TRANSFER PRICING PRISM 2017

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PREFACE

The Transfer Pricing Regulations were introduced in the Indian statute for the first time in 2001 and thankfully, it is now coming of age. It was only a couple of years ago that the post-Audit, transfer pricing disputes delivered a record number. At that time, the distrust between the Tax Authorities and MNE also reached its peak. Contrast to that, the present Government led by Mr. Narendra Modi seems to deliver on its election promise of a non-adversarial tax regime. Transfer pricing disputes are declining and the atmosphere is congenial to resolve and eliminate disputes, much to the relief of MNEs.

Even as the mood in India is changing, looming on the horizon is the implementation of Base Erosion and Profit Shifting (BEPS) recommendations which promises to dislodge long accepted methods of pricing between Associated Enterprises. Echoing the G-20 roll-out of 15 Action Plans that is core to the BEPS, Indian Transfer Pricing regulations are undergoing changes to incorporate the key recommendations. In the last annual budget 2016, several modifications have been incorporated. The Transfer Pricing documentation and reporting is now aligned to OECD BEPS Action Plan 13 and is applicable from financial year 2016-17.

One of the key provisions to reduce TP litigation was introduction of Safe Harbour provisions that was introduced for the first time by the Finance (No. 2) Act, 2009 with the intention of providing certainty, administrative simplicity and reduced litigation. However, the margin prescribed in the Rules is perceived as higher than the arm's length price ordinarily computed that could result in potential economic double taxation. Thus far, the response to usage of Safe Harbour margins has been at best, tepid.

On the other hand, the introduction of the Advanced Pricing Agreements (APAs) has met with a degree of success to reduce potential litigation and is an effective controversy management tool. The option of APA delivers certainty for 5 years in the future and with the rollback provisions for 4 preceding years, an overall tax certainty for upto 9 years. Additionally, the experience with the APA authorities reveals a pragmatic and fact-cognizant approach and conducted in a cordial and non-intrusive manner. However, the score-card of timely outcome is still falling short on expectations. Out of 712 applications (unilateral and bilateral) filed, only 108 APS have been signed till October 2016.

In the meanwhile, the 'flagship' TP dispute in India and brainchild of Indian Tax Authorities, Advertising, Marketing and Promotion (AMP) is now before the Supreme Court of India. Marketing intangibles now finds place in the UN manual; it recognises that if a foreign licensor is benefitting from the AMP functions, then the domestic entity ought to be remunerated at arm's length. Further, the concept of 'economic owner' in the hands of the Indian licensee entity is now accepted and acknowledged.

Currently, the tax world is in midst of a storm with the adoption of BEPS 15-point Action Plan along three key pillars on the anvil; introducing coherence in the domestic rules that affect cross-border activities, reinforcing substance requirements in the existing international standards and improving transparency as well as certainty. In the light of the divergent world that would seem to emerge on implementation of BEPS, more often unilaterally interpreted by countries, it is concerning to observe how the Tax authorities across several jurisdictions cope with taxing e-commerce transactions and dodge minefields of double taxation or potential non-taxation. In summary, BEPS promises to ensure that how international taxation, as it was being practised, will never be the same again.

Once again, in this 2nd edition of PRISM, the efforts of BDO India's Tax team to bring out this publication has been outstanding and I take pleasure in acknowledging their efforts.

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FOREWORD

Transfer pricing continues to be the most important global tax issue today. The recommendations of the OECD's BEPS project in October 2015 are having a real impact with respect to the documentation required to support the prices used for transactions between non-arm's length parties, with the adoption of these recommendations by many countries around the world. In its 2016 budget, India announced to the world that it will be introducing the new transfer pricing guidelines for documentation effective for the assessment year 2017-18.

These documentation changes require a three-tier approach to transfer pricing documentation. They include a Master file with an overview of an international group's business and transfer pricing policies, a local file which documents how the Indian entities in the group have complied with the arm's length principle, and a Country by Country Report, that provides specific data by country. Together, this documentation will greatly increase the transparency of how a global organisation conducts its business to the Indian and other tax authorities around the globe. With these changes, India has joined most of the rest of the world in elevating the importance of transfer pricing in combating inappropriate profit shifting between countries, by the prices charged for transactions between non-arm's length parties of an international group.

The Indian tax authorities have always paid close attention to transfer pricing policies used by business operations in India for both international and domestic transactions between non-arm's length parties. There are also a number of areas where the Indian tax authorities, focus which increases the transfer pricing risk for any business operating in India. It is critical that all Indian businesses pay attention to their transfer pricing policies and have sufficient documentation to support the prices used.

I am very pleased that BDO India has again produced this comprehensive Transfer Pricing update which is an invaluable resource for both Indian businesses and foreign businesses operating in India. BDO India is one of the leading Transfer Pricing practices in India and an important part of BDO's global Transfer Pricing team.

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It is clear that the transfer pricing environment for MNEs has changed forever as the OECD's BEPS initiative has united so many countries in their fight against perceived tax risk. We are seeing radical transparency measures and accountability imposed on MNEs, an increased rate of exchange of information between Tax Authorities, unilateral (and in some cases unique) actions being taken by countries and increasing public and political pressure forcing governments to take action.

MNEs are facing increased scrutiny by Tax Authorities and therefore the potential for reputational risk regardless of whether they are adopting perceived aggressive transfer pricing policies, as the general public is not in a position to assess whether or not a transfer pricing position is supportable by law.

Whilst Tax Authorities are united behind the BEPS project, they are not all aligned in their views or approach. For this reason, we expect a significant increase in transfer pricing disputes, double taxation and therefore an increasing appetite for Advanced Pricing Agreements, so MNEs can better manage tax certainty in an uncertain tax environment.

In a recent global survey, 55% of respondents considered that Action 13/CbCR would result in increased transfer pricing audits and/or adjustments. Somewhat alarmingly, only 20% had increased their resources to deal with BEPS. India was ranked in the top 5 countries causing most concern for MNEs.

India is front and centre in the global transfer pricing debate, responding promptly and comprehensively to perceived tax risks.

BDO India's comprehensive transfer pricing update will help Indian groups stay up to date on how to respond in an extremely complex and fast changing environment. I commend this publication and BDO India's expertise in identifying and sharing key insights and recommendations for MNEs to consider.

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OVERVIEW OF INDIAN TRANSFER PRICING REGIME

BACKGROUND

The Indian TP Regulations were introduced in 2001, as a measure against tax avoidance. The same are embodied as a separate chapter in the IT Act, IT Rules and various circulars, notifications and instructions issued by the Indian Government from time to time.

The Indian TP Regulations are largely influenced by the OECD TP Guidelines,[1] but are modified to specifically suit the Indian tax regime. Similar to the OECD TP Guidelines and TP Regulations of several other countries, Indian TP Regulations prescribe methods to compute 'Arm's Length Price' for an 'International Transaction' or a 'Specified Domestic Transaction' entered into by a taxpayer with its 'Associated Enterprise'. Any adjustment in transfer price would then be considered for determining taxable income of the said taxpayer.

Owing to India's commitment to the OECD/G20 BEPS Project, the Indian TP Regulations are being amended to align the same with the BEPS Action Plans. The principles laid down by the BEPS Action Plan are also finding their way into judicial pronouncements made by Indian Courts and Tribunals.

ASSOCIATED ENTERPRISE

The term 'Associated Enterprise' generally means any entity that participates directly or indirectly or through one or more

[1] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration, 2010

intermediaries in the management or control or capital of another entity. Further, where two entities are commonly controlled by one or more controlling entities, such entities are also considered as 'Associated Enterprises'.

The Regulations further provide specific conditions and circumstances under which two entities are deemed to be Associated Enterprises. Some of these basic conditions include, ownership in the voting power of an enterprise exceeding the stipulated limit and right to appoint more than half of the directors on the governing Board of an entity. Other specific relationships applicable to firms and family businesses are also prescribed.

In the context of Specified Domestic Transactions, a related party (also referred to as Associated Enterprise) includes, amongst others, a director of a Company, a relative of such director, an entity having substantial interest (i.e., holding more than 20% of the voting power) in the other entity, subsidiaries, fellow subsidiaries, etc.

INTERNATIONAL TRANSACTION

'International Transaction' is defined to mean a 'transaction' entered into between two or more Associated Enterprises, either or both of whom are non-residents, which has a bearing on the profits, income, losses or assets of an entity. The 'transactions' covered, *inter alia*, include:

- Purchase, sale, transfer, lease or use of tangible or intangible property;
- Capital financing;
- Provision of services;
- Business restructuring or reorganisation.

International Transactions also include transactions pertaining to cost allocations, cost contribution agreements, reimbursements, etc.

The definition of 'International Transaction' also includes a deeming fiction wherein transaction between two non-associated entities is deemed to be an Interntional transaction between Associated Enterprises and consequently subject to TP. These provisions are attracted in case where transactions between unrelated parties are influenced by a prior agreement/ arrangement existing between unrelated enterprise and Associated Enterprise.

SPECIFIED DOMESTIC TRANSACTION

With effect from Fiscal Year 2012-13, specified domestic transactions between two related parties or Associated Enterprises are subject to TP Regulations, where the aggregate of all such transactions exceeds a sum of INR 50 mn (this threshold has been revised to INR 200 mn from Fiscal Year 2015-16). The following transactions have been covered under the ambit of Specified Domestic Transactions:

- Payments in the nature of business expenditure made to a related party/ Associated Enterprise.
- Transfer of goods or services between a tax holiday and non-tax holiday unit of an entity.
- Any business transacted between an enterprise claiming tax holiday with another closely-linked enterprise.

ARM'S LENGTH PRICE

ALP has been defined to be the price which is applied or is proposed to be applied in a transaction between persons other than Associated Enterprises, in uncontrolled conditions.

Computation Of ALP

The Indian TP Regulations require computation of ALP based on the prescribed TP methods. The Regulations have prescribed the following five methods for determination of ALP – Comparable Uncontrolled Price Method (CUP), Cost Plus Method (CPM), Resale Price Method (RPM), Profit Split Method (PSM) and Transactional Net Margin Method (TNMM). The TP Regulations also provide for use of any other method which takes into consideration a price charged in a similar transaction between unrelated parties in uncontrolled circumstances.

In cases where there is more than one price determined using the most appropriate from the above methods, ALP shall be taken to be at arithmetic mean of such prices. Where the transfer price differs from ALP, no TP adjustment is made where the arithmetic mean falls within the tolerance range of transfer price. Currently, the tolerance range available for wholesale traders is 1%, while that for other taxpayers is 3% of the value of International Transaction/ Specified Domestic Transaction.

Use Of Range Concept

The Central Board of Direct Taxes (CBDT), the regulatory body responsible for tax administration in India, has also notified the concept of 'arm's length range' for computation of ALP for transactions after April 1, 2014. Under this concept, data points lying within the 35th and the 65th percentile of a data set constructed using comparable data would constitute the arm's length range. Accordingly, transfer price falling within the arm's length range would be considered to be at arm's length.

A minimum of 6 comparable entities are required for application of the range concept. In cases where the number of comparables in a data set is less than 6, the arithmetic mean would continue to be considered as the ALP. Where the arithmetic mean is considered as the ALP, the benefit of a tolerance range continues to be available.

Use Of Multiple Year Data

Originally, the TP Regulations did not provide for using data of years other than the year in which transactions were undertaken (except in certain specific cases). The CBDT has amended the Rules and now permitted use of 'multiple year data' while performing a benchmarking analysis. If certain conditions are satisfied, the taxpayer shall be permitted to use comparable data of 2 years preceding the relevant fiscal year along with that of the relevant fiscal year (also referred to as current year).

COMPLIANCE REQUIREMENTS

Reporting

Taxpayers entering into International and/ or Specified Domestic Transactions with their Associated Enterprises, need to report the same to the Indian tax authorities on or before the due date of filing of tax return, by furnishing a certificate obtained from an Accountant.

The Accountant needs to certify the following in the said certificate (in a specified Form):[2]

- That the ALP computed by the taxpayer is correct and in accordance with the Regulations; and
- That the taxpayer has maintained appropriate TP documentation as required by the Regulations.

The said certificate requires the Accountant to report specific details of the International

[2] Form No 3CEB

and/or Specified Domestic Transactions, the value of transaction, the method used to determine ALP.

Three-Tiered Documentation

Taxpayers are required to maintain comprehensive and contemporaneous documentation to substantiate the ALP determined for the transactions exceeding INR 10 mn, entered into with Associated Enterprises. However, even in case where the value of International Transactions does not exceed INR 10 mn, the taxpayer is required to maintain basic documentation demonstrating that the transactions were at ALP.

To align with OECD recommendations on TP documentation under the BEPS project, the Union Budget of 2016 introduced changes to the TP Regulations. The changes are in line with the 3-tier approach recommended in Action Plan 13 of the BEPS Project and calls for the taxpayer to maintain:

— A Master File;

— A Local File; and

— A Country by Country Report ('CbCR').

This 3-tier documentation approach is effective from April 1, 2016 (i.e., fiscal year 2016-17).

Penalties

The Indian tax law has prescribed the following penalties for various defaults in TP compliances:

Default	Penalty (from fiscal year 2016-17)
Failure to keep or maintain required documentation, failure to report required transactions and furnishing incorrect information or documentation	2% of Value of International Transactions and/or Specified Domestic Transactions
Failure to furnish TP documentation when called for by the Indian tax authorities	2% of Value of International Transactions and/or Specified Domestic Transactions
Failure to furnish Form 3CEB before the due date of furnishing the tax return	INR 100,000
Failure to furnish Master file when called for by the Indian tax authorities	INR 500,000
Failure to furnish CbCR or further information (called for) in respect of CbCR	INR 5,000 – 50,000 per day, depending upon period of delay
Providing inaccurate information in CbCR	INR 500,000
In case of TP adjustment during the course of audit by Indian tax authorities	▪ 50% of tax on TP adjustment where TP documentation not maintained. ▪ 200% of tax on TP adjustment where transaction or material facts not disclosed.

TYPICAL TRANSFER PRICING ISSUES UNDER LITIGATION

Selection Of Comparables

Typically, comparability analysis is performed by a comparison of the business activities and the Functions, Assets and Risks of the taxpayer *vis-à-vis* that of independent companies. Several financial parameters and quantitative filters are applied while screening comparables. Finally, qualitative analysis is carried out to identify final set of comparables. There is a lot of subjectivity in this matter, leading to numerous litigations. Some issues which are frequently debated upon in the course of TP audits are:

- Selection of loss-making or abnormal profit-making companies as comparables;
- Comparison of high-end services with low-end services;
- Comparison of trading functions with agency functions;
- Comparison of turnover, employee costs, transactions in foreign currency, etc.;
- Comparison of companies catering to export markets to those catering to domestic markets

Calculation Of Profit Level Indicators

Profit Level Indicators (PLIs) are ratios between the profits and costs incurred/ sales achieved/capital employed. It provides a reliable basis to compare operating profits of the taxpayer and the uncontrolled comparable. The dispute arising in this regard pertains to classification of expenses and incomes as operating or non-operating while computing the profit level indicator, since these terms are not defined in the Indian TP Regulations. Also, taxpayers and tax authorities differ in approaches to compute PLI in case of segmental data of diversified business activities.

Comparabilty Adjustments

Indian TP Rules permit making adjustment to the PLI in order to eliminate material differences between controlled and an uncontrolled transaction, which could materially affect the price, cost or profit. In view of these provisions, taxpayers have been resorting to the computation of working capital adjustments, risk adjustments, capacity utilisation adjustments, to improve comparability analysis. However, in the course of TP audits, there have been disputes around the allowability and manner of computation of these adjustments.

Advertising Marketing & Promotion Expenses

Over the past few years, taxpayers promoting international brands in India have been scrutinised for the level of advertising, marketing and promotion (AMP) expenses incurred by them. Many taxpayers have witnessed large TP adjustments on the issue. This has led to disputes between the taxpayer and tax authorities resulting in the disallowance of AMP expenses and the same being challenged in higher courts. In some cases, the courts have pronounced judgments in favour of the taxpayer and these disallowances have been deleted while in other courts, judgments have been pronounced in favour of the tax authorities. Even though several cases have been disposed by the Delhi High Court and the Appellate Tribunals, there is no clear, undisputed resolution for this controversy and it is still one of the most debated TP issues before the courts. It can be said with ease that the AMP controversy is still far from over.

Interest On Loans / Advances

Lending and borrowing of loans and advances falls within the purview of an international transaction and is to be benchmarked by justifying the interest rates charged on such loans/advances. The actual puzzle that needs to be solved in this transaction is the arm's length rate to be taken for benchmarking the interest rate at which such loans/advances are given/

received to/from associated enterprises. Going by the recent rulings, the courts have stated that factors like currency of the loan, comparable rates in borrower's jurisdiction, etc. needs to be taken into consideration while arriving at the ALP.

Corporate Guarantees

With the introduction of an explanation to section 92B of the IT Act by the Finance Act, 2012 corporate guarantee was brought within the ambit of TP and considered to be a qualifying transaction. Therefore, the same is since being regarded as an international transaction/specified domestic transaction by the tax authorities, while conducting TP Audits. Current litigation is dealing with issues such as whether remuneration is to be necessarily paid for the guarantees given and the determination of ALP in such cases.

Issue Of Shares

Court rulings have upheld that TP provisions are applicable to capital transactions and the same are to be reported as part of TP compliances. However, the Courts have stated that although capital transactions (like issue of share capital) qualify as international transactions, TP adjustments cannot be made since being capital in nature, they do not give rise to income and are not subject to tax.

Some of the above and other issues are discussed in detail in the later part of this publication.

ADVANCE PRICING AGREEMENT

In order to curb increasing TP litigation and with a view to provide certainty to taxpayers, Advance Pricing Agreements (APA's) were introduced in the Indian TP Regulations in 2012. APA refers to an agreement between the taxpayer and the tax authority in relation to an international transaction entered between Associated Enterprises for the purpose of determining ALP or specifying the manner in which ALP is to be determined. Indian TP regulations permit unilateral, bilateral and multilateral APAs.

An APA can be executed for a maximum period of 5 consecutive years from the year in which such APA has been entered into. Recently, the APA rules were amended to provide for roll back of the APA to 4 years prior to the year in which the same was entered into.

SAFE HARBOUR RULES

Safe Harbour Rules were announced from fiscal year 2012-13, for certain international transactions which saw significant TP litigation. These include, transactions in industries like software, ITeS, pharmaceutical and automotive and also cover financial transactions like advancing of loans and provision of corporate guarantees. The Safe Harbours are applicable for a period of 5 years, at the option of the eligible taxpayer. However, taxpayers opting for Safe Harbour will continue to be governed by the existing TP Documentation and Certification requirements. The tolerance range, would not be available for taxpayers opting for the Safe Harbours. Recently, Safe Harbour Rules were amended to include safe harbours for certain Specified Domestic Transactions undertaken by government electricity companies and milk co-operative societies.

Due to prescription of steep margins and minimal relaxation in compliance burden, Safe Harbour Rules have found limited popularity amongst taxpayers. However, considering that this regime has found favour with taxpayers in several countries like USA, Australia, UK, France, Singapore, Brazil, etc., relaxation of margins and ease in compliance by the Indian Government would make this regime viable for Indian taxpayers.

REVAMPING TRANSFER PRICING AUDIT PROCEDURES

The Indian TP regulations provide for TP audit by a special cell of officers called 'Transfer Pricing Officers'. As per earlier instructions of the CBDT, Tax Officers were necessarily required to refer the audit cases to the TP Officer where the aggregate value of international transactions of a taxpayer exceeded INR 150 mn The TP Officer would then proceed to assess the arm's length nature of international transactions reported by the taxpayers in accordance with the Indian TP regulations.

The above approach adopted by the CBDT underwent change when the CBDT decided to follow a 'risk-based approach' towards TP audits. That risk-based approach involves selecting cases for audit on the basis of potential tax risk emanating from TP arrangements, rather than the quantum of international transactions. The CBDT has issued a detailed set of guidelines to ensure procedural uniformity in conducting TP audits.

Some of the parameters which could lead to cases being referred to TP Officer are:

- Where the taxpayer has entered into international transactions and/or specified domestic transaction but has not filed the Accountant's report under section 92E of the IT Act, 1961 or has not disclosed the said transactions at all.
- Where there has been a TP adjustment in the year preceding the relevant Fiscal Year and has been upheld by courts is pending in appeal.
- Where the taxpayer has disclosed the transactions along with qualifying remarks and he believes that the said transactions are not in the purview of TP and do not impact his income.

