

CONTENTS

	PAGE
<i>About the Author</i>	I-5
<i>Acknowledgement</i>	I-7
<i>Preface</i>	I-9
<i>List of Abbreviations</i>	I-13
<i>Chapter-heads</i>	I-15

1

OPENING REMARKS

1.1	Rationale for Domestic Transfer Pricing Regulations	1
1.2	No Separate Domestic Transfer Pricing Regulations	3
1.3	What has changed?	3
1.4	Anomalies	3
1.5	What does this Book cover?	4

2

BRIEF OUTLINE OF PROVISIONS APPLICABLE TO DOMESTIC TRANSFER PRICING

2.1	Transactions covered by Domestic Transfer Pricing Regulations	7
2.2	Following is the list of “Specified Domestic Transactions” - The Transactions covered by the Domestic TP Regulations	8
2.3	Arm’s Length Principle applies to Specified Domestic Transactions	14
2.3.1	Section 92 - Computation of income having regard to arm’s length price	14
2.4	TP Regulations shall not apply where application of Arm’s Length Principle reduces income or increases loss - Sec. 92(3)	19
2.5	Burden of Compliance	20

	PAGE
2.5.1 Prescribed Information and Documents are to be kept and maintained	21
2.5.2 Accountant's Report in Form 3CEB is to be filed	22
2.5.3 Transfer Pricing Assessment	22
2.6 Penalties for Non-Compliance	22
2.7 Computation of Arm's Length Price	23
2.8 Steps in determining Arm's Length Price under Transfer Pricing Regulations	29
2.9 Brief Overview of Transfer Pricing Assessment Proceedings [Sec. 92CA]	31
2.10 Mechanism for Resolution of Disputes	32
2.10.1 Appeal	32
2.10.2 Dispute Resolution Panel - An alternative to Appeal before CIT(A)	32
2.10.3 Mutual Agreement Procedure (MAP) [Rules 44G & 44H]	34
2.10.4 Advance Ruling from AAR is not available on Transfer Pricing issues	36
2.10.5 Advance Pricing Agreement Scheme is not available for Specified Domestic Transactions	36
2.11 Circulars, Instructions and Notifications, applicable to Specified Domestic Transactions, Issued by the CBDT	37
2.11.1 Circulars	37
2.11.2 Instructions	37
2.11.3 Notifications	37
2.12 Conclusion	38

3

SPECIFIED DOMESTIC TRANSACTIONS

3.1 Monetary Limit of ₹ 5 crores	40
3.1.1 What if the transaction value recorded in books is less than the actual transaction value?	40
3.1.2 How to compute aggregate value when a single transaction gives rise to two distinct Specified Domestic Transactions?	43

	PAGE
3.1.3	Can we net-off an expense transaction with an income transaction to compute the aggregate value of transactions? 43
3.1.4	What is the implication of the monetary limit of ₹ 5 crores? 43
3.1.5	Possible Solution 45
3.1.6	Whether Monetary Threshold is to be computed on Net basis or on Gross Basis? 45
3.1.7	Summary 45
3.2	Transactions listed under Sec. 92BA should not otherwise be International Transactions 46
3.2.1	Definition of Transaction 47
3.3	Specified Domestic Transactions Listed in Sec. 92BA 48
3.3.1	Any expenditure in respect of which - Payment has been made, or is to be made - to a person referred to in Sec. 40A(2)(b) [Clause (i) of Sec. 92BA] 48
3.3.2	Any transaction referred to in Sec. 80A(6) [Clause (ii) of Sec. 92BA] 50
3.3.3	Any transfer of Goods or Services referred to in Sec. 80-IA(8) [Clause (iii) of Sec. 92BA] 51
3.3.4	Any business transacted between the assessee and other person as referred to in Sec. 80-IA(10) [Clause (iv) of Sec. 92BA] 55
3.3.5	Any transaction - referred to in any other section under Chapter VI-A or Sec. 10AA - To which provisions of Sec. 80-IA(8) or (10) are applicable [Clause (v) of Sec. 92BA] 57
3.3.6	Any other transaction as may be prescribed [Clause (vi) of Sec. 92BA] 59
3.4	We can categorize all Specified Domestic Transactions listed under Sec. 92BA into three Types 59
3.4.1	Type I SDT 59
3.4.2	Type II SDT 60
3.4.3	Type III SDT 61

