Transfer Pricing Forum

Transfer Pricing for the International Practitioner

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India

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Legislative Changes

Transfer Pricing ("TP") Regulations in India were introduced in April 2001 that covered intra-group cross-border transactions; from April 2013, the provisions were extended to cover Specified Domestic Transactions ("SDT's) between related enterprises and inter-unit transactions of the same enterprise. The regulations broadly align with the Organisation for Economic Co-operation and Development ("OECD") Guidelines on Transfer Pricing ("OECD Guidelines"), and the definitions of international transactions, documentation requirements and Associated Enterprises ("AE's") are broad and expansive. TP regulations in India have constantly evolved over the years, keeping pace with international best practices and global developments with regards to the OECD Base Erosion and Profit Shifting ("BEPS") reports on Action Plans ("AP") 4, 8-10, 13, 14 and 15. In addition to the substantive changes in 2012, that retrospectively expanded the definition of international transactions to cover a range of additional transactions, such as the purchase or sale of tangible or intangible assets, and capital financing, over the past few years, the Indian Tax Authorities ("ITA") have: introduced a number of amendments to the TP regulations to reduce TP litigation; introduced alternate dispute resolution mechanisms by way of Advance Pricing Agreements ("APAs"); clarified the availability of the Mutual Agreement Procedure ("MAP") with countries whose tax treaties with India do not contain an equivalent to Article 9(2) of the OECD Model Convention; introduced and expanded Safe Harbor Rules ("SHR"); formed a Dispute Resolution Panel ("DRP"); and implementing a risk-based assessment procedure for the selection of cases for TP audits, among other measures. Provisions in line with BEPS AP 13 and secondary adjustments provisions have also now been enshrined in the law. In the last three years, the following significant additions or revisions have been made to the Indian TP Regulations:

Year	Key Developments
2019	• **Secondary Adjustment** - Clarifications and rationalization regarding secondary adjustments including a time limit for repatriation for adjustments arising from APAs/MAPs, the date from which interest is to be charged and the provision of a one-time payment option of 18% (plus surcharge of 12%) if funds are not repatriated into India. • **Inclusion in Specified Domestic Transactions** - Transactions between existing company and new manufacturing domestic companies under Section 115BAB[1] of the Income Tax Act, 1961 ("the Act") covered under the Specified Domestic Transaction ("SDT") provisions. • **Master File Related** – Part A of the India Master File ("MF") to be filed by constituent entities ("CEs") even when there are no international transactions.

[1] These are companies that will enjoy a reduced headline corporate tax rate of 15% (plus applicable surcharges).

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Year	Key Developments
2020	• **Income Attribution for Permanent Establishment ("PE") under SHR and APA** – The scope of the SHR and APAs was expanded to cover income attributable to a business connection/PE of a non-resident. • **Substantive Revisions to MAP** – The MAP Rules were overhauled to address the OECD peer review report on India (for example, MAP cases are to be resolved within 24 months). • **Expansion in Scope of DRP** – Extension of the applicability of the DRP mechanism to non-corporate non-resident taxpayers and extension of the DRP mechanism's scope to disputes other than those impacting income or loss (such as orders pertaining to the levying of penalties).
2021	• **Minimum Alternate Tax ("MAT") for Additional Income from APAs or Secondary Adjustments** – The MAT computation for additional income arising out of APAs or secondary adjustments for previous years is to be recomputed in the prescribed manner based on an application made by the taxpayer with the Assessing Officer ("AO"). • **Reduction in TP Audit Time Limit** - The time limit for the completion of assessment proceedings has been proposed to be reduced by three months. For fiscal year 2020-21 onwards, the time limit for completion of transfer pricing assessments will be 33 months from the end of the financial year.

Some of the critical changes in TP regulation are discussed in detail in the ensuing paragraphs.

A. Secondary Adjustment Provisions

Finance Act, 2019 had amended Section 92CE of the Act to prevent the application of secondary adjustment provisions to the repatriation of APA adjustment amounts for APAs entered into on or before 31 March 2017. The Act also introduced a "one-time" payment option of paying additional income taxes at the rate of 18% (plus a surcharge of 12%) as an alternative to repatriation. The amendments also provide that, in the case of multiple associated enterprises, any one associated enterprise can repatriate the entire secondary adjustment amount to an Indian taxpayer rather than multiple AEs repatriating funds to meet secondary adjustment obligations in India.