IMPLEMENTING BEPS ACTION PLANS

The OECD, along with G20 countries, launched the BEPS Project in September 2013 to curb aggressive tax planning by MNEs through intra-group transactions. Being a part of the G20, India has been an active participant in the BEPS Project and is committed to align the Indian TP Regulations with BEPS project recommendations.

While the guidelines of Action Plan 13 of the BEPS project are already being incorporated into the Indian TP Regulations, Action Plans 8-10 are likely to find their way in Indian TP Regulations in near future. Indian courts/ tax authorities are already relying on the relevant principles under the Action Plans, while deciding litigation.

After 15 years from its first introduction in 2001, the TP regime is maturing with tax authorities and MNEs finding middle ground of resolving disputes by collaboration rather than confrontation which breeds a stable tax environment. This welcome change would prove greatly beneficial to international business community which see a large opportunity in the growing Indian economy.

SECTION B

CHANGES IN THE INDIAN TRANSFER PRICING LANDSCAPE

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1. MULTIPLE YEAR DATA AND PERCENTILE RANGE

BACKGROUND

Indian TP Regulations have evolved since their introduction in 2001. Despite the increased focus on TP, amidst all the controversy and global investor attention, certain issues remained unaddressed. One such area was a basic discrepancy between the approach to benchmarking adopted by the Indian tax authorities and that adopted by taxpayers. Upto fiscal year 2013-14, the Indian TP Regulations required the taxpayers to use comparable data pertaining to the current year, being the year in which the International and/or Specified Domestic transaction had taken place. As per the Indian TP Regulations, comparable data for 2 years prior to the current year was permitted to be used only when such data had a significant impact on data of the current year. As opposed to this, global practices have generally permitted use of multiple year data and an arm's length range for benchmarking purposes.

The use of single year data and arithmetic mean to compute ALP had made the TP Regulations inherently rigid. Further, it was impossible for taxpayers to find comparable companies reporting data of the current year to perform a meaningful comparability analysis within the prescribed timelines. Owing to such data insufficiency, taxpayers have been, in practice, using multiple year data while preparing the TP documentation. However, the current year data becomes available by the time the transactions come up for audit before the Indian tax authorities and are used by tax authorities for TP assessments, leading to diversion from ALP adopted by taxpayers. In past, tax authorities have rejected the benchmarking analysis performed by taxpayers in their TP documentation. This has been strongly argued against by taxpayers, stating that the same goes against the 'contemporaneous' nature of documentation mandated by TP Regulations. The use of single year data also did not average out the impact of cyclical fluctuations on the margins of comparable companies. Further, narrowing down the range of prices to a single arithmetic mean resulted in a distorted picture of the ALP in certain cases, as the arithmetic mean is susceptible to skewed data results caused by inclusion of outliers.

With a view to reduce TP disputes and align TP Regulations with international best practices, use of 'multiple year data' and 'range concept' for performing comparability analysis was notified by the CBDT effective April 1, 2014.

USE OF MULTIPLE YEAR DATA

The CBDT, *vide* the above notification, has amended the 'IT Rules to include the procedure for using multiple year data to construct datasets for application of CPM, RPM and TNMM as depicted below:

CY = Current Year, CY-1 = Year immediately preceding CY, CY-2 = Year before the one immediately preceding CY

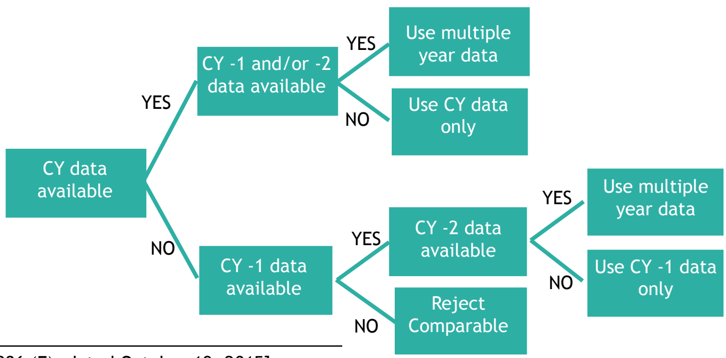
In case the data for the Current Year is not comparable upon application of qualitative or quantitative filters, the said company cannot be considered comparable. If data for the Current Year is available and comparable, data for previous two years can be used, provided it satisfies the qualitative and quantitative filters applied in either or both the previous years.

The concept of 'multiple year data' shall not apply while applying the CUP, PSM or other method while computing ALP.

The IT Rules also state that if Current Year data of the comparables becomes available subsequently at the time of TP Audit, then the ALP computed earlier will have to be updated so as to include the effect of the Current Year data. This is a tricky proposition, since the benchmarking results would change basis subsequent availability of data, leading to uncertainty even after preparation of contemporaneous TP documentation.

PERCENTILE RANGE FOR BENCHMARKING

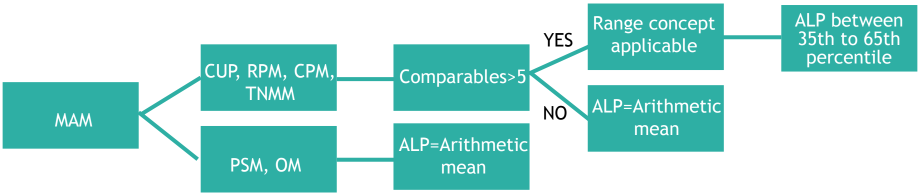
Where more than a single price was determined using the most appropriate method for benchmarking, the arithmetic mean of such prices was to be considered



3 [S.O. 2086 (E), dated October 19, 2015]

as ALP. The TP Regulations provided for a tolerance band of +/- 1% or +/- 3% deviation between the arithmetic mean and the transfer price.

The amendment to the IT Rules further provides that 'range concept' shall be used for determination of ALP in the manner depicted below:



The arm's length range shall consist of the values falling between the 35th percentile and the 65th percentile of the set of 6 or more comparables, arranged in ascending order. The price of an International/ Specified Domestic transaction will be considered to be at an arm's length if the same falls within the said arm's length range. If the price at which the transaction has taken place falls outside the arm's length range, the median of the set of the comparables shall be considered to be the ALP.

In other cases, arithmetic mean shall be used as ALP. In such cases, the benefit of tolerance range of +/- 1% in case of wholesale traders and +/- 3% in other cases shall be available.

GLOBAL PRACTICES

There are several other countries which are already using the multiple year data and range concept, including United States, United Kingdom, Australia, Singapore, France, Korea, Germany, South Africa, Spain, etc. The OECD TP Guidelines as well as the United Nations TP Manual recommend the use of inter-quartile range (range of values between 25th percentile to 75th percentile) to enhance the reliability of comparable data, where there are limitations in accuracy due to lack of information on the comparables used. Further, there is a general agreement by the OECD that multiple year data can be used by the taxpayer for calculating the arm's length range of comparables.

Practices with respect to use of 'multiple year data' and 'range concept' by a few countries are summarised in the table below:

Country	Multiple year data	Range concept	Remarks
Australia	Taxpayers are allowed to consider CY and previous 4 years data so that comparability can be determined more reliably.	The use of statistical techniques to deal with the low reliability of data that can occur in TP cases is allowed.	One such 'statistical technique' allowed is use of inter-quartile range.

Country	Multiple year data	Range concept	Remarks
Singapore	To enhance the reliability of the comparability analysis, taxpayers should examine multiple year data as it helps to identify factors that may have influenced or should have influenced transfer prices, such as long term arrangements, business or product life cycles.	Application of inter-quartile range is allowed to enhance the reliability of the comparability analysis where there is a range of prices, all of which are at arm's length.	Singapore TP guidelines urge taxpayers to examine multiple year data as opposed to single year data.
United Kingdom	Use of multiple year data is allowed depending on the relevant business and product life cycles of the comparables and the taxpayer.	Use of different statistical tools, including application of inter-quartile range, is permitted.	The TP Regulations in UK require taxpayers to follow OECD Guidelines, rather than making any specific rules regarding use of multiple year data and applying the range concept.
United States	One or more years data (prior to or subsequent to the relevant year) can be used depending upon the circumstances and availability of the data for the taxpayer.	If the comparables are of lesser reliability, then the reliability must be increased by adjusting the range through application of a valid statistical method to the results of all the uncontrolled comparables.	If multiple year data is taken for comparables, the data relating to the same years must be taken for the taxpayer. Further, even though use of range concept is not directly mentioned, use of inter-quartile range is allowed as a valid statistical method.

OUR COMMENTS

With these amendments, the Indian Government is steadily aligning Indian TP Regulations with accepted international practices. This has paved the way towards reducing TP litigation in future. While the use of multiple year data widens the data population available for use in benchmarking, the use of range eliminates distortions caused by the outliers in a dataset. However, the arm's length range prescribed above is narrower than the 'inter-quartile range' which is used internationally. Given the tightness of the prescribed range, the same may not prove to be more beneficial than the earlier tolerance range of +/- 1% and +/- 3% in certain cases. Further, the necessity to update margins during TP audits is likely to change the benchmarking results during such audits, leading to uncertainty. Nevertheless, proper documentation of procedures within the TP Regulations itself will reduce the prevalent uncertainty around acceptable and reasonable approaches, which also adhere to arm's length principles.

2. ADVANCE PRICING AGREEMENTS: AN UPDATE

A RECAP

In recent years, TP audits in India have consistently resulted in large tax demands and protracted litigation. Due to such aggressive approach of Indian tax authorities, MNE groups became wary of the long term uncertainty with respect to their TP affairs in India. It also created a negative environment for foreign investment in the country.

Globally, APAs have offered an effective mechanism for reducing prolonged TP litigation, thereby bringing certainty on board. Therefore, with a view to reduce litigation and providing a stable TP regime, the Indian Government introduced APAs in 2012. Further, in order to align the Indian APA regime with the global best practices, the Indian Government introduced rollback provisions *vide* the Finance Act 2014.

APA refers to an agreement between the taxpayer and the tax authorities for determining the ALP or manner of determination of ALP, for transactions with associated enterprises. An APA can be unilateral, bilateral or multilateral. Although, the TP Regulations have been expanded to cover even Specified Domestic transactions, the option of APA is currently not available for such transactions. Once an APA has been entered into, the ALP with respect to the International transactions under consideration would be determined in accordance with the terms agreed in the APA for the agreed period (subject to a maximum of 5 years).

Subject to fulfilment of specified conditions and upon choosing to do so, the taxpayer can seek application of the terms of already concurred position under an executed APA, to prior years (maximum of 4 years immediately preceding the first year for which the APA is agreed).

In other words, under the Indian TP regime, an APA has the potential to provide TP certainty up to 9 years.

THE PROCESS

Similar to global APA process, a typical APA process in India broadly involves the following stages:

Concept Stage	Pre-Application Stage	Application Stage	Negotiation and Conclusion Stage	Post APA Stage
Determining feasibility of applying for an APA	Review of TP policies	Preparing the application in prescribed form	Discussions and negotiations with tax authorities	Modifying tax returns
Evaluating TP issues to be covered	Review of status and quality of compliances	Benchmarking analysis	Drafting / review of agreement as per negotiation - critical assumptions, terms and conditions	Annual compliances

Concept Stage	Pre-Application Stage	Application Stage	Negotiation and Conclusion Stage	Post APA Stage
Identifying transactions to be covered	House keeping - TP positions taken during past audits, identifying sensitive areas	Legal research	Sensitivity analysis	Compliance audit
Determining the type of APA		Payment of APA filing fees (INR 1 mn to INR 2 mn depending on the value of international transactions)	Withdrawal/ amendment of application, if necessary	Cancellation / Renewal/ Revision of the APA
Conducting pre-filing discussions		▪ Filing of application ▪ Withdrawal/ amendment of application, if necessary		

ROLL BACK PROVISIONS

Background

Prior to the introduction of the concept of rollback, though APA provided TP certainty for future to the taxpayer, past litigation continued to haunt. Given the protracted litigation in TP, APA rollback was a logical need of taxpayers. Thus, it became imperative for the Indian Government to align the Indian APA regime completely with global best practices, making the process and the outcome more fruitful to both, the taxpayer and tax authorities. With a view to provide long term stable TP environment to the taxpayers, effective October 1, 2014, the Indian Government introduced the rollback provisions. Further, in March 2014 the rules specifying the operational procedure for rollback were notified.

As per the rollback provisions, the ALP or manner of determination of ALP agreed in the APA could be applied to transactions of the prior years (up to 4 years immediately preceding the first year of APA).

Salient Features of the Rollback Provisions

- An application for availing rollback benefit is to be filed in prescribed form along with the APA application.
- A fee of INR 0.5 mn is to be paid along with rollback application (this in addition to the APA filing fee).
- Rollback could only be applied in case of transactions similar to the International transaction for which the APA is agreed.
- Rollback is available only for the years where the tax return has been filed before the prescribed due dates.
- Rollback is available only if TP certificate in Form 3CEB has been furnished before the due date for each rollback year.

- Rollback must be requested for all prior years (maximum of 4 years immediately preceding the first year of APA) in which the International transaction has been undertaken.
- Modified tax returns have to be filed for all the rollback years along with tax return for first year under APA.
- Any appeal pending before the first or the second level appellate authorities pertaining to rollback years and transactions / issues covered under rollback should be withdrawn.
- In case effect cannot be given to the rollback provisions of an APA for any rollback year, on account of failure on the part of the taxpayer, the entire APA shall stand annulled.

Clarifications on Roll Back Provisions

The CBDT has provided certain clarifications on rollback provisions in the form of FAQs. Key clarifications provided in these FAQs are summarised below:

- The taxpayer who has filed a belated return for a year under the rollback period would not be eligible to seek rollback provisions. However, this does not apply in cases of revised returns being filed beyond due date, if the original return is filed in time.
- The international transactions to be covered in the rollback years ought to be of the same nature, with the same Associated Enterprise and with FAR profile not materially differing from those covered under the APA.
- Rollback shall apply for all 4 immediately preceding years, unless the said international transaction did not exist in a rollback year or the taxpayer is not eligible to avail rollback benefit for any of the 4 years. The taxpayer does not have an option to choose the rollback years.
- Rollback will not be available for years for which the Appellate Tribunal (second level appellate authority) has decided an appeal before signing of the APA.
- If MAP request is pending for any of the rollback years, the taxpayer would have the option to exercise either MAP or rollback provisions.
- ALP can be different for different rollback years, however the manner of determining ALP would need to be same.
- Compliance audit will have to be conducted for the rollback years, primarily to check if the agreed price or methodology has been applied in the modified tax return.
- The taxpayer would not have the option to accept only the rollback result without accepting the APA for the future years.
- In case of a merger or demerger, the taxpayer entity which applied for APA would be entitled to rollback provisions.

INDIA STATISTICS

The APA scheme has received immense response in India, as is apparent from the statistics below:[4]

[4] CBDT Press Release dated October 27, 2016

Particulars	As at October 2016
Total Number of APA applications filed (Unilateral and Bilateral)	700+
Total APAs concluded in the current fiscal year (beginning April 2016)	44
Total APAs concluded	108
Unilateral APAs concluded	104
Bilateral APAs concluded	4

The Indian Government concluded 5 APAs within record time of 1 year of introducing the APA programme, since then the programme has taken pace. The concluded APAs pertain to industry sectors like telecom, media, automobiles, IT services, pharma, etc. It is understood that recently, APAs have been concluded for banking, information technology and manufacturing industries. The APAs have addressed International transactions like provision of services (IT / ITES, non-binding investment advisory, etc.), contract manufacturing, interest payments, corporate guarantees, management/service charges, royalty payments, transactions of Indian headquartered MNE with overseas subsidiaries, etc.

CONCLUSION AND COMMENTS

The initiative of the Indian Government to align the TP regime with the global best practices is laudable. First, the introduction of the APA programme and subsequently, introduction of the rollback provisions clearly shows the commitment to provide a non-adversarial tax regime.

An APA can provide certainty to a taxpayer for up to 14 years (i.e., 4 years rollback + 5 years under APA + 5 years renewal) which is a significant relief enabling taxpayers to concentrate on business without the threat of having their international transactions aggressively taxed. However, taxpayers should evaluate their APA strategy in detail based on the nature of the international transaction, risk of TP adjustment, FAR analysis, corporate action plans, etc. Further, the taxpayer should thoroughly understand the entire specified procedural requirement involved in the process as any lapse on their part may endanger their entire APA programme.

3. ADMINISTRATIVE CHANGES

BACKGROUND

In recent years, TP has been a major cause of dispute between the Indian tax authorities and MNEs. TP audits in India have consistently resulted in large tax demands and protracted litigation. Due to such aggressive approach of the Indian tax authorities, the MNE groups have become wary of the long-term uncertainty with respect to TP affairs in India. While a large population, availability of skills and sheer consumption capacity have turned India into an attractive investment destination, growing TP risk and tax uncertainty have sown trepidation in their investment decisions. To comfort the investor community, reduce tax litigation and provide long term certainty to the taxpayer, the Indian Government has made several efforts to align the TP regulations with the global best practices. CBDT issued various guidelines to operationalise TP provisions and to provide procedural uniformity to Indian tax authorities. Time and again these guidelines in relation to the TP assessment have been revised by CBDT. Further, the Indian Government formed an alternative dispute mechanism called as Dispute Resolution Panel under the existing provisions of the IT Act to resolve the disputes relating to TP in international transactions.

GUIDELINES FOR TRANSFER PRICING ASSESSMENTS

The guidelines related to TP assessments have been a matter of deliberation with CBDT in the past. The earlier guidelines ('Old guidelines') issued were only applicable to international transactions where cases were selected for TP assessment based on the value of the international transaction. Recently, CBDT has issued a revised and updated instruction, the 'Guidance for implementation of Transfer Pricing Provisions' ('New guidelines').[5] In the said guidelines, CBDT has reiterated and prescribed the additional mandatory criteria to select cases for TP assessment. It captures the process to be followed by the tax authorities for making a reference of the matter to TP officer for international transactions as well as specified domestic transactions and selection of cases for scrutiny based on risk parameters. These guidelines do not define risk based parameters and to that extent ambiguity still remains. It has done away with the selection of cases for scrutiny based on the value of the international transactions. All the cases are selected for scrutiny either under computer assisted scrutiny selection system or under the compulsory manual selection system.

The key highlights of the new guidelines have been discussed in detail below:

1. Application of scrutiny selection criteria to specified domestic transactions (Newly introduced): New guidelines are applicable to domestic as well as international transactions. Old guidelines were only applicable to international transactions.

2. Circumstances where reference should be made by the tax officer to the TP officer:

[5] Instruction No. 3/2016 dated March 10, 2016

Selection Criteria	Action to be taken by the tax authorities
TP risk parameters	Mandatorily refer the case to TP officer for TP assessment
Non-TP risk parameters	Reference to be made to TP officer only if:
	(i) Taxpayer has either not filed prescribed Form 3CEB or has not reported transactions in the Form 3CEB – which comes to the notice of tax officer.
	(ii) TP adjustment of INR 100 mn or more has been carried out in an earlier assessment year and has been upheld by the judicial authorities or is pending in an appeal.
	(iii) Search and Seizure or Survey operations have been carried out on the taxpayer and findings on TP issues have been recorded by Investigation wing or tax officer.
	(iv) Cases involving any TP adjustment in an earlier assessment year where the matter has been fully or partially set aside by the ITAT, High Court or Supreme Court on the issue of the said adjustment.

3. Principles of Natural Justice

The tax officer, as a judicial requirement, must record to his satisfaction that there is an income or potential of an income arising from the international or specified domestic transaction and provide an opportunity of being heard to the taxpayer before making the reference to the TP officer where:

- The taxpayer has either not filed the prescribed Form 3CEB; or
- The taxpayer has not disclosed an international or specified domestic transaction in the prescribed Form 3CEB; or
- The taxpayer has reported such a transaction in the prescribed Form 3CEB with a qualifying remark to the effect that the said transaction is not an international or specified domestic transaction as it does not impact the income of the taxpayer.

It is noteworthy that the earlier guidelines also had similar requirements of providing an opportunity of being heard to the taxpayer, except for the passing of a speaking order against the objections raised by the taxpayer.

Further, for cases selected by a tax authority on the basis of TP risk parameters, he should overtly mention all relevant international transactions and / or specified domestic transactions in his letter of reference to the TP officer. For ease of understanding, the above content is tabulated hereunder:

If an international transaction referred above is benchmarked together at entity level due to its interlinkage with other international transactions, then all the international transactions should be referred to the TP officer by the tax officer.

