

TRANSFER PRICING - GEARING UP TO THE ISSUES

February 7, 2020 | Chennai

Speaker:

- Hussain Sunel,

GLOBAL SURVEY – APPROACH

- Survey conducted with multinational companies operating in various industry sectors
- Involved interviews with CFOs and inputs from Tax/Finance Directors
- Wide geographic coverage of the survey spanning companies in Asia Pacific, Europe and Americas

“to provide a current picture of global tax landscape and how multinational companies interact with the legislation and tax authorities that operate within it”

NASSCOM - Annual report FY 2014-15
Ministry of Finance – Annual report FY 2014-15

GLOBAL SURVEY – RESPONSES

REPUTATION

- 77% of respondents agreed that tax planning if perceived to be “aggressive” can be detrimental to the reputation of an organization
- Companies which achieve a lower ETR even through legitimate tax planning have been perceived to be “up to no good”
- Reputation risk stands high in the tax management decisions of corporates
- High attention paid to Transfer Pricing to follow best practices and ensure substance in operations

“ Whilst 80% of respondents believe that reforms in international tax policies are desirable, 55% believe this is achievable”

GLOBAL SURVEY – RESPONSES

TRANSPARENCY IN DISCLOSURES

- Respondents were of the view that OECD's BEPS initiative will have a material operational impact
- 83% of the respondents view **measures for global tax transparency** as likely to increase cost of compliance
- 57% of respondents were in favour of BEPS proposal of reporting country by country profits

“ Whilst 80% of respondents believe that reforms in international tax policies are desirable, 55% believe this is achievable”

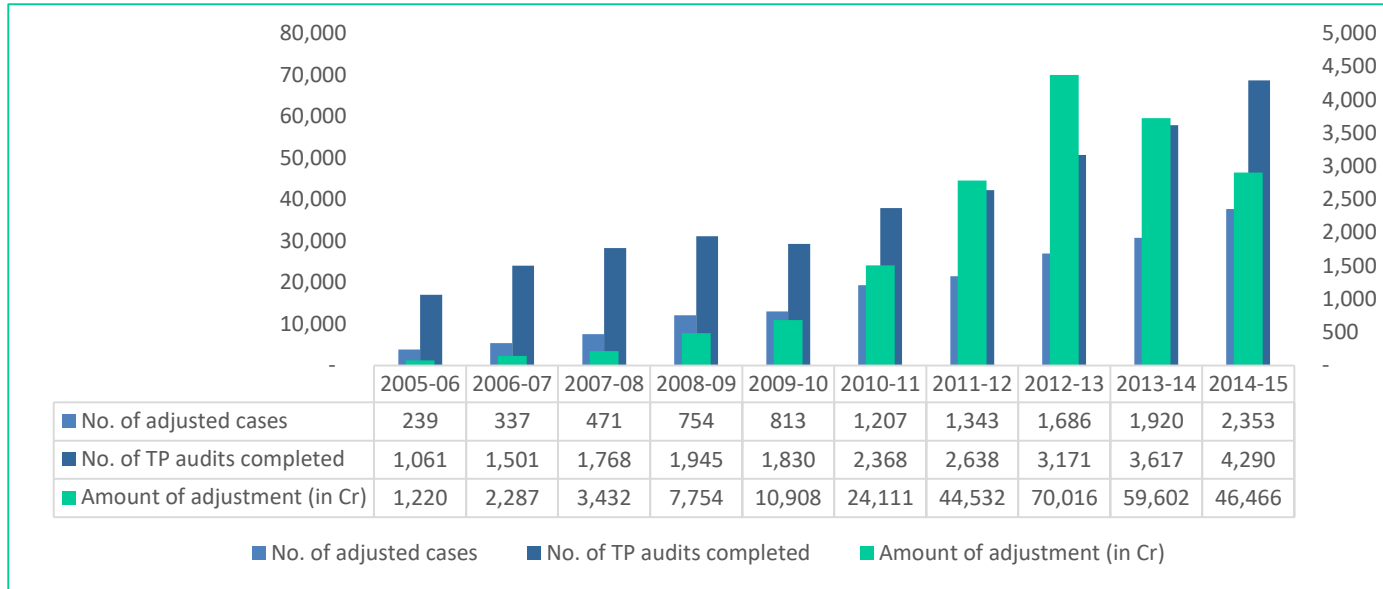
GLOBAL SURVEY – RESPONSES

PROFIT PLANNING AND REPATRIATION

- Respondents view transfer pricing as the most challenging area of tax by multinationals
- **Corporate inversions** have attracted particular interest in tax – however 68% of respondents believe that increased corporate inversions will result in increased competition between tax regimes
- 60% of respondents reported **an increase in the number of audits** undertaken by the tax authorities in the past year with over 70% stating that tax authorities were focusing heavily on substance of transactions and arrangements
- 40% of respondents stated that increased tax scrutiny had led to change in their corporate growth plan in certain countries

“ 26% of respondents cited repatriation as their strategy for any offshore cash currently held with 13% intending to keep this in their balance sheet”

TP Adjustment – Last 10 Years



In summary, over 24,000 cases were scrutinized by the TPOs with almost 45% of the cases scrutinized having faced adjustments. The total value of these adjustments is estimated to be about INR 2,700 billion.