In addition, the Central Board for Direct Taxes ("CBDT"), *vide* notification dated September 30, 2019, amended Rule 10CB of the Income Tax Rules, 1962 ("the Rules"). This supplements clarification with respect to a few more scenarios relating to the computation of interest income pursuant to secondary adjustments from fiscal year 2018-19 onwards. Key changes made to the time limits for the repatriation of funds are as follows:

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Secondary adjustment arising from	Due Date
APA	On or before 90 days from: (i) the date of filing of the return, if the APA was entered into on or before the due date for filing the return; (ii) from the end of the month in which the APA was entered into, if the APA was entered into after the due date for filing the return.
MAP	On or before ninety days from the date on which the ITA gives effect to the resolution.

The notification also clarified the date from which interest would be computed in each of the circumstance in which a secondary adjustment is applicable.

B. Amendments to MAP Provisions

On May 6, 2020, the CBDT released a detailed notification that effectively consolidated Rule 44H into Rule 44G of the Rules governing the MAP provisions and made certain amendments to address the recommendations in the OECD's Peer Review Report. The new rules apply to all MAP cases pending with the Competent Authority ("CA") of India as of May 6, 2020.

The key amendments are as follows:

- **Timeline for Resolution of MAP Cases** – In the earlier provisions, no specific timelines were prescribed for resolution of MAP cases, and therefore, resolutions were reached on an average timeline of 2-4 years, if not more. Per the amendment, an average timeline of 24 months has been outlined for achieving a resolution under MAP which is also in line with the recommended timeline under BEPS Action Plan 14 - Making Dispute Resolution Mechanisms More Effective.
- **Involvement of Taxpayer with Indian CA** – Historically, CA proceedings under the MAP have taken the form of a "closed room" discussion, with no taxpayer involvement being provided for in the Rules. However, taxpayers have often felt the need to present their positions and the approach adopted in a particular transaction. Now, under Rule 44G(3) of the Rules, it is provided that CA is to call for additional records/documents and also to discuss with the taxpayer or the taxpayer's representative with a view to providing understanding of the actions taken by the ITA in India or outside India that are not in accordance with the terms of agreements.
- **Effect of Resolution on Computation of Income** – Unlike in the earlier Rules, there is now specific provision to the effect that, where the MAP is invoked as a result of an action taken by any ITA in India, the resolution arrived at in any previous year will not result in a decrease in income or an increases in loss (as the case may be) of the taxpayer in India. Accordingly, in a scenario in which the CA resolution leads to an outcome that is more beneficial (for example, a lower mark up for transfer pricing cases) than the going-in position, then that benefit is not to be allowed to the taxpayer.
- **Reduced Timeline for Acceptance and Giving Effect** – Compared to the prior 90-day period allowed for acceptance of resolution by the taxpayer, withdrawal of appeals and payment of taxes, the revisions now provide for 30 day window for acceptance and appeal withdrawal; and another 30 days to the AO from the end of the month in which communication is received by the AO to give effect to the resolution and tax payable is

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determined. It is to be noted that the AO can agree to the timeline for the payment of tax balance (along with interest) post resolution under Rule 44G(4) of the Rules, as there is no specific timeline provided in the statute post the revision of Rules.

Further, the CBDT published detailed guidance (as recommended in BEPS AP 14 final report) on August 7, 2020, intended to provide key information on several aspects relating to India's MAP program amendments. The guidance prominently lays down the situations and procedure for accessing MAP, clarification on technical issues and implementation of MAP outcomes.

C. Profit Attribution to A PE Through APA and SHR

The issue of attribution of profit to a PE has resulted in incessant litigation, as ITA often resorts to ad-hoc attribution of profits to a PE. On April 18, 2019, CBDT issued a public consultation paper that proposed a "fractional apportionment" approach for profit attribution, as compared to the Authorized OECD Approach ("AOA"), which is based on functions performed, assets employed and risks assumed analysis. The draft guidelines on profit attribution to a PE is yet to see the final light of the day.

While profit attribution to a PE remains a high stakes, fact sensitive, and complex exercise, in order to obtain certainty on this issue, an amendment has been made in the Finance Act 2020 to enable the Indian Tax Administration to notify the taxpayers on the SHR or enable taxpayers to opt for APAs, for profit attribution to a business connection or PE.

Per amended Section 92CC of the Act, the Indian Government may enter into an APA to determine the income referred to under Section 9(1)(i) of the Act or specifying the manner in which that income is to be determined, as is reasonably attributable to the operations carried out in India by or on behalf of a non-resident. The amendment also provides that agreement under an APA will override any other income tax rules, as such, the APA with respect to attribution of profit to a PE provides certainty from a corporate tax perspective as well. However, the specific rules for application of SHR has not been prescribed yet.