4
—

**DOMESTIC TRANSFER PRICING AND
SEC. 40A(2)(b) - ISSUES**

4.1	Domestic TP Regulations will apply even when there is no tax arbitrage <i>i.e.</i> even when Payer and Payee both are taxable at the same effective tax-rate	63
4.1.1	Ruling of the High Court in <i>CIT v. V.S. Dempo & Company Pvt. Ltd.</i> [2011] 336 ITR 209/196 Taxman 193 (Bombay HC)	63
4.1.2	Cases where Payer and Payee are taxable at the same rate have not been excluded	64
4.2	Payee's Case is not covered even if there is scope to shift profits from the Payer to the Payee	64
4.3	Income Transactions are not covered	65
4.4	Double Taxation can occur because of absence of any provision for making corresponding downward adjustment of income in hands of the Payee	65
4.5	The Assessing Officer can disallow the expenditure even if the payment is at Arm's Length Price	65
4.6	Even Cross-Border Transactions are covered	66
4.7	Indirect payments are not within the scope of SDT	67
4.8	Payment made to a third party for the benefit of a Sec. 40A(2)(b) person is not covered	68
4.9	Advertisement, Marketing and Promotion Expenses incurred by the Taxpayer for creation of Marketing Intangibles for Related Party - Not covered	69
4.9.1	Advertisement, Marketing and Promotion Expenses incurred by the Taxpayer to create Marketing Intangibles for Related Party	70
4.9.2	Taxpayer receives brand-building services from a Sec. 40A(2)(b) Related Party and makes payment to that Party, for AMP expenses incurred by the latter in building the brand of Taxpayer	74
4.10	Payment made to a Sec. 40A(2)(b) person for the benefit of third party is covered	75
4.11	Reimbursements are not covered	75
4.12	Remuneration and Interest to Partners - Whether Covered?	75
4.13	Purchase of Capital Asset from a Sec. 40A(2)(b) Party	76
4.14	Interest-free loans given by the taxpayer are not covered	78

	PAGE
4.15 Corporate Guarantee given by a taxpayer to banks is not covered	79
4.16 ESOP to Directors - Whether covered?	79
4.17 Payments by Charitable Trusts - Whether covered?	80
4.18 Payments by Co-operative Societies not covered	81
4.19 Payments by Companies Registered under Sec. 8 of the Companies Act, 2013	81
4.20 Impact under the Companies Act, 2013	83
4.21 Computation of income under the head "Income from Other Sources" is also covered	83
4.22 Discount given to Sec. 40A(2)(b) party	83
4.23 Loss incurred on sales made to a Sec. 40A(2)(b) party	84
4.24 What will happen when the AO rejects books of account under Sec. 145?	85
4.25 Difficulty when Sec. 40A(2)(b) Payee is taken as Tested Party for Comparability Analysis	86

5

DOMESTIC TRANSFER PRICING AND SEC. 80A(6) OR SEC. 80-IA(8) - ISSUES

5.1 Transfer of only Goods and Services is covered	90
5.2 Transfer of only goods and services - Held for business - is covered	90
5.3 A cross-border inter-unit transaction is covered	91
5.4 Allocation of Head Office Expenses	92
5.4.1 Head Office is not 'Any other Business'	93
5.4.2 Head Office expenses are incurred for the common benefit of all Units	93
5.4.3 Relevant Cases	94
5.4.4 Domestic Transfer Pricing provisions do not apply to allocation of common Head Office expenses	95
5.4.5 Specific Services provided by Head Office	95
5.4.6 Conclusion	96
5.5 An Eligible Unit receives benefit of brand-building undertaken by the Head Office	97
5.5.1 The Brand Name and Trademark are owned by the Taxpayer, not by the Eligible Unit	97

	PAGE
5.5.2	There is no transfer of services by the Head Office to the Eligible Unit
	97
5.5.3	The Head Office is not a business enterprise of the Taxpayer
	98
5.5.4	Allocation of AMP Expenses incurred by the Head Office to the Eligible Unit is beyond the scope of Domestic Transfer Pricing
	98
5.6	Income of ineligible Unit cannot be enhanced
	99
5.7	Whether transfer of goods and service by ineligible Unit without consideration is covered?
	99
5.8	When computation of profits of eligible business on basis of ALP presents exceptional difficulties, the Assessing Officer may compute such profits on any reasonable basis
	101
5.9	Inter-Unit Transfers of Capital Assets
	101
5.9.1	What about inter-unit lease of Capital Assets?
	102
5.9.2	Is inter-unit lease of capital assets a transfer of services?
	102
5.10	Inter-Unit Transfers of Intangible Assets
	102
5.10.1	What about inter-unit licensing of Intangible Assets?
	103
5.11	Whether Domestic TP Regulations apply to Inter-Unit Transfers when the Eligible Unit incurs Loss?
	103
5.11.1	When provisions of Sec. 80-IA(5) apply
	104
5.11.2	When provisions of Sec. 80-IA(5) do not apply
	105
5.11.3	Conclusion
	106
5.12	Transfer of Goods and Services between two eligible Units is also covered
	107

6

DOMESTIC TRANSFER PRICING AND SEC. 80-IA(10) - ISSUES

6.1	Close connection - Between the assessee and other person - Is not defined
	109
6.1.1	General
	109
6.1.2	Meaning of the term "Close Connection"
	111
6.2	The words "for any other reason" in Sec. 80-IA(10) apparently rope in transactions with unconnected or unrelated persons
	112
6.2.1	General
	112