4. Miscellaneous Clarifications and guidance

The new guidelines define roles and responsibilities and powers of the TP officer. These are similar to those provided in the old guidelines. For efficiency in TP assessment, each TP officer shall be assigned not more than 50 TP scrutiny cases. Indian tax authorities designated at a higher position in the judicial hierarchy, over the tax officer and the TP officers, shall ensure that all the cases where TP reference has been made, are dealt expeditiously.

STRENGTHENING OF DISPUTE RESOLUTION PROCESS

Dispute Resolution Panel was first set up in 2009, when it was welcomed as a step towards facilitating expeditious resolution to TP litigation. However, the Panel failed to achieve its desired objective completely. Further, *vide* an amendment in 2012, tax authorities were allowed to appeal before the Appellate Tribunal against the directions of the Panel. This defeated the very purpose of setting up DRP for speedy disposal of disputes. Accordingly, in order to revamp the process of Dispute Resolution, Indian Government has recently appointed dedicated Commissioners of Income-tax on the DRP. Further, *vide* an amendment in the 2016 Union Budget, order passed by the Panel are no longer appealable by tax authorities. This is definitely a move in the right direction, however a lot more needs to be done to sharpen Dispute Resolution mechanism so that it achieves its stated objectives.

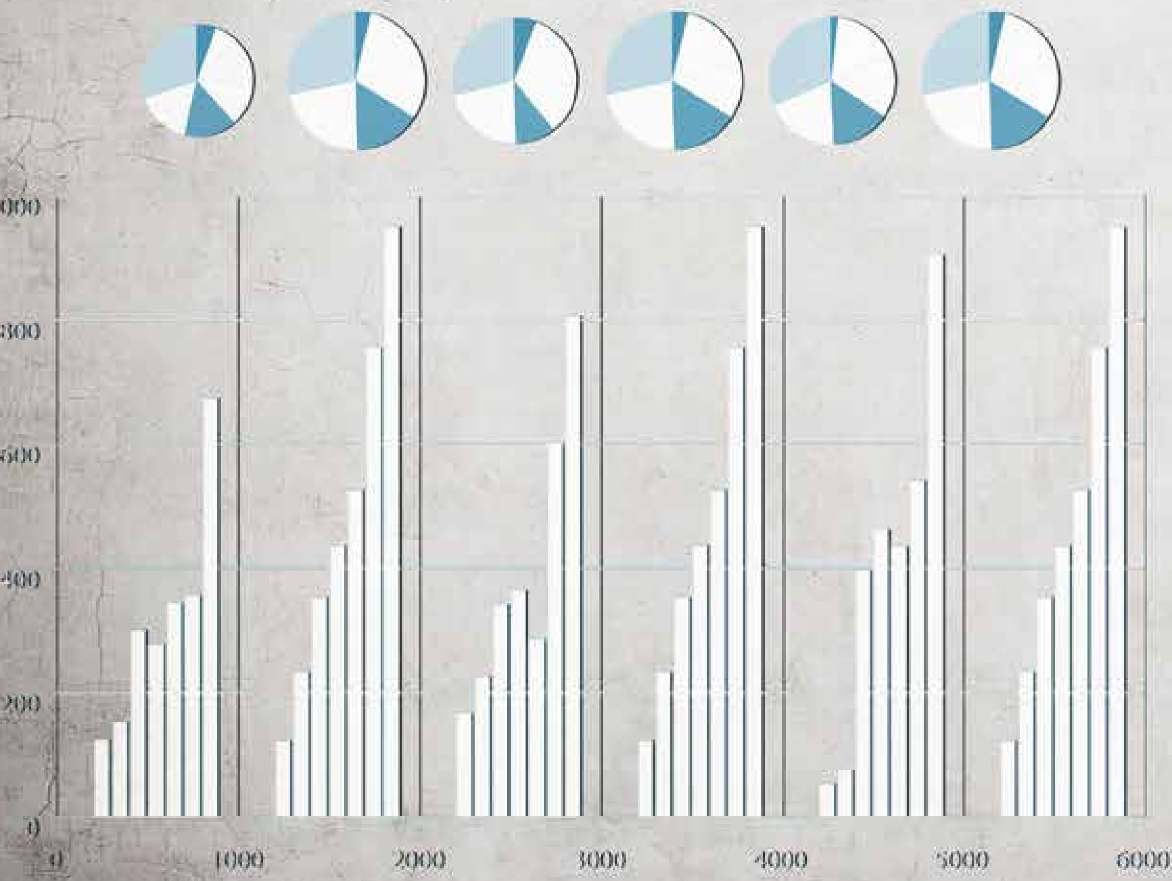
CONCLUSION

The old Guidelines introduced a threshold for compulsory TP audit where aggregate value of international transactions exceeded INR 50 mn, which was later enhanced to INR 150 mn This value based scrutiny criterion is substituted with new Guidelines. While the new Guidelines aim to reduce overall litigation, their impact can be assessed only over time. CBDT's intention to reduce litigation is also manifested in the fact that the new Guidelines do not permit tax officers to determine ALP in cases not referred to the TP officer. However, since the new guidelines do not specify as to what constitutes 'TP risk parameters', this aspect continues to be subjective and ambiguous and can be a matter of debate if CBDT does not clarify the same. The application of the risk based TP assessment in Indian tax regime may become more prominent once CbCR rules are followed by the taxpayers.

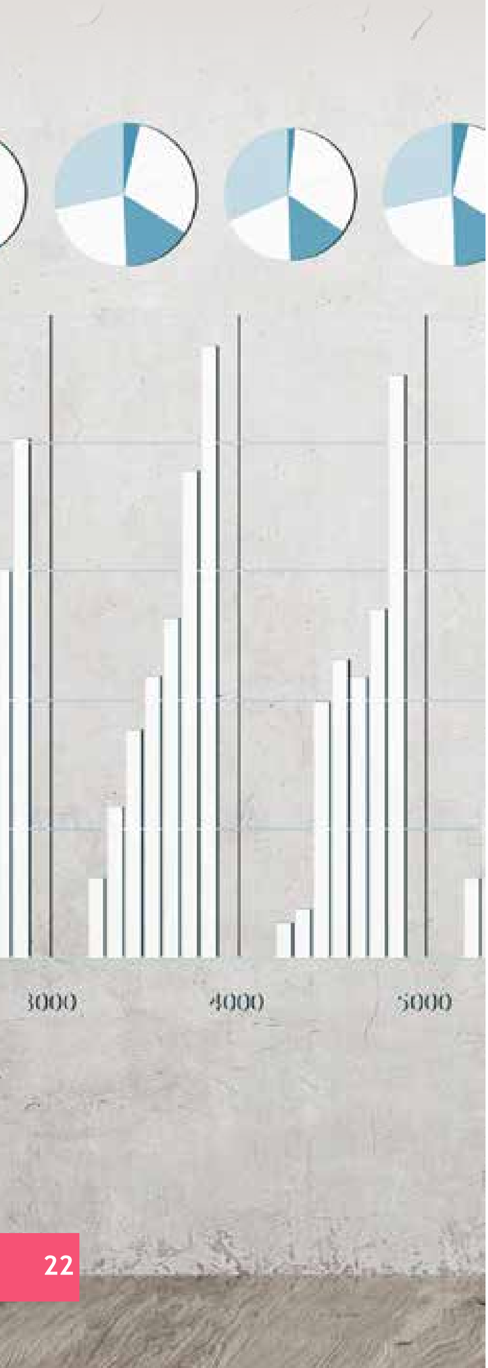
Thus, with the introduction of New guidelines to combat increased TP uncertainty and an effort to revamp the Dispute Resolution mechanism, the Indian Government is striving towards a shorter and speedy litigation process with a view to promote long term tax certainty to the MNEs and with focus to provide ease of doing business in India.

SECTION C

UPDATE ON RECENT TRANSFER PRICING ISSUES IN INDIA



SECTION C



UPDATE ON RECENT TRANSFER PRICING ISSUES IN INDIA

1. ADVERTISING MARKETING AND PROMOTION EXPENSES

BACKGROUND

The AMP expenses by a subsidiary that ostensibly creates marketing intangibles without corresponding compensation from its parent Associated Enterprise has been a contentious issue in the Indian TP domain for quite a few years. MNEs across various sectors, prominent ones being, consumer durables, electronics and media have been affected by this issue. The AMP saga has revolved around the intangible value (mainly in the nature of brand promotion) anticipated to be created by an Indian entity of a MNE group.

THE ISSUE

Under a licence/distributor arrangement, the Indian entity of a MNE group uses the group's international brand/trademark to sell its products in India. The advertising spends incurred by an Indian entity are essential to the marketing process. They are also critical for implementing the business growth strategy, including the aim of achieving market positioning and differentiation. The AMP activities by an Indian entity would carry the brand of the foreign Associated Enterprise. Accordingly, advertisement spend has been viewed by the tax authorities as assistance provided by the Indian entity to the legal owner of brand/trademark (the foreign entity), by building and/or enhancing the value of their brand in India. The tax authorities contend that AMP spends beyond the level of expenses incurred by comparable businesses (termed as 'Bright Line Test') are non-routine and result in creation of marketing intangibles for the legal owner of the brand. The tax authorities have been making TP additions by imputing income in the hands of Indian taxpayers on the premise that the Indian taxpayers, being licensed manufacturers or distributors alike, should have recovered such excess AMP expenses incurred from their foreign Associated Enterprise along with a suitable mark-up. The Indian taxpayers have been contesting such AMP related TP additions on following substantive grounds:

- Incurring of non-routine AMP expenses is on the Indian taxpayer's own volition and for its own benefit and therefore not an 'international transaction';
- Bright Line Test is not a method specified under Indian TP regulations;
- There is no need to separately benchmark the AMP expenses as the same are subsumed in the taxpayers' overall profit margin;
- Selling expenses and expenses connected with sales (such as, travelling and commission/incentive) paid to dealers or agents are not part of AMP expenses qualifying brand promotion.

LEGISLATIVE AMENDMENTS

Till the year 2012, transactions in respect of brand promotion or development services were not specifically included under the Indian TP Regulations. In the Union Budget for 2012, an inclusive definition of intangibles was inserted with retrospective effect from April 1, 2002 to include, *inter alia*, 'marketing related intangible assets', such as, trademarks, trade names, brand names, logos. An explanatory amendment in the definition of 'international transaction' was also brought in with retrospective effect from April 1, 2002 to include, *inter alia*, provision of services in the nature of market research and market development. Further, as an administrative measure, the TP officers were bestowed with the right to test transactions not specifically referred by the tax officer. This was done to overturn one of the judicial pronouncements that questioned the authority of TP officers to assess such AMP spends in cases where the same were not reported as International transactions.

THE JUDICIAL PATH

Internationally, the issue of marketing intangibles originated in the United States in case of DHL Corporation[6] wherein TP adjustment was made by the tax authorities applying Bright Line Test. However, this decision was subsequently reversed by the higher court of appeal.

In the Indian context, detailed guidance on this issue was first provided by a special bench of Appellate Tribunal which was constituted keeping in view the importance and the complexity of the issue. The Appellate Tribunal's decision pronounced on an appeal led by LG India[7] touched upon several important aspects and ruled as under:

- AMP expenses incurred by an Indian taxpayer result in creating and improving marketing intangibles for the overseas Associated Enterprises;
- Expenses for the promotion of sales directly lead to brand building while expenses directly connected with sales are only sales specific;

[6] *DHL Corporation & Subsidiaries vs. Commissioner of Internal Revenue* (T.C. Memo.1998-461, December 30, 1998)

[7] LG Electronics India Private Ltd. ITA No. 5140/Del./2011 (Delhi Special Bench)

- In addition to promoting its products through advertisements, the Indian taxpayer in question simultaneously promoted the foreign brand;
- The concept of economic ownership does not find place under the Indian tax law, therefore it is the legal owner of the brand who is benefitted;
- If the level of AMP expenses incurred by the Indian taxpayer is in excess of that of comparables, the excess AMP ought to be recovered by the Indian taxpayer along with appropriate mark-up;
- Selling expenses which do not lead to brand promotion do not form part of AMP expenses and hence are to be excluded for the purpose of benchmarking.

The impact of the above-mentioned special bench ruling was that most of the AMP related cases pending before various Appellate Tribunals got remitted to the file of the TP officers with specific direction to follow the principles laid down by the special bench. This resulted in significant TP adjustments in the case of several taxpayers, barring some relief on account of routine sales expenses being excluded from the ambit of AMP expenses.

The above ruling was challenged by several taxpayers (including consumer electronics and consumer durables giants like Daikin, Haier, Reebok, Canon and Sony) before the High Court. The High Court in the case of Sony Ericsson[8] noted and held as below:

- AMP expenses were treated as an international transaction with Associated Enterprise and thus subject to TP regulations in India (upholding the LG India ruling);
- Bright line test is not a method provided in Indian TP Regulations to compute the compensation for AMP expenses;
- Distribution and marketing are intertwined functions and should be analysed in a bundled manner for determining arm's length remuneration, unless need for de-bundling is adequately demonstrated;
- If under the bundled approach, the gross margins or net margins of the Indian taxpayers are sufficient to cover the excess AMP expenses, then a separate remuneration for such excess is not required;
- If the distribution and marketing functions are to be debundled then the taxpayer should be allowed a set-off for additional remuneration in one function against a shortfall in the other function;
- In order to apply bundled approach using an overall TNMM/RPM, the level of AMP functions in comparables should be similar to that of the Indian taxpayer/ tested entity;
- An attempt be made to find comparables with similar level of AMP functions and if such comparables cannot be found then proper adjustment be made to even out the differences;
- The entire AMP expenses may not necessarily result in brand building;
- The concept of economic ownership of the intangibles was recognised.

Despite the above explicit guidelines, there was ambiguity on applicability of the High Court ruling to licensed manufacturers, as the taxpayer and interveners in the above decision were distributors of branded goods manufactured by their Associated Enterprises. The TP issues in respect of AMP

8 Sony Ericsson Mobile Communications India Pvt. Ltd. ITA No. 16/2014 (Delhi High Court)

expenses for a licensed manufacturer was adjudicated by the High Court in the case Maruti Suzuki India Limited (MSIL).[9] The central issue required to be adjudicated in this case was whether the incurrence of AMP expenses by MSIL is an 'international transaction'.

In MSIL's case, the High Court held that incurrence of AMP expenditure cannot be considered as an international transaction. The decision was based on the High Court's earlier ruling in the case of Sony Ericsson, whereby the Bright Line Test, the very basis of determining the existence of an international transaction, had been rejected. Further, the High Court also reasoned that there was no agreement or arrangement (express or implied) between MSIL and its Associated Enterprise, obliging MSIL to incur AMP expenses. Since the Sony Ericsson and MSIL rulings expressed contrary views on whether AMP expenses constituted an international transaction, the High Court specifically reconciled both cases. The High Court highlighted that MSIL's appeal was delinked from Sony Ericsson's case for separate adjudication, since MSIL was a manufacturer. Further, Sony Ericsson's appeal never questioned the existence of international transaction before the High Court.

The essence of both the above High Court rulings is that the incurrence of AMP expenses by Indian taxpayers does not by itself constitute an international transaction in case of Indian manufacturing entities. Tax Authorities will have to establish that the Indian taxpayer is under an obligation (express or implied) to incur AMP expenses on account of the Associated Enterprise. Further the tax authorities will also need to demonstrate that the AMP expenses has in fact increased the value of brand owned by the Associated Enterprise. However, in case of Indian distributors, AMP spends may require benchmarking. Wherever AMP is characterised as international transaction, a bundled approach may be followed in appropriate cases to justify the arm's length nature of such AMP expenses.

WAY FORWARD

The Indian jurisprudence on AMP, as reflected in the above-mentioned High Court rulings, is broadly in line with international guidelines on the AMP issue. The central issue that needs an answer is whether the Indian taxpayer has incurred the AMP expenses as service provider or as an entrepreneur on its own account. This can be verified from the functional analysis between the Indian tax payer and the foreign group entity owning the trade mark/brand, and from the conduct of both parties. Basis the same, if it is concluded that the Indian taxpayer is incurring AMP expenses in the capacity of a service provider only, then the question for remuneration in respect of AMP arises. Further, recovery of AMP expenses from the overseas entity may not be the only way in which the Indian taxpayer can be remunerated. Other ways for remunerating the Indian taxpayers may be by way of higher gross margin to cover the AMP expenses or reduction in the purchase price of goods to leave sufficient gross margin to the Indian taxpayer for covering the AMP expenses incurred. Presence of long-term exclusive distribution rights, entrepreneurial and strategic functions and entrepreneurial risks in the Indian distributor's profile may suggest economic ownership of a marketing intangible. In such a situation, Indian taxpayer will be entitled to a return associated with the marketing intangibles in the form of premium pricing and increase

9 *Maruti Suzuki India Limited vs Commissioner of Income-tax* (ITA 110/2014; ITA 710/2014) (Del.)

in the market share. However, in case of licensed manufacturers who also operate as an entrepreneur, issue of remuneration for AMP spends should not arise.

The AMP saga is still not over in India as some of the Indian taxpayers, viz., Sony Ericsson, Canon India and Daikin India have filed a Special Leave Petition before the Supreme Court challenging the Sony Ericsson ruling. It is learnt that these taxpayers have filed the Petition mainly on the ground that the incurrence of AMP by the Indian taxpayers cannot be considered as international transaction. Further, the Supreme Court has also admitted the tax authorities' Petition against the High Court ruling in the case of Maruti Suzuki, whereby tax authorities have sought to challenge the High Court's ruling that AMP spend does not by itself constitute an international transaction in the context of manufacturers.

2. INTRA-GROUP SERVICES AND COMMERCIAL EXPEDIENCY

INTRODUCTION AND CONTEXT

Intra-group services refer to two broad categories, viz., management or administrative services and commercial or income producing services. The context of this broad categorisation is that the while management and administrative services are concerned more with staff functions of an organisation, the latter category refers to what is generally known as line functions. Management and administrative services are generally rendered within a group to bring broad harmonisation of entity level policies like human resource, information technologies, accounting etc. with group level policies. Such services are at times rendered within the group to bring overall efficiencies and avoid unwanted duplication. Management and administrative services are, at time, also referred as "headquarters' charges" as these services are generally rendered by regional headquarters of the MNE or central headquarters of the group. Income producing services are core services rendered by an entity within a group with a view to generate revenue. The other interesting characteristic is that commercial services have associated risks related to their operation and hence may often command a higher charge. Management or administrative services, on the other hand, are virtually risk free and hence command a relatively lower return. However, it is important to note that this distinction between the two concepts is loosely based on reality since what constitutes a management or administrative service for one corporation may very well be a commercial or income-producing service for another. In general, the categories of services that could be considered to be intra-group services can be as varied as follows:

- Management or administrative services;
- Research and development;
- Product development;
- Sharing of know-how;
- Purchasing, marketing and distribution;
- Engineering or construction services.

As such, every service rendered by a group entity to another entity can be considered as intra-group services in legal sense. However, the context in which the terminology "intra-group services" is being discussed here refers to management and administrative services rendered within an MNE.

TRANSFER PRICING ISSUES

Payment made by an Indian affiliate of an overseas MNE for management and administrative services availed is one of the most litigated TP issues in India. Headquarters' services and sharing of resources is a common feature of transnational businesses. However, management fees and other similar administrative/shared service charges are, more often than not, perceived by tax authorities as a means of lowering the tax base by increasing expenses in a high-tax jurisdiction. Following are the key issues taxpayers are confronted with while justifying the arm's length characteristic of payment of management and administrative support services:

Evidence for rendition/availing of services

Tax authorities in India require the taxpayers to provide evidence in respect of the genuineness of transactions. Mere furnishing of invoices is not considered sufficient. The taxpayers are required to furnish documents evidencing the availment of services. The nature and type of documents would depend upon the type of services availed by the taxpayers. Few of the documents that are typically furnished as a proof of services availed are e-mail exchanges, documents received in respect of services, IT policies, updates, details of staff located in jurisdictions providing services, proof of travel, copy of third party invoices where the services or part of the services were originally procured by the Associated Enterprise, invoices, ledger of the Associated Enterprise, inter-company agreements, board resolutions etc.