D. Amendment to MF and Country-by-Country Report ('CbCR')

Since the introduction of MF and CbCR by the Finance Act 2016, the Indian Government has been trying to harmonize the applicable provisions with the global standards i.e., OECD guidelines. On January 6, 2020, the CBDT amended Rule 10DA (MF) and Rule 10DB (CbCR) compliances in India by way of Notification No. 03/2020/F No. 370142/19/2019-TPL, which is to be effective from fiscal year 2019-20. The amendments provide for the procedural aspects of MF and CbCR notification applicability, the due dates, and also the authority with which the Forms are to be filed. A detailed overview is provided in the ensuing section.

Cases and Rulings

The TP controversy environment in India has matured in the last decade. The ITA have moved from selecting cases largely based on quantum of international transactions, to using data analytics in identifying high-risk cases. The issues generating controversy have also advanced from selection of comparable companies to more complex topics such as royalties, loans & guarantees, advertising and marketing promotion ("AMP") expenses, etc. As a result of these changes, the number of audits has declined in the past few audit cycles. A summary of few key rulings in relation to TP is as follows:

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A. Determination of Associated Enterprise

1. Interplay between 92A(1) & 92A(2) of the Act - Kaybee Private Limited vs ITO[2]

The taxpayer had undertaken certain business transactions with a related Singapore-based entity, Kaybee Exim Private Limited ("KE-S"), which had a common director who held 99.9% of the shares in the taxpayer and was also the Chief Operating Officer in KE-S. Based on Section 92A(1)(b) of the Act, the ITA considered KE-S as an AE because both the taxpayer and KE-S had a common person participating directly in each company's management or control, and accordingly performed a TP adjustment.

The taxpayer argued before the Income Tax Appellate Tribunal ("the Tribunal") that Section 92A(1)(b) of the Act should be read in conjunction with Section 92A(2) of the Act which envisages different scenarios for establishing an AE relationship. As KE-S cannot be considered an AE under section 92A(2) of the Act, KE-S cannot be considered as an AE, and therefore the TP regulations would not apply to such transactions. The inter-play is supported by the memorandum to the Finance Bill 2002, wherein it is mentioned that the mere fact of common participation by one or more persons in the management or control or capital would not make two entities into AEs, unless the criteria specified in sub-Section (2) are fulfilled. The same point has been reiterated in a circular issued by the CBDT. Accordingly, the Tribunal agreed with the contentions of the taxpayer and held that KE-S did not qualify to be an AE of the taxpayer.

2. AE constitutes for full year even if transactions are for part of year - Lonsen Kiri Chemical Industries Ltd.vs DCIT[3]

The taxpayer was established as a Joint Venture ("JV") between Well Prospering Ltd. (a Chinese based entity) and Kiri Dyes and Chemicals Ltd (an Indian entity belonging to Dyestar Group) on February 4, 2010. Thus, Dyestar formed an AE relationship with taxpayer during the latter part of the fiscal year (i.e., February 4, 2010 through March 31, 2010). The taxpayer exported finished goods to both Dyestar Group and Well Prospering Ltd., and considered the average price charged by the taxpayer to Dyestar prior to 4th February 2010, as an uncontrolled transaction by which to benchmark exports made after the JV. This approach was rejected by the ITA.

The taxpayer contended that the AE relationship was established only from the date of JV, and until that date, the transaction with Dyestar Group was an uncontrolled transaction. Section 92A(2) of the Act states that two enterprises shall be deemed to be AEs for the entirety of the fiscal year, if, the companies are AEs at any time during the previous year. Further, Rule 10A(ab) of the Rules, read with section 92A(2) of the Act states that the term uncontrolled transaction means a transaction between enterprises other than AEs. Hence, Tribunal opined that once the company becomes an AE to the taxpayer during any part of the concerned year, that company would be considered an AE for whole of the year, and hence the transactions with that company cannot be considered as uncontrolled.

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[2] ITA No 2165/Mum/15.
[3] ITA No. 1116/Ahd/2015.

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3. Impairment of assets as operating/ Non-operating in nature - Imsofer Manufacturing India Pvt. Ltd. Vs DCIT[4]

The taxpayer, a manufacturer of chocolate and other confectionary products, had undertaken multiple international transactions and for the purpose of computing its Profit Level indicator ("PLI"), had considered provision for impairment of assets as non-operating in nature for fiscal year 2009-10. The machine, against which the provision was created, was purchased for production and was kept as capital work in progress at the year-end, since the production could not be started. Subsequently, the taxpayer decided to discard the production line and sell the machine as scrap. However, the ITA considered the sale as creating an operating expense for computing the PLI.

The taxpayer submitted before the Tribunal that it created the provision for impairment of losses to reflect the carrying amount of the asset at market price and that the accounting treatment is in confirmation with the Accounting Standards issued by the Institute of Chartered Accountants of India. The Tribunal held that provision for impairment of loss is neither a depreciation charge nor amortization of a fixed asset but, rather an adjustment made to the carrying amount, and furthermore that a provision for impairment of loss is neither recurring in nature nor related to business operations. Therefore it cannot be considered as an operating expense.

