

TRANSFER PRICING AUDIT & REPORTING UNDER FORM 3CEB ALONGWITH END DOCUMENTATION

ITF -I STUDY GROUP MEETING -1ST SEPT 2009

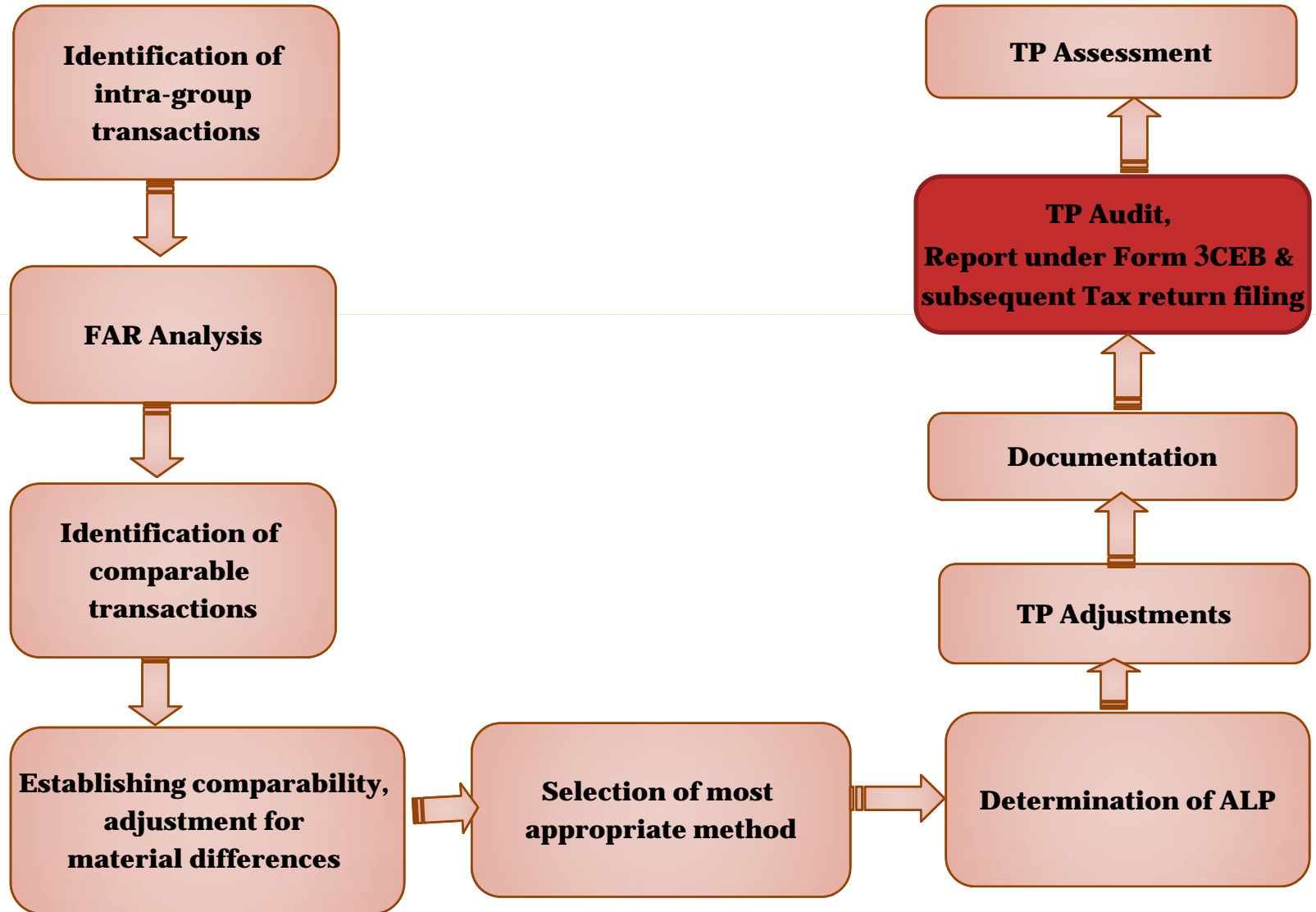
**-HARSHAL BHUTA
-MOHIT RAWAT**

TRANSFER PRICING AUDIT & REPORTING UNDER FORM 3CEB ALONGWITH END DOCUMENTATION

Bifurcation of topics:

T P Audit and Reporting under Form 3CEB	--	Mohit Rawat
Documentation, Grey areas and Way Ahead	--	Harshal Bhuta

