



Documentation Requirements in Transfer Pricing

**Workshop on Transfer Pricing -
Day 4
SIRC of ICAI | 9 OCTOBER 2014.**

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Background

- The Finance Act 2001 has introduced a new section 92 and inserted sections 92A to 92F and certain other provisions in the Income tax Act.
- The procedural rules under these are by Notification S.O 808 (E) dated 21 August, 2001.
- Rule 10D also prescribes that the Transfer pricing Documentation is to be supported by authentic documents.
- In case the value of the international transaction < INR 10 million,
 - The prescribed documentation as per 10D is not applicable [Rule 10D(2)]
 - However documentation and information to substantiate claim for the ALP required

Regulatory requirement



Documentation Requirements As per Rule 10D

The Procedural sections are supported by rule 10D which read as:

- A description of the ownership structure
- Details of shares
- Other ownership interest held therein by other enterprises;

- A profile of the multinational group
- A broad description of the business of the taxpayer
- The industry in which it operates and the business of the associated enterprises;

- The nature, terms and prices of international transaction entered
- With each associated enterprise with details

- Description of the functions performed, risks assumed and assets employed by both

Documentation Requirements As per Rule 10D

- Economic and market analyses, forecasts, budgets or any other financial estimates which may have a bearing on the international transaction.

- A record of
 - uncontrolled transactions with nature, terms and conditions with third parties which may be of relevant to the pricing;
 - A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;

- A description of the methods considered for determining the ALP,
- the method selected as the most appropriate method
- And how such method was applied in each case

Documentation Requirements As per Rule 10D

- A record of the actual working carried out for determining the arm's length price
- The assumptions, policies and price negotiations
- Details of the adjustments, if any made
- Any other information data or document which may be relevant for determination of the arm's length price.

Supportive documents as in Rule 10D

Rule 10D also prescribes that the documentation is to be supported by the following:

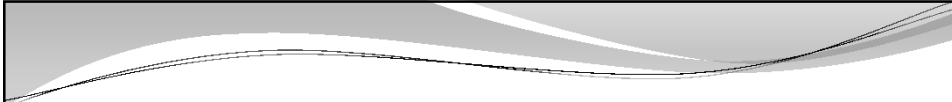
- Official publications, reports, studies and data bases of the government of the country of residence of the associated enterprise or of any other country;
- Reports of market research studies carried out and technical publications of institutions of national or international repute;
 - Software like Capitaline, Prowess
- Publications relating to prices including stock exchange and commodity market quotations;

Supportive documents as in Rule 10D ...cond

- Published accounts and financial statements relating to the business of the associated enterprises;
- Agreements and contracts entered into with associated enterprises or with unrelated enterprises
- Letters and other correspondence on the transaction and normally issued in connection with various transaction under the accounting practices followed.

Various documentations



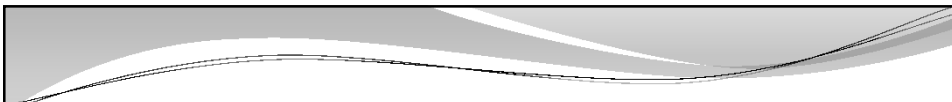


Documentation in TP

- Letter of engagement
- Form 3CEB
- Report
- Management letters
 - Industry analysis
 - Information about the products
- Comparables filters
- Comparable analysis

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Letter of engagement

- Period
- Scope
- Deliverable
- Timeframe
- anythingelse?

- Caveats
- Exclusions
- Contact points

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Form 3CEB

Report under Form 3CEB has been prescribed under section 92E.

- As per Section 92E any person involved in an international transaction in the previous year shall submit the report in Form 3CEB (e file) through a Chartered Accountant.
- It must be duly verified and certified, on or before the date prescribed by the authority, furnishing all the required details .
- The transactions are in terms of a property that is tangible or intangible, a service offered by the company, or any form of lending of money, etc.
- It is compulsory that at least one of the participants involved in the transaction is a non-resident of India for international Transfer Pricing regulations.

- CA may differ in opinion with assessee. In such a case bring the difference under the various clauses of Form 3CEB.
 - Do not withhold the report for non receipt of information : Qualify the report
 - Obtain management representation letters

Structure of a Transfer pricing Report

Executive Summary:

A summary of the report made in brief. The report is framed so that the main problems and the conclusions regarding the report so arrived

Introduction and scope:

- A brief on the parties and the scope which the report aims to achieve.

Brief on the Business:

- An introduction of the business of the parties. It can be subdivided as per the business of the individual parties involved.

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Economic Analysis:

- The results of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the Company.

Conclusion:

- Summary of the findings and conclusions of the report. The data is displayed clearly leaving no room for misinterpretations.

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Group Overview:

Objective:

- A background to the group's structure and operations, in relation to the businesses conducted in India.

Details on the Group:

- A description of valid associations including a profile of the multinational group of which the Company is a part of.

Products manufactured / services offered

- A note on the various products manufactured by the parent along with those relevant to the Indian AE.
- Description on the products and how they are different from their competitors
- Trade secrets, drawings etc. not required to be part of the TP report.

