length price.

The Finance Act, 2001 introduced Transfer Pricing Regulations (TPR) in India with effect from 1st April 2001 corresponding to the assessment year 2002-03. The sections and rules under the Income Tax Act, 1961 which deal with TPR are Sections 92A to 92F and rules 10A to 10E and Sections 271(1) (C), 271AA, 271BA and 271G. The provisions are;

(1) Section 92 seeks to provide that income arising from international transactions (between associated enterprises) shall be computed having regard to the arm's length price.

(2) Section 92A and Sec 92B provide the meaning of the expressions "associated enterprises" and "international transaction" with respect to which the income is to be computed under the new Sec 92. Rule 10A provide for the basic and the additional criteria to determine associated enterprises.

(3) Section 92C provides for the computation of Arm's Length Price. The section prescribes the following methods as being the most appropriate in determining the Arm's Length Price;

(i) Comparable uncontrolled price method; or

(ii) Resale price method; or

(iii) Cost plus method; or

(iv) Profit split method; or

(v) Transactional net margin method; and

(vi) Any other method which may be prescribed by the board.

In a case where more than one price can be determined by the most appropriate method, the Arm's Length Price shall be the arithmetical mean of such two or more prices. Rule 10B explains in detail methods prescribed above. Rule 10C provides the criteria's which will facilitate the selection of the most appropriate method. Further, based on the material and information available, the assessing officer, in the course of the assessment proceedings, can determine the Arm's Length Price where price is not in accordance with the proposed provisions or prescribed information is not maintained/furnished or data used for computing such price is not reliable or correct. The tax authorities shall not make any adjustments to the Arm's Length Price adopted by the taxpayer if such price is up to 5% less or 5% more than such price determined by the assessing officer.

(4) Section 92D seeks to provide that every person who has undertaken an international transaction shall keep, maintain and retain such information and documents as may be specified by the Central Board of Direct Taxes (CBDT). Documentation requirements shall not be applicable in cases where the aggregate value of international transactions entered into during a year is up to Rs10 million. Rule 10D provide for the documents required to be kept and maintained by persons falling in Category 1 (those persons who have entered into international transactions the total value of which exceeds Rs. 1.cr) and Category 2 (those persons who have entered into international transactions the total value of which does not exceeds Rs.1cr).

(5) Section 92E seeks to provide that every person who has entered into an international transaction during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date in the prescribed form and manner.

(6) Section 92F defines the expressions "accountant", "arm's length price", "enterprise", "specified date" and "transaction"

(7) With a view to ensure that multinational enterprises comply with the requirements of the new sections, amendment was made in Section 271 and new Sections 271(1) (c) 271AA, 271BA and 271G were inserted in the Income Tax Act, so as to provide for penalty to be levied in cases of non-compliance with the procedural requirements, and in cases of understatement of profits through fraud or willful negligence.

Considering the complex issues involved in transfer pricing, and with a view to avoid hardship to the taxpayers in the initial stages of implementation of the new regulations, the Central Board of Direct Taxes (CBDT) has from time-to-time issued clarifications through notifications and circulars.

The Finance Act 2002 certain amendments were made in the Transfer Pricing Regulations through the Finance Act 2002. The amendments are effective from 1st April 2003 corresponding to the Assessment Year 2003-04. The exercise of amendment is carried out to remove inconsistencies, administrative problems and inconveniences besides widening the tax base.

(1) Section 92 is amended to clarify that provision of transfer pricing shall not apply where it has the effect of reducing income chargeable to tax or increasing the loss computed on the basis of entries made in the books of account

(2) Section 92A is amended to clear the confusion on the meaning of ‘associated enterprises’. The definition of ‘associated enterprises’ included situations in which an enterprise was regarded as a ‘deemed associate enterprise’ and these conditions were very wide. It has now been clarified that if only one of the conditions in the definition of a ‘deemed associate enterprise’ is met, will an enterprise be regarded as an associate enterprise.