Transfer Pricing Audit in the Transfer Pricing Process

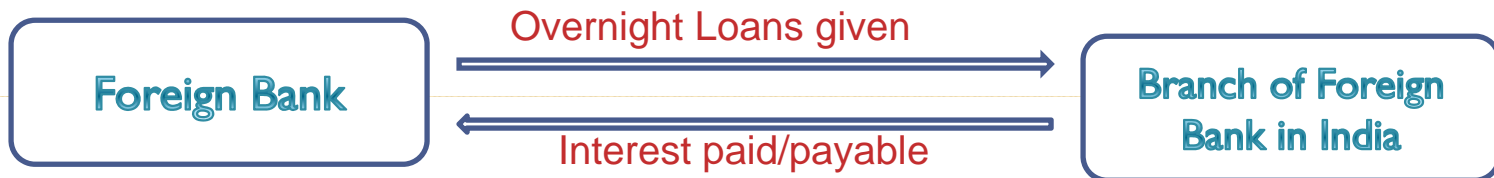


Transfer Pricing Audit – How is different from other types of audits mandated by law ??

- Transfer Pricing Audit required under Sec 92E r.w. Rule 10E for furnishing Form 3CEB.
- Only “International Transactions” under purview of TP Audit. No value based exemption limit provided.
- “*International Transaction*” defined u/s 92B(1) as:
*“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.”*

Transfer Pricing Audit – How is different from other types of audits mandated by law ??

- Example of International Transaction where both AEs are non-residents:

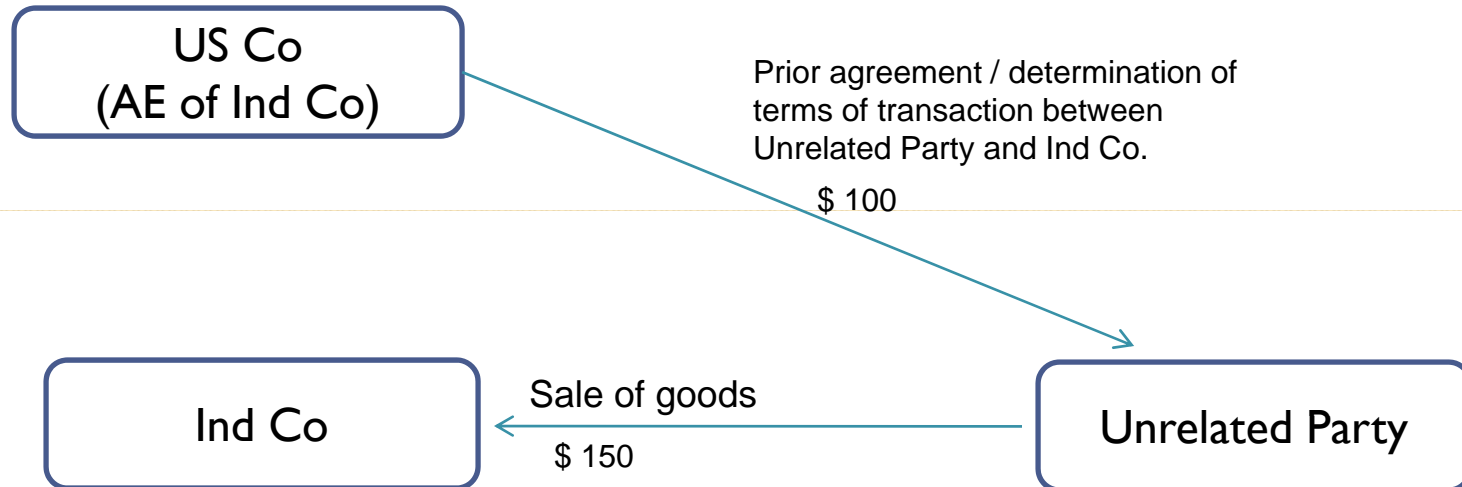


- *Deemed International Transaction* u/s 92B(2):

*“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.”*

Transfer Pricing Audit – How is different from other types of audits mandated by law ??

- Example of Deemed International Transaction:



- Most direct way to ascertain completeness of International Transactions reporting:
 - ❖ AS-18 disclosure in annexure to audited Balance Sheet
 - ❖ Management Representation

Transfer Pricing Audit – How is different from other types of audits mandated by law ??

- Certain differences AS-18 disclosure and Transfer Pricing Regulations to be taken into account while relying on AS-18 disclosure:

AS-18	Transfer Pricing
For significant influence to exist, 20% shareholding is necessary.	26% shareholding for applicability of transfer pricing.
Parties do not become related merely because one is 100% dependent on the other.	These dependent parties will be associated parties for the purpose of transfer pricing.
Focuses on disclosure for correct representation of financial statements.	Focuses on correct calculation of profits to determine the actual tax payable on them.
Applicable for all related parties whether situated locally or abroad.	Applicable only for international transactions.