4. Restructuring of shareholding in the context of corporate gift subject to TP - Redington (India) Limited Vs PCIT[5]

The taxpayer transferred 100% of its shares held in Redington Gulf FZE ("RG") to Redington International (Holdings) Limited ("RC"), a newly incorporated step-down subsidiary in Cayman Islands, as a corporate gift, without any consideration, during fiscal year 2008-09. The ITA rejected the transaction as a "gift," and construed this transaction as a business restructuring, based on the absence of the word "Gift" in minutes of the board resolutions and the share transfer deed, and also based on the Board's resolution to transfer shares towards a restructuring with or without consideration.

The taxpayer appealed before the Tribunal, which upheld the contention of the taxpayer that there is nothing barring the taxpayer from making a gift to another company, and therefore, the taxpayer was entitled to transfer the shares without consideration. Disagreeing with the pronouncement of the Tribunal, the ITA lodged an appeal before the High Court ("HC"). The HC held that Board's approval of a transfer of shares with or without consideration clearly indicated that the transfer was not on a gratuitous basis, and that voluntary consent was missing. Further, the HC observed that within less than a week of the share transfer to RC, a private equity fund, Investcorp GO FRG ("IVC") invested USD 65 million in RC for a 27% stake. Thus, the HC held that this whole chain of event is self-explanatory, that the whole intention of the taxpayer was a corporate restructuring in order to accommodate an investment by IVC in RG.Accordingly, voluntariness in the transfer was absent. The HC noted that, in substance, an asset in the form of shares in RG which was once owned by the taxpayer stood shifted to the Cayman Islands, which is a tax heaven. Accordingly, it concluded that the subject chain of events was a colorable device, and "undoubtedly a means to avoid taxation in India and the said two companies have been used as conduits to avoid income tax." Thus the court upheld the

[4] ITA No.5158/DEL/2015 and ITA No.1049/Del/2016.
[5] T.C.A.Nos.590 & 591 of 2019.

application of a TP provision on the transaction being in the nature of business restructuring.

5. Optional/ Compulsory Convertible Debentures as 'Shareholder Activity' - Kolte Patil Developers Ltd. Vs DCIT[6]

The taxpayer, a real estate developer, issued Compulsory Convertible Debentures ("CCDs") and Optionally Convertible Debentures ("OCDs") to its AEs in India and abroad during fiscal year 2012-13. The ITA considered the international transaction to be in the nature of a shareholder activity, and determined the arm's length price ("ALP") of interest payment as nil, relying on the thin capitalization principle, General Anti-Avoidance Rules ("GAAR") and comparing taxpayer's debt-equity ratio of 1:23 in the light of Reserve Bank of India ("RBI's") Master circular stipulating 4:1 on External Commercial Borrowing ("ECB"). Thus, it proposed the TP adjustment.

The Tribunal rejected the ITA's action of treating the transaction as a shareholder activity, based on OECD Guidelines that state that shareholder activity encompasses a transaction undertaken solely on the basis of a shareholding interest in other group companies. The Tribunal also emphasized the fact that invoking the GAAR provision to treat a certain transaction as an Impermissible Avoidance Agreement ("IIA") requires substantiating that a certain transaction lacks commercial substance pursuant to Section 97 of the Act and following the procedure enshrined in Section 144BA of the Act. The Tribunal also arrived at its conclusion based on the fact that GAAR and thin capitalization came into effect prospectively from 01 April 2018 (i.e., years after the issue in the case, so not applicable to the case), and also that the debt-equity ratio for the thin capitalisation rule had not yet been prescribed for the year under appeal.

6. Application of TP provision on domestic inter-unit transfer - Wipro Limited Vs ACIT[7]

The taxpayer is a software and IT service provider rendering services from different undertakings (i.e., divisions eligible for different rates of tax within the same entity) comprising of eligible units (i.e., divisions within same entity being eligible to claim tax exemption at the rate of 50% and 100%) and non-eligible units (i.e., divisions within same entity that are not eligible for any tax exemption) to third parties and to other undertakings as well. The ITA observed that there was a huge variation in the net margins declared by various undertakings of the taxpayer, ranging from 21% to 159%. This compared to 15.58% earned by comparable companies, so that ITA concluded that profit had been shifted from non-eligible or 50% eligible undertakings to 100% eligible undertakings to reduce the overall tax payout. It considered the margin earned by eligible undertakings over and above the mark-up earned by comparables as a TP adjustment.

The taxpayer contended that under section 80IA(8) of the Act, an ALP is to be determined for transactions between eligible and non-eligible units or any other taxpayer, and does not exclude any 'eligible unit' from the category of 'eligible units' based on the amount of deduction., This contention was accepted by the Tribunal.