Need and benefit tests

Tax authorities in India require the taxpayers making payment for management and administrative services to explain the need for the services and the actual benefit realised from the services so availed. In most of the cases the tax authorities in India determine the ALP of management services availed at 'NIL'. This is done on the ground that taxpayers failed to provide an explanation for the need for the services in the context of their business and/or could not demonstrate the tangible benefits (like increase in turnover, reduction in cost or increase in profit etc.) as a result of availing these services. The tax authorities claim that NIL value has been derived applying CUP method, as third parties would not have paid any consideration for these services in similar circumstances.

Computation of management fee

In several cases the tax authorities have made TP addition on the ground that taxpayers either could not provide the working of management fee charged or the computation provided was not reliable. The tax authorities require the taxpayers to justify the selection of allocation keys used for computing each entities' share and also require separate benchmarking analysis for the mark-up charged, if any.

Duplicative and shareholder services

Duplicative services are those services provided by the Associated Enterprises, which are already undertaken by the tax-payers in India. Shareholder activities are the activities performed as part of an entity's role as a shareholder, e.g. activities relating to the reporting or other legal requirements of the parent, costs of raising funds for acquisitions of the parent's ownership interests and periodic review of the subsidiary's performance in order to protect the investment. Indian tax authorities question the payment by Indian taxpayers for such services.

COMMERCIAL EXPEDIENCY

The idea of commercial expediency in tax jurisprudence is well enshrined through several court rulings. The Supreme Court in the case of S.A. Builders Limited[10] held that tax authorities cannot justifiably claim to place itself in the arm chair of businessman or in the position of the Board of Directors and assume the role to decide how much is the reasonable expenditure having regard to the circumstances of the case. In *Walchand & Co. (P.) Ltd.*[11], it was held by the Supreme Court that in applying the test of commercial expediency for determining whether the expenditure was wholly and exclusively laid out for the purpose of business, reasonableness of the expenditure has to be judged from the point of view of the businessman and not of the tax authorities.

10 *S.A. Builders Ltd. vs. CIT [2007] 289 ITR 26/ 158 Taxman 230 (SC)*

11 *CIT vs. Walchand & Co. (P.) Ltd. [1967] 65 ITR 381 (SC)*

Relying on these judgments, the Delhi High Court in EKL Appliances Limited,[12] a TP case involving justification of royalty, held that the TP Officer has no authority to disallow the entire expenditure or a part thereof on the ground that the taxpayer has suffered continuous losses.

In the context of payment for management services availed, the TP officers have been questioning the need of management and administrative support services and have also been requiring taxpayers to demonstrate the tangible benefit of such services. However, the tax tribunals and courts[13] have consistently held that the tax authorities cannot go in the commercial expediency of availing the services. Further, it was also held that the term 'benefit' to a company in relation to its business has a very wide connotation and may not necessarily be capable of being accurately measured in money terms in all cases.

Various Appellate Tribunals have also rejected the arguments of applying CUP method for determining 'NIL' value. The Appellate Tribunals[14] have held that for determining ALP under CUP method, the TP officer has to find comparable transactions to benchmark the price of services availed by the taxpayers. Where the TP officer has not brought any comparable company and has instead applied the so called benefit test to justify the determination at NIL value, the method applied by the TP officer is not an application of CUP as provided in Indian TP regulations.

WAY FORWARD

Fees for management and administrative services charged to Indian entities must be carefully analysed and well documented in order to ensure compliance with the arm's length standard. Jurisprudence evolved on the subject guides us that robust documents evidencing the availment of services would go a long way to avoid or minimise the exposure in respect of management services. In view of the complexities involved and the kind of detailed analysis required to be undertaken, it is advisable for taxpayers to be prepared in advance, rather than waiting for TP audit proceedings to be initiated in their case, as there is always a time constraint at that stage.

12 *CIT vs. EKL Appliances Limited IT* Appeal Nos. 1068 & 1070 of 2011

13 *Hive Communication (P) Ltd. vs. CIT (Delhi HC) & Knorr-Bremse India (P) Ltd. (P&H HC)*

14 *TNS India (P) Ltd. vs. DCIT (ITAT HYD); Ingersoll Rand (India) vs. DCIT (ITAT Bang); Castrol India Ltd. vs. Addl CIT (ITAT Mum.); N L C Nalco India Ltd. vs. DCIT (ITAT Kol)*

3. SOGO SHOSHA COMPANIES

INTRODUCTION

As we know, Sogo shosha are Japanese companies that trade in a wide range of products and materials. In addition to acting as intermediaries, Sogo shosha also engage in logistics, plant development and other services, as well as international resource exploration. Unlike trading companies in other countries which are generally specialised in certain types of products, Sogo shosha have extremely diversified business lines. This business model is unique to Japan. Sogo shosha are engaged in both import and export of a diversified range of products. Such companies are not defined by the products or services they offer. They offer a wide range of goods and functions and play an important role in linking buyers and sellers to a wide range of products. Although the Sogo shosha companies perform trading activities which involve transferring the title in goods, the functions carried out by them are, in substance, merely those of service-providers, facilitating procurement and selling activities.

FUNCTIONAL PROFILE AND RELATED ISSUES

Generally, Sogo shosha companies in India enter into international transactions with the Associated Enterprises in the nature of ‘indenting’ and ‘principal’ transactions. Under indenting transactions, the Indian entities provide trade facilitation services to the Associated Enterprises wherein they receive commission from Associated Enterprises for procurement and / or sales support services. While the Associated Enterprises record purchase and sales in their books of account, the Indian entity receives commission from Associated Enterprises. Under principal transactions, the Indian entity purchase goods/ commodities from Associated Enterprises for onward sales to third parties. They also purchase from unrelated suppliers for onward sales to Associated Enterprises. However, the functional and risk analysis of ‘principal’ transactions can vary from a full risk trader to a mere trade facilitator.

International transactions entered into by Sogo shosha in India have been a subject matter of TP disputes. The issues involved range from re-characterisation of international transactions to the selection of PLI. Most of the Sogo shosha companies in India characterise themselves as service provider and choose Berry Ratio as PLI under TNMM. However, the tax authorities have rejected Berry Ratio as PLI, claiming that the same is not permitted under Indian TP legislation. Further, the tax authorities have also sought to re-characterise the ‘indenting commission’ activities as trading activities and included the free on board value of goods handled by Indian entity in their cost base for computing the PLI. In few instances, the tax authorities have characterised ‘trade facilitation’ recorded in the books of account as full risk trading functions.

INDIAN JURISPRUDENCE

The Appellate Tribunal, in the case of Mitsubishi India,[15] upheld the difference between trading activities of the taxpayer and normal trading activities. The Tribunal held that the trading functions of the taxpayer in India were only ‘akin to a trader’ and the same cannot be treated ‘exactly as trader’. The High Court, in the taxpayer’s case for an earlier year[16] itself had clarified that while testing the arm’s length nature of buy / sale related to Associated Enterprises,

15 *Mitsubishi Corporation India Private Limited Vs. DCIT* ITA No. 5042/Del. 2011 (AY 2007-08)

16 *Mitsubishi Corporation India Private Limited Vs. Addl. Commissioner of Income Tax* ITA No. 332/2014 (AY 2006-07)

the FAR of comparables should be similar to taxpayers' FAR profile. In respect of 'indenting functions', the Appellate Tribunal (relying on the High Court's decision in the case of Li & Fung),[17] rejected the inclusion of FOB value of the goods in the cost base for service fee / commission segment. The Appellate Tribunal reasoned that notionally adding costs which are not borne by the taxpayer are beyond the mandate of the law. The Appellate Tribunal also agreed that Berry Ratio can be used as PLI in cases where the business does not assume any significant inventory risk or perform any functions to add value to the goods traded.

In the case of Sumitomo Corporation, another Sogo shosha company, the Indian tax authorities made adjustment to the 'indenting' segment by applying the gross trading margin earned by it in the third party trading segment on the FOB value of goods handled by it in the indenting segment. The taxpayer argued that by doing so, the tax authorities in fact re-characterised the indenting function as trading function. The Appellate Tribunal held that TP officers cannot re-characterise the indenting functions of the taxpayer as trading functions since the FAR of both were completely different. The Appellate Tribunal, however, did not rely on the taxpayer's Berry Ratio approach. Instead, the Appellate Tribunal held that the ALP of indenting function be determined by comparing the percentage commission earned in AE indenting segment with non-AE indenting function, irrespective of significant volume differences between both segments. On further appeal by the taxpayer, the High Court[18] affirmed the Appellate Tribunal's assertion that the indenting functions cannot be re-characterised as trading function. However, the High Court rejected the Appellate Tribunal's approach of determining the ALP by comparing the commission rate earned by the taxpayer in the AE and non-AE indenting segment. This was because the Appellate Tribunal did not analyse whether the dissimilarity of the commodities affected rate of commission in both segments. In respect of application of Berry Ratio under TNMM, the High Court held that the Berry Ratio can be applied only in situations where operating expenses represent all the functions performed and risks assumed by the taxpayer. Therefore, Berry ratio is applied only in cases of stripped down distributors, i.e. distributors that have no financial exposure and risks in respect of goods distributed by them.

The above stated rulings have relevance and application not only for Sogo shosha companies, but also to limited-risk distributors and traders, which perform nil or limited functions, and accordingly assume nil or minimal risks with respect to the inventory held by them. The 'value-added' functions performed and risk assumed by limited risk distributors are relevant in determining their arm's length remuneration.

[17] *Li & Fung India Private Limited vs. CIT* ITA No. 306/2012

[18] *Sumitomo Corporation India Private Limited vs. CIT* ITA No. 381/2013

4. ISSUE OF SHARES

APPLICABILITY UNDER TRANSFER PRICING PROVISIONS

Prior to the retrospective amendment by Finance Act, 2012 (w.e.f. April 1, 2002), the Indian TP Regulations did not expressly cover transactions pertaining to issue of shares. For such years, a controversial view regarding TP adjustment on income arising from issue of shares to non-resident Associated Enterprise topped the TP disputes in the country.

In a landmark judicial matter, the High Court[19] dealt with a case where undervaluation of share premium on shares issued to a foreign entity was the subject matter of TP adjustment. The High Court analysed the provisions of the IT Act and made important observations as below:

- Plain reading of Section 92(1) of the IT Act clearly brings out that 'income arising from an international transaction' is a condition precedent for application of Chapter X dealing with TP provisions.
- It cannot be disputed that income will not, in its normal meaning, include capital receipts unless it is so specified. The amount received on issue of share capital including the premium is undoubtedly on capital account. Section 56 of the IT Act deems shortfall between issue price and fair market value of shares issued to an Indian resident, as income. In this case what is being sought to be taxed is capital received from a resident, not from a non-resident. Therefore, in light of absence of express legislation, amounts received, accrued or arising on capital account transactions cannot be subjected to tax as 'income'.
- Neither the capital receipts received by the taxpayer on issue of equity shares to its holding company, a non-resident entity, nor the alleged short-fall between the so called fair market price of its equity shares and the issue price of the equity shares can be considered as income.
- Accordingly, there is no occasion to apply Chapter X in such a case.

Following the ratio of above ruling, another judgment by the same High Court in the case of Shell India Markets (P) Ltd. decided the identical issue in favour of taxpayer.

The above judgments have provided an important judicial precedent for many taxpayers (including high profile names such as JP Morgan, Essar Projects, etc.) that were confronted with similar TP adjustments by the tax authorities. In further boost to the sentiments of foreign investors, the Indian Government decided to accept the above order of High Court and not file further appeal before the Apex Court.[20] Additionally, decision was taken to accept orders of Courts in cases of other taxpayers where similar TP adjustments had been made, and the issue has thereby been decided in favour of taxpayers. This decision of Indian Government brought in greater clarity and predictability for taxpayers and tax authorities, paving the way for reduced litigation on transactions related to issuance of shares.

SHORT SHARE PREMIUM RECEIVED – DEEMED LOAN AND NOTIONAL INTEREST

Parallel to the above issue, another objection raised by the taxpayers pertained

[19] Vodafone India Services (P) Ltd. W.P. 871 of 2014

[20] Press Release dated January 28, 2015

to treatment of shortfall in share premium as deemed loan (advanced by Indian subsidiary to foreign entity). Such a position let to an adjustment made by tax authorities by imputing notional interest on the shortfall. This objection was nullified by the High Court in the Shell decision mentioned above, wherein such consequent deemed interest brought to tax on the amount not received was set aside. It is important to note that since the Indian domestic law (unlike some other countries) does not have any express legislation on such 'secondary adjustments', the same may be struck down by the Courts.

ISSUE OF SHARE CAPITAL – WHETHER AN INTERNATIONAL TRANSACTION

As mentioned above, the High Court has ruled against the applicability of TP provisions to transactions not giving rise to 'income'. In contrast, a view has been taken in an Appellate Tribunal decision that the transaction of issue of shares to Associated Enterprise constitutes an international transaction.[21] This is based on the reasoning that share issue has a direct bearing on assets of the issuing company in terms of receipt of consideration. The Appellate Tribunal referred to the retrospective amendment (w.e.f. April 2, 2002) by Finance Act, 2012 providing that international transaction shall include: 'capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;'. By referring to the above, the Appellate Tribunal concluded that the issue of share capital is an international transaction. However, following the decision of the Bombay High Court in case of Vodafone, concluded that no addition to income can be made on account of transfer pricing adjustment, as the IT Act does not contain any provision for charging tax on income from such transactions.

REPORTING AND DOCUMENTATION

The compliance requirements relating to certification in Form 3CEB and TP documentation apply to taxpayers who have entered into international transactions. Considering the view above, as a conservative/precautionary approach, taxpayers may consider undertaking compliances for transaction of issue of shares, without prejudice to contention that provisions of Chapter X of IT Act do not apply.

BUSINESS RESTRUCTURING INVOLVING ISSUE OF SHARES

Transactions of business restructuring or reorganisation between Associated Enterprises are included within the inclusive definition of international transaction w.r.e.f. April 1, 2002. Such transactions are covered, irrespective of whether they have a bearing on the profit, income, losses or assets of the entity at the time of transaction, or at any future date. Considering the scope of this definition, issue of shares pursuant to restructuring of businesses (amalgamation/demerger) may be considered to be an international transaction and thus liable to TP compliances.

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[21] First Blue Home Finance Ltd ITA 5460/Del/2011(Delhi Tribunal)

SECTION D

INTERNATIONAL DEVELOPMENTS IN TRANSFER PRICING

SECTION D

INTERNATIONAL DEVELOPMENTS IN TRANSFER PRICING

1. BEPS AND TRANSFER PRICING

OBJECTIVE OF BEPS PROJECT

Tax avoidance and sophisticated tax planning, at times even lacking economic rationale, has been practiced by several MNEs to lower the effective tax rate. Some of world's biggest MNEs like Google, Apple, Starbucks, Amazon etc., have been in the news for their aggressive tax planning and alleged tax avoidance.

Tax administrators of several tax jurisdictions are of the view that the gaps and mismatches in the existing domestic tax laws, international tax treaties and their interpretations, result in erosion of tax base. Such discrepancies provide an opportunity for tax arbitrage to taxpayers and bring about disparity in the allocation of tax base amongst the entities participating in the entire value chain spreading across boundaries of sovereign states. Tax administrators of several tax jurisdictions are of the view that the existing principles of international tax and domestic tax legislations are not well equipped to tackle the issues of digital economy and the challenges of modern and integrated business models. The magnitude of loss in corporate tax revenue has been estimated in the range of 4% to 10% of the global corporate tax revenue, i.e., USD 100 bn to USD 240 bn annually.

In response to this, OECD and G20 nations, in the year 2013, initiated a project to critically evaluate the existing tax system of the world and provide guidance to plug the loopholes causing base erosion and profit shifting (popularly coined as "BEPS project"). OECD/G20 identified 15 Action Plans addressing the BEPS concerns. Final reports on 15 Action Plans was released by the OECD/G20 in October 2015. These Action Plans were framed around three broad categories, viz.:

- Introducing coherence in the domestic tax rules affecting cross-border transactions;
- Reinforcing the idea of substance; and
- Improving transparency.

ACTION PLANS 8-10: ALIGNING THE TRANSFER PRICING OUTCOME WITH VALUE CREATION

The broad objective of Action Plans 8-10 is to develop TP rules which enable TP outcome to align with value creation. "Substance" and "commercial rationality" are the common theme which permeates through the Action Plans 8-10. Action Plans 8-10 achieve their objective of alignment of TP outcome and value creation by providing guidance on:

(i) Applying the arm's length principle by appropriately delineating the transaction including "risks", "capital" and "re-characterization" (replacing the existing section D with a new section D of Chapter 1 of the OECD TP Guidelines):

The existing arm's length principle, as mentioned in Article 9(1) of the OECD/UN Model tax convention, have been found to be interpreted and applied in ways creating mismatch between the allocation of profit and economic activity creating/driving profits. Further, it is also generally perceived that the existing TP guidance emphasises too much on contractual allocation of functions, assets and risks which lead to manipulation and allocation of profit, devoid of correlation between the entity which actually contributed to the profit and the entity to which the profit is allocated. This necessitated the guidance for clarifying and strengthening the existing arm's length principle. The revised guidance on applying the arm's length principle focuses on accurate delineation of the transaction; which essentially requires assessment of actual behaviour of the entities in the value chain, as against the contractual terms provided in the agreement. The revised guidance on applying arm's length principle recommends:

- Identifying the economically significant risks; and identifying the entity which has control over the risk and financial capacity to assume the risks;
- Contractual allocations of risk may be a starting point of reference, but should be respected only when they are supported by actual behaviour displayed by the parties to the contract;
- An entity will be considered to assume risks only when it has control over the risks and has the financial capacity to assume the risks;
- In order to analyse as to which entity has control over the risks, it is important to find out the entity performing risk management functions;

- Risk management functions includes:
  - Capability to make decisions to take on, lay off or decline a risk bearing opportunity, together with actual performance of such decision making;
  - Capability to make decisions on whether and how to respond to the risks associated with the opportunity, together with the actual performance of that decision-making function; and
  - Capability to mitigate risk, i.e., the capability to take measures that affect risk outcomes, together with the actual performance of such risk mitigation;
- An entity may still be considered as controlling and assuming risk if it decides to hire some other entity to perform risk mitigation function under its supervision;
- An entity which provides only funding and exercises control over the financial risk related to the provision of funding but does not have control over, any other specific operation risk, should not expect more than risk-adjusted return on its funding;
- Transactions to be respected by the tax authorities "as structured", barring exceptional circumstances like lack of commercial rationality. In such cases, the tax authorities may disregard or re-characterise the transaction for TP purposes. The guidance, however, clarifies that the transactions between associated entities ought not to be derecognised merely on the ground that such transactions are not seen between independent parties.

The revised guidelines also provide guidance on determining ALP for commodity transactions. The revised guidelines recommend using CUP method for such transactions and provide guidance on selection of dates for application of CUP.

(ii) Determining ALP for the transactions involving the use of intangible or transfer of intangible (replacing the existing Chapter VI with a new Chapter VI of the OECD TP Guidelines):

The role of Intangibles, R&D, Brand, Software licenses in the modern economy cannot be over emphasised. Tax planning around Intangibles has always been on the radar of the tax administrators across globe. MNEs have been found to be lowering their effective tax rate using Intangibles as tool, viz., migrating Intangibles from one location to other, cost sharing arrangement, contractually shifting the risks to the legal owner in low or no tax country, etc. The revised guidance in respect of Intangibles, through Action Plan 8, has been developed to prevent the base erosion and profit shifting by:

- Adopting a clear and broad definition of intangibles;
- Ensuring that profits associated with the transfer and use of intangibles are aligned with value creation; and
- Developing TP rules for transfers of hard-to-value Intangibles.

The recommendations of Action Plans 8-10 in respect of intangibles are summarised hereunder:

- Mere legal ownership of Intangibles does not determine the entitlement to returns from Intangibles;
- Entity performing value-added functions, viz, development, maintenance, enhancement, protection and exploitation of the intangibles should be entitled to return on Intangibles;
- The revision in Part D of Chapter-I of the TP guidelines, in so far it relates to the "risk", "capital" and delineation of transactions, applies equally to determine the entity entitled to return on Intangibles;
- Entity providing capital and assuming the related financial risks, but not performing any functions relating to Intangibles, should not expect more than a risk-adjusted return on its capital;
- If the entity providing capital does not exercise control over the financial risks associated with the capital, then it is entitled to no more than a risk-free return;
- Location savings, assembled work force and group synergy do not fall in the category of Intangibles but should be considered as comparability factors for determining the ALP;
- Situations and circumstances in which classical valuation techniques may be used.