Scope of Examination u/s 92E of ITA

Para 1 of Form 3CEB - Examination of accounts and records :

*“I/We have **examined the accounts and records** of _____
(name and address of the assessee with PAN) relating to the international
transactions entered into by the assessee during the previous year ending on 31st
March, ____.”*

- ‘Accounts and records’ to be examined solely in relation to ‘International Transactions’ entered into by assessee during relevant PY.
- Where TP Auditor has relied on audited figures, clearly state in the report that general purpose financial statements audited by the Statutory auditor have been used and relied upon.
- Provide a reconciliation between figures to be reported in 3CEB and those appearing under AS-18 disclosure.

Scope of Examination u/s 92E of ITA

Para 2 of Form 3CEB – Opinion on maintenance of proper information and documents :

*“In my/our opinion **proper information and documents as are prescribed have been kept** by the assessee in respect of the international transaction(s) entered into so far as appears from my/our examination of the records of the assessee.”*

- Guidance note states TP auditor is not responsible for content of transactions and documentation maintained by the assessee.
- If proper documentation not maintained as per Rule 10D, auditor needs to qualify the report.
- Even where aggregate value of International transactions < 1 crore, assessee has to substantiate on basis of material in his possession. In these cases, auditor has to verify whether any material is available with the assessee in this regard and thereafter examine the same.

Scope of Examination u/s 92E of ITA

Para 3 of Form 3CEB – Certification regarding particulars in Annexure :

*“The particulars required to be furnished under section 92E are given in the Annexure to this Form. In my/our opinion and to the best of my/our information and according to the explanations given to me/us, the **particulars given in the Annexure are true and correct.**”*

- ‘True and correct’ v/s ‘true and fair’. True and correct means factual accuracy.
- Qualifications falling under this Para may be given only in respect of material items.
- Guidance note mentions that auditor’s scope of work and review procedures are limited to the extent of certification in Form 3CEB.
eg: Auditor has to ensure that method state as being used to determine ALP has been actually used and is not responsible for ensuring that Most Appropriate Method has been used.

Reporting in Form 3CEB

Clause 1 – 6 of Annexure to Form 3CEB:

PART A	
1. Name of the assessee	ABC Ltd. (formerly known as XYZ Ltd.)
2. Address	Registered / Corporate Address
3. Permanent account number	PAN
4. Status	As per definition u/s 2(31) including PE
5. Previous year ended	2008-09
6. Assessment year	2009-10

Reporting in Form 3CEB (contd...)

XYZ Ltd
(Formerly known as ABC Ltd.)

Previous year ended March 31, 2009
Assessment Year:2009-10

Clause 7 List of Associated Enterprises with whom the assessee has entered into international transaction

Sr.No.	Name and Address of the Associated Enterprise	Nature of relationship with the associated enterprise as referred to in section 92A(2)	Business Description
1		Holding company (section 92A(2)(a))	
2		Any other relationship along with the relevant section under which it will be covered	

Note: (i) Sections mentioned above refer to the sections of the Income Tax Act,1961

For XYZ Limited
Name
Designation

Reporting in Form 3CEB (contd...)

XYZ Ltd
(Formerly known as ABC Ltd.)

Previous year ended March 31, 2009
Assessment Year:2009-10

Clause 8A: Particulars in respect of transactions in tangible property

Sr. No.	Name and address of the AE	Description of Transaction	Quantity purchased / sold (Kg)	Total Amount paid/payable as per books of accounts	Total Amount paid/payable as per ALP (<i>as computed by the assessee</i>)	Total Amount received / receivable as per books of accounts	Total Amount received / receivable as per ALP (<i>as computed by the assessee</i>)	Method used for determining the arm's length price
1		Details of purchase / sale of raw material and consumables	###	###	###	###	###	CUP
2		Other tangible property used as input in the business of the company	###	###	###	###	###	CUP

For XYZ Limited
Name
Designation

Reporting in Form 3CEB (contd...)

The following are examples of general types of transactions which are covered under clause 8A:

- Purchase of raw cotton used in the manufacture of cloth
- Purchase of components used in the manufacture of machines
- Other types of materials used in the business of the company

Reporting in Form 3CEB (contd...)

XYZ Ltd
(Formerly known as ABC Ltd.)