The taxpayer further contended that, if revenue of a "service providing unit" is reduced, then the corresponding cost in the hands of a "service receiving unit" should also be reduced, and the deduction

[6] ITA No.2111/PUN/2017.
[7] IT(TP)A No.99/Bang/2014.

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under Section 10AA of the Act should be recomputed. The requirement of a determination of the ALP value under Section 80IA(8) of the Act is there for both a service provider and a service receiver. The Tribunal also upheld this contention.

The final contention of the taxpayer was that the restriction placed in the first proviso to Section 92C(4) of the Act which denies a deduction in respect of a TP adjustment is applicable only when the total income is enhanced, and not in a case where such income is reduced. However, the Tribunal held that Section 92(3) of the Act (which provides for refraining from application of ALP, having a detrimental effect to the ITA) is inapplicable as the ALP adjustment will be a tax neutral exercise as both units were part of the same taxpayer.

Transfer Pricing Documentation

Indian TP documentation requirements are largely in line with the OECD's Guidelines. There are however some features unique to the Indian TP requirements, for instance, TP regulations for SDT, concept of deemed international transactions, use of the arithmetic mean (in case there are less than six comparables), use of a customised and narrow range (i.e., 35th to 65th percentile if more than six comparables) and a prescribed sixth transfer pricing method, i.e., another method. To align with global practices, India has adopted the three-tier structure (which entails Master File, Local File and CbCR) as mandated by BEPS AP 13, wherein the BEPS report recommends adopting a standardized approach to TP documentation. The India MF requirements are largely in line with BEPS AP 13 outline with some specific deviations in the information to be submitted.

The TP regulations in the past couple of years have not undergone any changes, except for the amendment to MF and CbCR as noted above. On January 6, 2020, the CBDT amended Rule 10DA of the Rules (for MF) and Rule 10DB of the Rules (for CbCR) compliances in India to be effective from fiscal year 2019-20. The new amendment has focused on administrative provisions laid down in Rule 10DA of the Rules (requirements in relation to MF) and Rule 10DB of the Rules (Requirements in relation to CbCR) of the Rules.

Changes in Rule 10DA of the Rules as per the notification dated 06 January 2020:

- Prior to the amendment in Rule 10DA(2) of the Rules, the MF was required to be filed with the Directorate General of Income Tax. Per the new amended Rule, the MF is now required to be filed with the Joint Commissioner on or before the due date of furnishing the return of Income under section 139(1) of the Act.
- Per the amended Rule 10DA(3) of the Rules, the constituent entity must furnish Part A of Form No. 3CEAA even if the conditions specified under Rule 10DA(1) of the Rules is not satisfied.
- Rule 10DA(4) and Rule 10DA(5) of the Rules have been amended with revised Rule 10DA(4) of the Rules. Per the amended sub-rule, where there are more than one constituent entities of an international group resident in India, the Form 3CEAA may be furnished by any one constituent entity, if, a) the international group has designated that entity for this purpose, and b) that information has been conveyed in Form 3CEAB to the Joint Commissioner in this behalf thirty days before the due date of furnishing the Form No. 3CEAA. The amended sub-rule opens creates some uncertainty, as the revised rule does not clearly indicate which entity (i.e. the designated entity, the international group, or the other constituent entities who are not designated) is required to furnish Form 3CEAB.

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Changes in Rule 10DB of the Rules as per the notification dated 06 January 2020:

- Per the new sub-rule (2) of Rule 10DB of the Rules, the CbCR notification is to be furnished with the Joint Commissioner. Notification must be furnished in Form 3CEAC before 2 months from the due date of filing of CbCR.
- Amended sub-rule (5) of Rule 10DB of the Rules provides that the information required to be conveyed under section 286(4) of the Act regarding the designated constituent entity shall be furnished in Form 3CEAE and does not clearly provide for the entity (i.e. designated entity or the international group or the other constituent entities who are not designated) who is required to furnish Form 3CEAE.

Transfer Pricing Examinations/Audits

The initial years of transfer pricing witnessed significant litigation, but was primarily around the choice of comparables, screening filter applications and thereby was limited to the end margins or mark ups earned, without delving deep into the business understanding of the taxpayers. As the learning curve improved with experience and investment in training for tax officers, the focus of audits shifted to more complex economic concepts of re-characterization, marketing intangibles, use of Profit Split Method, location savings, management charges, royalty payments, cost sharing agreements, financial transactions etc. With the first Income Tax Appellate Tribunal ("ITAT" or the "Tribunal") ruling pronounced for TP in 2007, ITA has come a long way in imbibing global best practices, approaches and learnings in its transfer pricing administration.