	PAGE
6.2.2	There is no justification in applying TP Regulations to transactions between unrelated persons 113
6.2.3	Implication of the term “for any other reason” 113
6.2.4	Support from CBDT Circular 114
6.2.5	Conclusion 115
6.3	There has to be an Arrangement between the Assessee and Other Person 115
6.3.1	Ruling in case of <i>CIT vs. Schmitz India (P) Ltd.</i> [2012] 79 DTR 356 (Bombay HC) 115
6.3.2	Other Cases 116
6.3.3	For compliance, how should the Assessee determine whether there is an arrangement with any other person and whether there is a SDT Type III? 116
6.4	Stray and isolated transactions are not covered 118
6.4.1	There must be a regular business carried on by the Assessee with the Other Person 119
6.4.2	Stray and isolated transactions may be included for compliance purposes 120
6.5	Income of Other Person cannot be enhanced 120
6.6	Cross-Border Transactions are covered 121
6.7	Two SDTs in one transaction; one in case of Assessee and the other in case of Related Party - Sec. 40A(2)(b) applies to the other person and Sec. 80-IA(10) applies to the Assessee 122
6.8	Two SDTs in one transaction; both in case of the same Assessee - When Sec. 40A(2)(b) and Sec. 80-IA(10) apply simultaneously 123
6.8.1	General 123
6.8.2	Actual payment to Sec. 40A(2)(b) person is more than ALP 123
6.8.3	Actual payment to Sec. 40A(2)(b) person is less than ALP 125
6.8.4	Closing 126
6.9	Transfers of Capital Assets 126
6.10	Creation of Marketing Intangibles in the Context of Type III SDT 127
6.11	Whether Domestic TP Regulations apply to business transacted by an eligible assessee when such assessee incurs Loss in the eligible business? 128
6.11.1	When provisions of Sec. 80-IA apply 128

	PAGE
6.11.2 When provisions of Sec. 80-IA(5) do not apply	129
6.11.3 Conclusion	131
6.12 Transactions between two eligible Assesseees are also covered	131
6.12.1 Can there be a different view in the context of Type III SDT?	132

7

RELEVANT TRANSFER PRICING PROVISIONS

7.1	Sec. 92. Computation of income having regard to arm's length price	134
7.2	Sec. 92(2) Cost Sharing Arrangements and Cost Contribution Arrangements	135
7.2.1	Having Regard To	135
7.2.2	The CSA or CCA between AEs should be a Specified Domestic Transaction	136
7.2.3	What is a CSA or CCA?	138
7.3	The Arm's Length Principle	140
7.3.1	Article 9 of the DTAA's	142
7.3.2	Difficulties in applying the Arm's Length Principle	143
7.3.3	Advantages of Arm's Length Principle (ALP)	143
7.4	Sec. 92(2A)	144
7.4.1	Scope	144
7.4.2	Computation Provision	144
7.4.3	Any allowance for an expenditure or...	144
7.4.4	Expense, interest, cost allocation and income "in relation to" SDT	145
7.4.5	Allocation of any cost or expense	145
7.4.6	Corresponding Compensating Adjustments	146
7.5	Sec. 92(3) - Sec. 92 shall not apply where the application of Arm's Length Principle reduces income or increases loss	147
7.6	Sec. 92A. Associated Enterprises	148
7.6.1	Meaning of "Associated Enterprises" and "Deemed Associated Enterprises"	148
7.6.2	The various criteria laid down in clauses (a) to (m) of Sec. 92A(2) are explained below	149

	PAGE
7.7 Sec. 92B. International Transaction	156
7.7.1 Deemed International Transaction	157
7.8 Sec. 92C Computation of Arm's Length Price	159
7.8.1 Sec. 92C(1) Transfer Pricing Methods for determining ALP	161
7.9 Sec. 92C(2) - Most Appropriate Method	165
7.9.1 First Proviso to Sec. 92C(2) - Where more than one price is determined by MAM	165
7.9.2 Second Proviso to Sec. 92C(2) - Permissible variance from ALP	166
7.9.3 Third Proviso to Sec. 92C(2) - Inserted w.e.f. 1st April, 2015	167
7.10 Sec. 92C(3) - Circumstances in which the AO can compute ALP	168
7.11 Sec. 92C(4) - Completion of assessment based on the ALP computed by the AO and effect of such assessment	170
7.11.1 First Proviso to Sec. 92C(4)	170
7.11.2 Second Proviso to Sec. 92C(4)	172
7.12 Sec. 92CB Safe Harbour Rules	173

8

TRANSFER PRICING METHODS - GENERAL

8.1 Background	174
8.1.1 Definition of Arm's Length Price [Sec. 92F(ii)]	174
8.1.2 Comparability Analysis	175
8.1.3 Different types of Transfer Pricing Methods are needed	176
8.2 Prescribed Transfer Pricing Methods	177
8.3 Brief Introduction of the Six Transfer Pricing Methods	178

