

TRANSFER PRICING

Meaning

Commercial transactions between the different parts of the multinational groups may not be subject to the same market forces shaping relations between the two independent firms. One party transfers to another goods or services, for a price. That price is known as transfer price. This may be arbitrary and dictated, with no relation to cost and added value, diverge from the market forces. Transfer price is, thus, a price which represents the value of goods; or services between independently operating units of an organisation. But, the expression transfer pricing generally refers to prices of transactions between associated enterprises, which may take place under conditions differing from those taking place between independent enterprises. It refers to the value attached to transfers of goods, services and technology between related entities. It also refers to the value attached to transfers between unrelated parties, which are controlled by a common entity.

Suppose a company A purchases goods for 100 rupees and sales it to its associated company B in another country for 200 rupees, who in turn sells in the open market for 400 rupees. Had A sold it direct, it would have made a profit of 300 rupees. But by routing it through B, it restricted it to 100 rupees, permitting B to appropriate the balance. The transaction between A and B is arranged and not governed by market forces. The profit of 200 rupees is, thereby, shifted to the country of B. The goods are transferred on a price (transfer price) which is arbitrary or dictated (200 hundred rupees), but not on the market price (400 rupees).

Thus, the effect of transfer pricing is that the parent company or a specific subsidiary tends to

produce insufficient taxable income or excessive loss on a transaction. For instance, profits accruing to the parent can be increased by setting high transfer prices siphon profits from subsidiaries domiciled in high tax countries, and low transfer prices to move profits to subsidiaries located in low tax jurisdiction. As an example of this, a group, which manufactures products in high tax countries, may decide to sell them at a low profits to its affiliate sales company based in a tax heaven country. That company would in turn sell the product at an arm's length price and the resulting (inflated) profit would be subject to little or no tax in that country. The result is revenue loss and also a drain on foreign exchange reserves.

Transfer pricing – Arm's length price

92F(ii) Arms length price means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions;

Enterprise

92F(iii) enterprises means a person (including a permanent establishment of such person) who is, or has been, or is proposed to be, engaged in any activity, relating to the production storage, supply, distribution, acquisition or control of articles or goods, or know-how, patents, copyright, trademarks, licenses, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights, or the provision of service of any kind, [or in carrying out any work in pursuance of a contract,] or in Investment, or

providing loan or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, whether such activity or business is carried on, directly or through one or more of its units or divisions or subsidiaries, or whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or places;

Permanent establishment

92F [(iia) permanent establishment, referred to in clause (iii), includes a fixed place of business through which the business of the enterprise is wholly or partly carried on;

Transaction

92F (v) transaction includes an arrangement, understanding or action in concert,

- (a) whether or not such arrangement, understanding or action is formal or in writing; or
- (b) Whether or not such arrangement, understanding or action is intended to be enforceable by legal proceeding.

Computation of arms length price.

92C. (1) The arms length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely :

- (a) comparable uncontrolled price method;
- (b) resale price method;
- (c) cost plus method;
- (d) profit split method;
- (e) transactional net margin method;
- (f) such other method as may be prescribed by the Board.

(2) The most appropriate method referred to in sub-section (1) shall be applied, for determination of arms length price, in the manner as may be prescribed :

Provided that where more than one price is determined by the most appropriate method, the arms length price shall be taken to be the arithmetical mean of such prices, or, at the option of the assessee, a price which may vary from the arithmetical mean by an amount not exceeding five per cent of such arithmetical mean.

(3) Where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that

- (a) the price charged or paid in an international transaction has not been determined in accordance with sub-sections (1) and (2); or
- (b) any information and document relating to an international transaction have not been kept and maintained by the assessee in accordance with the provisions contained in sub-section (1) of section 92D and the rules made in this behalf; or
- (c) the information or data used in computation of the arms length price is not reliable or correct; or
- (d) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of section 92D. the Assessing Officer may proceed to determine the arms length price in relation to

the said international transaction in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him:

Provided that an opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the arms length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer.

(4) Where an arm's length price is determined by the Assessing Officer under sub-section (3), the Assessing Officer may compute the total income of the assessee having regard to the arms length price so determined:

Provided that no deduction under section 10A [or section 10AA] or section 10B or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this sub-section:

Provided further that where the total income of an associated enterprise is computed under this sub-section on determination of the arms length price paid to another associated enterprise from which tax has been deducted [or was deductible] under the provisions of Chapter XVIIIB, the income of the other associated enterprise shall not be recomputed by reason of such determination of arms length price in the case of the first mentioned enterprise.

Meaning of international transaction.

92B. (1) For the purposes of this section and sections 92, 92C, 92D and 92E, international transaction means

a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

(2) A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be a transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise.

Meaning of associated enterprise.