The guidelines on hard-to-value Intangibles recommends price adjustment mechanism to the inter-company agreement when the value of the Intangibles being transferred is highly uncertain. The guidance provides for a rebuttable presumption that transfer price will not be considered at arm's length if there is material difference between the forecast used to price the transaction and the actual result. Material difference is considered in cases where the actual compensation differs more than 20% from projected compensation of hard-to-value Intangibles. However, the presumption may be rebutted if the taxpayer can demonstrate that the difference in forecast and the actual result was due to unforeseen events.

(iii) Determining the ALP for commodity transaction (revising Chapter II of the OECD TP Guidelines):

The revised guidelines provide guidance on determining the ALP in the case of commodity transactions. It recommends using CUP method over other methods. It also provides guidance on choosing pricing dates for application of CUP. The revised guidance on pricing of commodities transaction is consistent with third party behaviour, in the particular, commodity trading industry.

(iv) Simplified approach for low value adding services (revising Chapter VII of the OECD TP Guidelines):

The revised guidelines recommend taxpayers to follow a simplified and elective approach in determining whether a service is actually availed. It further provides guidance on calculating the ALP in case of certain low value added services, generally classified under management services or head quarter charges. The guidance provides that, because of the construction of the elective and simplified approach, the benefits test by the payer country is simplified and moderated. The services that qualify for simplified and elective approach should be support services in nature and should not be part of the core business of the MNE. The guidance suggests a mark-up of 5% on the cost to be recharged and the mark-up does not require justification through benchmarking. It also recommends that the countries may include, in its domestic TP provisions, a maximum threshold for the application of the elective and simplified approach.

(v) Cost Contribution Agreements (revising Chapter VIII of the OECD TP Guidelines):

The guidance in respect of CCAs aims to achieve consistency in applying the arm's length principle for a CCA as is applicable in respect of other controlled transactions. Therefore, the approach and principles followed in delineation of controlled transactions (as provided in Section D of Chapter I), valuation of intangibles and development, maintenance, enhancement, protection and exploitation functions (as provided in Chapter VI) should equally apply to CCA. The fundamental principles that the contributions of the participants should be in proportion to the expected benefits; and that all the participants should have a reasonable expectation of benefiting from the CCA, remain unchanged. However, under the new guidance, the participant must exercise control on the risks arising from the CCA and must have financial capacity to assume such risks. If the CCA does not meet these criterion, the tax administration may re-characterise the CCA or may even disregard the CCA. The guidance also provides that the return for a cash box participant will be limited to risk free or risk adjusted return on capital invested and would not be entitled to the benefits of surplus from exploitation of Intangibles.

ACTION PLAN 13: THREE TIER APPROACH TO TRANSFER PRICING DOCUMENTATION

The objective of Action Plan 13 of the BEPS project was to develop rules regarding TP documentation to enhance transparency for tax administration. The enhanced transparency is to enable them to conduct an informed TP risk assessment and collect useful information that could be used while conducting audit of TP practice of the entities. In order to achieve the above stated objective, BEPS Action plan has recommended a three-tiered approach to TP documentation, viz, Master File, Local File and Country by Country Report. Further, it is also important to mention that the focus of Action Plans 8-10 on substance over form and aligning the value creation with the TP outcome, have been adequately considered while recommending the various elements of above stated three-tiered TP documentation.

Master File

The Master File is intended to provide an overview of an MNE group's global business model, specifically covering the following aspects:

- Organisational structure;
- Description of the various businesses including important drivers of profits, supply chain of group five largest product/services, names of important

geographic markets for the main product lines, written functional analysis describing the principal contributors, a list of important service arrangements between members of the MNE group and description of important business restructuring transactions, acquisitions, divestitures during the fiscal year;

- Intangibles used in the businesses;
- Intercompany financial transactions including group's TP policies regarding inter-company financing; and
- Financial and tax positions including consolidated financial statements for the fiscal year concerned and details of MNE group's existing APA and other tax rulings.

The BEPS guidelines provide that the Master File will be required to be filed by each entity of the MNE group with the tax administrator of the respective country in addition to the local TP documentation.

The guidelines pertaining to Master File in Action Plan 13 do not mandate as to which entity of the MNE group should prepare the Master File. However, given the nature of data required and the efficiency with which such data can be compiled, it is practical for the ultimate parent company of the group to compile the details of Master File.

Local File

The Local File is structured to contain most of the same information as was traditionally required to be compiled for a specific entity under the existing TP documentation regime i.e., Chapter V of the OECD TP guidelines. While the master file provides an over-all blue print of group, the local file provides more detailed information regarding the specific "material" inter-company transactions. In respect of threshold for "materiality", the guidelines recommend that the specific country's TP regulation should provide for the level of materiality to cover the inter-company transactions in Local File. One welcome suggestion of the guideline is that it may not be necessary to do fresh benchmarking for searching comparable every year as long as the financial data of the comparable selected is updated every year. The guideline provides that where functional profile of the company has not changed, the fresh benchmarking may be done every three years. The guideline also supports the use of local comparable as against regional comparable if the local comparable are available.

Country-by-Country Report

The CbCR is an aggregate tax jurisdiction wide information containing following information in respect of each entity:

- Revenue,
- Profit & loss before Income-tax,
- Amount of Income-tax paid and accrued,
- Details of capital,
- Accumulated earnings,
- Number of employees,
- Tangible assets other than cash or cash equivalent,
- Details of each constituent entity of the group including the country of incorporation and tax residency,
- The nature of main business activities of each constituent entity.

The Report on Action Plan 13 has recommended a standard template for compiling the above said information.

The CbCR will assist the tax administrators and taxpayers to assess the high-level

TP risks in respect of the existing value chain. As per the Report, maintaining and filing of CbCR be mandatory only to MNEs with annual consolidated group turnover in the immediately preceding fiscal year exceeding EUR 750 mn This monetary threshold, however, does not apply to Master File and Local File.

The Report recommends January 1, 2016 – December 31, 2016, as the first fiscal year for which the CbCR should apply and thus the filing is to be completed by December 31, 2017.

2. RECENT INTERNATIONAL CASES

The history of TP regulations can be traced back to section 482 of Internal Revenue Code of United States of America. This section authorises the Internal Revenue Service (IRS) to reallocate income and deductions among parties owned or controlled by the same interests, so as to prevent evasion of taxes or clearly reflect the income of any such entities. Subsequently, other countries including India introduced the concept of transfer pricing in their tax laws.

TP Regulations have had far reaching impact on the tax litigation in India and worldwide. While India has been leading in terms of number of cases in TP, there are TP litigation issues in other countries which are interesting and have a bearing on key TP principles. We have discussed below some of the recent and interesting TP cases across the globe.

MEDTRONIC AND CONSOLIDATED SUBSIDIARIES vs. COMMISSIONER OF INTERNAL REVENUE[22]

Facts and Issues

This involved a US parent corporation (Medtronic US — taxpayer) and its group of consolidated subsidiaries, including a Puerto Rican subsidiary (MPROC) and a Swiss subsidiary (Medtronic Europe). The taxpayer was a medical technology company with operations and sales worldwide.

Medtronic US and MPROC had entered into an agreement for the licensing of intangible property used by MPROC in manufacturing certain medical devices (devices and leads).

The tax authority issued the taxpayer a notice of tax deficiency, where it was determined that the profits the taxpayer attributed to MPROC were significantly above the arm's-length range and that TP (upward) adjustments should be made to the royalty that Medtronic US received from MPROC. The taxpayer filed a suit with the US Tax Court to contest the tax authority's determinations.

The tax authority took the position that the taxpayer's use of the Comparable Uncontrolled Transaction (CUT – Identical to CUP) method did not meet the standards of TP regulations. The tax authority argued that the CPM (equivalent to TNMM) is the best method to determine the arms-length royalty rates on the intercompany licences. The taxpayer, on the other hand, took a position that the tax authority's allocations using CPM were much greater than arm's length and hence were unreasonable.

The issues in the present case were:

- Whether income related to intercompany licenses for the intangible property should be reallocated to Medtronic US from MPROC; and
- Whether Medtronic Europe made arm’s length payments of royalties to Medtronic US on behalf of MPROC under a supply agreement between Medtronic Europe and MPROC

Court Decision

The US Tax Court held as under:

- The tax authority's attribution shifted too much profit to Medtronic US based on its faulty analysis and hence the taxpayer met its burden of showing that the tax authority's allocations were unreasonable.
- The tax authority's analysis was dismissive of the importance of MPROC's role in quality and considerably downplayed the role of MPROC. In contrast to the tax authority's analysis,

22 Case Number 6944-11 [USA]

MPROC did more than assembling components and used its highly skilled workforce and systems engineering expertise to design improvements and improve quality.

- The tax authority's use of the CPM was not required under the US TP regulations since the CUT method is a proper method to determine taxable income from exploitation of intangible property.
- However, the royalty rates which the taxpayer proposed were also not at arm's length because, *inter alia*, appropriate adjustments were not made to the CUT method to account for variations in profit potential between the transaction under review and the comparable transactions.

The US Tax Court made adjustments taking into account exclusivity, know-how, profit potential, and the scope of the products involved in the licences. Further, the US tax court held that the issue regarding arm's length payments by Medtronic Europe should be resolved in the same manner and adjusted the royalty rate accordingly.

CHEVRON AUSTRALIA VS. COMMISSIONER OF TAXATION[23]

Facts & Issues

Chevron is a well-known oil and gas exploration and production (E&P) multinational of which the ultimate parent company is listed and resident in United States of America. A Credit Facility Agreement was entered between Chevron Australia Holdings Pty. Ltd. ('CAHPL') (the parent of the Australian group and resident in Australia) and its wholly owned subsidiary ChevronTexaco Funding Corporation('CFC'). CFC was resident in the US and was formed to enable raising of USD 2.5 bn in the US commercial paper market. The financing was done in a way which qualified for an interest withholding tax exemption in Australia. The funds were raised by CFC in USD and an equivalent amount of AUD was advanced for five years to CAHPL in return for a promise to repay the same with interest payable at Australian LIBOR plus 4.14%.

CAHPL did not provide any security or any financial/operational covenants. The advance to CAHPL was not guaranteed by the US parent company, though the parent did guarantee the USD borrowing by CFC. CFC did not hedge the AUD/USD currency risk. CAHPL could at its option repay the loan at any time. The USD funds were raised by CFC at approximately 2% interest and on-lent to CAHPL in AUD at approximately 9% interest.

The profit made by CFC was distributed as a tax-free dividend to CAHPL, and CAHPL also made substantial dividend distributions to its US parent during the period of the loan. CAHPL claimed deduction for the interest paid to CFC over the five-year term of the loan.

The Australian tax authorities denied a significant proportion of the interest deductions claimed. The tax authorities applied a 25% penalty on the basis that CAHPL entered the facility for the sole or dominant purpose of obtaining a "scheme benefit."

Court Decision

- The tax authorities proceeded to first determine the credit rating of CAHPL and the loan itself and then benchmark an arm's length interest rate or credit spread based on market rates for similarly rated comparable debt arrangements. As per the order of the Federal Court, the correct approach for determining

23 [2015] FCA 1092 [Australia]

the borrower's creditworthiness is from the perspective of a commercial lender and not by reference an external credit ratings agency's approach.

- The Federal Court accepted taxpayer's argument that parental affiliation has no significance in the pricing of the loan.
- The tax authorities had argued for recharacterizing the loan from an AUD loan to a USD loan, since the loan would have been in USD had it been between third parties. However, the Federal Court rejected this approach and accepted the taxpayer's submission that borrowing was in AUD to avoid or limit foreign currency gains and losses.
- To identify comparable uncontrolled transactions, the credit risk of the borrower should be assessed in the same/similar way as would be carried out by independent lenders at the time of advancing the loan. Given the very high standard of comparability that was expected in a CUP analysis, the burden of proof is placed on the shoulders of the taxpayer and CUP may not be relevant.

AMDOCS CANADIAN MANAGED SERVICES INC. VS. THE QUEEN

Facts and Issues

The taxpayer, Amdocs Canadian Managed Services Inc. (ACMS), is a member of the Amdocs Group of companies, which provides software and related services to over 250 communication, media and entertainment services providers in over 80 countries. During the course of audit by the tax authorities, the taxpayer failed to share documents held by related overseas entities.

The issue before the Federal Court was whether to grant the tax authorities a compliance order directing ACMS to produce documents potentially held by related firms in other countries during the course of TP audit.

Court Decision

The Federal Court held that the parties had been working towards full production but had reached an impasse because ACMS did not have the documents requested and had been unable to secure them from other entities within the Amdocs Group. The documentation in question may exist, but there is no evidence that it does. Hence, the application raised the issue of what the parties are legally obliged to do in this situation.

The Federal Court held that the Income-tax Act does not contemplate creation of records where they do not exist. That which does not exist cannot be produced. The Court concluded that ACMS has made reasonable efforts to acquire the documentation at issue, but is simply unable to provide the balance of the documentation and information requested by the tax authorities. There is no point in ordering ACMS to do something it cannot do.

FINLAND CASE NO: KHO:2014:119

Facts and Issues

The taxpayer was a Finnish company (FI Co) which was 95.7% owned by a company resident in Luxembourg (LU Co). In 2009, FI Co received a loan of EUR 15 mn from LU Co and wanted to deduct EUR 1.34 mn as interest expenses paid to LU Co. The loan was given without any collateral and did not have any provisions for repayment by a definite date. The interest rate was fixed at 30% and the interest was added to the principal. The loan could be paid back only upon FI Co's request and was under IFRS accounting rules treated as equity (hybrid loan). The Finnish tax authorities recharacterised the loan as equity investment and consequently, disallowed the interest deduction.

The issue before the Finish Court was whether the loan could be re-characterised as equity investment and, consequently, the deductibility of the interest paid for such loan could be disallowed under Article 9 of the tax treaty.

Court Decision

- The Supreme Administrative Court upheld the decision of the District Administrative Court of Helsinki. The Court held that the legal form of the loan could not be disregarded and the hybrid loan could not be recharacterised as equity investment.
- The Supreme Administrative Court considered the evaluation of the transaction and the financial circumstances at the material time. 80% of FI Co's turnover came from products sold to the car industry. FI Co had established that it was in desperate need of additional funding due to the financial crisis. Its main source of funds was a bank which required additional funding from other sources to provide FI Co with further bank loans. Furthermore, the bank required that the funding should be in the form of a subordinated hybrid loan.
- The Supreme Administrative Court emphasised the consequences of re-characterization to FI Co. Firstly, recharacterizing a transaction into equity would be a much harsher measure than simply adjusting the interest charged. Secondly, the consequence of such re-characterization would be extremely unfavourable as it would lead to total non-deductibility of the interest expense, whereas TP adjustment would simply adjust the interest expense at the arm's length. As such, the recharacterization could be only made if there would be a specific provision of law authorizing such an adjustment.

The Supreme Administrative Court was of the view that it is not necessary to evaluate the situation based on the treaty as tax treaties do not create a taxing right over domestic law. The case was remitted back to the tax authorities for adjusting the interest rate as per arm's length principles.

GLAXOSMITHKLINE INC. VS. HER MAJESTY THE QUEEN

Facts and Issues

The taxpayer, GlaxoSmithKline Inc. (Glaxo - taxpayer), is a Canadian company that manufactures a drug which is prescribed to treat stomach ulcers and is marketed by the taxpayer in Canada under the brand name Zantac. The active pharmaceutical key ingredient is Ranitidine ("API") which the taxpayer purchased from a related non-resident company.

During the period under appeal, other pharmaceutical companies (generic companies) were selling generic versions of Zantac in Canada. These companies purchased Ranitidine for much less than the taxpayer. The taxpayer paid Adechsa S.A., a related party based in Switzerland, the following amounts in Canadian Dollars per kilo for Ranitidine during the years in appeal:

1990	1991	1992	1993
1,512	1,575	1,635	1,651

The Ranitidine purchased by the taxpayer from Adechsa S.A. was manufactured by a related party manufacturer in Singapore.

At the same time, the generic companies in Canada paid the following amounts in Canadian Dollars per kilo to their suppliers of Ranitidine:

1990	1991	1992	1993
292-304	244-289	220-253	194-248

The TP arrangements between the parties allowed the Singapore related party manufacturer to earn gross profits of approximately 90% on the sale of Ranitidine to Adechsa S.A. Adechsa S.A. was required to earn a minimum 4% profit (by agreement with the Swiss tax authorities), and Glaxo earned gross profits of approximately 60% on the sale of Zantac.

The tax authorities made a TP adjustment by disallowing the difference between amounts paid to Adechsa S.A. for a kilogram of Ranitidine and the highest price paid by the generic companies for a kilogram of Ranitidine at during the relevant time period. The tax authorities also deemed the excess amount to be a dividend to have been paid to Glaxo Group, a UK company, subject to withholding tax. The tax authorities' position was that Glaxo did not pay a reasonable price for the purchase of Ranitidine to minimize profit in Canada and move the profit to a related corporation in a low-tax jurisdiction.

The taxpayer argued that the price it paid for the Ranitidine was similar to the price paid by independent third parties in comparable circumstances and was therefore reasonable. The taxpayer also submitted that its business model and circumstances are not comparable to those of the generic companies.

Court Decision

Decision of the Tax Court (decision of 30th May 2008, Docket 98-712(IT)G)

- The Tax Court upheld the assessments relying on the arm's length principles as mentioned in the OECD Commentary on Art. 9(1) of the OECD Model. It concluded that the CUP method is the preferred method for benchmarking and that the highest purchase price paid by the generic pharmaceutical producers is an appropriate CUP.
- The Tax Court also determined that the Supply Agreement with Adechsa S.A. and a Licence Agreement with Glaxo Group covered separate matters and, therefore, the Licence Agreement should not form part of the consideration in determining the appropriate price.

Decision of the Federal Court of Appeal (decision of 26th July 2010, No. A-345-08)

- The Federal Court of Appeal upheld the use of CUP method, but observed that the Tax Court used incorrect comparables. Firstly, the Court found that the Tax Court was wrong in disregarding the License Agreement by erroneously relying on a Supreme Court decision. The taxpayer had argued that consideration of the License Agreement was crucial for determining the ALP. The Licence Agreement gave the Canadian distributor access to Glaxo's trademark for Zantac, and the trademark gave the company access to the premium prices paid for the product, over its generic competitors. Glaxo also said that the Agreement, which required the distributor to purchase Glaxo-manufactured Ranitidine, gave the company access to other Glaxo-patented and trademarked products.
- Further, the Federal Court of Appeal found that the Tax Court erred in using the generic prices as comparables. It observed that the Tax Court failed to consider the business reality of the situation, since in the real business world, presumably an arm's length purchaser could always buy Ranitidine

at market prices from a willing seller. However, the question was whether that arm's length purchaser would be able to sell his Ranitidine under the Zantac trademark. Therefore, the terms of the License Agreement needed consideration in determining the ALP. Thus, the Court sent the case back to the Tax Court to determine the ALP based on the terms of the License Agreement.

Decision of the Supreme Court of Canada (decision of 18th October 2012, Docket 33874)

- The Supreme Court upheld the decision of the Federal Court of Appeal and remitted the matter to the Tax Court for redetermination of the arm's length/reasonable price. The Supreme Court held that the Tax Court erred in following the transaction-by-transaction approach, thereby precluding consideration of the license agreement. The said agreement constituted an 'economically relevant characteristic' in the circumstances of the case. The Supreme Court relied on the principle that closely linked transactions cannot be evaluated adequately on a separate basis. It was by virtue of the License Agreement that the taxpayer was required to purchase its Ranitidine from Glaxo-approved sources. Accordingly, there was a link between the supply agreement and the license agreement such that the taxpayer was subject to contractual terms affecting the price of Ranitidine, which did not affect generic marketers of Ranitidine products.

CONCLUSION

With the increase in complexities of commercial business, more particularly among entities of the same group, it becomes imperative for organizations to relook at the way they conduct business. Courts, worldwide, have looked for 2 most important aspects in any TP litigation:

(i) Substance of the transaction

(ii) Documentation/evidence

Differences in economic environment in which businesses operate also contribute to varying ALP computational methodologies. The situation also becomes complex when some transactions are not normally entered between unrelated entities or in the open market. To untangle the complex knot of TP litigation, Courts will be diving deep into the substance of the transaction and the related documentation. Where the transactions fell short of substance, the courts did not shy away from resorting to recharacterisation of the transactions.