“New thinking – New possibilities – Recent trends!”

- Reverse royalty – AMP expenditure – Bright line tests
- Interest on receivables from Associated Enterprises (“AEs”)
- Software services – R&D centre
- ITES services – deep dive analysis of whether a KPO or a BPO
- Location savings and Location Specific Advantages
- 92B – Extended meaning of International transaction

- Secondary adjustment effective FY 2016-17
- Impact on account of BEPS implementation in India – Action Plans 8-10, 13
- Limitation of interest deduction under section 94B
- TP regulations enhanced to include Specified Domestic Transactions
- Companies Act 2013 – extends the arm's length pricing requirement

ASPECTS TO WATCH OUT (2 of 2)

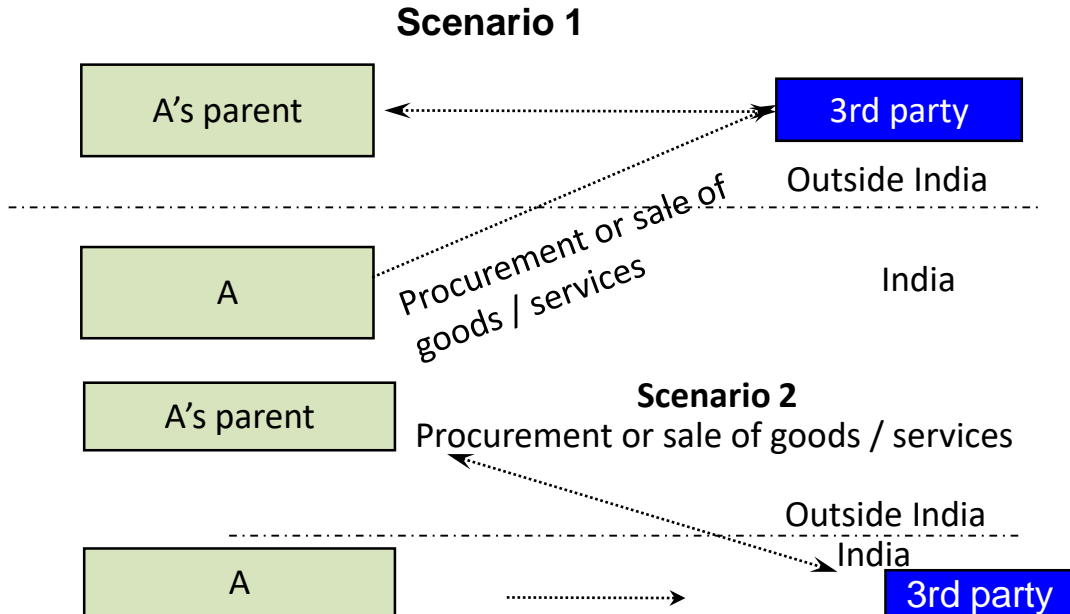
- GLOBAL ARRANGEMENTS – DEEMED INTERNATIONAL TRANSACTION RISK

- Transaction between the assessee and a third party enterprise shall be deemed to be an international transaction with an AE if:

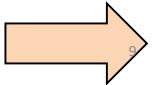
Prior agreement exists between A's parent and 3rd party; or

Prior agreement exists between A's parent and 3rd party; or

Terms of transaction are determined in substance by A's parent and 3rd party

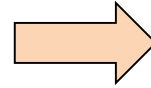
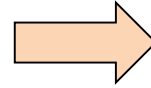


Deemed international transaction – scope extended to cover transaction with **resident unrelated entities**



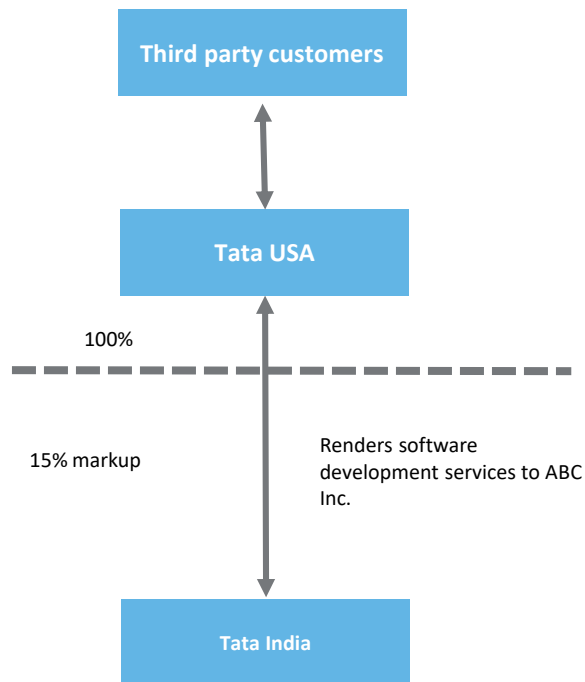
GOVERNMENT INITIATIVES

- Concept of range and use of multi-year data included under Rules;
- **Advance pricing agreements** introduced with effect from July 2012
 - Rollback for APAs
- **Safe Harbour Rules**