(3) Proviso to Section 92C is amended to provide that the taxpayer shall have an option in case where more than one price is determined by the most appropriate method, to opt for the arithmetical mean or price which may vary from the arithmetical mean by an amount not exceeding 5 percent of such arithmetical mean

(4) A new Section 92CA has been inserted w.e.f. 1.6.2002. This section provides for a procedure for reference to a Transfer Pricing Officer (TPO) of any issue relating to the computation of arm’s length price in an international transaction. The T.P.O. has been given all the powers of an A.O for such computation

(5) Definition under Section 92F of ‘enterprise’ is widened to include person or permanent establishment engaged in carrying out any work in pursuance of contracts

(6) Definition of ‘permanent establishment’ (PE) is inserted and shall mean to include a fixed place of business through which the business of the enterprise is wholly or partly carried on

(7) Specified date of filing transfer pricing audit report is now linked to the due date of filing return provided under section 139(1) of the Act.[5]

5. OECD Guidelines on Arm’s Length Principle (ALP)

Article 9[6] of the OECD model tax convention, which forms the basis of bilateral tax treaties involving OECD member countries and an increasing number of non-member countries. By seeking to adjust profits by reference to the conditions which would have obtained between independent enterprises in comparable transactions and comparable circumstances (i.e. comparable uncontrolled transactions), the arm’s length principle follows the approach of treating the members of MNE group as operating as separate entities rather than as inseparable parts of single unified business.

There are several reasons why OECD member’s counties and other countries have adopted the Arm’s Length Principle. A major reason is that the Arm’s Length Principles provide broad parity of tax treatment for members of MNE groups and independent enterprises. Because the arm’s length principle puts associated

[5] Suveera Gill “The Indian Response to Transfer Pricing” University Business School, https://www.researchgate.net/publication/268183572

[6] Article 9 provides, where conditions are made or imposed between the two associated enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions have accrued to one the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprises and taxed accordingly.

and independent enterprises on a more equal footing for tax purposes, it avoids the creation of tax advantages or disadvantages that would otherwise distort the relative competitive positions of either type of entity. In so removing these tax considerations from economic decisions, the arm's length principles promote the growth of international trade and investment.

The Arm's Length Principle is viewed by some as inherently flawed because the separate entity approach may not always account for the economies of scale and interrelation of diverse activities created by integrated businesses. There are, however, no widely accepted objective criteria for allocating between associated enterprises the economies of scale or benefits of integration resulting from group membership.

6. Maintaining the Arm's Length Principle as the international consensus

While recognizing the foregoing considerations, the view of OECD member countries continues to be that the Arm's Length Principle should govern the evaluation of transfer prices among associated enterprises. The arm's length principle is sound in theory since it provides the closest approximation of the workings of the open market in cases where property is transferred or services are rendered between associated enterprises. While it may not always be straightforward to apply in practice, it does generally produce appropriate levels of income between members of MNE groups, acceptable to tax administrations. This reflects the economies realities of the controlled taxpayer's particular facts and circumstances and adopts as a benchmark the normal operation of the market.

A move away from the Arm's Length Principle would abandon the sound theoretical basis described as in the OECD guidelines and threaten the international consensus, thereby sustainably increasing the risk of double taxation. In certain cases, the arm's length principle may result in an administrative burden for both taxpayer and tax administrators of evaluating significant numbers and types of cross-border transactions. Although associated enterprises normally establish the conditions for a transaction at the time it is undertaken, at some point the enterprises may be required to demonstrate that these are consistent with the arm's length principle.

7. Administrative approaches to avoiding and resolving transfer pricing disputes

Various administrative procedures that could be applied to minimize transfer pricing disputes and to help to resolve them when they do arise between taxpayer and tax administrations, and between tax administrations. Such disputes may arise even through the guidance in these guidelines is followed in a conscientious effort to apply the arm's length principle. It is possible that taxpayers and tax administrators may reach differing determinations of the arm's length conditions for controlled transactions under examinations given complexity of some transfer pricing issues and difficulties in interpreting and evaluating the circumstances of individual cases.