Previous year ended March 31, 2009
Assessment Year:2009-10

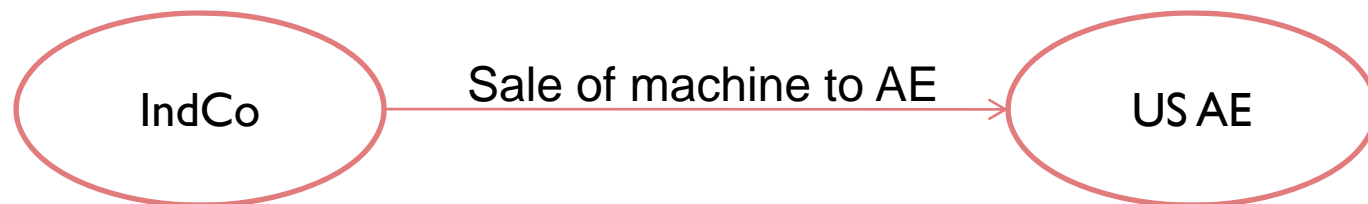
Clause 8B: Particulars in respect of transactions in tangible property

Sr. No.	Name and address of the AE	Description of Transaction	Quantity purchased / sold (Kg)	Total Amount paid/payable as per books of accounts	Total Amount paid/payable as per ALP (<i>as computed by the assessee</i>)	Total Amount received / receivable as per books of accounts	Total Amount received / receivable as per ALP (<i>as computed by the assessee</i>)	Method used for determining the arm's length price
1		Details of purchase / sale of finished goods	###	###	###	###	###	CUP / CPM
2		Details of purchase / sale of traded	###	###	###	###	###	RPM

For XYZ Limited
Name
Designation

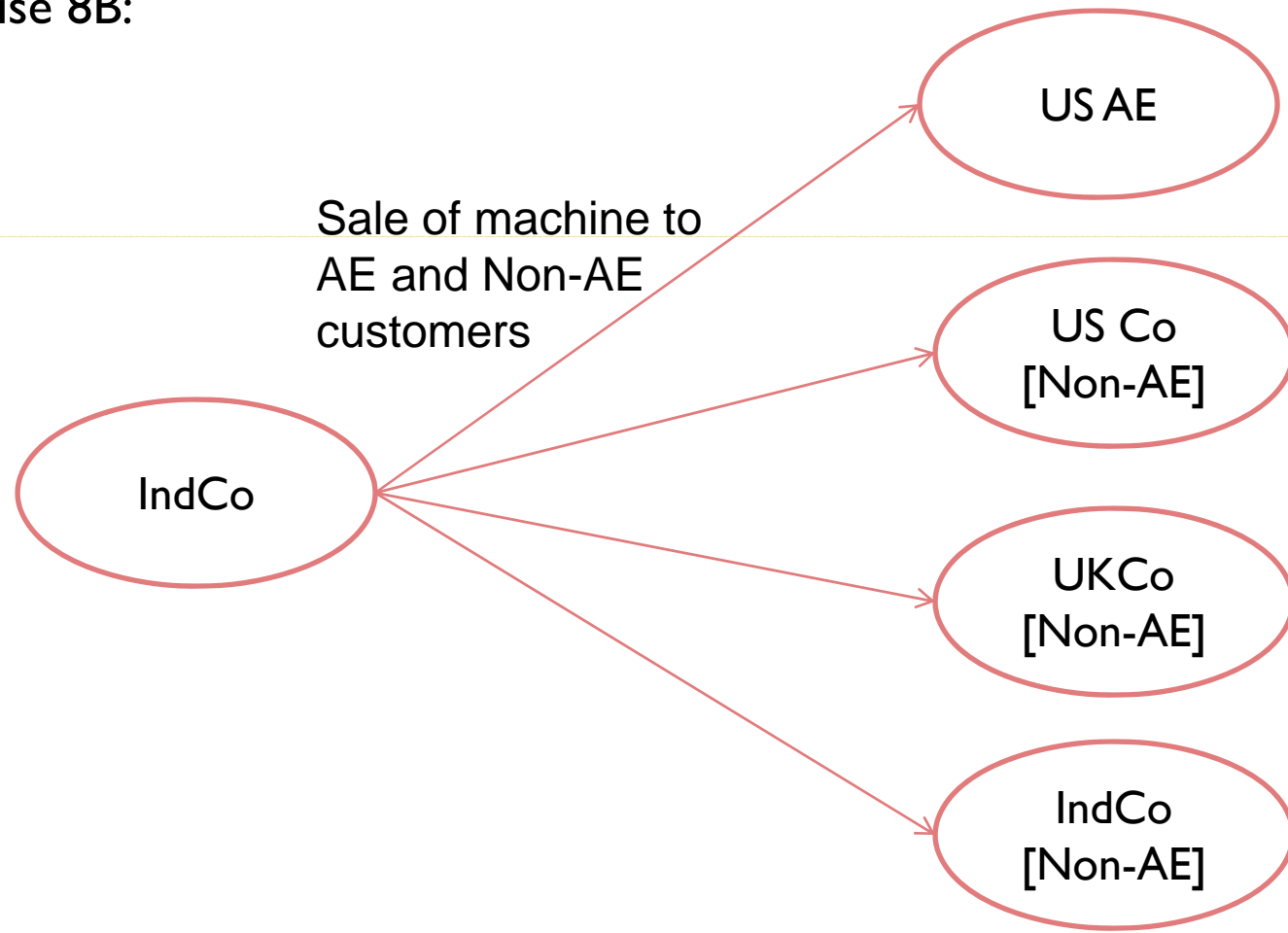
Reporting in Form 3CEB (contd...)

