TP Niche

A spectrum of transfer pricing issue
Quarterly Edition: April-June 2017
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Dear Readers,

We are glad to present our quarterly newsletter - TP Niche. Through this newsletter our endeavour is to share our experience on emerging Transfer Pricing (‘TP’) aspects and hope to provide our readers valuable insights on the evolving TP landscape in India.

This issue of TP Niche covers a wide range of TP topics categorised under five Sections viz. ‘Perspective’, ‘Our experience’, ‘From the judiciary’, ‘Tracker’ and ‘Global corner’. The perspective section provides an outlook on the revised safe harbour rules issued by the Central Board of Direct Taxes, highlighting the implication of the revised safe harbour rules against the corresponding earlier rules.

In ‘Our Experience’ Section, we share our experience in Country-by-Country reporting assignments, focusing on key considerations during data compilation.

With so many decisions being pronounced by the Tribunal and High Courts on TP issues on regular basis, it is challenging to keep track of fundamental positions emerging from such decisions on peculiar issues. With this in mind, we have captured some key rulings reported in the last quarter to give our readers a snapshot of important judicial pronouncements.

‘Tracker’ section lists key developments in the form of notifications, circulars and other publications touching different legislative and practical aspects of TP, which the readers may want to take note of for their easy reference.

‘Global Corner’ is a Section which is designed to highlight the key developments in the global TP arena. In this edition, readers get to know of recent developments in TP regime in United Kingdom. Readers may also read about other global updates from OECD in relation to BEPS in this Section.

We hope that you will find the TP Niche edition highly informative and useful. In case you have any comment or query, please reach out to us. Your feedback is important to us. We look forward to receiving it.

Arun Chhabra
Director
Grant Thornton Advisory Private Limited
This section provides a perspective on the revised safe harbour rules issued by the Central Board of Direct Taxes and also highlights the comparison of revised safe harbour rules with the corresponding earlier rules and its implication.

In the spirit of boosting foreign investment and easing the litigation environment in India, the Government has modified its existing safe harbour thresholds, addressing the safe harbour rates and the intra-group services. The new safe harbour regulations drew some attribute from the international practices as outlined in the Organisation for Economic Co-operation and Development’s (‘OECD’) Base Erosion and Profit Shifting (‘BEPS’) Actions.

A “safe harbour” in the context of Indian tax law would mean a transfer price computation mechanism followed by the Indian taxpayer, which the tax authorities shall accept to be at arm’s length and not conduct TP audits. The safe harbour regulations are optional in nature and it is the prerogative of the Indian taxpayer to apply for the same after adhering to the transfer price computation mechanism and other rules prescribed under the ‘Safe Harbour Rules’.

The safe harbour regulations were introduced as Section 92CB in the Income-tax Act, 1961 (“The Act”) by the Finance Act, 2009 and the Safe Harbour Rules 10TA to 10TG in the Income-tax Rules, 1962 (“The Rules”) in 2013. Though the introduction of safe harbour was a welcome move, it attracted the interest of only a handful of taxpayers primarily due to high safe harbour mark-up rates/margins which prima facie were not perceived to be aligned with the industry and economic realities.

On the other hand, a scheme of Advance Pricing Agreement (‘APA’) which was introduced a year earlier of safe harbour gained immense popularity in India. An APA refers to an agreement between the taxpayer and the tax authorities on the pricing of an existing or proposed transaction between AEs. The success of APA is evident from the number of APA applications (close to 815 applications till date) received from various categories of taxpayers.

In order to meet the expectation of taxpayers, after three years of its introduction, the Central Board of Direct Taxes (“CBDT”) amended Safe Harbour Rules by way of a notification issued on 07 June 2017.