9

COMPARABLE UNCONTROLLED PRICE

9.1 Introduction	181
9.2 Steps in applying CUP	181

	PAGE
9.3 Comparability criteria in applying CUP	182
9.3.1 The case of <i>UCB India (P.) Ltd. v. ACIT</i> [2009] 121 ITD 131/30 SOT 95/124 TTJ 289 (ITAT Mumbai)	183
9.4 Types of Transactions which can be analysed using CUP	184
9.5 CUP method is preferable to other methods	184
9.6 Internal CUP	185
9.6.1 Internal CUP 1	186
9.6.2 Internal CUP 2	187
9.6.3 Internal CUP 3	188
9.6.4 Internal CUP 4	189
9.7 Points to keep note of while applying External as well as Internal CUP	190
9.7.1 Industry Average Rates cannot be taken as External CUP	190
9.7.2 Other Points	190
9.8 Use of CUP to benchmark Royalty	193
9.9 Adjustments under CUP Method	194

10

RESALE PRICE METHOD

10.1 Introduction	195
10.2 Steps in applying RPM - as laid down in Rule 10B(1)(b) and as described in the ICAI Guidance Note on Report under Sec. 92E	197
10.2.1 Example	197
10.3 The Case of <i>Mattel Toys (I) (P.) Ltd. v. DCIT</i> [2013] 144 ITD 76/158 TTJ 461 (ITAT Mumbai)	198
10.4 Internal RPM	200
10.5 Following points may also be noted while applying RPM	201

11

COST PLUS METHOD

11.1 Introduction	203
11.2 CPM is a Traditional Transactional Method	204
11.3 Difficulty in applying CPM	205

	PAGE
11.4 Steps in applying CPM - As laid down in Rule 10B(1)(c) and described in ICAI Guidance Note on Report under Sec. 92E	205
11.4.1 Example 1	206
11.4.2 Example 2	208
11.5 Internal CPM	209
11.5.1 Example	210
11.5.2 Cases on Internal CPM	210
11.6 Points to keep note of while applying CPM	212

12

PROFIT SPLIT METHOD (PSM)

12.1 Introduction	214
12.2 Examples of Highly Integrated, or Highly Interrelated, Transactions	215
12.2.1 Example 1	215
12.2.2 Example 2 (As given in ICAI Guidance Note on Report under Sec. 92E)	217
12.2.3 Example 3	217
12.3 Examples of Transaction where both parties (AEs or Related Parties) contribute valuable intangibles	218
12.3.1 Example 1	218
12.3.2 Example 2	219
12.4 There are two approaches to PSM : Total Profits Split and Residual Profit Split	220
12.5 Total Profit Split	220
12.5.1 An Example of Total Profit Split Method	222
12.6 Residual Profit Split Method	224
12.6.1 An Example of Residual Profit Split Method	226
12.7 When external comparables of profit split percentage cannot be found	229
12.7.1 Total Profit Split (in absence of Comparable Uncontrolled Transactions)	229
12.7.2 Residual Profit Split (in absence of Comparable Uncontrolled Transactions - use of Allocation - Keys)	232
12.8 Points to keep in mind while applying PSM	236

13**TRANSACTIONAL NET MARGIN
METHOD (TNMM)**

13.1	Introduction	238
13.2	Tested Party	238
13.2.1	How to choose the Tested Party when Sec. 40A(2)(b) Related Party (or Sec. 80-IA(8) Other Business or Sec. 80-IA(10) Other Person) is a foreign or a non-resident enterprise?	239
13.3	Operating Profit	241
13.4	Profit Level Indicators (PLIs)	241
13.4.1	Operating Profit/Sales	242
13.4.2	Operating Profit/Operating Cost	242
13.4.3	Operating Profit/Operating Assets (Return on Assets)	242
13.4.4	Operating Profit/Capital Employed (Return on Capital employed - RoCE)	242
13.4.5	Berry Ratio	243
13.5	Comparability between the Tested Party and the Uncontrolled Comparable Enterprises, and between the Controlled Transaction and the Uncontrolled Comparable Transactions	243
13.6	Controlled Transactions which can be analysed using TNMM	244
13.7	Examples showing application of TNMM	244
13.7.1	Example 1	244
13.7.2	Example 2	246
13.8	Steps in applying TNMM - As prescribed in Rule 10B(1)(e) and ICAI Guidance Note on Report under Sec. 92E	248
13.9	Adjustments for Differences between the Tested Party and Comparable Uncontrolled Enterprises	249
13.10	TNMM to benchmark Royalty	250
13.11	Internal TNMM	251
13.11.1	Example	252
13.12	Important points to keep note of while applying TNMM	255
13.12.1	Aggregating the various Controlled Transactions (various SDTs or various International transactions) for combined analysis under TNMM	255

	PAGE
13.12.2 Only the Controlled Transactions (SDTs and International transactions) should be taken into account, while making comparison and while calculating the Arm's Length Price, under TNMM	260
13.12.3 Data of only the Relevant Year should be considered for comparison	262
13.12.4 Uncontrolled Comparable Enterprises should not have significant Related Party Transactions	263
13.12.5 Turnover Filter to accept or reject potential comparable enterprises	265
13.12.6 Super Profit Comparables	266
13.12.7 Loss making Comparables	268
13.12.8 If abnormal loss-making companies are excluded then abnormal profit-making companies should also be excluded	269