AUSTRALIA

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Country Transfer Pricing Facts

Questions	Country Response
1. Do the TP regulations of your country require taxpayers to prepare TP documentation annually?	No, however it is mandatory to self-assess TP arrangements under the law and this requires some level of TP analysis and documentation.
2. What is the deadline for preparing the TP documentation for a particular transaction?	No specific deadline. Contemporaneous documentation is however required, to be able to mitigate penalties in the event of a TP adjustment by the Revenue Authority (ATO). TP documentation is required to be completed in a format complying with local laws prior to lodging the income tax return.
3. Is there any exemption (relief) from preparing the TP documentation?	Yes. Australia has *quasi de-minimis* rules (Simplified TP record keeping rules) for preparation of documentation. These are based on parameters such as materiality, small taxpayers, distributors and for specific transactions such as management services etc. subject to conditions. If the rules can be satisfied, taxpayers are considered low risk and generally won't be subject to TP reviews by the Revenue Authority.
4. Is the benchmarking analysis to be performed afresh every year?	No, benchmarking analysis is normally undertaken every 3 years.

Questions	Country Response
5. Does your country TP regulation require taxpayers to file the details of the related party transactions with the revenue authority? If yes, what is the due date?	Yes, in cases where taxpayers have international related party dealings of more than AUD 2 mn per year or any cross-border intragroup dealings involving foreign branches of Australian entities or Australian branches of foreign entities then an International Dealings Schedule needs to be lodged with the income tax return (normally 6 ½ months after the end of the income tax year), eg. 31 December year ends must lodge by 15 July the following year.
6. Is there any penalty imposable on taxpayers for not preparing or filing the TP documentation/ details of related party transaction?	Technically no penalty for not preparing or filing TP documentation. However, if a TP adjustment is made and tax is payable, if there is no TP documentation then a penalty can be applied. The rate of penalty can be 10%, 25% or 50% depending on certain criteria like existence of 'reasonably arguable position' or tax avoidance. Further, small administrative penalties are prescribed for incorrect disclosures in the tax return. Penalties may be doubled where the turnover of a taxpayer's MNE group exceeds AUD 1 bn.
7. Are there any safe harbour provisions prescribed under the TP regulation of your country?	Yes. Australia has simplified TP record keeping rules setting out options so that eligible taxpayers can minimise their documentation obligations and compliance costs. Further, there are safe harbor provisions prescribed with respect to the thin capitalisation rules and certain non-core management fees.
8. Do TP regulations of your country provide for unilateral/ bilateral/ multilateral APA?	Yes, APAs are encouraged. APA generally covers a period of 3 to 5 years and is subject to an annual reporting requirement.
9. Has the government/tax authorities of your country begun implementing recommendations under BEPS?	Yes. Australia has introduced many BEPS initiatives including CbCR requirements (introduced in 2015); TP recommendations (Actions 8-10) are to be implemented effective for years commencing from 1st July 2016; Multinational Anti-Avoidance Law in 2015 dealing with deemed Permanent Establishments and proposed a Diverted Profits Tax for global groups where turnover exceeds AUD 1bn and existing Controlled Foreign Corporation rules which already limit interest deductions based on a 60% threshold. Anti-hybrid laws have also been proposed.

Questions	Country Response
10. Has your country introduced provisions to enable CbCR? If yes, what is the first reporting year?	Yes, applicable for accounting periods commencing on or after 1st January 2016 with CbCR due to be lodged within one year of an entity's year end. The rules differ from Action 13 recommendations and require filing of the CbCR, master file and local file (which is different to standard TP documentation).

Country Views On BEPS

1. **What are the typical TP issues that the taxpayers in your jurisdiction are facing?**

   Typical transactions under review by the Australian tax authorities include, financing arrangements, royalty / license fee transactions, transfers of intellectual property, arrangements which lack requisite substance, management fees and transactions with low tax jurisdictions. There is a focus on arrangements entered into by Australian MNEs involving offshore marketing and / or procurement hubs. Australia has specific recharacterisation provisions as part of its TP law, which requires consideration of the legal form of each transaction versus the underlying economic substance. Australia has deviated from the OECD guidance in relation to the local file, prescribing unique content requirements involving financial data to be filed in electronic form to enable data analytics.

2. **Do MNE headquartered in your country believe that their effective tax rate on global basis may increase as a result of recalibrating their value chain to comply the guidelines emanating from BEPS action plans?**

   MNEs headquartered in Australia have mixed views on the impact of BEPS on their effective global tax rates. Most MNEs are however assessing the requirement to recalibrate their value chain, and understand that it could impact their costs in the short term but lead to tax certainty in the longer term. Many groups are satisfied their arrangements comply with legal requirements.

3. **Is there any specific guidance in Action 8-10 which the revenue authorities of your country are not in agreement with?**

   No. The Australian legislation specifically requires application to be consistent with the OECD TP guidelines. Further, Australia has proposed to adopt (with effect from 01 July 2016) the revised TP guidance issued by the OECD in 2015.

4. **How is the tax administration of your country gearing up to alleviate the doubts and concern of the taxpayers regarding the confidentiality of data to be shared with the revenue authorities under the TP documentation regime recommended by Action Plan 13 of BEPS?**

   The ATO is introducing strict requirements and has been proactive in consulting with taxpayers in relation to these genuine concerns.

5. **What are the key TP concerns or challenges that the taxpayers in your country may have as a result of overall BEPS projects?**

   Concerns include increased transparency of financial results and how such data will be used by Revenue Authorities beyond merely risk assessment; maintenance of TP documentation which are compliant with the new law and revised OECD guidelines, particularly with regard to the increased threshold requirements under Actions 8-10. There would be increased compliance requirements and investment in resources. Further, concerns arise from Australia's unique approach to what information is required to be filed as part of the Local File which is a departure from OECD Action 13.

CANADA

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Country Transfer Pricing Facts

Questions	Country Response
1. Do the TP regulations of your country require taxpayers to prepare TP documentation annually?	Yes.
2. What is the deadline for preparing the TP documentation for a particular transaction?	Six Months after Year-end.
3. Is there any exemption (relief) from preparing the TP documentation?	No.
4. Is the benchmarking analysis to be performed afresh every year?	Yes.
5. Does your country TP regulation require taxpayers to file the details of the related party transactions with the revenue authority? If yes, what is the due date?	Yes. Six months after year-end. Summary Form (T106) to be filed with Tax Return for the year if the total of all reportable transactions for all non-arm's-length non-residents exceeds CAD 1 million.
6. Is there any penalty imposable on taxpayers for not preparing or filing the TP documentation/ details of related party transaction?	Yes. Penalty of 10% of any TP adjustment exceeding the lesser of: (i) 10% of the Company's gross revenues; and (ii) CAD 5 million.
7. Are there any safe harbour provisions prescribed under the TP regulation of your country?	No. Canada Revenue Agency will not accept safe harbours, even if recommended by OECD.
8. Do TP regulations of your country provide for unilateral/ bilateral/ multilateral APA?	Yes.

Questions	Country Response
9. Has the Government/tax authorities of your country begun implementing recommendations under BEPS?	Yes. However, the only real change made here in Canada is the implementation of CbCR. All of the other OECD BEPS TP revisions were codified in our domestic tax legislation, and are consistent with the tax authorities' current auditing/assessing practices. As such, no new legislation was required to follow the BEPS recommendations.
10. Has your country introduced provisions to enable CbCR? If yes, what is the first reporting year?	Yes, tax years ending December 31, 2016

Country Views On BEPS

1. **What are the typical TP issues that the taxpayers in your jurisdiction are facing?**

   The Canadian tax authorities focus on: management and other services fees; royalties; transfer of intellectual property out of Canada and financial transactions. Target industries include branded and generic pharmaceuticals, technology, automotive, and financial institutions.

2. **Do MNE headquartered in your country believe that their effective tax rate on global basis may increase as a result of recalibrating their value chain to comply the guidelines emanating from BEPS action plans?**

   Over the past 10 years or so, the Canadian Government has been introducing domestic tax legislation that effectively deals with most of the issues that OECD dealt with under its BEPS action plans. As a result, most Canadian MNEs do not expect to be challenged in a manner that would increase their global effective tax rate. What does concern Canadian MNEs is the increased level of scrutiny and transparency under the BEPS action plans, which will lead to more focus on risk based auditing in the other countries with which the Canadian MNE has intercompany transactions.

3. **Is there any specific guidance in Action 8-10 which the revenue authorities of your country are not in agreement with?**

   Canada is studying its position on recommendations regarding compensation for cash boxes. Further, Canada disagrees and will not accept the safe harbour concept for low value added services.

4. **How is the tax administration of your country gearing up to alleviate the doubts and concern of the taxpayers regarding the confidentiality of data to be shared with the revenue authorities under the TP documentation regime recommended by Action Plan 13 of BEPS?**

   There are no specific actions being considered currently. There are very specific provisions in the Income Tax Act (Canada) for the protection of taxpayer confidentiality, with potential fines and/or imprisonment for any Government official who divulges any taxpayer's confidential information. The

Canadian Government has not made any official pronouncements regarding how it will respond if the EU, or any other government, makes information in the CbC Reports public.

5. **What are the key TP concerns or challenges that the taxpayers in your country may have as a result of overall BEPS projects?**

Taxpayers are concerned with the increased public scrutiny and transparency under the BEPS action plans, and with the increased Reputational Risk that all companies are now facing.

CHINA

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Country Transfer Pricing Facts

Questions	Country Response
1. Do the TP regulations of your country require taxpayers to prepare TP documentation annually?	Yes, taxpayers with related-party (domestic and foreign) transactions pertaining to purchase / sale of goods exceeding RMB 200 mn, provision / availing of services exceeding RMB 40 mn, transfer of financial assets / intangible assets exceeding RMB 100 mn and single-function entities (risk-free or captive entities) with operating losses are required to prepare TP documentation.
2. What is the deadline for preparing the TP documentation for a particular transaction?	Deadline for preparing is June 30 after the end of preceding fiscal year. The TP documentation is required to be filed only when the local tax authority requests in a formal notice.
3. Is there any exemption (relief) from preparing the TP documentation?	Yes. Taxpayers having transactions with only domestic related parties, or those who are under the implementation period of an APA are exempt.
4. Is the benchmarking analysis to be performed afresh every year?	Yes. Benchmarking analysis should be updated on an annual basis.
5. Does your country TP regulation require taxpayers to file the details of the related party transactions with the revenue authority? If yes, what is the due date?	Yes. The details of the related-party transactions shall be disclosed in the annual related-party transaction reporting forms, which are submitted before May 31 after the end of preceding fiscal year.

Questions	Country Response
6. Is there any penalty imposable on taxpayers for not preparing or filing the TP documentation/ details of related party transaction?	Yes. Taxpayers who fail to prepare and submit TP documentation will face a penalty between RMB 5,000 to RMB 20,000. An additional 5% interest rate will be levied on the interest base rate (i.e., base lending rate released by the People's Bank of China) to calculate the total interest amount if there is a tax adjustment made during a TP investigation.
7. Are there any safe harbour provisions prescribed under the TP regulation of your country?	No. There is no particular safe harbour provision under TP regulation.
8. Do TP regulations of your country provide for unilateral/ bilateral/ multilateral APA?	Yes. Bulletin 64 issued recently updated requirements for all 3 types of APA.
9. Has the Government/tax authorities of your country begun implementing recommendations under BEPS?	Yes. Bulletin 42 was updated with CbCR requirement and preparation of master file and local file in accordance with BEPS Action 13.
10. Has your country introduced provisions to enable CbCR? If yes, what is the first reporting year?	Yes. The regulation was introduced in Bulletin 42 and the first reporting year is fiscal year 2016.

Country Views On BEPS

1. **What are the typical TP issues that the taxpayers in your jurisdiction are facing?**

   The typical challenges include remittance of royalty and services fees to overseas related parties, management service fees, intra-group services, advertisement and brand promotion expenses. Recently, market premium and location savings have become the key focus by the Chinese tax authorities. In a TP audit, the typical challenge is a single-function entity, such as contract manufacturers and limited-risk distributors, that have incurred losses in most of its operating period since establishment. According to Circular 363, a single-function entity should be entitled to a fixed profitability regardless of market conditions.

2. **Do MNE headquartered in your country believe that their effective tax rate on global basis may increase as a result of recalibrating their value chain to comply the guidelines emanating from BEPS action Plans?**

   Following the global tax co-operation to enhance tax transparency, it becomes more difficult for MNEs to evade tax in order to lower their effective tax rate. MNEs headquartered in China are facing the same challenge, especially after the introduction of CbCR and master file by the Chinese tax authorities.

3. **Is there any specific guidance in Action 8-10 which the revenue authorities of your country are not in agreement with?**

No. In fact, Chinese tax authorities have utilised Action 8-10 in the update of Bulletin 42 to emphasise that value creation should be aligned with economic activities, and cash boxes shall not be entitled to any excess profits. Management supervision service, which is defined as low-value adding intra-group services, is also a key focus of the Chinese tax authorities.

4. **How is the tax administration of your country gearing up to alleviate the doubts and concern of the taxpayers regarding the confidentiality of data to be shared with the revenue authorities under the TP documentation regime recommended by Action Plan 13 of BEPS?**

   Since the related-party transactions threshold for CbCR is RMB 5.5 bn and for master file is RMB 1 bn, most taxpayers are exempt from CbCR and master file requirement. For large MNEs, the Chinese tax authorities have held several seminars to explain the requirements and answer the questions to ease the concerns of the taxpayers.

5. **What are the key TP concerns or challenges that the taxpayers in your country may have as a result of overall BEPS projects?**

   Following the introduction of CbCR and master file/local file/special issue file approach, the primary concern of most taxpayers in China is the manner and approach for completion of compliances and increase in tax compliance cost for preparing and submitting the forms and documentation.

FRANCE

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Country Transfer Pricing Facts

Questions	Country Response
1. Do the TP regulations of your country require taxpayers to prepare TP documentation annually?	TP documentation should be updated every 3 years or before in case of significant changes in the activity, Group structure or method used.
2. What is the deadline for preparing the TP documentation for a particular transaction?	TP documentation should be provided to the tax administration on the first day of a tax audit.
3. Is there any exemption (relief) from preparing the TP documentation?	No.
4. Is the benchmarking analysis to be performed afresh every year?	Every 3 years.
5. Does your country TP regulation require taxpayers to file the details of the related party transactions with the revenue authority? If yes, what is the due date?	A specific return must be filed in to the tax administration by a French entity part of a Group where the turnover or gross assets of any group company exceeds EUR 400 Mn It should be submitted within 9 months as from the fiscal year end.
6. Is there any penalty imposable on taxpayers for not preparing or filing the TP documentation/ details of related party transaction?	The penalties are only applicable to French entity part of a Group where one company exceeds EUR 400 mn of turnover or gross assets. In case of non-compliance, the company is liable to a fine that can reach 0.5% of undocumented transactions or 5% of the profits transferred (i.e. the shortfall between actual profit and arm's length profit) relating to such transactions, whichever is higher.

Questions	Country Response
7. Are there any safe harbour provisions prescribed under the TP regulation of your country?	Only for Financial transactions. A safe harbour interest rate is published each year (2.15% for the year 2015). You can exceed such rate but only if you document the arm's length nature of the rate.
8. Do TP regulations of your country provide for unilateral/ bilateral/ multilateral APA?	Yes.
9. Has the Government/tax authorities of your country begun implementing recommendations under BEPS?	Yes.
10. Has your country introduced provisions to enable CbCR? If yes, what is the first reporting year?	Yes, FY16 figures should be reported by end of FY17.

Country Views On BEPS

1. **What are the typical TP issues that the taxpayers in your jurisdiction are facing?**

   The most typical TP issues pertain to the justification of losses incurred by limited risk distributors (who should ideally earn a guaranteed risk-free return), payment of management fees/royalties whereby taxpayers are unable to justify the necessity and actual availing of services and benefits therefrom. Tax authorities also tend to challenge cost plus as the most appropriate method for trading/ sales driven activities. Such entities also face the risk of being treated as permanent establishments of their related parties. Tax Authorities also tend to question transactions involving business restructuring which involve a transfer of clientele.

2. **Do MNE headquartered in your country believe that their effective tax rate on global basis may increase as a result of recalibrating their value chain to comply the guidelines emanating from BEPS action plans?**

   Some MNEs believe that their effective tax rate may increase and are ready for it to comply with BEPS recommendations, if the approach is safe and guarantees stability in their effective tax rates.

3. **Is there any specific guidance in Action 8-10 which the revenue authorities of your country are not in agreement with?**

   No, the French tax authorities are in line with all Action 8-10 recommendations.

4. **How is the tax administration of your country gearing up to alleviate the doubts and concern of the taxpayers regarding the confidentiality of data to be shared with the revenue authorities under the TP documentation regime recommended by Action Plan 13 of BEPS?**

   No specific action. In principle, confidentiality is guaranteed.

5. **What are the key TP concerns or challenges that the taxpayers in your country may have as a result of overall BEPS projects?**

   The main TP challenges are related to IP management and CBCR consequences.

The other recommendation of the BEPS project having already been applied by the Free Trade Agreement before the recommendations were published (e.g., substance over form, low value added services etc.)

GERMANY

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Country Transfer Pricing Facts

Questions	Country Response
1. Do the TP regulations of your country require taxpayers to prepare TP documentation annually?	No, however, if a taxpayer is (tax) audited the tax auditor may request to be presented with a TP documentation.
2. What is the deadline for preparing the TP documentation for a particular transaction?	Once the tax auditor's request for TP documentation is received the general deadline to present it is 60 days. For extra-ordinary transactions the deadline is 30 days.
3. Is there any exemption (relief) from preparing the TP documentation?	The German documentation regulations apply to companies with cross border transactions, if the sum of the remunerations for the delivery of goods or commodities in related party transactions exceeds EUR 5 Mn or if the sum of remunerations for other transactions, especially services with related parties exceeds EUR 0.5 Mn Accordingly, companies whose transactions do not exceed these thresholds are exempt from preparing TP documentation.
4. Is the benchmarking analysis to be performed afresh every year?	No. There are no strict rules as to how often a benchmark analysis should be updated.
5. Does your country TP regulation require taxpayers to file the details of the related party transactions with the revenue authority? If yes, what is the due date?	There is no strict requirement to inform tax authorities on details of related party transactions apart from the TP documentation.

Questions	Country Response
6. Is there any penalty imposable on taxpayers for not preparing or filing the TP documentation/details of related party transaction?	For failure to submit documentation or submission of insufficient documentation, a penalty between 5% and 10% of the income adjustment must be raised (with a minimum of EUR 5,000). If adequate TP documentation is not provided to the tax authorities within 60 days/30 days (as applicable) after request, the penalty amounts to at least € 100 for each full day beyond the deadline but to a maximum of EUR 1 mn.
7. Are there any safe harbour provisions prescribed under the TP regulation of your country?	There are no safe harbour provisions other than the thresholds mentioned above.
8. Do TP regulations of your country provide for unilateral/bilateral/multilateral APA?	Yes.
9. Has the Government/tax authorities of your country begun implementing recommendations under BEPS?	Yes. Draft laws *inter alia* on the automatic exchange of information and CbCR are currently in Parliament.
10. Has your country introduced provisions to enable CbCR? If yes, what is the first reporting year?	Not yet, as mentioned above.

Country Views On BEPS

1. **What are the typical TP issues that the taxpayers in your jurisdiction are facing?**

   As regards TP, tax authorities pay increased attention during tax audits to licensing of intellectual property, financing arrangements and cost allocation. Another topic is the shift of functions, e.g. moving of intellectual or tangible property (e.g. production lines) from Germany abroad. If functions are shifted, tax authorities want to tax profit potentials that move along.

2. **Do MNE headquartered in your country believe that their effective tax rate on global basis may increase as a result of recalibrating their value chain to comply the guidelines emanating from BEPS action plans?**

   German MNEs used less aggressive tax planning in the past than MNEs from other countries. This may be due to quite strict tax rules on foreign conduit companies. German MNEs see a risk that with the introduction of CbCR and other BEPS recommendation, certain non-OECD countries' tax authorities' appetite for a bigger 'part of the pie' increases and that the amendments to Article 5 of OECD Model Tax Convention lead to increased uncertainty about the (non-)existence of Permanent Establishments, both increasing double taxation and, thus, effective tax rates.