The revised safe harbour rules would be applicable for three years starting from Assessment Year (‘AY’) 2017-18 and would extend to AY 2019-20.
### a. Revised safe harbour – A comparison

Comparison between the existing safe harbour rules with revised safe harbour rules for eligible international transactions is illustrated below:

<table>
<thead>
<tr>
<th>Eligible International</th>
<th>Existing Safe Harbour Rules upto FY 2016-17</th>
<th>Revised Safe Harbour Rules From FY 2016-17 to FY 2018-19</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Threshold for value of international transaction</td>
<td>Margin to be declared</td>
</tr>
<tr>
<td>Provision of software development services and information technology enabled service</td>
<td></td>
<td></td>
</tr>
<tr>
<td>&lt; 500 Crore</td>
<td>Not less than 20% on total operating expense</td>
<td></td>
</tr>
<tr>
<td>&gt; 500 Crore</td>
<td>Not less than 22% on total operating expense</td>
<td></td>
</tr>
<tr>
<td>Provision of knowledge process outsourcing services</td>
<td>NA</td>
<td>Not less than 25% on operating expense</td>
</tr>
<tr>
<td>Advancing of intra-group loans where loan is denominated in Indian currency</td>
<td></td>
<td></td>
</tr>
<tr>
<td>&lt; 50 Crores</td>
<td>Base rate of SBI + 150 basis points</td>
<td>CRISIL rating between AAA to A or its equivalent</td>
</tr>
<tr>
<td></td>
<td></td>
<td>CRISIL rating of BBB-, BBB, BBB+ or its equivalent</td>
</tr>
<tr>
<td>&gt; 50 Crores (Refer note 3)</td>
<td>Base rate of SBI + 300 Basis points</td>
<td>CRISIL rating of BB to B or its equivalent</td>
</tr>
<tr>
<td></td>
<td></td>
<td>CRISIL rating between C &amp; D or its equivalent</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Credit rating is not available, and</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Amount of loan does not exceed INR100 crores as on 31 March of relevant previous year</td>
</tr>
<tr>
<td>Advancing of intra-group loans where loan is denominated in foreign currency</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td></td>
<td></td>
<td>6 month LIBOR interest rate as on 30th September of relevant previous year plus:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>CRISIL rating between AAA to A</td>
</tr>
<tr>
<td></td>
<td></td>
<td>CRISIL rating of BBB-, BBB, BBB+</td>
</tr>
<tr>
<td></td>
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<td>CRISIL rating of BB to B</td>
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<tr>
<td></td>
<td></td>
<td>CRISIL rating between C &amp; D</td>
</tr>
<tr>
<td>Eligible International Transaction</td>
<td>Eligible International Transaction</td>
<td>Eligible International Transaction</td>
</tr>
<tr>
<td>-----------------------------------</td>
<td>-----------------------------------</td>
<td>-----------------------------------</td>
</tr>
<tr>
<td></td>
<td>Existing Safe Harbour Rules upto FY 2016-17</td>
<td>Revised Safe Harbour Rules From FY 2016-17 to FY 2018-19</td>
</tr>
<tr>
<td>Threshold for value of international transaction</td>
<td>Margin to be declared</td>
<td>Threshold for value of international transaction</td>
</tr>
<tr>
<td>• Credit rating is not available, and • Amount of loan does not exceed equivalent of INR100 crores as on 31 March of relevant previous year</td>
<td>400 basis points</td>
<td></td>
</tr>
<tr>
<td>Providing corporate guarantee</td>
<td>Up to Rs 100 Crore</td>
<td>not less than 2% p.a</td>
</tr>
<tr>
<td>Above Rs 100 Crore</td>
<td>not less than 1.75% p.a</td>
<td></td>
</tr>
<tr>
<td>Provision of contract research and development services relating to software development</td>
<td>NA</td>
<td>not less than 1% per annum</td>
</tr>
<tr>
<td>Provision of contract research and development services relating to generic pharma drugs</td>
<td>NA</td>
<td>&lt; 200 Crores</td>
</tr>
<tr>
<td></td>
<td>Not less than 30% on operating expense</td>
<td>not less than 24% of operating expense</td>
</tr>
<tr>
<td></td>
<td>Not less than 29% on operating expense</td>
<td></td>
</tr>
</tbody>
</table>

The intra-group services have always been an area of controversy in India. In order to curb the increasing number of litigation related to intra-group services, the scope of safe harbour is extended to include low-value adding intra-group services. The definition of low value-adding intra-group services is largely in line with the guidelines of OECD’s BEPS projects.