CASE STUDIES

Service Provider



Facts:

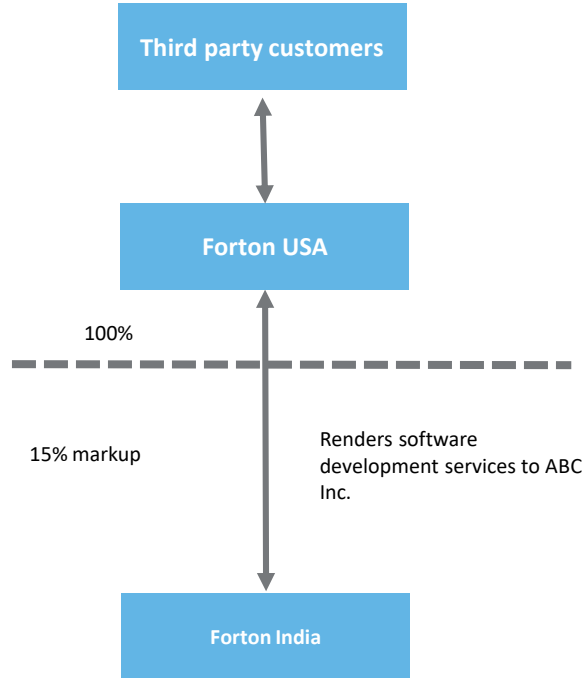
- Tata Inc is engaged in developing anti-virus software and developed a block buster product
- Tata Inc gets sale contract from third parties, and outsources a part of the contract to Forton India.
- Tata India is engaged as a captive software development service provider to Forton USA
- Tata India operates at a cost plus mark-up of 15%.

Issues:

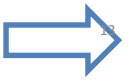
- Benchmarking methodology - how much mark-up is reasonable ?
- Tata Inc earns a profit of 200%, given the legal owner of the block buster product – the anti-virus software. The Indian Revenue Office has alleged that the Indian entity being a contributor to the Intangible should be entitled to the share in profit of the Group, and not just cost plus markup. Your views ?



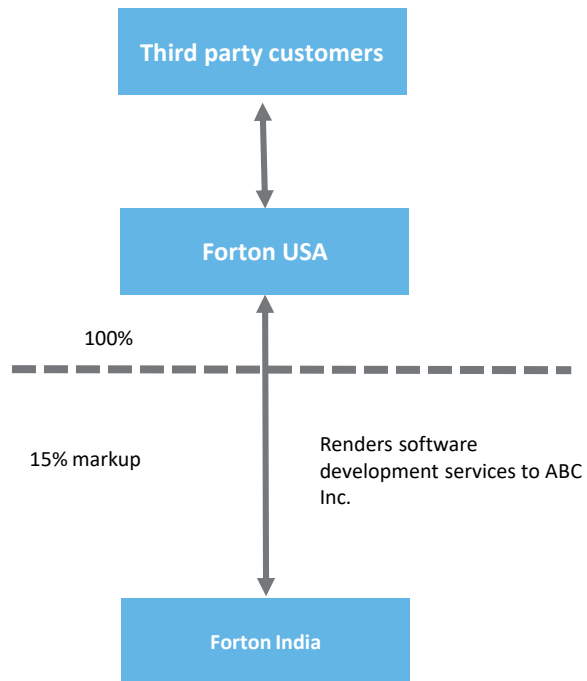
Service Provider



Revenue has also stated that the Group has saved significantly from outsourcing the work to India, and a part of the cost savings should be transferred to India, and the Company should pay tax on the same.