A. Recent Trends/Approaches

Some of the key themes that have emerged from recent experiences are summarized as follows:

1. Value Chain Analysis and DEMPE Functions

TP audit proceedings as well as TP audit methodologies have matured in India, focusing more on a comprehensive understanding of the entire value chain and an Indian taxpayer's contribution to the value chain. The ITA requests meetings with operational and technical employees to delve deeper into the functionality of business activity (whether manufacturing, trading or services) and ITA places heavy reference on press releases and professional networking platforms such as LinkedIn, etc., as well as a taxpayers' internal job description and performance appraisal documents to corroborate and frame its opinion of the functional characterization of the taxpayer or transaction. ITA has also been routinely requesting Development, Enhancement, Maintenance, Protection and Exploitation ("DEMPE") analysis in relation to transactions involving Intellectual Property ("IP") including marketing intangibles between the taxpayer and its Group companies. With further access to information available in a taxpayer's MF, the intensity of the value chain analysis and DEMPE analysis is expected to take centerstage.

2. Leveraging Technology

A key trend witnessed in recent days is the use of artificial intelligence and data analytics by the ITA to detect cases of tax evasion and non-compliances. ITA has been extensively using technology to corroborate data across tax departments such as TP, Corporate tax and Indirect taxes alongside the department of corporate affairs. Various Memoranda of Understanding ("MoU") between tax departments have facilitated availability of computerized data of the taxpayers across tax departments specifically between Customs and TP. Implementation of BEPS AP 13 and shift to risk-based assessment has necessitated the use of technology to identify risk areas and gaps in reporting which is shifting the focus from quantity to the "intensity" of audits.

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3. Experiential Learnings Being Implemented from APA

By virtue of its design and requirements, the APA procedure (site visits, detailed business model and competitor analysis) provides deep learning to field officers in understanding the nuances of businesses, industry and sectors. Further, with officers holding multiple positions – in both the TP Audit team and the APA team - and the non-existence of "firewall" provisions in Indian APA rules, there is now significant transfer of internal knowledge from officers handling APA cases. Also, expanding interaction with other TP authorities around the world while finalizing APAs and MAPs also presents ample learning opportunities to ITA on varied analysis and interpretations on diverse issues which are working both ways for taxpayers during audits.

4. Evaluation of Cost Base

As mentioned earlier, in the initial years, the focus of the ITA had been to determine the appropriate arm's length mark up by deciding on the comparable set and applying the so determined margins on the reported cost base of the taxpayers (in case of income transactions). Primary reliance was placed on the audited financial statements of the taxpayer.

In recent times, ITA has been closely scrutinizing the costs base itself and has gone beyond the audited financial statements to assess if there exist any benefits or services provided by AEs or costs incurred for which no payment is made by the Indian entity, thereby resulting in deflation of the costs in the books of Indian entity. Cost and benefits in the nature of Employee Stock Option ("ESOP")/ Restricted Stock Unit ("RSU") cross charges, free-of-costs assets received (on which depreciation is not claimed), global licenses or software tools procured by Group etc. are being increasingly inquired about by ITA, and any presence of such arrangements has led to ITA notionally including the same for the purpose of cost base determination and thereafter applying the mark up.

B. Issues Presently Focused on by ITA

Currently, the Indian TP Regulations are wide enough to cover various aspects of complex transactions involving intangible assets including marketing, human assets, or technology related intangibles, global business reorganizations or restructuring, financial transactions, including corporate guarantee. Some of the significant litigated TP issues in India include:

- **Marketing Intangibles**: In a number of cases, the ITA has alleged that the AMP related activities and expenses add value to the trademark or brand legally owned by the foreign related party by way of brand building. ITA thereby concludes that the local Indian subsidiary must be compensated by the legal overseas brand owner for the benefit bestowed on an arm's length basis.
- **Profit Attribution to a PE in India**: The attribution of profits to a PE has always been contentious, and there is lack of guidance in the regulations. In many cases, attribution has been done by either considering the profits as per the percentage of revenue accruing or arising considered reasonable by the ITA, or profits are derived as a proportion of the total business profits of the non-resident based on the ratio of revenue accruing or arising in India to total revenue.
- **Location Savings**: The major dispute with regard to location savings is based on the premise that the price determined on the basis of local comparables does not adequately allocate location savings, which comes along with further challenges of quantification of such location savings or the extra profits and attribution of them amongst the Indian subsidiary and the related party.