- The following are examples of general types of transactions which are covered under clause 8B:
 - ❖ Sale of ready made garments
 - ❖ Sale of machines / chemicals / other products
- What if an entity purchases spare parts / raw cotton and in turn sells the same, without any value addition ??
- Benchmarking of transaction using CPM in Clause 8B:



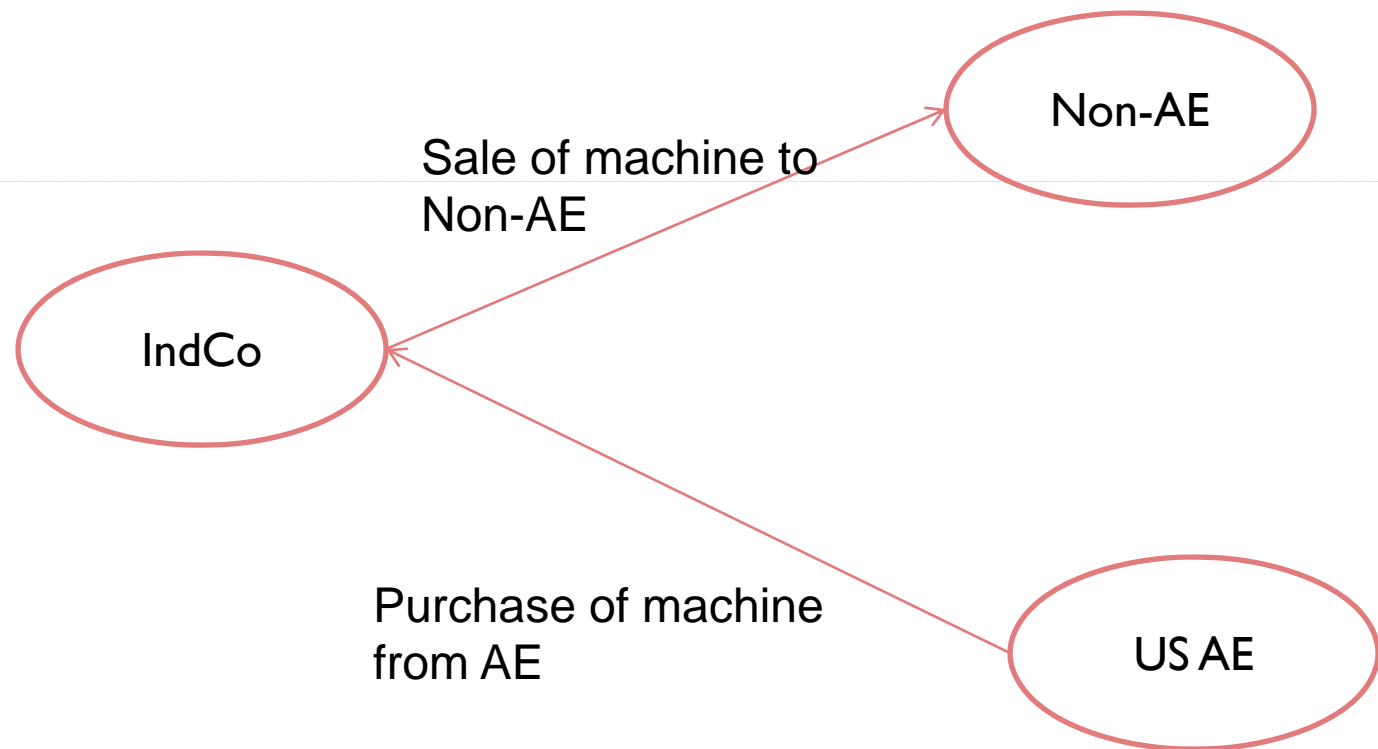
Reporting in Form 3CEB (contd...)

Benchmarking of transaction using CUP in
Clause 8B:



Reporting in Form 3CEB (contd...)