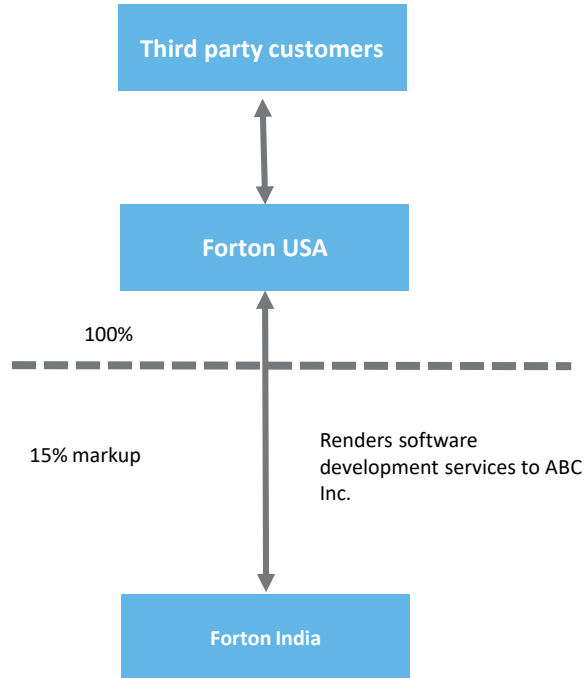
Service Provider



Other Issues:

- Forton India receives the remittance of its receivables in 90 days time, the TPO has alleged that the same is beyond a reasonable period of 30 days and therefore interest should be levied on the overdue receivables.
- Forton India received certain assets free of cost from its Group, the TPO has alleged that the cost pertaining to the said asset should be included in the cost base of the Forton India, and then the profit should be computed.

Service Provider – (1/1)

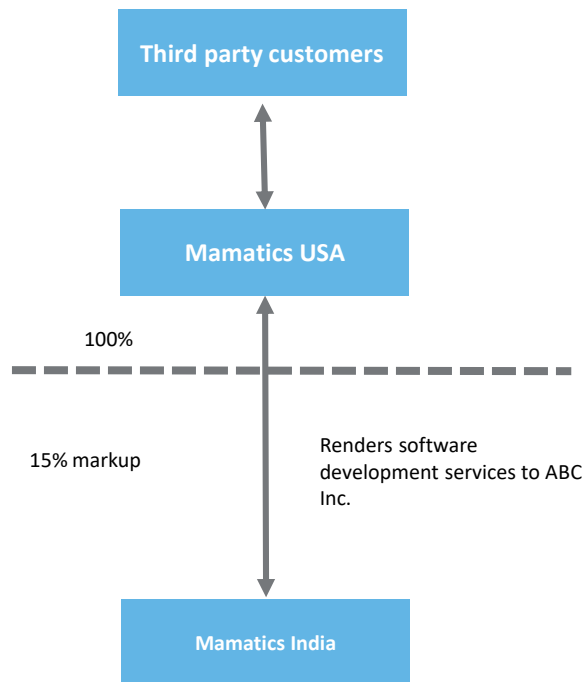


Facts:

In the immediate following years, Forton US is incurring huge loss, and wishes to revisit the transfer pricing policy for Forton India:

> Forton Group wishes to revise the TP policy of the Forton India in way that Forton India is compensated for utilized man hours only, instead of cost plus basis.

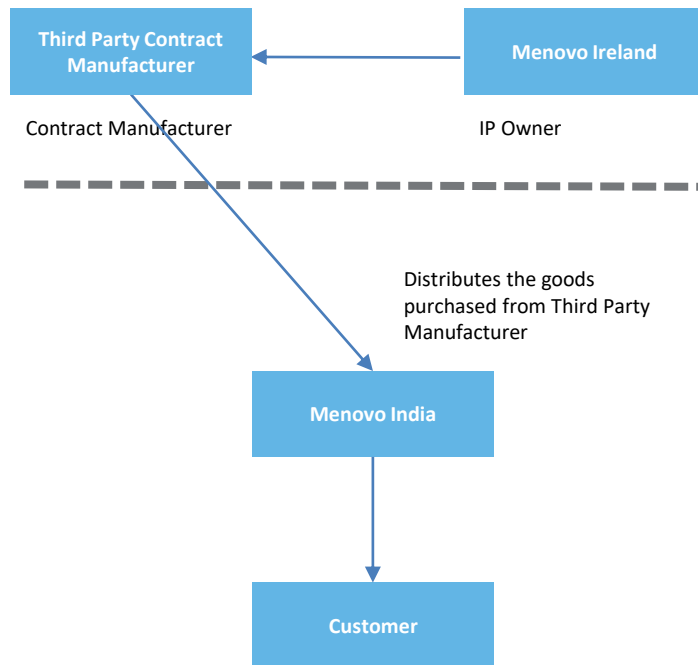
Service Provider – (1/1)



Facts:

- Mamatics Group is engaged in rendering analytics, human resource services to the Group;
- Mamatics Inc gets the contract from the customers, and outsources a part of the work to Mamatics India.
- Mamatics India is compensated at cost plus 17% by comparing itself with companies which are engaged in ITES services;
- During the TP proceedings, the TPO states that Analytics services are high end in nature and the comparison for application of TNMM purposes should be done only with high end service providers and proposes a margin of 30%.
- Whether you agree with the views of the TPO ?
- How would you substantiate whether the services rendered by the Company are high end or low end in nature ?