When two or more tax administrators take different positions in determining arm's length conditions, double taxation may occur. Double taxation means the inclusion of the same income in the tax base by more than one tax administration, when either the income is in the hands of different tax payers. Double taxation is undesirable and should be eliminated whenever possible, because it constitutes a potential barrier to the development of international trade and investment flows. The double taxation inclusion of income in the tax base of more than one jurisdiction does not always mean that the income will actually be taxed twice.[7]

Tax compliance practices are developed and implemented in each member country according to its own domestic legislation and administrative procedure. Many domestic tax compliance practices have three main elements;

(1) To reduce opportunities for non-compliance;
(2) To provide positive assistance for compliance; and
(3) To provide disincentives for non-compliance.

These three aspects of transfer pricing compliance that should receive special consideration to help tax jurisdictions administer their transfer pricing rules in a manner that is fair taxpayers and other jurisdictions. While other tax law compliance practices are in common use OECD member countries.

8. Transactions subject to Transfer Pricing:

The following are some of the typical international transactions which are governed by the transfer pricing rules: ˆ

(a) Sale of finished goods; ˆ
(b) Purchase of raw material; ˆ
(c) Purchase of fixed assets; ˆ
(d) Sale or purchase of machinery etc. ˆ
(e) Sale or purchase of Intangibles. ˆ
(f) Reimbursement of expenses paid/received; ˆ
(g) IT Enabled services; ˆ
(h) Support services; ˆ
(i) Software Development services; ˆ
(j) Technical Service fees; ˆ
(k) Management fees; ˆ
(l) Royalty fee; ˆ
(m) Corporate Guarantee fees; and
(n) Loan received or paid.[8]

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[7] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators, available at https://read.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2017_tpg-2017-en#page174

[8] International Taxation and Transfer Pricing, The President, The Institute of Cost Accountants of India, Kolkota,

9. Transfer Pricing Methodologies

The OECD (The Organisation for Economic Co-operation and Development) Guidelines discusses the transfer pricing methods which could be used for examining the arms-length price of the controlled transactions. Here, Arm's Length Price (ALP) refers to the price which is applied or proposed or charged when unrelated parties enter into similar transactions in an uncontrolled condition. The following are the most commonly used transfer pricing methodologies:

(1) Comparable Uncontrolled Price (CUP) Method:

Under this method, the transfer price is compared with price in a transaction between unrelated enterprises. This method is useful when the good or service under transfer pricing is identical or very similar to the good or service under transaction between unrelated parties.

(2) Resale Price Method

Under this method, the first transaction with the unrelated party is taken as the benchmark price, from which an appropriate margin is deducted to adjust for pro□it, risk, costs and other considerations. The remaining amount is considered arm's length price (ALP). This method is preferred when the product or service is not exactly identical but the function and other considerations associated in terms of production, risk, sale and assets are similar.

(3) Cost Plus Method

Under this method, the cost is calculated in producing the product or service which is being sold to a related entity, which includes cost of different inputs and processes. An appropriate mark-up, to adjust for profit and other considerations like risk, is then added to the cost to calculate the ALP. This method is useful when the reliable details of costs are available to make the comparison.

The above three methods are known as 'Traditional Transactional Methods', where the focus is on finding of price of product or service. The next two methods are known as 'Transactional Profit Methods', where the focus is on the profit or net margin to find out the ALP. These methods are likely to be used when using the first three methods is not feasible. The reasons for this can be that the products or services under transactions are relatively unique and hence finding a comparable transaction with same product or service is difficult. These methods are used primarily in case of complex products, services and intangibles.

(4) Profit-Comparison or Transactional Net Margin Method (TNMM)

Under this method, the level of profit arising out of transfer price is compared with the level of profit arising in the comparable uncontrolled transactions. In case the level of profit is found to be inappropriate, it is adjusted accordingly to find the ALP. The process to determine arm's length price through transactional net margin method (TNMM) is similar to cost plus or resale price method, in the sense that net pro□it margin in case of a controlled transaction is compared with the net profit margin in case of comparable uncontrolled transaction.