3. **Is there any specific guidance in Action 8-10 which the revenue authorities of your country are not in agreement with?**

   We are not aware of any major disagreements here.

4. **How is the tax administration of your country gearing up to alleviate the doubts and concern of the taxpayers regarding the confidentiality of data to be shared with the revenue authorities under the TP documentation regime recommended by Action Plan 13 of BEPS?**

   Tax authorities emphasised that one of their concerns was to make sure the legislator includes safeguards in the domestic implementation of the automatic exchange of information legislation that information provided to other countries' tax authorities is only allowed for taxation purposes and, if other use is found, the exchange will be stopped.

5. **What are the key TP concerns or challenges that the taxpayers in your country may have as a result of overall BEPS projects?**

   Increased number of cases of double taxation and mutual agreement procedures due to more aggressive taxation of licensing of Intellectual Property Rights, CbCR and profits claimed to be have to be allocated to Permanent Establishments abroad.

JAPAN

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Country Transfer Pricing Facts

Questions	Country Response
1. Do the TP regulations of your country require taxpayers to prepare TP documentation annually?	Yes
2. What is the deadline for preparing the TP documentation for a particular transaction?	CbCR and Master file are to be prepared within one year from the day following the end of the applicable fiscal year of the Reporting MNE. The deadline for preparing the Local file is the same as the filing deadline for corporation tax return for the fiscal year, however the same can also be submitted within 45 days from the submission request by a tax inspector.
3. Is there any exemption (relief) from preparing the TP documentation?	Yes. MNE group where aggregate revenue is less than JPY 100 bn is exempt from preparation of CBCR & Master File. Further, entities whose transactions with a foreign affiliated party for a fiscal year are less than JPY 5 Bn in aggregate or intangible asset transactions with a foreign affiliated party are less than JPY 300 Mn in aggregate are exempt from preparation of local file.
4. Is the benchmarking analysis to be performed afresh every year?	No, however arm's length range should be updated every year. A full study can be done every 3 years, in line with the BEPS recommendations.

Questions	Country Response
5. Does your country TP regulation require taxpayers to file the details of the related party transactions with the revenue authority? If yes, what is the due date?	No. However, TP documentation (equivalent to local file) may be requested by the tax inspector even if a taxpayer's transactions are below the above thresholds. In such a case, the submission due date would be specified in the tax inspector's request (generally within 60 days).
6. Is there any penalty imposable on taxpayers for not preparing or filing the TP documentation/details of related party transaction?	Yes. CBCR & Master File: JPY 300,000 Local file: No prescribed penalties, however the National Tax Agency may presume a certain price to be at arm's length, based the comparable data obtained by a tax inspector and thereby make an adjustment.
7. Are there any safe harbour provisions prescribed under the TP regulation of your country?	No
8. Do TP regulations of your country provide for unilateral/ bilateral/multilateral APA?	Yes, Japan is one of most active countries with respect to the APA regime.
9. Has the Government/tax authorities of your country begun implementing recommendations under BEPS?	Yes, Tax Authorities have released guidelines for CBCR, Master file and local file.
10. Has your country introduced provisions to enable CbCR? If yes, what is the first reporting year?	Yes, for fiscal year starting April 1, 2016. Deadline is March 31, 2018

Country Views On BEPS

1. What are the typical TP issues that the taxpayers in your jurisdiction are facing?

A typical issue generally challenged by the revenue authorities is that a foreign related entity enjoys relatively high profitability. In the most cases revenue authorities focus on transfer prices for tangible assets, royalty rates, intra-group services, especially technical services relating to intangible property, like technical guidance to establish new production lines in manufacturing subsidiaries or instructions for manufacturing knowhow to the local workers.

2. Do MNE headquartered in your country believe that their effective tax rate on global basis may increase as a result of recalibrating their value chain to comply the guidelines emanating from BEPS action plans?

The taxpayers who take aggressive tax planning are small portion and most taxpayers are too much honesty here in Japan. The effective tax rate on global basis may not increase.

3. Is there any specific guidance in Action 8-10 which the revenue authorities of your country are not in agreement with?

Japanese revenue authorities always comply with OECD TP guidelines & BEPS action plans.

4. **How is the tax administration of your country gearing up to alleviate the doubts and concern of the taxpayers regarding the confidentiality of data to be shared with the revenue authorities under the TP documentation regime recommended by Action Plan 13 of BEPS?**

   There is no special means for alleviating doubts in Japan. Japanese revenue authorities are reliable for the confidentiality of data and have explained the information exchange mechanism to the taxpayers in detail.

5. **What are the key TP concerns or challenges that the taxpayers in your country may have as a result of overall BEPS projects?**

   The key concerns of taxpayers in Japan pertain mainly to the burden of additional documentation which the BEPS project entails. Such documentation involves costs, which may increase every year and hence need to be evenly spread over future years. Further, documentation needs to be prepared in such a manner as would be able to justify the arm's length nature of transactions from the perspective of the taxpayer as well as the foreign related party. Further, the implementation of BEPS action plans by other countries may affect arrangements with foreign related parties, with respect to transactions like royalties, management fees and advertisement, marketing and promotion activities.

NETHERLANDS

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Country Transfer Pricing Facts

Questions	Country Response
1. Do the TP regulations of your country require taxpayers to prepare TP documentation annually?	Yes, TP documentation has to be updated annually if the consolidated group revenues exceed EUR 50 mn. Further, for members of an MNE group resident in the Netherlands and exceeding this turnover threshold, Master File and local file requirements have been introduced.
2. What is the deadline for preparing the TP documentation for a particular transaction?	The deadline for preparing the TP documentation is the same as the deadline for filing corporate tax return.
3. Is there any exemption (relief) from preparing the TP documentation?	No. However, less strict documentation requirements (i.e. no specific format requirements) are applicable for Dutch tax resident group entities that have a consolidated turnover of less than EUR 50 Mn
4. Is the benchmarking analysis to be performed afresh every year?	Yes, recommended yearly update and every 3 years new benchmark needs to be performed.
5. Does your country TP regulation require taxpayers to file the details of the related party transactions with the revenue authority? If yes, what is the due date?	No, only documented in the TP documentation of the taxpayers in the Netherlands and needs to be kept in the administration. Filing is upon request.
6. Is there any penalty imposable on taxpayers for not preparing or filing the TP documentation/ details of related party transaction?	Yes, the Netherlands has a penalty regime regarding tax administration and the existing regime is also applicable to the Master File and the local file (a fine for non-compliance, and in case of a TP adjustment, an additional fine up to 100% of the amount of the adjustment). Furthermore, non-compliance could lead to double taxation and shift the burden of proof.

Questions	Country Response
7. Are there any safe harbour provisions prescribed under the TP regulation of your country?	No
8. Do TP regulations of your country provide for unilateral/bilateral/multilateral APA?	Yes, the Netherlands provide unilateral/ bilateral and multilateral APA.
9. Has the Government/tax authorities of your country begun implementing recommendations under BEPS?	Yes, the Netherlands has started the implementation of various Action Plans. A number of BEPS proposals entered into force since January 1, 2016. These include measures against various forms of hybrid mismatch arrangements, more in particular hybrid loan agreements (Action 2); CbCR requirements (including Master File and Local File requirements) (Action 13) and amendments of the general anti-abuse rules in the corporate Income-tax act and dividend withholding Tax Act (Action 5/6).
10. Has your country introduced provisions to enable CbCR? If yes, what is the first reporting year?	Yes, the CbCR requirements apply to Dutch tax resident entities which are members of an MNE group with a minimum consolidated group turnover of EUR 750 mn 2016 will be the first reporting year.

Country Views On BEPS

1. **What are the typical TP issues that the taxpayers in your jurisdiction are facing?**

   In general, as of the heated state aid discussion within Europe, the Dutch Tax Authorities (and taxpayers) are more careful in engaging an APA procedure with the Tax Authorities. Specifically, new rulings with respect to the payment of royalties and informal capital are difficult to obtain. Informal capital means that part of the initial profit which will be deemed to be capital instead of profit and would be excluded from the Dutch entity's profit base, depending on its functional and risk profile. Profit split methodology is also a specific issue.

2. **Do MNE headquartered in your country believe that their effective tax rate on global basis may increase as a result of recalibrating their value chain to comply the guidelines emanating from BEPS action plans?**

   This is the overall feeling as tax authorities are more focused on profit allocation and tax havens. In addition, there is a fear of MAPs which will (temporarily) lead to possible double taxation and tax uncertainty.

3. **Is there any specific guidance in Action 8-10 which the revenue authorities of your country are not in agreement with?**

The Dutch tax authorities consider the existing rules to be consistent with the proposed changes under Actions 8-10.

4. **How is the tax administration of your country gearing up to alleviate the doubts and concern of the taxpayers regarding the confidentiality of data to be shared with the revenue authorities under the TP documentation regime recommended by Action Plan 13 of BEPS?**

   By law, the information available should be treated by the Dutch Tax Authorities as confidential. The Dutch Tax Authorities in addition make use of secured data storage and exchange with the taxpayer.

5. **What are the key TP concerns or challenges that the taxpayers in your country may have as a result of overall BEPS projects?**

   As a result of the overall BEPS project, from a Dutch TP perspective, the challenges pertain to the compliance with the new law which implements new TP documentation requirements in line with BEPS Action 13, mainly in those countries that deviate (unilaterally) from the overall OECD guidelines and principles. Multinational enterprises will have to deal with a three-tiered approach to TP documentation. Under the adjusted legislation, the Master file, local file, and CbC Report requirements will be applicable for fiscal years starting on or after 1st January 2016. Non-compliance leads to legal sanctions. It is expected (also as a result of BEPS and implementation of CbCR) that multilateral agreement procedures will increase and tax uncertainty for the taxpayers as well.

SINGAPORE

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Country Transfer Pricing Facts

Questions	Country Response
1. Do the TP regulations of your country require taxpayers to prepare TP documentation annually?	The Singapore tax authorities (IRAS) expects taxpayers to maintain contemporaneous TP documentation to support the pricing of their transactions with related parties. However, administrative simplifications have been provided.
2. What is the deadline for preparing the TP documentation for a particular transaction?	TP documentation should be prepared on a contemporaneous basis. For ease of compliance, tax authorities will accept as any documentation prepared at any time no later than the time of completing and filing the tax return for the financial year in which the transaction takes place.
3. Is there any exemption (relief) from preparing the TP documentation?	Yes, tax authorities have introduced administrative simplifications e.g., TP documentation is not required for taxpayers transacting with only domestic related parties, in case of certain related domestic loans, taxpayers under an APA and for transactions where 5% mark-up has been applied for routine services.
4. Is the benchmarking analysis to be performed afresh every year?	Taxpayers are encouraged to update their TP documentation at least once every three years. In any case, taxpayers should update their TP documentation when there are material changes to the operating conditions that impact their functional analysis or TP analysis.

Questions	Country Response
5. Does your country TP regulation require taxpayers to file the details of the related party transactions with the revenue authority? If yes, what is the due date?	No.
6. Is there any penalty imposable on taxpayers for not preparing or filing the TP documentation/details of related party transaction?	Yes. For failure to provide the TP documentation to tax authorities, the penalty is a fine not exceeding SGD 1,000 and in default of payment to imprisonment for a term not exceeding six months. Further, a penalty equal to the amount of tax that has been/would have been undercharged would be levied in case of an omission or understatement of any income. Where the taxpayer through negligence makes an incorrect return by omitting or understating any income, the penalty is equal to double the amount of tax undercharged and shall also be liable to a fine not exceeding SGD 5,000 or to imprisonment for a term not exceeding three years or to both. For tax evasion and fraudulent cases, there are severe penalties of three to four times, or imprisonment for a term not exceeding three years and five years respectively, or both.
7. Are there any safe harbour provisions prescribed under the TP regulation of your country?	Yes. As an administrative practice, taxpayers can apply a cost plus 5% mark-up for certain routine support services as a reasonable arm's length charge when certain conditions are satisfied.
8. Do TP regulations of your country provide for unilateral/ bilateral/multilateral APA?	Yes.
9. Has the Government/tax authorities of your country begun implementing recommendations under BEPS?	Yes. Singapore has joined the inclusive framework for implementing measures against BEPS and has thereby committed to implement the following four minimum standards under the BEPS project – Countering harmful tax practices (Action Plan 5), Preventing treaty abuse (Action Plan 6), TP documentation – CbCR (Action Plan 13), Enhancing dispute resolution (Action Plan 14).

Questions	Country Response
10. Has your country introduced provisions to enable CbCR? If yes, what is the first reporting year?	Yes, a CbC Report will need to be prepared starting from financial year on 31 December, 2017 and the CbC Report would be due to tax authorities by 31st December, 2018.

Country Views On BEPS

1. **What are the typical TP issues that the taxpayers in your jurisdiction are facing?**

   Substantiating related party transactions of intra-group services, payment for royalty, continuous loss making entities with substantial revenue from related entities, low margins compared to average industry returns, etc.

2. **Do MNE headquartered in your country believe that their effective tax rate on global basis may increase as a result of recalibrating their value chain to comply the guidelines emanating from BEPS action plans?**

   Singapore does not condone activities aimed at BEPS and abides by the principle that profits should be taxed where the real economic activities generating the profits are performed and where value is created. To that extent, if the MNEs' structures are not aligned with these principles then any recalibration of their value chains may result in an increase of their effective tax rate depending on the facts and circumstances of their case.

3. **Is there any specific guidance in Actions 8-10 which the revenue authorities of your country are not in agreement with?**

   Singapore has demonstrated that it supports the BEPS principle without any reservation that profits should be taxed where substantive activities generating the profits are performed and where value is created. Further, the Ministry of Finance clarified that Singapore welcomes the OECD's final BEPS recommendations to G20 to combat international tax avoidance but measures should not inadvertently end up stifling competition for substantive economic activities.

4. **How is the tax administration of your country gearing up to alleviate the doubts and concern of the taxpayers regarding the confidentiality of data to be shared with the revenue authorities under the TP documentation regime recommended by Action Plan 13 of BEPS?**

   The CbCR filed with the tax authorities will be exchanged with other jurisdictions by the tax authorities only after establishing that these jurisdictions have a strong rule of law and are able to ensure confidentiality of the information exchanged and prevent its unauthorised use. The exchange programme will be suspended in case of any misuse of information contained in the CbC Reports or breach of the confidentiality obligation by the other jurisdictions.

5. **What are the key TP concerns or challenges that the taxpayers in your country may have as a result of overall BEPS projects?**

   With the implementation of CbCR, MNEs whose ultimate parent entities are in Singapore may be impacted. The information contained within a CbC report may be exchanged with other tax jurisdictions who may have a holistic view of the tax position of that MNE. With this information, tax authorities may be able to assess where the MNE is under paying its taxes in contrast to the value generated. In addition, if they are required to file CbCR locally in foreign jurisdictions under the 'secondary mechanism', protecting data confidentiality contained in CbCR may be a concern. Any confidentiality protections may effectively be overridden by rules in other jurisdictions in which Singapore MNEs are doing business by mandating public disclosure of CbC Reports.

UNITED KINGDOM

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Country Transfer Pricing Facts

Questions	Country Response
1. Do the TP regulations of your country require taxpayers to prepare TP documentation annually?	No. However, taxpayers should keep sufficient records to enable them to complete an accurate tax return.
2. What is the deadline for preparing the TP documentation for a particular transaction?	No specific deadlines, in the absence of any requirement to submit any documentation with the tax authorities (HMRC), unless specifically asked.
3. Is there any exemption (relief) from preparing the TP documentation?	Yes. Specific exemptions are available for transactions carried out by a business that is a small or medium sized[24] enterprise, unless transactions are with parties in non-qualifying territories; TP notice given to medium sized enterprise; there has been an election to (irrevocably) remain subject to TP rules or relief is claimed under Patent Box.
4. Is the benchmarking analysis to be performed afresh every year?	No. The UK TP regulations follow the OECD guidance which recommends that MNE groups rely on benchmarking results that do not exceed 3 years. This period of 3 years is also embodied in BEPS Action 13.
5. Does your country TP regulation require taxpayers to file the details of the related party transactions with the revenue authority? If yes, what is the due date?	No. Whilst contemporaneous TP documentation must be prepared in support of tax returns, there is no obligation to submit the same with the annual tax return. It needs to be made available at the request of the tax authorities within the specified time.

[24] An entity qualifies as either small or medium if it meets the staff headcount ceiling for that class and the defined financial limits

Questions	Country Response
6. Is there any penalty imposable on taxpayers for not preparing or filing the TP documentation/details of related party transaction?	UK legislation provides for penalties of up to GBP 3,000 per tax return for failure to compile and retain TP documentation.
7. Are there any safe harbour provisions prescribed under the TP regulation of your country?	Small and medium sized enterprises are not required to apply TP (subject to a few exceptions mentioned above). Further, transactions which are taxed on a capital gains basis are not subject to TP.
8. Do TP regulations of your country provide for unilateral/ bilateral/ multilateral APA?	The UK has an APA programme. Unilateral, bilateral and multilateral APAs are all potentially available to the taxpayer.
9. Has the Government/tax authorities of your country begun implementing recommendations under BEPS?	UK has begun to implement the OECD's recommendations from the BEPS project. In areas such as controlled foreign company rules, the UK is already in line with the OECD recommendations. Meanwhile, tax authorities are working with other tax administrations to improve information exchange, including as part of the expanding Joint International Tax Shelter Information Collaboration network. Tax authorities will monitor the implementation and effectiveness of BEPS outcomes, both at a domestic and international level. The UK intends to implement the suggestions of the OECD, including the development of a multilateral instrument to implement BEPS treaty measures.
10. Has your country introduced provisions to enable CbCR? If yes, what is the first reporting year?	The Finance Act, 2015 regulations stipulate for accounting periods starting on or after 1st January, 2016 that UK parented multinationals with revenues above the GBP equivalent of EUR 750 mn in the previous period will be required to submit a CbC Report for the global group to the tax authorities within 12 months of the year end.

Country Views On BEPS

1. **What are the typical TP issues that the taxpayers in your jurisdiction are facing?**

   Following the issuance of the BEPS Action reports, there is an increased focus on TP issues like treatment of intangibles, (lack of) economic substance, Diverted Profits Tax and management charges. These are in addition to the typical transactions which are generally challenged by the revenue authorities, like intra-group services, payment for royalty, advertisement and brand promotion expenses, etc.

2. **Do MNE headquartered in your country believe that their effective tax rate on global basis may increase as a result of recalibrating their value chain to comply the guidelines emanating from BEPS action plans?**

   Anecdotal evidence suggests that many multinationals believe the BEPS programme could lead to an increase in their effective tax rate through a combination of changes to interest deductibility rules and the rules on TP. The TP changes most likely to have an impact are those relating to intangibles and risk allocation.

3. **Is there any specific guidance in Action 8-10 which the revenue authorities of your country are not in agreement with?**

   No. The Taxation (International and Other Provisions) Act, 2010 expressly refers to the OECD TP Guidelines, and states that UK TP legislation is to be interpreted in such a way as to secure consistency with the OECD Guidelines.

4. **How is the tax administration of your country gearing up to alleviate the doubts and concern of the taxpayers regarding the confidentiality of data to be shared with the revenue authorities under the TP documentation regime recommended by Action Plan 13 of BEPS?**

   The tax authorities are working with other tax administrations to improve information exchange, including as part of the expanding Joint International Tax Shelter Information Collaboration network. The tax authorities will monitor the implementation and effectiveness of BEPS outcomes, both at a domestic and international level. It is expected that where appropriate safeguards are not in place or when there has been a breach in keeping the information confidential and the situation has not been appropriately resolved, exchange of information (including CbCR information) would be suspended.

5. **What are the key TP concerns or challenges that the taxpayers in your country may have as a result of overall BEPS projects?**

   Typical concerns include isues like large MNEs being subject to multiple audits from various revenue authorities at any one time. Further, there could be interpretation issues leading to more tax disputes globally and potential double taxation. The BEPS project does not address issues regarding the allocation of taxing rights between source and residence countries. Businesses expect countries to set an equitable system for determining the allocation of taxation rights. Further, concerns have been raised about the proliferation of inconsistent reporting requirements. Taxpayers also have concerns about the rigour of confidentiality protections where taxpayer information is shared outside of the established exchange of information network. Other concerns include increased compliance and administrative costs.