Distribution – (1/2)



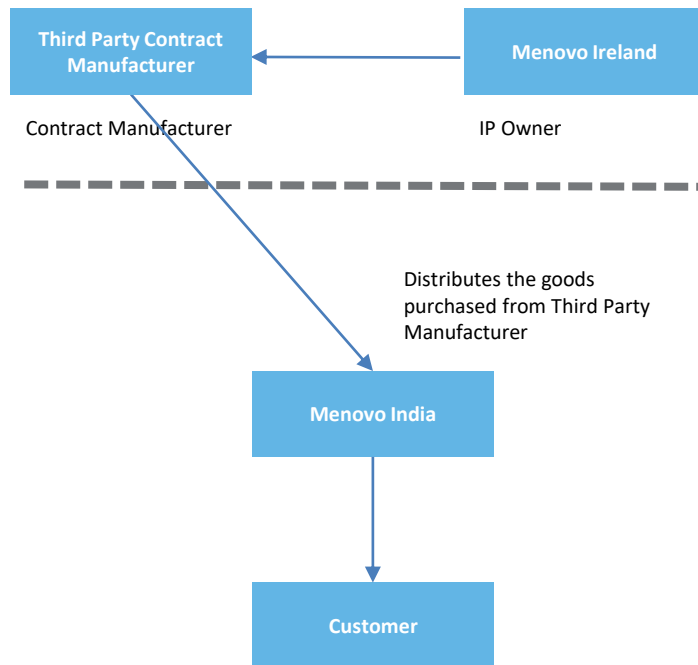
Facts:

- Menovo Ireland holds the IP for the development of the products (laptops and accessories);
- Menovo Ireland contracts a third party to manufacture its product using the know-how of Menovo Ireland;
- Menovo India, subsidiary of Menovo Ireland, purchases the products from the said third party contract manufacturer under the license and brand name of Menovo Ireland, for distribution of the products in India;
- Menovo India earns a GPM of 25% with a NPM of (1%).

Issues:

- Whether TP provisions will apply to Menovo India ?
- During TP assessment, the TPO states that the comparables companies engaged in similar business have earned a net profit margin of 5% and proposes an adjustment.

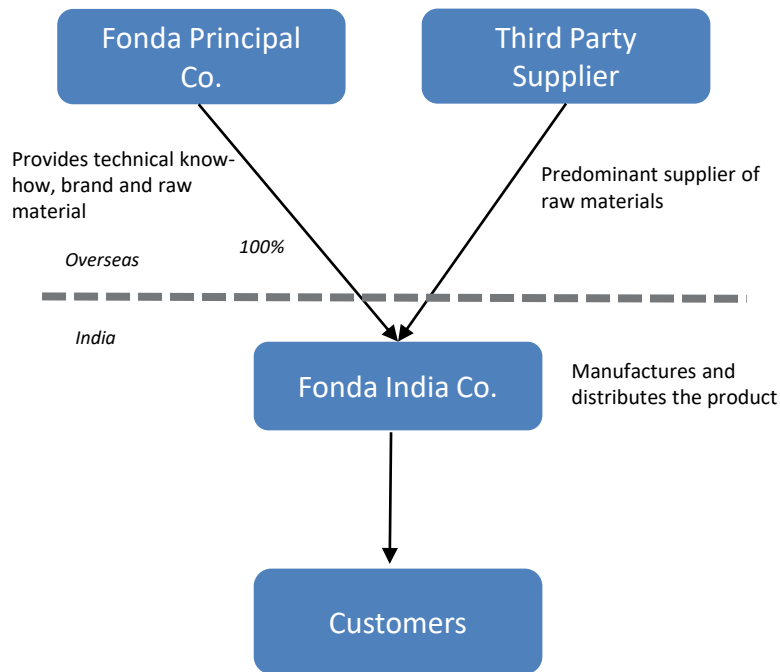
Distribution – (2/2)



Facts:

- The TPO also notes that the Indian Company (Menovo India) has incurred significant discounts, commission and advertisement expenses which promotes the products of the foreign Company. The TPO states that Menovo India should have received a compensation for the brand promotion service rendered by the Menovo India to Menovo Ireland.