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Industrial Overview:

Objective:

- A description of the Group's structure and operations, in relation to the businesses conducted in India.

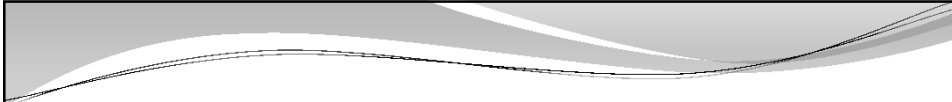
Background:

- A brief note on the industrial background of the business being carried on by the Company and its associates.

Characteristics of the Industry:

- An introduction to the attributes of the industry. It can be divided as per, size and other classifications.

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Industry Drivers:

- A brief on the key drivers for the industry. This also includes factors such as Modern technology, cost-effective manufacturing, research, labour, etc.
- Special features of the products manufactured to be emphasised here

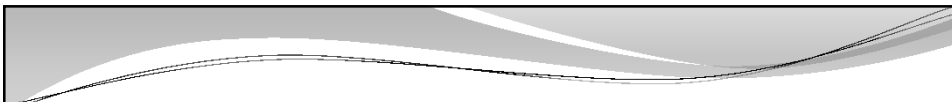
Competitive Landscape:

- A brief on the current competitors and market status of the concerned industry. It also contains an analysis of competition of foreign markets.

Regulatory Environment:

- A summary of all the regulations : All the regulations that are applicable to the business.

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Key Trends:

- Data on the gradual change in the condition, output or process of the market both domestic and foreign. It identifies specific factors that will have an impact on the business of the group.

Key Challenges:

- The main challenges that the Business/group faces. This may be problems such as, raising prices of raw material, changes in human resources, problems with import of components etc.

Way Forward/ conclusion :

- A feasible conclusion as to what steps that should be undertaken by Company/Group with regards to effective Transfer Pricing strategies and tax minimization practices.

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Functional and Economic Analysis:

Objective:

- A functional analysis to determine the characterisation of the transactions between the Group after using the variables to establish comparability between similar transactions in an uncontrolled environment.

International Transactions:

- A description of the international transactions conducted by the Group. It can be further subdivided into manufacturing and trading segments.

- List the international transactions
- A table of risk and functions is advisable

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Function asset and risk analysis - FAR

For each segments separately:

Functional analysis:

- An analysis of the functions of the group. It includes data on research and development, product innovations, methods of procurement, quality control etc.

Functions Performed:

- A description of the functions performed by the group. It includes data on sales and marketing, management of raw materials, technology used, production scheduling and processes etc.

Assets Employed:

- A breakdown of the asset types utilized by the company. It can be classified as per tangible and intangible.

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Risks assumed:

- A risk profile undertaken by the company with its Associated Enterprises. It includes Market risks, production liabilities, R&D, credit, inventory, etc.

Characterization:

- A report based on the functional analysis, assets employed and risks assumed. It gives a brief characterization of the company from the data of the after forth mentioned analysis.

Economic Analysis:

- An analysis of the company's uses of its resources and the most optimal method. It is broken up into selection of tested party, most appropriate method, the application of the best method etc.

Explain with a table for easy reference and understanding

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Various segments to be bench marked



- Manufacturing
- Trading
- Royalty / fee for technical services
- Management services
- Other fees paid
- Reimbursement of Expenses (Paid/Received)

No requirement that all segmental working of ALP to be audited by the statutory auditor.

Management certification is sufficient

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Role of a Chartered Accountant



Not all accountants are the same

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TP auditor - Appointment

- Signed and verified : Form 3CEB
- Need not be the statutory Auditor
- Due date
- 3CEB independent of return of Income
- Accountant is only CA : Office of profit as in Sec.314 of Companies Act 1956.

- Appointment need not be at AGM
- Joint TP auditor possible

- Fees : .. No provision, ICAI Guidelines.....

- Should one be a CA or a firm of Chartered Accountants ?

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Functions, duties and powers of the CA

- Express opinion
- May rely on the internal auditors reports

- Maintain proper notes
- Materials as per the TP rules

- Power to qualify report
- Call for books of accounts, information and docs.
- May rely work of the internal auditor

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Transfer Pricing-Audit Check lists

General Details

- Details of the multinational group of which the assessee enterprise is a part of along with the industry and nature of business.

- A description of the ownership structure of the parent/Group company with details of shares and other ownership interests.

- A description of the ownership structure of the associated enterprises including, other ownership interests if any.

- Name, address, jurisdiction and legal status of each of the associated enterprises comprised in the group.

- Tax residence certificate of each of the associated enterprises.

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Arm's Length Price:

- A list of all the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the parent company for the business as a whole and for each division or product separately.
- Details of the international transactions entered into by the company with the associated enterprises.
- The rates of material including invoice rates in AEs and the same with Indian customers and the difference between them with reasons.
- A record of uncontrolled transactions taken into account for analysing their comparability with international transactions entered into.
 - This includes a record of the nature, terms and conditions relating to any uncontrolled transactions with third parties which are of relevance.