UNITED STATES OF AMERICA

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Country Transfer Pricing Facts

Questions	Country Response
1. Do the TP regulations of your country require taxpayers to prepare TP documentation annually?	No, but contemporaneous TP documentation is needed for penalty protection and must be provided within 30 days of request from the tax authorities (IRS).
2. What is the deadline for preparing the TP documentation for a particular transaction?	15th of third month following end of tax year (Corporate taxpayers may request 6-month extension)
3. Is there any exemption (relief) from preparing the TP documentation?	There is no exception from preparing the TP documentation.
4. Is the benchmarking analysis to be performed afresh every year?	Yes.
5. Does your country TP regulation require taxpayers to file the details of the related party transactions with the revenue authority? If yes, what is the due date?	Yes. Information is to be filed as part of Form 5471 on the Federal tax return.
6. Is there any penalty imposable on taxpayers for not preparing or filing the TP documentation/details of related party transaction?	Yes, 20-40 per cent penalty on additional tax from adjustments (plus interest).
7. Are there any safe harbor provisions prescribed under the TP regulation of your country?	In general, no. Limited safe harbours are available for certain qualifying loan transactions.
8. Do TP regulations of your country provide for unilateral/ bilateral/ multilateral APA?	Yes. Multilateral, bilateral, and unilateral APAs are available.
9. Has the government /tax authorities of your country begun implementing recommendations under BEPS?	Yes, the Government has introduced CbCR requirements.

Questions	Country Response
10. Has your country introduced provisions to enable CbCR? If yes, what is the first reporting year?	Yes, companies with a group revenue of greater than USD 850 mn must file CbCR for fiscal years beginning after June 30, 2016.

Country Views On BEPS

1. What are the typical TP issues that the taxpayers in your jurisdiction are facing?

Taxpayer information related to intercompany transactions are routinely addressed at exam. Typical transactions challenged by the revenue authorities include issues around tangibles, services, intangibles and finance-related transactions. The determination of which transactions is largely dependent on the accuracy and consistency with which a taxpayer describes and supports their behaviour. Taxpayers that have not sufficiently supported their transactions to have been conducted at arm's length are often at greatest risk.

2. Do MNE headquartered in your country believe that their effective tax rate on global basis may increase as a result of recalibrating their value chain to comply the guidelines emanating from BEPS action plans?

Some MNEs are concerned that their effective global tax rate will increase if their value chain must be moved around so that certain functions or profits need to be moved to higher tax jurisdictions, like the US.

3. Is there any specific guidance in Action 8-10 which the revenue authorities of your country are not in agreement with?

In general, US regulations are consistent with the recommendations under the BEPS initiative. There are some differences that Treasury is addressing through proposed changes to Section 482, changes to the competent authority procedures and changes to regulations that can affect the way in which TP is addressed.

4. How is the tax administration of your country gearing up to alleviate the doubts and concern of the taxpayers regarding the confidentiality of data to be shared with the revenue authorities under the TP documentation regime recommended by Action Plan 13 of BEPS?

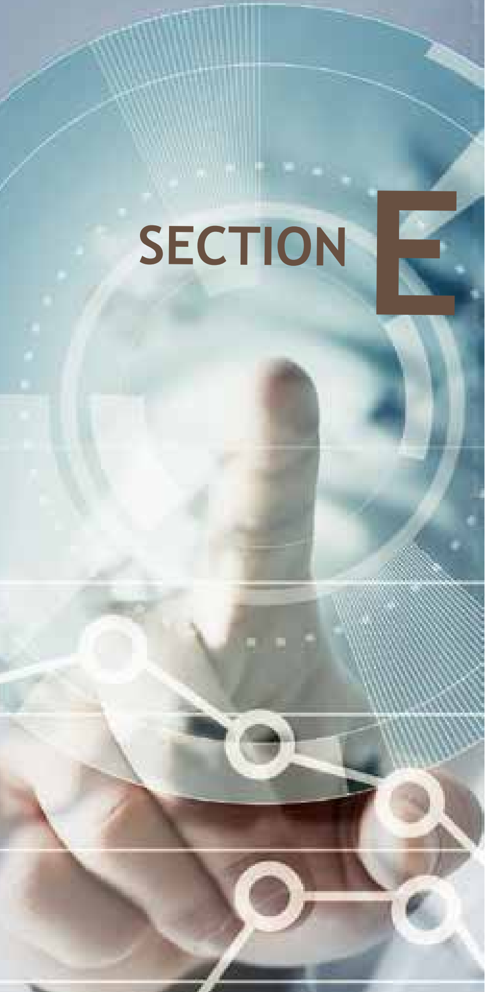
The US has not signed the MCAA agreement, which would automatically share any CbC Reports with other signatories of the agreement. We understand that any sharing of information by the US tax authority will happen through existing treaties and information exchange agreements.

5. What are the key TP concerns or challenges that the taxpayers in your country may have as a result of overall BEPS projects?

Two taxpayer concerns are related to the security of financial information that they will share with tax authorities through CbCR. Taxpayers are also concerned with increased compliance costs around reporting requirements related to Masterfile/Local file and CbCR.

SECTION E

INDIA'S COMMITMENT TO BEPS



SECTION E

INDIA'S COMMITMENT TO BEPS

1. MASTER FILE AND COUNTRY BY COUNTRY REPORTING

Keeping in view the commitment of the Government of India to implement the OECD/G20's BEPS recommendations, Union Budget of 2016 introduced the Master File and CbCR in the existing TP documentation regime. The three-tiered TP documentation viz., Master File, Local File and CbCR ensure greater transparency in maintaining TP documentation and at the same time act as an important tool in the hands of tax administrator for evaluating TP risk.

The salient features of this three-tiered TP documentation approach are:

Particulars	**Master File**	**Local File/ Existing Document Under Rule 10D***	**Country-By-Country Report**
Effective from	April 1, 2016 (AY 2017-18)	Already in operation	April 1, 2016 (AY 2017-18)
What are the contents	Detailed contents to be specified in IT Rules. Memorandum to the Union Budget indicates that a standard document containing group level information will form part of Master File: ▪ Overview of the business of the group ▪ Org Structure	Documents specified in the existing Rule 10D	Template and detailed contents to be prescribed in IT Rules to be notified. Essential information that CbCR shall mandatorily contain: ▪ Revenue ▪ Profit & loss before Income-tax

Particulars	Master File	Local File/ Existing Document Under Rule 10D*	Country-By-Country Report
	▪ MNEs business including profit drivers, supply chain of major products/ services ▪ MNEs intangibles ▪ Inter-company financial arrangements ▪ Overall TP Policies ▪ Global Revenue and Global economic activities ▪ MNE's financial and tax positions		▪ Amount of Income-tax paid and accrued ▪ Details of capital ▪ Accumulated earnings ▪ Number of employees ▪ Tangible assets other than cash or cash equivalent ▪ Details of each constituent entity of the group including the country of incorporation and tax residency The nature of main business activities of each constituent entity
Who to maintain	**All the constituent entities of the MNE group.** **Note: However, It would be administratively convenient for the parent of the group to prepare the Master File and share the same with all the constituent entities of the group**	**Constituent entity operating in India**	**Indian parent entity or alternate reporting entity resident in India**
Who will file	All the constituent (parent or any other affiliate of parent whose accounts are consolidated in parents' accounts) of the international group operating in India	All the constituent entities of the international group operating in India	▪ Indian parent entity or alternate reporting entity resident in India ▪ Every other constituent entity if the parent entity is resident in a country with which India does not have an agreement for exchange of information or there has been a systematic failure on the part of the country/ entity and the said failure is already reported to the constituent entity in India

Particulars	Master File	Local File/ Existing Document Under Rule 10D*	Country-By-Country Report
To whom to file	To be prescribed	TP officer	To be prescribed
When to file	Within a date to be prescribed	Within 30 days of receipt of notice issued by the TP officer which is extendable to a maximum of additional 30 days upon request by the taxpayer	Within the due date of filing of Return of Income, in case the ultimate parent of the international group is tax resident in India or the alternate reporting entity is tax resident in India
Exemption	No exemption	No exemption except that already provided in Rule 10D(2)	Not required if the consolidated turnover of the group is less than a threshold in the previous accounting period. The minimum threshold to be prescribed although memorandum explaining the budget indicates that the turnover threshold would be in line with what is prescribed in Action Plan 13 of BEPS project which is INR equivalent of 750 mn Euro. Therefore for the compliance cycle of FY 2016-17, consolidated turnover of the group during year ended March 2016 should be INR equivalen of 750 mn Euro

Particulars	Master File	Local File/ Existing Document Under Rule 10D*	Country-By-Country Report
Penalty	INR 500,000	Substantially unchanged	▪ **For non-furnishing of CbCR:** Graded penalty of INR 5,000 to INR 50,000 per day depending upon the number of days delay in furnishing CbCR ▪ For wilfully furnishing inaccurate particulars of CbCR: INR 500,000 ▪ For failure to file information/documents required by the prescribed authority to verify the accuracy of CbCR: Graded penalty of INR 5,000 to INR 50,000 per day depending upon the number of days delay in furnishing the details

*Note: Contents of the Local File as prescribed in BEPS Action Plan 13 are similar to what the existing Rule 10D prescribe barring certain additional details mentioned as below:

- Description of management structure and organisation chart of the local entity and description of individual to whom local management reports and countries in which these individuals maintain their principal offices
- A detailed description of the business and strategy followed by local entity and an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately preceeding year and an explanation of those aspects of such transactions affecting the local entity
- A copy of existing unilateral and bilateral/multilateral APAs and other tax rulings to which the local tax jurisdiction is not a party and which are related to controlled transactions described above

WAY FORWARD

The basic purpose of BEPS project in respect of TP is to align the TP outcome with the value creation. While the Master File provides a blue print of entire group's business model, value driver and value chain a careful compilation and analysis of CbCR will assist in evaluating the gap between value creation and the outcome of the TP under the existing TP models. It is crucial to identify those risks and take corrective measures to fill the gaps and set things right.

Given the fact that three-tiered TP documentation regime may highlight the inconsistencies in the outcome of the TP, the need for centralising the management and control of MNE group's TP documentation is more than ever. The need for centralisation may not necessarily be induced from the fact that enhanced transparency would enable the tax administration to question the pricing arrangement of the supply chain. Instead the executives of the multi-billion and huge conglomerate would have themselves acted on the mismatches had the information and financial data on global businesses been analysed holistically rather than on a decentralised basis.

The introduction of three-tiered TP documentation should not be viewed as, merely a compliance burden but also as an opportunity to revisit the entire supply chain from the perspective of correcting the mismatch between value creation and location of tax base. The very nature of Master File and CbCR is such that ultimate parent, in general, would be administratively best suited to compile the data efficiently. While the data and information in respect of Master File and CbCR would generally be compiled centrally at ultimate parent level, the involvement of local entities forming part of the group would be required to compile the country specific details and also to verify the details and information compiled by the parent entity. Although the rules and related forms in respect of Master File and CbCR are yet to be notified by the CBDT, it is expected it would be in line with that recommended by the OECD/G20 Action Plan 13.

2. INDIA SIGNS MULTILATERAL COMPETENT AUTHORITY AGREEMENT

The BEPS Action Plan adopted by the OECD and G20 nations recognises the need for enhancing the transparency for tax administration by providing relevant information to assess the TP and other BEPS related risks. Considering this objective, the BEPS Action 13 report requires MNEs to report annually and for each tax jurisdiction certain information in a specified format. This report is called the CbCR.

In order to facilitate implementation of CbCR, the BEPS Action Plan 13 recommends model legislation which could be used by countries, which would require the ultimate parent entity of an MNE group to file the CbCR in its jurisdiction of residence. The model legislation also provides three model competent authority agreements which may be used to facilitate implementation of exchange of CbCR:

(i) Multilateral Competent Authority Agreement (MCAA);

(ii) Double Tax Conventions; and

(iii) Tax Information Exchange Agreements

The Multilateral Competent Authority Agreement on the exchange of CbC Reports (the "CbC MCAA") has been developed based on the Convention on Mutual Administrative Assistance in Tax Matters (the "Convention") which requires the Competent Authorities of the parties to the Convention to mutually agree on the scope of the automatic exchange of information and the procedure to be complied with. The CbC MCAA is also inspired by the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information concluded in the context of the implementation of the Common Reporting Standard (CRS MCAA).

The purpose of the CbC MCAA is to formulate rules and procedures for Competent Authorities of jurisdictions implementing BEPS Action 13 to automatically exchange CbC Reports prepared by the reporting entity of an MNE Group and filed on an annual basis with the tax authorities of the jurisdiction of tax residence of that entity with the tax authorities of all jurisdictions in which the MNE Group operates.

As a party to the signatories of recommendation of minimum standard Action Plan 13, India demonstrated its commitment to enhance transparency and implementation of Action Plan 13 by signing CbC MCAA on May 12, 2016. As on October 21, 2016, 49 countries have already signed CbC MCAA.

By signing the CbC MCAA, India agrees to bilaterally and automatically exchange CbCR with other countries that have also signed the MCAA. India will also receive CbCR from other countries. India has signed other such information sharing agreements in an effort to check the flow of black money and increased tax compliance.

3. INDIAN TAX AUTHORITIES' VIEWS ON ACTION PLANS 8-10

Action Plans 8-10 attempts to address the BEPS concerns by strengthening the application of arm's length principle so that outcome of the transfer price is in sync with value creation. Emphasis on "substance" and alignment of taxation with location of economic activity and value creation (source based taxation) are the cornerstones on which the whole edifice of Action Plans 8-10 stands. The doctrine of "substance over form" is the central theme of the Action Plans 8-10. This view is reflected in the Action Plans 8-10 when it unequivocally emphasise that contractual allocation of risks and legal ownership of intangibles will be respected for determining the ALP only when the entity contractually assuming risk has and actually exercises the control over risks and has the financial capacity to assume the risks. Similarly, Action Plan 8-10 also prescribes that mere legal ownership would not guarantee the return related to intangibles unless the legal ownership is not substantiated with functions and risks associated with development, maintenance, enhancement, protection and exploitation of intangibles. Action Plans 8-10 also provide guidance in respect of thickly capitalised entities by limiting the remuneration for funder unless the funder also performs strategic functions and assume operational risks.

Since the publication of Action Plans 8-10 on October 5, 2015, the Indian tax authorities have voiced their support to most of the recommendations at several public forums:

- BEPS Action Plans 8-10 endorses India's position on allocation of risks and capital. There seems to be a sense of vindication at least in respect of guidance towards risks and capital. Indian tax authorities have always taken a position that remote control of risks through contractual assumption risk leads to manipulation of transfer price at the cost of substance of the transaction in question.

- India also agrees with the view that mere capital funding does not entitle the capital provider intangible related return.

Further, Government of India's position on several TP issues like allocation of risks, role of capital, intangibles including marketing intangibles, addressed in BEPS Action Plans 8-10, can be understood from Country Practices Chapter 10 in UN TP Guidelines[25]. Interestingly, the chapter was revised in October 2016 which clearly reflects as to how Government of India has also recalibrated its stand on various issues including marketing intangibles through several judicial rulings and release of final BEPS Action Plan in October 2015. The Government of India's stand on issues in so far as it relates to Action Plans 8-10 are summarised hereunder:

ISSUES PERTAINING TO RISKS ALLOCATION AND CONTRACT RESEARCH & DEVELOPMENT

- India believes that functions & risk go hand in hand and it is not fair to give undue importance to risk while determining the ALP. Substance, rather than the form, should determine which party assume risks. The party assuming the risks should have control over the risks and should have financial capacity to assume the risks. Core functions and key decision making authorities are the important factors to identify the party assuming the risks.

- In respect of contract R&D services performed by Indian affiliates of MNEs,

[25] Chapter 10 of United Nations Practical Manual on Transfer Pricing for Developing Countries, 2013

India believes that in many cases core functions including R&D requires taking strategic decisions like designing of product or software, the direction of R&D and monitoring etc., which the employee of the Indian affiliate perform. Accordingly, the risks in relations to the R&D functions are in substance controlled by Indian affiliate. In such cases, remunerating Indian entity on a routine cost plus model may not be considered as at arm's length.

LOCATION SAVINGS

- Allocation of location savings and location rent should be made between associated enterprises by reference to what independent parties would have agreed in comparable circumstances. In situations, when comparable uncontrolled transactions are not available, PSM may be applied to determine the allocation of location savings and rent, keeping in view the bargaining strength of the entities to the transactions.

- Earlier the Government of India's position was that benchmarking using local comparables do not necessarily capture the remuneration related to location savings and location rent. Government of India seems to have taken cues from several rulings in the recent past on the aspect of location savings/rent. The result is that there is clear shift in the view of Government of India so far as it relates to need of additional remuneration for location savings/rent, if good comparables are used for determining the ALP. Government of India now believes that if good local comparables are available, the benefits of location savings can be said to have been captured in the ALP so determined. However, if the good local comparables are not available or where the overseas associated enterprise is selected as tested party, the issue of capturing the benefits of location savings would remain an issue in determining the ALP.

MARKETING INTANGIBLES

- Based on the several Appellate Tribunal decisions and High Court rulings, the Government of India has deleted reference of "Bright Line Test" from the Country Chapter 10 dealing with Government of India's stand on several TP issues including marketing intangibles.

- There are several examples in the annexure to Action Plans 8-10 which explain the circumstances where a separate compensation for AMP is required and also explains situations where a separate remuneration is not required. Government of India believes that the essence of the examples is that compensation for AMP will depend upon the intensity of AMP functions, the assets employed and the amount of risks borne by the parties in respect of AMP functions. Compensation need not be separate. It can be a part of the price of the other transactions. Where the AMP function is performed with an intention to exploit the result itself, no separate compensation is receivable for the AMP functions. Further the person who takes the important decisions relating to AMP functions such as deciding the strategy, fixing the budget, and exercising the overall control over the functions is the person who bears the risk relating to AMP functions and he is entitled to all the excess profits generated on account of such functions. The revised position of Government of India on AMP seems to have mellowed down and it does not object to the above stated essence of various examples used in Action Plans 8-10 to explain and possible solution under various scenarios.

- However, the Government of India believes that the issue is subjudiced and decision from Supreme Court should settle the controversies.

INTRA-GROUP SERVICES AND LOW VALUE ADDED SERVICES

- TP of intra-group services is a high risk area in India. India considers the payment for intra-group services to be base eroding in nature;
- An overall ceiling should be fixed for payment of intra-group services even if the payment by Indian affiliate satisfies the arm's length characteristic;
- India has not endorsed the simplified and elective approach of documentation in respect of certain low value adding intra-group services and accordingly does not agree with 5% mark up on such cost.

The Government of India believes that global thinking on international tax policies is moving in the "source-based" direction – something which India has been advocating for a long time. India has endorsed Action Plans 8-10 dealing with TP issues related to risk, capital and intangibles. Government of India endorses the focus on delineating the actual transaction that is to find out the "real deal" in the transactions and preferring substance over form.

GLOSSARY OF TERMS

ALP	Arm's Length Price
AMP	Advertising, Marketing And Promotion
APA	Advance Pricing Agreement
AUD	Australian Dollar
BEPS	Base Erosion and Profit Shifting
Bn	Billion
CAD	Canadian Dollar
CbCR	Country-by-Country Reporting
CBDT	Central Board of Direct Taxes
CCA	Cost Contribution Agreements
CPM	Cost Plus Method
CUP	Comparable Uncontrolled Price
CUT	Comparable Uncontrolled Transaction
CY	Current Year
DRP	Dispute Resolution Panel
EUR	Euro
FAR	Function, Assets and Risks
FOB	Free on Board
GBP	Great Britain Pound

INR	Indian Rupee
IT Act	Income Tax Act, 1961
IT Rules	Income Tax Rules, 1962
ITAT	Income Tax Appellate Tribunal
JPY	Japanese Yen
MAP	Mutual Agreement Procedure
MCAA	Multilateral Competent Authority Agreement
Mn	Million
MNE	Multinational Enterprise
OECD	Organisation for Economic Co-operation and Development
PLI	Profit Level Indicator
PSM	Profit Split Method
R&D	Research and Development
RMB	Chinese Renminbi
RPM	Resale Price Method
SGD	Singapore Dollar
TNMM	Transactional Net Margin Method
TP	Transfer Pricing
USD	US Dollar

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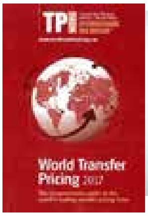

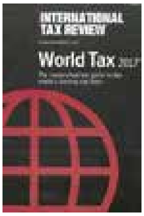

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