(5) Profit-Split Method:

This method is generally applied when the product or service under transaction provides some unique benefits to the transacting parties, meaning the same product or service will be less valuable to a third entity. Under this method, the combined profit of two or more related entities, arising from series of transactions related to one product or service, is divided among the entities based on the level of pro□it of comparable transactions or entities.

(6) The Sixth Method:

This method was first developed by Argentina in 2003, mainly in response to the transfer pricing of agricultural commodities and minerals. Under this method, the pricing of the commodity should be based on the publicly available data from commodities exchange on the day of shipment. Some other countries, mainly in Latin America, have also started using this method. It is useful mainly in case of minerals and commodities that are publicly traded and the reliable data for the same is available in a timely and transparent manner. In essence, this method can be categorised as a variant of 'Comparable Uncontrolled Price (CUP)' method prescribed by the UN and OECD manuals. The difference is while CUP method requires looking for a comparable transaction, the sixth method directly uses the price for that particular product from a publicly available source.

(7) The Fixed Margin Method:

This method is used mainly in Brazil, and can be categorized as a variation of OECD's resale price and cost plus method. The process to determine arm's length is same as cost plus or resale price method, the difference lies in calculating the profit margin. Unlike cost plus or resale price method where the margin is taken from a comparable uncontrolled transaction, under fixed margin method, there are fixed margin applicable while calculating transfer price.[9]

10. India Focus on BEPS – Base Erosion and Profit Shifting

India, as a member of the G-20, has participated in the Base Erosion and Profit Shifting (BEPS) Project on an equal footing with the OECD and other non-OECD member countries and is a party to the consensus developed under the various Action Points of the BEPS Project.[10] The final reports of all the 15 Action Points of the BEPS Project have been endorsed at the highest political level by all G-20 countries,

[9] A premier on Transfer Pricing: Norms, Standards, Misuse for Tax Avoidance, and Impact on Developing Countries, Centre for Budget and Governance Accountability (CBGA) 2017, available at https://www.cbgaindia.org/

[10] Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules to avoid paying tax. Developing countries higher reliance on corporate income tax means they suffer from BEPS disproportionately. BEPS practices cost countries USD 100-240 billion in lost revenue annually. Working together within OECD/G20 inclusive framework on BEPS, 140 countries and jurisdictions are collaborating on the implementation of 15 measures to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment.

including India. Accordingly, India is committed to implementing all the recommendations contained in the BEPS reports including those on transfer pricing.

The view of governments across the world is that the current international tax standards have not kept pace with the changes in global business practices. Many countries have perceived the relevance of adopting BEPS as these reports include recommendations for significant changes in key elements of the international tax architecture. India is actively following the BEPS recommendations and has been bringing amendments in the domestic law to be in line with BEPS regulations. A number of proposals in Indian Finance Act, 2016, are influenced from the recommendations emanating from the final reports of the OECD under its Action Plan on BEPS. These include implementation of Master File and Country-by-Country (CbC) Reporting (in compliance with Action 13), introduction of equalization levy which requires withholding on gross basis for all payments in relation to certain specified digital services (Action 1) and a "Patent Box" tax regime for royalty income (Action 5). Response to BEPS will have to be managed in a phased manner and will require proactive and timely planning. Companies will have to build consideration of potential BEPS impact into current tax planning and prepare different scenarios for its application.

11. India is committed to the BEPS outcome

For past few years, the Organisation for Economic Co-operation and Development [OECD] and G20 countries have actively worked on Base Erosion and Profit Shifting [BEPS] project. BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profit 'disappear' for tax purpose or to shift profits to locations where there is little or no real activity but taxes are low, resulting in little or no overall corporate tax being paid. The OECD and G20 has released their recommendations on BEPS action plans (15 action plans) on 5 October 2015. The BEPS action plans are structured around three fundamental pillars.