- **Contract Research & Development ("R&D") Centers**: ITA has opined that, notwithstanding the formal structures of contract R&D service provider models being put in place, high-value-adding and sophisticated services are performed by Indian contract R&D centers. This in return leads to generation of valuable and unique intellectual property from the work undertaken in India. Accordingly, the Revenue alleges that the Indian R&D Centre becomes an economic owner of intellectual property, which is transferred without adequate compensation.
- **Financial Transactions**: such as the issue of guarantees, making of intra-group loans, use of newer hybrid instruments to raise funds, thin capitalization rules, etc., are under litigation due to lack of guidance, both in domestic regulation and international literature. Also, the computation of the arm's length price or range for financial transactions is a very niche area, requiring significant expertise in execution and the deployment of sophisticated databases.

C. Developments in MAP Process

With India signing the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS ('Multilateral Instrument' or 'MLI'), the Indian Government has committed to implement the minimum standards laid down in the BEPS Action 14 with regards to MAP.

The Indian government introduced amendments to the Rules governing MAP on May 6, 2020 to address the recommendations in the Peer Review Report released on 24 October 2019 ('Peer Review Report') to implement the minimum standards.

The Indian government merged Rule 44H into Rule 44G of the Rules governing the MAP provisions and made certain amendments therein to address the recommendations in the OECD's Peer Review Report as discussed previously. Other key recommendations of the Peer Review Report which is to be addressed by the Indian government are:

- Adherence to OECD TP Guidelines over domestic tax law;
- Providing MAP access to cases involving domestic anti-abuse as well as no double taxation; and
- Increasing resources for handling of MAP cases.

Further, the CBDT published detailed guidance (the Guidance) on August 7, 2020, to provide key information on several aspects of India's MAP program amendments to address other recommendations in the OECD's Peer Review Report. That guidance will assist all the stakeholders in this regard, i.e. the taxpayers, tax practitioners, ITA in India, and Competent Authority of India. However, it is pertinent to note that the provisions of domestic legislation, rules, instructions, and circulars or the tax treaties l prevail in the case of any clash with the MAP guidance. The recent developments highlight Indian Government's initiative to create a non-adversarial tax regime in India and provide a more promising outlook of MAP regime in India.

D. Developments in APA

The Finance Act, 2020 made certain amendments to APA provisions to include within the scope of subjects on which an APA may be issued the attribution of profits to the PE of a non-resident under clause (i) of sub-section (1) of Section 9 of the Act. The purpose of this amendment is to provide options to choose certainty and clarity to the non-resident taxpayers in relation to attribution of profits to the PE.

Per amended Section 92CC of the Act, the Government of India may enter into an APA to determine the income referred under Section 9(1)(i) of the Act or specifying the manner in which that income is to be determined, as is reasonably attributable to the operations carried out in India by or on behalf of a non-resident. The amendment also provides that Agreement under APA will override any other Income-tax Rules and hence the APA with respect to attribution of profit to a PE provides certainty from corporate tax perspective as well.

APA program in India has largely been hailed as a success by the Government of India. The status of APA applications in India through March 31, 2019 can be seen in the table below.

Unilateral APA Applications Filed	Bilateral APA Applications Filed	Total Applications Filed (A)	Agreements Signed out of (A)	Applications disposed of out of (A) due to other reasons	Applications Under Processing out of (A)
944	211	1,155	271	82	802

Impact of COVID-19

The Coronavirus pandemic has not only terribly impacted human lives but has also led to severe economic breakdown and market chaos. The measures taken by the Indian Government to control this pandemic (including nationwide lockdowns) have created other economic issues such as impacting liquidity, organizations' supply chain operations, cross border and in-border restrictions on movement of people creating inequities in demand and supplies, all leading to a dent in output and consumption. While liquidity, functionality of supply chain and sustainability are the immediate focus, MNEs are also re-looking at the existing operations to acclimatize their TP policy and design to the post COVID-19 environment.

On December 18, 2020, the OECD released Guidance on the TP implications of the COVID-19 pandemic. The guidance emphasizes the application of arm's length principle and OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations to issues that may arise from the COVID-19 pandemic as well. The guidance focused on four priority issues namely comparability analysis, losses and the allocation of COVID-19 specific costs, government assistance programs, and APAs.

All the measures suggested by OECD ultimately call for a 'but for COVID-19 test' and this clearly reinforces the fact that the key to mitigate TP risk lies in maintaining adequate evidence and ensuring TP positions are well-documented.

In response to the difficulties faced by taxpayers arising from the COVID-19 pandemic in adhering to the deadlines for compliance under various laws, the Indian government had extended the due dates of various compliance requirements for fiscal year 2019-20 including the annual compliance requirements for TP in India for Fiscal Year 2019-20. However, the guidance from Indian Government to address TP challenges originating from COVID-19 are much awaited.

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What Can We Expect in 2021?