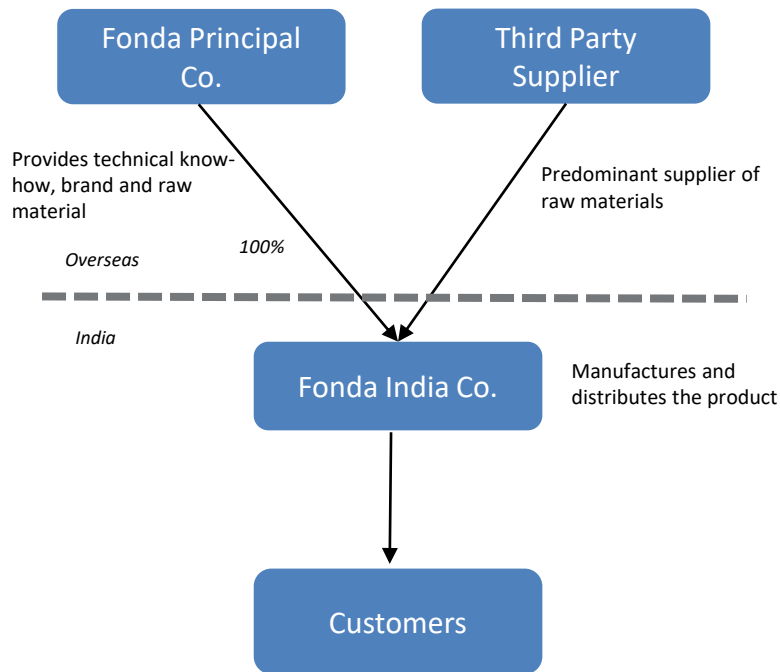
Manufacturing – (1/2)



Facts:

- Fonda India Co. is a subsidiary of Fonda Principal Co., Japan
- Fonda India Co. manufactures the products (bikes) using the know-how of Fonda Principal Co. and distributes the bikes under the brand name of the Principal; Fonda India Co. pays royalty for the use of technology/ know how and brand/ trademark of Fonda Principal Co.;
- Raw materials are mainly purchased from unrelated third parties and few from Fonda Principal Co.;
- Fonda India Co. also receives support from the central team of Fonda Principal Co. in day to day operations for which it pays management fee based on cost allocation.
- Fonda India Co. caters to customers in India and overseas.

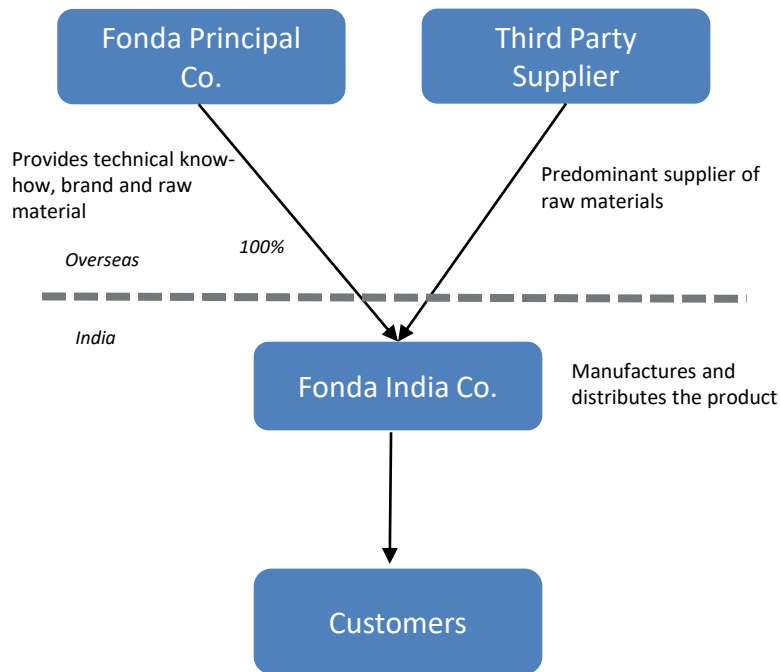
Manufacturing – (2/2)



Questions:

- In the year 2016, Fonda could not utilize its full capacity due to floods in Chennai, and due to the same it incurred a loss. Fonda India claimed capacity utilization adjustment. The TPO did not agree as the capacity utilization details of the comparable companies was not available. Given the same, the TPO disallowed the adjustment, and imputed transfer pricing adjustment.

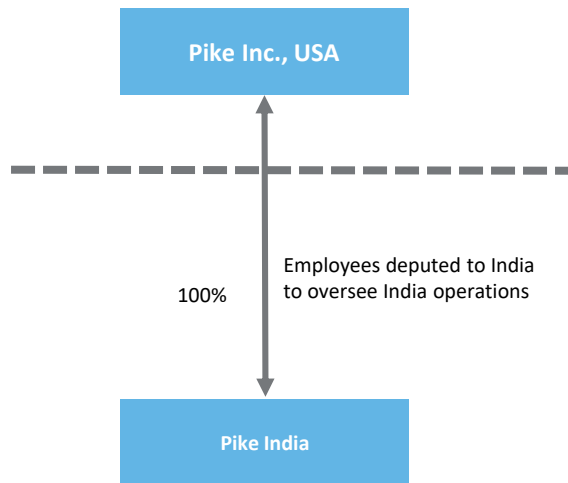
Manufacturing – (2/2)



Questions:

- The Revenue proposes to disallow the Royalty payment stating that the Company has incurred a loss, and therefore the technology does not benefit the Company at all.
- Based on the analysis of management services, the TPO requested the Company to furnish evidences for management services received and in the absence of the same, determines the ALP of management services at Nil.
- The TPO benchmarks the transactions with the Group under TNMM, and identifies the comparable margin to be 5%, and proposes an adjustment.
- For Fixed Asset purchase transaction, the TPO stated that in the absence of specific benchmarking undertaken for the same, the ALP of purchase of fixed asset is determined as Nil.