Introducing coherence in domestic rules that affect cross-border activities: These actions include aspects relating to limitations on interest deductions, Countering tax avoidance using hybrid mismatches, and challenging harmful tax Practices, etc. Reinforcing substance requirements in international standards to ensure alignment of taxation with the location of economic activity and value creation: There are aspects to prevent tax treaty abuse (i.e. treaty shopping), strengthen rules relating to creation of a permanent establishment for taxation in the source country, ensuring transfer pricing outcomes are in line with value creation in relation to intangibles, etc.

Improving transparency, as well as certainty for businesses and governments: The key action relates to transfer pricing documentation, which will provide significant information to the revenue authorities in relation to global operations and financial information of companies. The BEPS action plans also deal with the digital economy across all the three areas discussed above. As a member of G20 and an active participant of the BEPS project, India is committed to the BEPS outcome. To implement the BEPS actions, India has been amending its domestic tax law as well as tax treaties. This publication analyses key issues around BEPS as well as outlines the Indian perspective in relation to these issues.

12. Preventing treaty abuse and counter harmful tax practices

Tax treaty abuse Treaty abuse and in particular, treaty shopping is the most significant source of BEPS concerns as governments are probing ways to tackle this issue. Treaty shopping can be defined as the use of the tax treaty by a person who is not the resident of either of the treaty countries, usually through the use of a conduit entity resident in one of the countries.

The major concern for the developing and emerging economies like India is that they face no taxation or lower taxation where a person takes advantage of the treaty in an unintended manner. BEPS Action 6 targets tax treaty shopping by multinational enterprises that establish 'letterbox', 'shell' or 'conduit' companies in countries with favorable tax treaties although such companies exist on paper, they may have no (or very little) substance in reality and may exist only to take advantage of tax treaty benefits.

13. Key current and emerging TP audit issues in India

Indian transfer pricing administration over the past 10 years has witnessed several challenges in administration of transfer pricing law. In the above backdrop, the highlights some of the emerging transfer pricing issues and difficulties in implementation of arm's length principle.

India believes that comparability analysis is key to determine arm's length price of international transaction. However, increased market volatility and increased complexity in international transaction have thrown open serious challenges to comparability analysis and determination of arm's length price. Some of these challenges and responses of Indian transfer pricing administration in dealing with these challenges have been analyzed below;

(a) **Use of contemporaneous data:** Commodity price volatility, debt, recession and worries have brought volatility to world market. The volatility impede a stable business environment and result in fluctuation in margins of MNEs and their subsidiaries. In this context, use of contemporaneous comparables provides a more accurate arm's length price in a particular year

(b) **Application of data rules:** The Indian transfer pricing regulation stipulates that data to be used in analyzing the comparability of uncontrolled transaction with an international transaction should be the data relating to the financial year in which international transactions have been entered into. However, the rule also provides exception and permits use of data for the preceding two years if and only if, it is proved that such data reveals a fact which could have an influence on the determination of arm's length price. Therefore, the exception comes into the play only when a proof that earlier year data could have an influence on determination of arm's length price is brought on the record.

(c) **Rationale:** The mandatory requirement under the law to use contemporaneous document has a solid economic sense in the way that contemporaneous transaction reflect similar economic condition. Therefore, use of current year data is more relevant and appropriate for ensuring a higher degree of comparability of uncontrolled transaction for arriving at arm's length price in respect of international transaction. In India, contemporaneous data which may be available to the taxpayer and tax administration at the time of filing of the tax return or conducting ex post facto analysis of transfer pricing studies cannot be held as use of hindsight.

(d) **Arm's length range:** Application of most appropriate method may set up comparable data which may result in computation of more than one arm's length price. Where there may be more than one arm's length price, mean of such prices is considered. Indian transfer pricing regulations provide that in such a case the arithmetic mean of the prices should be adopted as arm's length price.