Though TP Regulation has been evolving in India to complement global evolution, sweeping changes are required in the fundamental TP Regulations that are now a couple of decades old in India. The following are a few changes that are expected in the new decade:

1. Increase in Threshold for Maintaining TP Documentation

The threshold for maintaining information and documents in relation to international transactions is an aggregate of INR 10 Million. Thresholds for various other corporate tax compliance and audit requirements have been increased in the recent past, however, there has been no change to the threshold for maintaining TP documentation. Hence, an increase in the threshold for maintaining TP Documentation can be expected, probably to INR 50 Million.

2. Introduction of Block Assessment in TP Audit

TP audit in India are currently conducted on a yearly basis, wherein the international transactions and SDT are evaluated distinctly for each of the years under audit. It is a well-settled principle in India that the international transactions and SDTs should be evaluated independently for each year based on facts and circumstances applicable for that particular year. However, TP is an economic subject, wherein the performance of business is more often evaluated to determine the ALP, and performance of business is affected by facts and circumstances existing beyond the year under consideration. Further, the infrastructure for a TP audit is currently limited, preventing the ITA from spending adequate time to identify and analyse the facts impacting the business, thereby impacting the diligence of the TP audit. Hence, block assessment of TP audits would be a welcome move from Indian Government in the year 2021 that may help in overcoming the aforementioned obstacles.

3. Implementation of Faceless TP Audit

In September 2019, an e-assessment scheme was launched for automation of various proceedings of assessment under the Income Tax Law. Further, Finance Act 2020 also introduced provision for enabling the Central Government for framing a scheme of conducting faceless appeal proceedings before the First Appellate Authority so as to impart greater efficiency, transparency and accountability. The scheme seeks to eliminate the human interface between the taxpayer and the ITAs, i.e. paper submissions, offline discussions, personal meetings and physical hearings in tax cases have been done away with. Since the announcement of the Faceless Assessment Scheme in August 2020, the Indian Government has introduced the procedural guidelines for the Faceless Appeals scheme and the Faceless Penalty scheme, and most recently has proposed to extend the Faceless scheme to Tribunals as well. Though provisions have been made to include TP audits into the Faceless Scheme (under the Faceless Assessment Scheme), this has not yet commenced. Considering that the Faceless framework is already in place, it is expected that the TP audit may also go faceless in the year 2021.

4. Flexibility Expected in Relation to COVID-19

- The SHR are by and large announced for a block of years. However, the SHR announced by the Indian Government recently has been for fiscal year 2019-20 only. It seems that the Government of India has wisely made this announcement considering that the pandemic lockdown in India and underlying economic factors would begin to negatively impact businesses from fiscal year 2020-21 onwards. Accordingly, for the future years, it is expected that the Indian Government may consider special rates and factor for the pandemic impact on the

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businesses and is also expected to provide specific guidance to deal with various TP challenges arising due to COVID-19.

- The Indian Government on its part, may likely revisit the following aspects in the year 2021 and align the Indian TP regulations with the OECD Guidance on the TP implications of the COVID-19 pandemic and also the realities of businesses to help them sail through the Covid-19 period through following measures:

    a) Rules providing for reliable and accurate adjustments for arriving at the arm's length price. Additional guidance by the Government of India can be provided on possible adjustments which can be considered acceptable while undertaking a comparability analysis to neutralize the impact of Covid-19.

    b) Secondary Adjustment provisions under Section 92CE of the Act, may be suspended for fiscal year 2020-21 and 2021-22.

    c) Relaxation or increase in the tolerance band in situations where the arithmetic mean is applied (i.e., comparables less than 6), a tolerance band of +/-5% should be considered instead of the existing +/-3% (or +/-1% for certain distribution companies). Since the range is published in the Official Gazette for every year, at least for fiscal year 2020-21 and fiscal year 2021-22, a +/-5% tolerance band or anything higher than this can be considered. Further, in situations where inter-quartile range is applied (i.e., for comparables being 6 or more), a range of 25th to 75th percentile could be adopted to align with the worldwide usage, instead of the existing 35th to 65th percentile.

    d) The Indian Government needs to immediately provide dispensations in the matter of computing ALP for at least the fiscal years likely to face the economic downturn, namely fiscal year 2020-21 and fiscal year 2021-22, through modification of the Rules, or issuance of a benevolent circular, to the effect that the taxpayer may be permitted to either compare the weighted average of financial data for latest three fiscal years or use only the financial data for the current fiscal year of comparable companies and the tested party.

    e) For fiscal year 2020-21 and onwards, the SHR are yet to be announced, and this provides an opportunity whereby the margins and rates to be considered in the SHR can be rationalized to consider the current Covid-19 economic realities for fiscal year 2020-21 and onwards. Further, more categories of transactions can be included under SHR, to provide companies with a realistic option to select from.

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