Employee Deputation

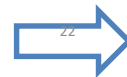


Facts:

- Pike India is engaged in the business of manufacturing of apparels for Pike Inc., USA.
- During the year, it had several employees from the Pike Inc. deputed to Pike India in order to oversee the operations of Pike India.
- The employees of Pike Inc. deputed to India constituted Pike Inc. PE in India.

Issues:

- How can the profit attribution be done in India?



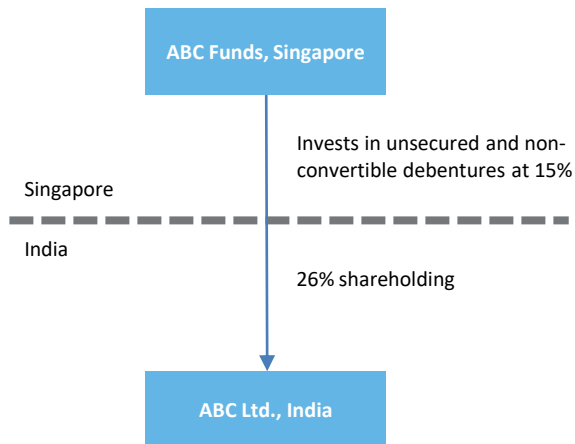
Financing Arrangements

Facts:

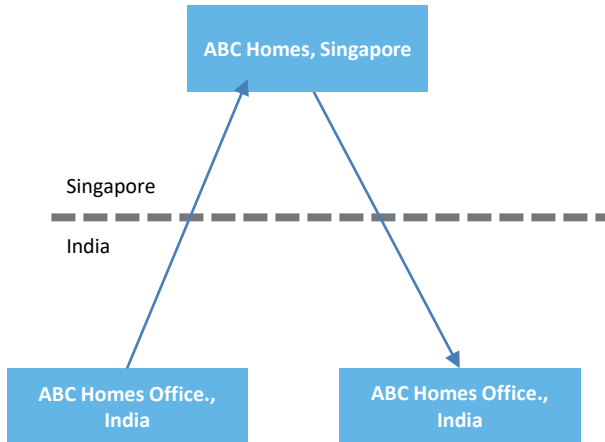
- ABC Funds, Singapore provided a loan to ABC India, which was unsecured in nature and was not supported by any guarantee.
- ABC Funds, Singapore based on the credit rating applicable to a fully unsecured loan, charged an interest rate of Libor plus 6% from ABC India, as the loan was unsecured.

Issues:

- Is the pricing OK from a benchmarking perspective?
- How can you benchmark loan transactions ?
- Any other considerations ?



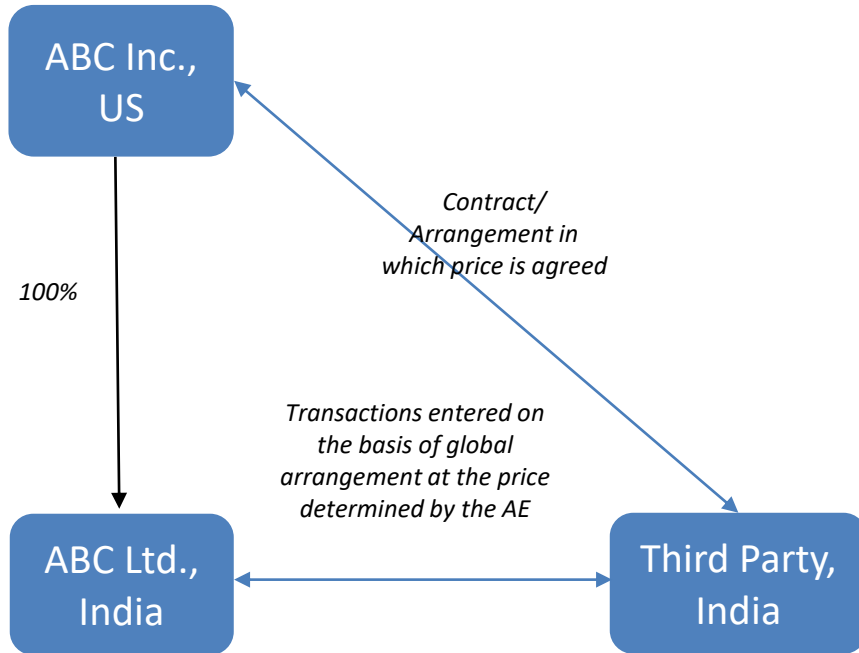
Digital economy



Facts:

- ABC Homes registered in Singapore operates an online site in India through which people can book hotels;
- The server of ABC homes is located in Singapore and any payment by an Indian customer is directly received by ABC Homes.
- ABC Homes Revenue during the FY 2018-19 was 300 Million USD and its profit was 150 Million USD
- ABC Homes has a small office in India which is response for merely coordination activities (activities involved includes KYC for hotels and customers, customer compliant management, hotel physical verification).
- ABC homes wishes to understand if the income earned by it will be taxable in India and what will be the amount ?