14

OTHER METHOD

14.1 Transactions that can be analyzed using the Other Method	272
--	-----

15

FUNCTIONS, ASSETS AND RISKS (FAR) ANALYSIS

15.1 What is Functions, Assets and Risks (FAR) Analysis?	274
15.1.1 Relevant Cases	276
15.2 Objectives of FAR Analysis	278
15.2.1 FAR Analysis provides a basis for characterization of the Controlled Transaction	278
15.2.2 FAR Analysis is important in evaluating comparability between the Controlled Transaction and the Uncontrolled Transactions	278
15.2.3 FAR Analysis seeks to identify and compare economically significant activities	279
15.3 Economics of FAR Analysis	280
15.3.1 Example 1	281
15.3.2 Example 2	282
15.3.3 Example 3	283
15.4 Why is FAR Relevant?	283

	PAGE
15.4.1 FAR Analysis helps in understanding the Controlled Transaction	284
15.4.2 FAR Analysis helps in selecting the Most Appropriate Method	284
15.4.3 FAR Analysis helps in selecting Uncontrolled Comparables	285
15.4.4 The case of <i>Bechtel India (P.) Ltd. v. DCIT</i> [2011] 12 taxmann.com 299/46 SOT 427 (ITAT Delhi)	285
15.4.5 Other Cases	285
15.5 Functions, Assets and Risks - A close look	287
15.5.1 Functions	287
15.5.2 Assets	288
15.5.3 Risks Assumed	289
15.6 How to carry out FAR Analysis?	290
15.6.1 Gather the relevant information	290
15.6.2 Findings from the information gathered	292
15.6.3 Identify economically significant activities	292
15.6.4 Information about Assets	292
15.6.5 Identify Risks assumed	293
15.7 Case Studies on FAR Analysis	293
15.7.1 Case 1. Pharma India Group	293
15.7.2 Case 2. Diamond India Group	300
ANNEXURE I : FUNCTIONAL ANALYSIS CHECKLIST	309

16

MOST APPROPRIATE TRANSFER PRICING METHOD

16.1 Sec. 92C. Computation of Arm's Length Price	316
16.2 Most Appropriate Method (MAM)	317
16.3 Factors to take into account in selecting the Most Appropriate Method	318
16.4 ITAT Decisions on Most Appropriate Method	318
16.4.1 Two important cases on selection of Most Appropriate Method	318
16.4.2 Other ITAT Decisions	323
16.5 Factors to take into account in selecting the Most Appropriate Method	324

	PAGE
16.5.1 Factor 1. The nature and class of the Specified Domestic Transaction or International Transaction	324
16.5.2 Factor 2. The class or classes of Related Parties entering into the transaction and the functions performed by them, taking into account assets employed and risks assumed by such enterprises	333
16.5.3 Factor 3. The availability, coverage and reliability of data necessary for application of the method	338
16.5.4 Factor 4. The degree of comparability existing between the Specified Domestic Transaction (or International Transaction) and the Uncontrolled Comparable Transaction, and between the Enterprises entering into such transactions	340
16.5.5 Factor 5. The extent to which reliable and accurate adjustments can be made to account for differences, if any, between the Specified Domestic Transaction and the Comparable Uncontrolled Transaction, or between the enterprises entering into such transactions	342
16.5.6 Factor 6. The nature, extent and reliability of assumptions required to be made in application of a method	344
16.6 When more than one price is determined by the Most Appropriate Method	345

17

CASE STUDIES ON MOST APPROPRIATE METHOD FOR SPECIFIED DOMESTIC TRANSACTIONS OF PAYMENTS TO SEC. 40A(2)(b) PERSONS

17.1 Selection of Most Appropriate Method for various Types of SDTs	347
17.2 Tested Party for various Type I SDTs	348
17.2.1 Example	349
17.2.2 Controlled Enterprise (Taxpayer or the Related Party; Eligible Business or the Other Business; the Taxpayer or the Other Person) with simpler functional profile is taken as the Tested Party	350
17.2.3 A word of Caution about taking Sec. 40A(2)(b) Payee as Tested Party for analysis of Type I SDTs	351
17.3 For the purpose of determination of Arm's Length Price the Assessee and the Related Parties are Associated Enterprises	352

	PAGE
17.4 Meaning of Reliable Data	352
17.5 Case Studies on selection of Most Appropriate Method for various Type I SDTs	353
17.5.1 Selection of Most Appropriate Method for Type I SDTs	355
17.6 Further Steps in determining Arm's Length Price after the Most Appropriate Method is selected	406

18

CASE STUDIES ON MOST APPROPRIATE METHOD FOR SPECIFIED DOMESTIC TRANSACTIONS OF INTER-UNIT TRANSFERS OF GOODS AND SERVICES