- A description of the methods considered for determining the arms' length price in relation to each international transaction, the method selected.
 - An explanation as to why such a method was so selected and how the method was applied in each case should also be included.
- The details of the working carried out for determining the arm's length price.
- Details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any.
- The assumptions, policies and price negotiations, if any which would have critically affected the determination of the arm's length price.
- The nature and terms of international transactions entered into with each associated enterprise, with the Indian industry.

Transactions:

- Details of property transferred or services provided and the quantum and the value of each such transaction.
- Details of payments made to or received from head office by the way of royalties, fees or other payments on use of any intellectual property including Patents or other rights.
- Record of the transactions entered into with non-associated enterprises along with bills raised for determining arm's length price as well as comparability analysis.
- Sales invoices for comparison of the prices on which goods have been sold to Indian Branch. The sales invoice from non-associated entity.

- Global Transfer Pricing Report of the Group (If any).
- Commission/agency/royalties/technical fees/other agreements between Indian entity and parent company.
- A note and reason to justify the percentage of sales commission allocated to Indian Co, along with the agreement of agency.
- Month wise details of the exports and imports with the associated enterprise during the period of audit.
- Details of any other business activity of the parent/group/other AEs are carried on in India.
- Annual reports of the AEs and parent (asking for too much)

Risks:

- A description of the functions performed, risk assumed and assets employed or to be employed by the Indian entity and by the AE involved.
- And the table too.

Activities through Branch:

- Detail of the service performed by the branches for any service to conclude the export order in India.
- Note on the role of branches/liaison office, if any in connection with direct import/export from AEs without routing the same through branches and the apportionment of commission, branches have earned.
- Details if any, of any other executive and administrative general or any other expenses have been incurred in India or elsewhere for the purpose of interest on monies lent to the branch.

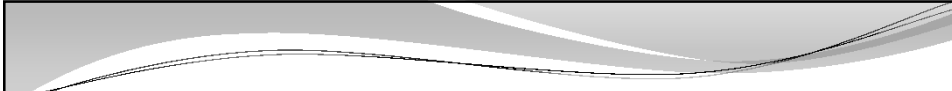
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- Details of any payment made to or received from the head office by way of interest on monies lent to the branch.

The above information not restricted to the following:

- Official publications, reports, studies and data bases from the Government of the country of residence of the AE, or any other Country.
- Reports of Market research studies carried out and technical publications brought out by institutions of national or international repute.
- Price publications including stock exchange and commodity market quotations.
- Public accounts and financial statements relating to the business affairs of the AE.

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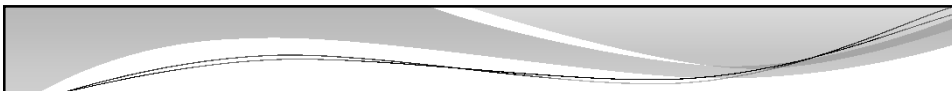


- Agreements and contracts entered into with AE or unrelated enterprises in respect of transactions similar to international transactions.
- Intelligence gathered on the competitors and the rates charged by them of similar products.
- Any other relevant and appropriate information.

- Gather as much information as possible.
- Understanding the business is most important

Informations backed with signed representation letters, mails etc. are preferable than oral explanations.

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Tips

- Assessee, in the documentation to reserve his right to rework the ALP where required
- Including for adjustments if any
- Check 3CEB for all transaction
- Identify segments and prepare segmental P&L too
- Make a note that the documentation is prepared as per the law on date
- Remember CONTEMPORANEOUS DOCUMENTATION
 - Occurring during the same period of time
 - Modern and relate to the present time
 - Belonging or occurring in the present
- Institute guidance note available in soft

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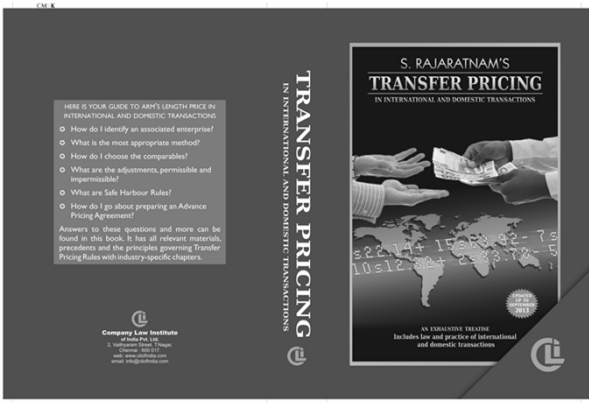
Issues

- Where the foreign party is not an AE in the strict sense but falls into the definition, then documentation?
- Any other information not in Rule 10D ?
- What happens if no data on comparable is available
- Is average date acceptable?
- Extent of information on the parent and other AEs


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Reference materials

- Income Tax Act 1961
- UN Manual on audit requirements
- Guidance note on TP by ICAI
- S.Rajaratnam's TP



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QUESTIONS & COMMENTS

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**TRANS
LAW**

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