Deemed International Transaction – (1/2)



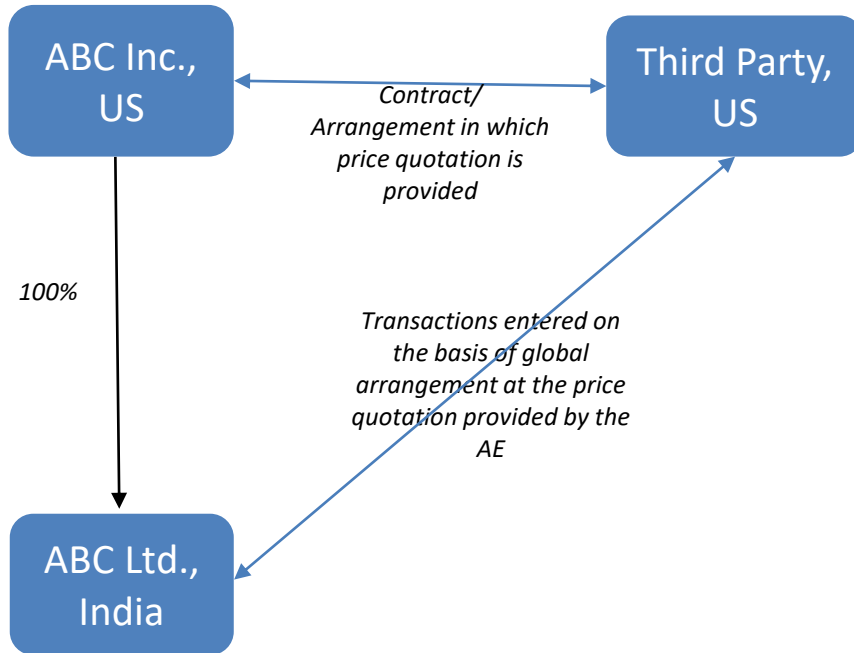
Facts:

- ABC Inc., USA enters into a global arrangement with a third party in India for procurement of laptops. Price and specifications of the product is pre-determined;
- ABC Ltd., India purchases the laptops from the said third party based on the specifications of its AE, ABC Inc.

Questions:

- Whether purchase of laptop by ABC Ltd., India from unrelated third party in India be considered as Deemed International Transaction?

Deemed International Transaction – (2/2)



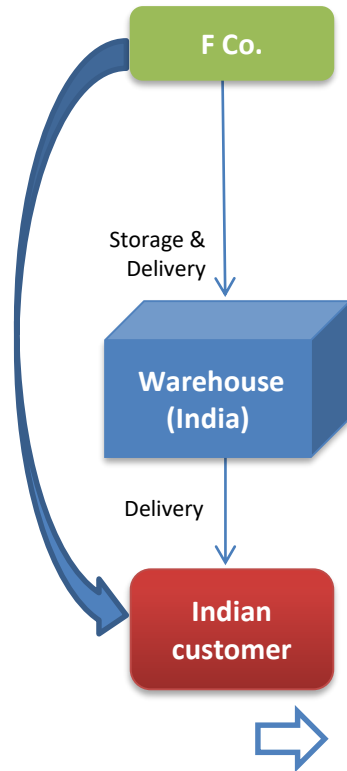
Facts:

- ABC Inc., USA enters into a global arrangement with a third party in India for the supply of garments. The price is not agreed but the global arrangement provides for the price range at which different entities would supply to the said unrelated third party;
- ABC India negotiates the other terms of sales and agrees to sell the goods at the price quotation provided by its AE;

Questions:

- Whether such transaction of sales by ABC Ltd., India to unrelated third party in US be considered as Deemed International Transaction?

PE Attribution



Facts:

- F Co. is engaged in the business of manufacture & sale of goods
- F Co. has a sales contract to supply goods to Indian customer
- F Co. operates a warehouse in India to maintain stock of goods & deliver to Indian customer.
 - 'Just-in-time' inventory management system
 - Title to goods remains with F Co. until delivery to customer.
 - Warehouse has to store goods in accordance with F Co. specifications
 - F Co. employees in India are responsible for inspection of goods/ repacking/ delivery

Questions:

- Whether the activities of Warehouse in India be considered as that of a preparatory or auxiliary character ?
- Whether Warehouse in India providing the storage and delivery services to F Co. be considered as a fixed place PE in India of F Co.?
- How much profits be attributed to the PE in India?