18.1 Selection of Most Appropriate Method for various Types of SDTs	409
18.2 Type II Specified Domestic Transactions	409
18.2.1 Type II SDTs can take place in cases of the following businesses/taxpayers/assesseees	410
18.3 For the purpose of determination of Arm's Length Price various business units belonging to a taxpayer are Associated Enterprises	411
18.4 Meaning of Reliable Data	411
18.5 Case Studies on Selection of Most Appropriate Method for various Type II SDTs	412
18.5.1 Selection of Most Appropriate Method for Type II SDTs	413
18.6 Further Steps in determining Arm's Length Price after the Most Appropriate Method is selected	493

19

CASE STUDIES ON MOST APPROPRIATE METHOD FOR SPECIFIED DOMESTIC TRANSACTIONS OF THE KIND DESCRIBED IN SEC. 80-IA(10)

19.1 Selection of Most Appropriate Method for various Types of SDTs	496
19.2 Type III SDTs	496
19.2.1 Type III SDTs can take place in cases of the following businesses/taxpayers/assesseees	497

	PAGE
19.3 The Other Person - A person closely connected to the assessee, or any other person	498
19.4 Business Arrangement	498
19.5 For the purpose of determination of Arm's Length Price the Eligible Assessee and the Other Person are Associated Enterprises	499
19.6 Meaning of Reliable Data	499
19.7 Case Studies on Selection of Most Appropriate Method for various Type III SDTs	500
19.7.1 Selection of Most Appropriate Method for Type III SDTs	501
19.8 Further Steps in determining Arm's Length Price after the Most Appropriate Method is selected	584

20

COMPARABILITY ANALYSIS

20.1 Background	587
20.2 What is Comparability Analysis?	588
20.2.1 Three Distinct Steps	589
20.3 Why is Comparability Analysis required?	590
20.3.1 Relevant Regulatory Provisions	591
20.4 Comparability Factors	592
20.4.1 Rule 10B. Determination of arm's length price under Sec. 92C	592
20.4.2 Significance of Rule 10B(2) and (3)	593
20.4.3 The Four Comparability Factors	594
20.5 How to carry out Comparability Analysis?	602
20.5.1 Performing a comparability analysis	602
20.5.2 Typical process	603
20.5.3 The Nine Step Process	603
20.5.4 Implications of various Steps	605
ANNEXURE I : COMPARABILITY ANALYSIS	632
APPENDIX : DATABASES AND THEIR LIMITATIONS	646

21

COMPARABILITY ADJUSTMENTS

21.1 General	648
21.2 Adjustments under various Transfer Pricing Methods	649

	PAGE
21.3 Adjustments under CUP Method	650
21.4 Adjustments under RPM	652
21.5 Adjustments under CPM	653
21.6 Adjustments under TNMM	653
21.6.1 Working Capital Adjustment	654
21.6.2 Risk Adjustment	657
21.6.3 Capacity Under-utilization Adjustment	661
21.6.4 Depreciation Adjustment	668
21.6.5 Extraordinary Expense Adjustment	670

22

DOCUMENTATION UNDER TRANSFER PRICING REGULATIONS

22.1 Sec. 92D(1) - Every person who has entered into an international transaction or a SDT must keep and maintain the prescribed information and documents	673
22.2 Definition of Associated Enterprise under the I.T. Rules, 1962	673
22.3 Rule 10D(1) - Information and documents to be kept and maintained under section 92D	675
22.4 Rule 10D(3) - Information and documents to be kept and maintained under section 92D	678
22.5 Is the assessee required to keep and maintain all of the abovementioned prescribed information and documents?	679
22.5.1 In <i>ACIT vs. Global One India (P.) Ltd.</i> [2012] 19 taxmann.com 249/[2012] 53 SOT 106 (ITAT Delhi) (URO)	679
22.5.2 Similar decision was rendered in the case of <i>Cargill India (P.) Ltd. vs. DCIT</i> [2008] 110 ITD 616/[2008] 116 TTJ 1 (ITAT Delhi)	679
22.6 What is meant by 'keep and maintain'?	681
22.7 Document includes electronic records	681
22.8 Monetary threshold for keeping and maintaining the prescribed information and documents	681
22.9 Contemporaneous documentation	683
22.9.1 Proviso to Rule 10D(4)	683

	PAGE
22.9.2 The case of <i>Airtech (P.) Ltd. vs. DCIT</i> [2011] 10 taxmann.com 51/[2011] 45 SOT 100/[2011] 139 TTJ 318 (ITAT Delhi)	683
22.10 Data available, after the specified date, can be used	685
22.10.1 Relevant ITAT decisions	685
22.10.2 But can the assessee rely on additional data which comes into his knowledge only after the specified date?	686
22.11 Preservation of the prescribed information and documents	687
22.12 Power of AO and CIT (Appeals) to call for information and documents	687
22.12.1 The term Assessing Officer includes Transfer Pricing Officer	688
22.12.2 Information must be called for in the course of any proceeding	688
22.12.3 Notice under Sec. 92D(3) must require specific information	688
22.13 Closing	692