Benchmarking of transaction using RPM in
Clause 8B:



Reporting in Form 3CEB (contd...)

XYZ Ltd
(Formerly known as ABC Ltd.)

Previous year ended March 31, 2009
Assessment Year:2009-10

Clause 8C: Particulars in respect of transactions in Tangible Property

Sr. No.	Name and address of the AE	Description of Transaction	Quantity purchased / sold (Kg)	Total Amount paid/payable as per books of accounts	Total Amount paid/payable as per ALP (<i>as computed by the assessee</i>)	Total Amount received / receivable as per books of accounts	Total Amount received / receivable as per ALP (<i>as computed by the assessee</i>)	Method used for determining the arm's length price
1		Details of Purchase / Sale of any other tangible moveable / immovable property	###	###	###	###	###	CUP
2		Details of lease of any other tangible moveable / immovable property	###	###	###	###	###	CUP

For XYZ Limited
Name
Designation

Reporting in Form 3CEB (contd...)

The following are examples of general types of transactions which are covered under clause 8C:

- Purchase / Sale motor car / computer
- Lease of office premises
- Sale of old machine

Reporting in Form 3CEB (contd...)

XYZ Ltd
(Formerly known as ABC Ltd.)

Previous year ended March 31, 2009
Assessment Year:2009-10

Clause 9: Particulars in respect of transactions in intangible property

Sr. No.	Name and address of the AE	Description of Transaction	Quantity purchased / sold (Kg)	Total Amount paid/payable as per books of accounts	Total Amount paid/payable as per ALP (<i>as computed by the assessee</i>)	Total Amount received / receivable as per books of accounts	Total Amount received / receivable as per ALP (<i>as computed by the assessee</i>)	Method used for determining the arm's length price
1		Details of Purchase / Sale of any intangible property such as know how, patents, copyrights, licenses, etc.	###	###	###	###	###	Note #
2		Details of use of any intangible property such as know how, patents, copyrights, licenses, etc.	###	###	###	###	###	CUP

Note # Valuation Report

For XYZ Limited
Name
Designation

Reporting in Form 3CEB (contd...)

The following are examples of general types of transactions which are covered under clause 9:

- Payment of license fee for use of trademark, logo, etc.
- Payment of royalty for use of technical know, R&D, etc.
- Purchase of license / brand name.

Reporting in Form 3CEB (contd...)

XYZ Ltd
(Formerly known as ABC Ltd.)

Previous year ended March 31, 2009
Assessment Year:2009-10

Clause 10: Particulars in respect of providing of services

Sr. No.	Name and address of the AE	Description of Transaction	Quantity purchased / sold (Kg)	Total Amount paid/payable as per books of accounts	Total Amount paid/payable as per ALP (<i>as computed by the assessee</i>)	Total Amount received / receivable as per books of accounts	Total Amount received / receivable as per ALP (<i>as computed by the assessee</i>)	Method used for determining the arm's length price
1		Details of services such as financial, administrative, technical, commercial services, etc	###	###	###	###	###	CPM

For XYZ Limited
Name
Designation

Reporting in Form 3CEB (contd...)

The following are examples of general types of transactions which are covered under clause 10:

- Director's commission, if the director also holds more than 26% equity share capital.
- Provision of technical / marketing, etc. services.
- Provision of training services.
- Freight forwarding agency services
- Guarantee fees
- Providing of back office services
- Any other service provided free of charge.

Reporting in Form 3CEB (contd...)

XYZ Ltd
(Formerly known as ABC Ltd.)

Previous year ended March 31, 2009
Assessment Year:2009-10

Clause 11: Particulars in respect of lending or borrowing money

Sr. No.	Name and address of the AE	Description of Transaction	Quantity purchased / sold (Kg)	Total Amount paid/payable as per books of accounts	Total Amount paid/payable as per ALP (<i>as computed by the assessee</i>)	Total Amount received / receivable as per books of accounts	Total Amount received / receivable as per ALP (<i>as computed by the assessee</i>)	Method used for determining the arm's length price
1		Details of transactions in respect of granting / receiving loans / advances	###	###	###	###	###	CUP

For XYZ Limited
Name
Designation

Reporting in Form 3CEB (contd...)

The following are examples of general types of transactions which are covered under clause II:

- Subscription to Fully convertible debentures
- Interest free loans / advances

Reporting in Form 3CEB (contd...)

XYZ Ltd
(Formerly known as ABC Ltd.)