92A. (1) For the purposes of this section and sections 92, 92B, 92C, 92D, 92E and 92F, associated enterprise, in relation to another enterprise, means an enterprise

- (a) Which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- (b) In respect of which one or more persons

who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise. (2) For the purposes of sub-section (1), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year,

- (a) one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise; or
- (b) any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises; or
- (c) a loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one per cent of the book value of the total assets of the other enterprise; or
- (d) one enterprise guarantees not less than ten per cent of the total borrowings of the other enterprise; or
- (e) more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or
- (f) more than half of the directors or members of the governing board, or one or more of the executive directors or members of the

governing board, of each of the two enterprises are appointed by the same person or persons; or

- (g) the manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licenses, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights; or
- (h) ninety per cent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise; or
- (i) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; or
- (j) where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; or
- (k) where one enterprise is controlled by

a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family or by a relative of a member of such Hindu undivided family or jointly by such member and his relative; or

(l) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than ten per cent interest in such firm, association of persons or body of individuals; or

(m) there exists between the two enterprises, any relationship of mutual interest, as may be prescribed.

Reference to Transfer Pricing Officer.

92CA. (1) Where any person, being the assessee, has entered into an international transaction in any previous year, and the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval of the Commissioner, refer the computation of the arms length price in relation to the said international transaction under section 92C to the Transfer Pricing Officer.

(2) Where a reference is made under sub-section (1), the Transfer Pricing Officer shall serve a notice on the assessee requiring him to produce or cause to be produced on a date to be specified therein, any evidence on which the assessee may rely in support of the computation made by him of the arms length price in relation to the international transaction referred to in sub-section (1).

(3) On the date specified in the notice under sub-section (2), or as soon thereafter as may be, after hearing such evidence as the assessee may produce, including any

Information or documents referred to in sub-section (3) of section 92D and after considering such evidence as the Transfer Pricing Officer may require on any specified points and after taking into account all relevant materials which he has gathered, the Transfer Pricing Officer shall, by order in writing, determine the arms length price in relation to the international transaction in accordance with sub-section (3) of section 92C and send a copy of his order to the Assessing Officer and to the assessee. (3A) Where a reference was made under subsection (1) before the 1st day of June, 2007 but the order under sub-section (3) has not been made by the Transfer Pricing Officer before the said date, or a reference under sub-section (1) is made on or after the 1st day of June, 2007, an order under sub-section (3) may be made at any time before sixty days prior to the date on which the period of limitation referred to in section 153, or as the case may be, in section 153B for making the order of assessment or reassessment or recompilation or fresh assessment, as the case may be, expires.

(4) On receipt of the order under sub-section (3), the Assessing Officer shall proceed to compute the total income of the assessee under sub-section (4) of section 92C in conformity with the arms length price as so determined by the Transfer Pricing Officer.

(5) With a view to rectifying any mistake apparent from the record, the Transfer Pricing Officer may amend any order passed by him under sub-section (3), and the provisions of section 154 shall, so far as may be, apply accordingly.

(6) Where any amendment is made by the Transfer Pricing Officer under sub-

section (5), he shall send a copy of his order to the Assessing Officer who shall thereafter proceed to amend the order of assessment in conformity with such order of the Transfer Pricing Officer. (7) The Transfer Pricing Officer may, for the purposes of determining the arms length price under this section, exercise all or any of the powers specified in clauses (a) to (d) of sub-section (1) of section 131 or sub-section (6) of section 133.

Explanation. For the purposes of this section, Transfer Pricing Officer means a Joint Commissioner or Deputy Commissioner or Assistant Commissioner authorized by the Board⁸⁵ to perform all or any of the functions of an Assessing Officer specified in sections 92C and 92D in respect of any person or class of persons.

Maintenance and keeping of information and document by persons entering into an international transaction.

92D. (1) Every person who has entered into an international transaction shall keep and maintain such information and document in respect thereof, as may be prescribed

(2) Without prejudice to the provisions contained in sub-section (1), the Board may prescribe the period for which the information and document shall be kept and maintained under that sub-section.

(3) The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceeding under this Act, require any person who has entered into an international transaction to furnish any information or document in respect thereof, as may be prescribed under sub-section (1), within a period of thirty

days from the date of receipt of a notice issued in this regard :

Provided that the Assessing Officer or the Commissioner (Appeals) may, on an application made by such person, extend the period of thirty days by a further period not exceeding thirty days.

Report from an accountant to be furnished by persons entering into international transaction.

92E. Every person who has entered into an international transaction during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date in the prescribed form duly signed and verified in the prescribed manner by such accountant and setting forth such particulars as may be prescribed

Penalty for failure to keep and maintain information and document in respect of international transaction.

271AA. Without prejudice to the provisions of section 271, if any person fails to keep and maintain any such information and document as required by sub-section (1) or sub-section (2) of section 92D, the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two per cent of the value of each international transaction entered into by such person.

Penalty for failure to furnish information or Document under section 92D

271G. If any person who has entered into an international transaction fails to furnish any such information or document as required by sub-section (3)

of section 92D, the Assessing Officer or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two per cent of the value of the international transaction for each such failure.] Penalty for failure to furnish report under section 92E.

271BA. If any person fails to furnish a

report from an accountant as required by section 92E, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of one hundred thousand rupees.

Time Limit for furnishing Form No. 3CEB

On or before 31st October of the relevant Assessment Year.