23

TRANSFER PRICING STUDY REPORT

23.1 Introduction	693
23.2 Regulatory Mandate	694
23.2.1 Sec. 92D(1)	694
23.2.2 Rule 10D(1)	694
23.2.3 Rule 10D(3)	695
23.3 Rule 10D (1) - Information and documents to be kept and maintained under section 92D	695
23.4 Broad Contents of a Transfer Pricing Study Report	697
23.4.1 Enterprise Related Documents - Clauses (a) to (c) of Rule 10D(1)	697
23.4.2 Transaction Specific Documents - Clauses (d) to (f) of Rule 10D(1)	697
23.4.3 ALP Computation Related Documents - Clauses (g) to (m) of Rule 10D(1)	698
23.5 Parts of a Transfer Pricing Study Report	698
23.6 Preparation of a Transfer Pricing Study Report	699
23.7 Specimen of Transfer Pricing Study Report	712

	PAGE
23.8 Other Points to keep note of in the context of Transfer Pricing Study Report	712
23.8.1 Monetary threshold for keeping and maintaining the prescribed information and documents	712
23.8.2 Due Date for preparing the Transfer Pricing Documentation	712
23.8.3 Data of comparables that becomes available after the due date can be used	712
23.8.4 Comparables included in the Transfer Pricing Study Report can be later excluded	713
23.8.5 Consequences of failure to keep and maintain Transfer Pricing Documentation or Study Report	713
23.9 Closing	714
ANNEXURE I : SPECIMEN OF A TYPICAL TRANSFER PRICING STUDY REPORT	715
ANNEXURE II : DATABASES AND THEIR LIMITATIONS	758

24

ACCOUNTANT'S REPORT IN FORM 3CEB

24.1 Relevant Regulatory Provisions	760
24.2 General	760
24.3 Specified Date	761
24.4 Monetary Limit	761
24.5 Failure to file Form 3CEB would entitle the AO to reopen the assessment	761
24.6 Scope of Accountant's Report in Form 3CEB	762
24.7 Broad Contents of Form 3CEB	762
24.8 Guidance Note of the Institute of Chartered Accountants of India	763
24.9 Salient features of the guidance provided by the ICAI in Chapter 9 of Guidance Note are summarised below	763
24.9.1 Scope of Examination under section 92E	763
24.9.2 Report in Form No. 3CEB	764
24.9.3 Duties and obligations of the Accountant	764
24.9.4 Particulars to be given in the Annexure to Form 3CEB	765
24.9.5 Role and Responsibility of the Taxpayer	766

	PAGE
24.10 Scope of examination under section 92E (Chapter 9 of the ICAI guidance note on report under sec. 92E)	768
24.11 Questionnaire, Management Representation Letter, Check List, and Specimen of Filled up Form 3CEB	781
ANNEXURE I : SPECIMEN OF THE QUESTIONNAIRE THE ACCOUNTANT MAY SEND TO THE CLIENT	782
ANNEXURE II : MANAGEMENT REPRESENTATION LETTER	785
ANNEXURE III : PRACTITIONERS' CHECKLIST	789
ANNEXURE IV : SPECIMEN OF TRANSFER PRICING AUDIT REPORT IN FORM 3CEB	796

25

TRANSFER PRICING ASSESSMENT

25.1 Introduction	814
25.2 Sec. 92CA(1) - Reference by the Assessing Officer to the Transfer Pricing Officer	815
25.3 Necessary or expedient	815
25.3.1 Summary of the above decisions	818
25.4 Instruction of the CBDT for reference to the TPO	819
25.4.1 Mandatory Nature of the Instruction	819
25.4.2 Instruction No. 3 does not apply to SDTs	820
25.4.3 New norms for scrutiny	821
25.5 Sec. 92C(3) versus Sec. 92CA(1)	821
25.6 Should the AO give opportunity of hearing to the assessee before reference to the TPO?	822
25.7 Approval of Commissioner before making reference to the TPO	823
25.8 Who is a Transfer Pricing Officer?	824
25.9 What is the role of Transfer Pricing Officer (TPO)?	824
25.9.1 Judgment in case of <i>CIT vs EKL Appliances Ltd.</i> [2012] 24 taxmann.com 199/209 Taxman 200/345 ITR 241 (Delhi HC)	824
25.9.2 Other cases on the role of TPO	827
25.10 Sec. 92CA(2) - Notice by the TPO	828
25.11 Sec. 92CA(2A) and (2B), Other International Transaction - not referred by the AO, nor reported in Form 3CEB - comes to the notice of TPO	830