Previous year ended March 31, 2009
Assessment Year:2009-10

Clause 12: Particulars in respect mutual agreement or arrangement

Sr. No.	Name and address of the AE	Description of Transaction	Quantity purchased / sold (Kg)	Total Amount paid/payable as per books of accounts	Total Amount paid/payable as per ALP (<i>as computed by the assessee</i>)	Total Amount received / receivable as per books of accounts	Total Amount received / receivable as per ALP (<i>as computed by the assessee</i>)	Method used for determining the arm's length price
1		Details in respect of arrangement or agreement for allocation or apportionment of, or for contribution to, cost or expenses	###	###	###	###	###	CPM / TNMM

For XYZ Limited
Name
Designation

Reporting in Form 3CEB (contd...)

- The following are examples of general types of transactions which are covered under clause 12:
 - ❖ Amount payable to HO in respect of general administration expenses
 - ❖ Sharing of exhibition participation cost
 - ❖ Sharing of sales promotion expenses.
 - ❖ Management charges
- Difference between cost sharing arrangement (covered under clause 12) and re-imburement of expenses ??

Reporting in Form 3CEB (contd...)

XYZ Ltd
(Formerly known as ABC Ltd.)

Previous year ended March 31, 2009
Assessment Year:2009-10

Clause 13: Particulars in respect of other transactions

Sr. No.	Name and address of the AE	Description of Transaction	Quantity purchased / sold (Kg)	Total Amount paid/payable as per books of accounts	Total Amount paid/payable as per ALP <i>(as computed by the assessee)</i>	Total Amount received / receivable as per books of accounts	Total Amount received / receivable as per ALP <i>(as computed by the assessee)</i>	Method used for determining the arm's length price
1		Details of any other international transactions not specifically covered in any other clauses	###	###	###	###	###	Note #
2		Re-imbursement of expenses	###	###	###	###	###	CPM

For XYZ Limited
Name
Designation

Reporting in Form 3CEB (contd...)

The following are examples of general types of transactions which are covered under clause 13:

- Subscription to share capital
- Buy-back to share capital
- Payment of receipt of dividend
- Interest rate swaps
- Allocation of general over head expenses
- Advance converted into equity

Documentation requirements under Rule 10D

- *Rule 10D(1)* lays down **13** different types of information and documents.
 - Broadly they may be classified as :
 - ❖ Enterprise wise documents- Clauses (a) to (c)
 - ❖ Transaction specific documents- Clauses (d) to (h)
 - ❖ Computation related documents- Clause (i) to (m)
 - Chronologically, they may be classified as:
 - ❖ Organizational Structure;
 - ❖ Description of International Transactions;
 - ❖ FAR analysis;
 - ❖ Assessment of Comparables;
 - ❖ Selection and application of methodology for determining ALP.

Documentation requirements under Rule 10D

Points to be kept in mind while maintaining documentation under different clauses of Rule 10D(1):

[Kindly refer alongside Case Study on Documentation]

Clause (a) – “a description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises;”

- Other enterprise refers to only AEs, however if large percentage of shareholding of assessee is held by entities other than AEs, then details about them should be given additionally.
- Description of ownership structure should be given on the day when a ‘person’ became an AE and as on every date when there was a change in ownership interest of that other AE in the assessee enterprise.

Documentation requirements under Rule 10D

Clause (b) – *“a profile of the multinational group of which the assessee enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions have been entered into by the assessee, and ownership linkages among them;”*

- The assessee is not required to maintain this information in respect AEs who are not part of the group. Eg: AEs by virtue of provisions of clauses (c) to (m) of section 92A(2).

Clause (c) – *“a broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the associated enterprises with whom the assessee has transacted;”*

- General description of business and industry of assessee enterprise and business of the AEs.
- Where assessee/AEs engaged in more than one line of business, explanation to cover all businesses.

Documentation requirements under Rule 10D

Clause (d) – *“the nature and terms (including prices) of international transactions entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;”*

- In addition to standard information, additional information on matters such as form and time of payment, discounts, shipment, purchase commitments, supportive services, services provided free of cost alongwith the transaction under consideration, etc. should also be provided.

Clause (e) – *“a description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involved in the international transaction;”*

- **FAR analysis of business process** involved and not the business as a whole.
- Main purpose of FAR analysis is to identify the comparable transactions.

Documentation requirements under Rule 10D

Clause (f) – *“a record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately, which may have a bearing on the international transactions entered into by the assessee;”*

- If assessee is not in the practice of preparing any forecasts, budgets or other financial estimates, then the fact should be disclosed suitably.

Clause (g) – *“a record of uncontrolled transactions taken into account for analysing their comparability with the international transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions;”*

- Record of **compilation** of uncontrolled transactions yet to be processed/analysed.