(e) **Comparability adjustment:** Like many other countries, Indian transfer pricing regulations provide for "reasonably accurate comparability adjustments". The onus to prove "reasonably accurate comparability adjustment" is on the taxpayer. The experience of Indian transfer pricing administration indicates that it is possible to address the issue of accounting difference and difference in capacity utilization and intensities of working capital by making comparability adjustments. However, Indian transfer pricing administration finds it extremely difficult to make risk adjustments in absence of any reliable and robust and internationally agreed methodology to provide risk adjustment

(f) **Location Savings:** It is view of the Indian transfer pricing administration that the concept of "location savings" - which refer to cost savings in a low cost jurisdiction like India – should be one of the major aspects to be considered while carrying out comparability analysis during transfer pricing audits. Location savings has a much broader meaning; it goes beyond the issue of relocating a business from a 'high cost' location to a 'low cost' location and relates to any cost advantage. MNEs continuously search options to lower their costs in order to increase profits. India provides operational advantages to the MNEs such as labour or skill employee cost, raw material cost, transaction costs, rent, training cost, infrastructure cost, tax incentive etc.

It has also been noticed that India also provides following Location Specific Advantages (LSAs)[11] to MNE in addition to location savings;

(a) Highly specialized skilled manpower and knowledge;

(b) Access and proximity to growing local/regional market ;

(c) Large customer base with increased spending capacity;

[11] Location savings can result also as revenue-enhancing effect15. This means that in a given market, there can be a high demand for determined prices but also a limited market access to other competitors. The advantage of an MNE operating under these conditions, is a bonus, since it will benefit from increased transaction quantities than it would be compared to a standard market. This characteristic is however related to the broader concept of Location Specific Advantages, because directly related to a specific territorial location, more information about LSA on "Review of the Inter-relationship between the country policy and the OECD, available at http://arno.uvt.nl/show.cgi?fid=148276

(d) Superior information network;

(e) Superior distribution network;

(f) Incentives; and

(g) Market premium[12]

14. Conclusion

The international tax system is a complex system of interlocking principles deriving its sustenance from both domestic tax law and a patchwork of bilateral DTAAs. Taxpayers, particularly multinational companies took advantage of the inherent flexibility afforded by contractual relationships (sale, purchase, lease, incorporation, restructuring) to minimise their taxes worldwide. Tax law might want to impose a certain taxable status over the commercial activities of companies but the intricate tax planning developed through ingenious contracting by taxpayers has outsmarted frequently the reach of tax legislation. The history of international tax law has so far been a history of the trump of contracts over status.

In India, one of the most contentious areas in transfer pricing has been concerned with AMP (Advertisement, Marketing and Promotion) expenses. The revenue has contended that if an Indian enterprise performs certain brand promotion functions that directly or indirectly promote the brand of its foreign associated enterprise; the Indian enterprise needs to be compensated for conferring a benefit on the foreign enterprise. In practice, this meant that the revenue would challenge any marketing expenses or such enterprises that the revenue deemed as excessive. Further, the courts have decisively rejected the bright line test (which drew transfer pricing conclusions from the quantum of AMP expenses) as not founded in the Indian statutory regime.

The OECD has invited India to join the Organization's Development Centre. The Centre, a semi-independent body within the OECD, works to foster policy dialogue and understanding between OECD Countries and Developing world. India is now the 27th member of the Centre, joining many OECD Countries. However, also India has been invited to participate as an observer in the OECD's Committee on Fiscal Affairs, which contributes to setting international tax standards, particularly in areas such as tax treaties and transfer pricing. India's transfer pricing regulations broadly adopts the OECD principles. Tax offices have also indicated their intent of broadly following the OECD Guidelines during audits, to the extent the OECD Guidelines are not inconsistent with the Indian Transfer Pricing Code.[13]

[12] United Nations Organization's on current emergency TP audit issues, available at https://www.un.org/esa/ffd/wp-content/uploads/2014/09/8STM_Chap10_CPIndia_20120904_v3_HC-accp.pdf

[13] https://www.pwc.com/gx/en/international-transfer-pricing/assets/india.pdf