	PAGE
25.12 Sec. 92CA(3) - Proceedings before the TPO	831
25.12.1 Opportunity of hearing to the assessee	831
25.12.2 What if the assessee does not avail of the opportunity granted?	832
25.12.3 The TPO has to determine ALP in accordance with Sec. 92C(3)	832
25.12.4 Onus is on Assessee	833
25.12.5 TPO cannot reject, without giving reasons, the method and comparables selected by the assessee	835
25.13 Sec. 92CA(3A) - Time limit for passing of order by the TPO	837
25.14 Sec. 92CA(4) - The AO has to compute total income in conformity with the ALP determined by the TPO	838
25.14.1 The Transfer Pricing Order passed by the TPO under Sec. 92CA(3) is binding on the AO	838
25.14.2 High Court Judgments	839
25.15 Reopening of Assessment under Sec. 147 read with Sec. 148	841
25.15.1 Failure to file Form 3CEB would entitle the AO to reopen the assessment	841
25.15.2 Reassessment making TP addition is invalid when there is no nexus between reasons recorded and income assessed	842
25.15.3 Reassessment merely on the reason that ALP is to be determined, is invalid	843
25.15.4 Reassessment on a mere difference of opinion is invalid	844
25.15.5 Reassessment on the basis of information which comes to Assessing Officer after completion of the original assessment and in course of the assessment proceedings for a subsequent assessment year is valid	845
25.16 Revision of Transfer Pricing related Assessment under Sec. 263	847

26

DISPUTE RESOLUTION AND APPEAL

26.1 Section 144C. Dispute Resolution Panel - An alternative to Appeal before CIT(A)	853
26.2 Dispute Resolution Panel (DRP)	853
26.3 DRP mechanism is available only to an Eligible Assessee	854

	PAGE
26.4 How do you go to DRP? The Procedure	855
26.5 Assessment completed without following DRP procedure is invalid	857
26.6 Filing of objections before DRP is optional	858
26.7 DRP cannot set aside any proposed variation or issue any direction for further enquiry	859
26.8 Power of DRP to confirm, reduce or enhance the variations	859
26.9 Directions by DRP	860
26.10 Time limit for the DRP to issue its directions	861
26.11 Withdrawal of objections filed before the DRP	862
26.11-1 The case of <i>AIA Engineering Ltd. v. DRP</i> [2011] 196 Taxman 477 (Guj.)	862
26.12 Completion of assessment by the AO in conformity with the directions of DRP	863
26.13 Filing of appeal against the Final Order passed by the AO	863

27

PENALTIES

27.1 <i>Explanation 7</i> to Section 271(1)(c)	866
27.1.1 Penalty for concealment or for furnishing of inaccurate particulars of income - <i>Explanation 7</i> to Sec. 271(1)(c)	867
27.1.2 Being a deeming fiction <i>Explanation 7</i> to Sec. 271(1)(c) cannot apply when the transfer price is computed in the prescribed manner in good faith and with due diligence	868
27.1.3 Mere transfer pricing adjustment or addition cannot automatically lead to penalty	869
27.1.4 In good faith and with due diligence	870
27.1.5 Change in the ALP determined under the TP Study Report	874
27.1.6 When the assessee accepts the transfer pricing adjustment	875
27.1.7 No penalty when the ALP adjustment does not survive in appeal	876
27.1.8 <i>Explanation 1</i> to Sec. 271(1)(c) v. <i>Explanation 7</i> to Sec. 271(1)(c)	876
27.2 Sec. 271AA - Penalty for failure to keep and maintain TP Documentation or TP Study Report	878

	PAGE
27.2.1 Scope	878
27.2.2 No penalty when there is no transfer pricing adjustment to the ALP	879
27.2.3 To levy penalty under Sec. 271AA specific failure should be pointed out	881
27.3 Sec. 271BA - Penalty for failure to furnish TP Audit Report	881
27.3.1 Scope	882
27.3.2 Reasonable cause for failure to file the transfer pricing audit report in time	882
27.3.3 Penalty leviable when explanation for default is not found to be correct	882
27.4 Sec. 271G - Penalty for failure to furnish information or document under section 92D	883
27.4.1 General	884
27.4.2 Sec. 271G cannot be invoked on basis of a vague Sec. 92D(3) notice	885
27.4.3 Specific failure should be pointed out to invoke Sec. 271G	885
27.4.4 Sec. 271AA vs. Sec. 271G	886
27.4.5 No penalty under Sec. 271G when there is no ALP adjustment	887
27.5 Penalty is not mandatory, penalty is not automatic	887
27.6 Sec. 273B - Penalty not to be imposed in certain cases	888
27.6.1 Scope	888
27.6.2 Initial onus lies on assessee to prove reasonable cause	889
27.6.3 Reasonable cause	890
27.7 Examples of reasonable cause for failure in the context of Secs. 271AA, 271BA and 271G	891
27.7.1 Penalty under Sec. 271AA	891
27.7.2 Penalty under Sec. 271BA	891
27.7.3 Penalty under Sec. 271G	892

28

CLOSING REMARKS

<i>Closing Remarks</i>	894
ANNEXURE : PERSONS SPECIFIED IN SEC. 40A(2)(b)	899
SUBJECT INDEX	911