Documentation requirements under Rule 10D

Clause (h) – *“a record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;”*

- Record of **analysis of comparability** of uncontrolled transactions.
- Make adjustments for comparability differences arising as primarily illustrated in Rule 10B(2).

Clause (i) – *“a description of the methods considered for determining the arms length price in relation to each international transaction or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case;”*

- OECD guideline on Transfer Pricing for Multinational Enterprises provide guidance for application of a method under certain set of circumstances. These guidelines have only persuasive value and cannot supersede the provisions of TPR in ITA and ITR.

Documentation requirements under Rule 10D

Clause (i) contd-

- Determination of Most Appropriate Method transactionwise.
- Summary of methods suited for particular functions as per OECD guidelines:

Functions \ Methods	CUP	Resale Price	Cost Plus	TNMM	Profit Split
Distribution	✓	✓		✓	
Manufacturing	✓		✓	✓	
Services and routine software dev., ITES, etc	✓			✓ (total cost plus)	
Common facilities			✓ (cost sharing)		
Joint R&D					✓
Various Classes of Transactions				✓	

Documentation requirements under Rule 10D

Clause (j) – *“a record of the actual working carried out for determining the arms length price, including details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions;”*

- Record of **actual numerical computation** for arriving at ALP.
- Quantification of adjustments due to comparability differences.
- Record of data used and data rejected.

Clause (k) – *“the assumptions, policies and price negotiations, if any, which have critically affected the determination of the arms length price;”*

- This Clause specifically for assumptions, policies and price negotiations that have played a role in determining ALP.

Documentation requirements under Rule 10D

Clause (k) contd-

- Eg for Assumption- Purchase commitment assumption for 2 yrs reduces purchase price.
- Eg for Policy- Policy of obtaining loan from Indian market only increases the interest rate which will affect benchmarking exercise.
- Eg of Price negotiation- Payment credit offered increases the purchase price.

Clause (l) – “details of the adjustments, if any, made to transfer prices to align them with arms length prices determined under these rules and consequent adjustment made to the total income for tax purposes;”

- When book value of transactions is not in conformity with ALP, Total income needs to be adjusted thus offering the differential amount to tax.

Clause (m) – “any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arms length price.”

- Residuary clause for any other factors that may have affected the process of determination of ALP.

Documentation requirements under Rule 10D

- Rule 10D(3) mentions the “authentic” documents supportive of information and documents maintained under Rule 10D(1)
- Rule 10D(3) is inclusive. Other additional documentation may cover:
 - Ownership structure & industry background
 - Role of each AE in the overall scheme of things!
 - Relevant correspondence
 - Underlying supporting documentation (invoices, debit notes, etc)
 - Accounts & tax treatment of overseas associated enterprise in its home jurisdiction
 - Press cuttings
 - Brochures and catalogues
 - Price lists / quotations
 - Marketing material
 - Management accounts / reports
 - Internal presentations
 - Business Plans
 - information published by trade associations, other official publications, etc.
 - Approvals received from Regulatory Authorities (RBI, GOI, etc.)
 - Independent Valuation Reports

Documentation requirements under Rule 10D

Rule 10D(4) –

- Documentation should be maintained latest by 31/7 or 30/9 as the case may be.
- No need for fresh documentation if there is no change affecting the economic analysis. In such a case, FAR analysis and economic analysis steps would be the same as in earlier years.

Documentation – when most critical ?

- Continuous loss situation
- GP / Operating margin is very volatile & fluctuating
- Market penetration strategy is adopted
- Changes in transfer pricing policy
- Unutilized / idle capacity
- Monopolistic situation
- Start up phase/ Winding up
- Transactions involving
 - ❖ Royalties and / or intangibles
 - ❖ Intra group services
 - ❖ Cost sharing arrangements

Grey Areas

- Customs Pricing can be adopted for TP purposes?
- Loan v/s equity – Thin Cap Regulations in Developed countries.
- Can laws and Government orders in force be taken as safe comparables [Rule 10B(2)(d)] ?? . Eg: FEMA regulations, RBI approval for royalty.
- Some intra-group transactions are so unique that they cannot be compared.
- What if no comparables ??
- TP reports of two AE's would have conflicting conclusions.

The way ahead

- Finance Act 2009
 - ❖ Safe Harbour Rules to be formed
 - ❖ Dispute Resolution Panel
- Direct Tax Code
 - ❖ Advance Pricing Arrangement
 - ❖ Anti-Avoidance measures
 - ❖ Thin Capitalisation Concept
 - ❖ Associated Enterprises criteria modified
 - ❖ Risk Based Assessment



THANK YOU FOR PATIENT LISTENING