<table>
<thead>
<tr>
<th>Eligible International Transaction</th>
<th>Revised Safe Harbour Rules</th>
</tr>
</thead>
<tbody>
<tr>
<td>Threshold on value of international transaction</td>
<td>Conditions to be adhered</td>
</tr>
<tr>
<td>Receipt of low value adding intra group services by the Indian Taxpayer for which a payment has to be made to the AE</td>
<td>Upto 10 Crore including mark-up</td>
</tr>
<tr>
<td></td>
<td>• Upto 5% mark-up charged by the service provider; and • Cost pooling method, exclusion of shareholders cost, duplicate costs and reasonableness of allocation keys is certified by an accountant</td>
</tr>
</tbody>
</table>
To be covered as the low value-adding intra group services under the safe harbour rules, the intra-group services should:

• be in the nature of support services;
• not be a part of the core business of the multinational enterprise group, i.e., such services neither constitute the profit-earning activities nor contribute to the economically significant activities of the multinational enterprise group;
• not in the nature of shareholder services or duplicate services;
• neither require the use of unique and valuable intangibles nor lead to the creation of unique and valuable intangibles;
• neither involve the assumption or control of significant risk by the service provider nor give rise to the creation of significant risk for the service provider; and
• not be having reliable external comparable services that can be used for determining their arm's length price ('ALP').

The government specifically excluded ten categories of services from the ambit of low value-adding intra group services like research & development (‘R&D’), manufacturing and production, information technology (.software development), knowledge process outsourcing (‘KPO’) , business process outsourcing (‘BPO’), purchasing activities of raw materials or other materials that are used in the manufacturing or production process, sales, marketing and distribution activities, financial transactions, extraction, exploration, or processing of natural resources; and insurance and reinsurance. Thus, any taxpayer willing to avail a safe harbour on the intra-group service availed from its AE(s) would need to maintain a robust documentation substantiating the basis on which such intra group services could be classified as 'low value-adding intra group services'.

Moreover, under the safe harbour rules pertaining to low value-adding intra group services, the taxpayer needs to obtain a certificate from an external accountant certifying the cost pooling method, exclusion of shareholders cost, duplicate costs and reasonableness of allocation keys with respect to the intra group service charges.

The revised safe harbour rules would be applicable for three years starting from FY 2016-17 through FY 2018-19. For FY 2016-17 being the overlapping year with the prior rules, the taxpayer has the option to opt for the rule which is more beneficial.

b. Key highlights of new guidance and changes to existing guidance

The objective analysis of the new safe harbour rules are as provided below:

• Taxpayers falling outside the prescribed threshold limit cannot opt for safe harbour
• Receipt of low value intra group services have been covered in the notification
• Safe harbour for knowledge process outsourcing services is linked with the level of employee cost incurred by the taxpayer
• Exhaustive list of cost items to be considered as a part of the employee costs has been provided
• Definition of operating cost has been amended to include cost relating to employee stock option plan or similar stock based compensation as provided by the AE to employee of the taxpayer, reimbursement / recovery of expense to / from AE

c. Revised Safe Harbour – an attempt to achieve international standards

The new safe harbour scheme with improved rates / margins was introduced at a time when the burden of tax compliance was at its peak on account of a global effort coordinated by the OECD to tackle aggressive tax planning of businesses.

The liberalised safe harbour rules will help multinational companies (MNCs) avoid rigorous auditing of cross-border transactions. The most immediate impact of introduction of safe harbour rule on MNEs will be a likely focus on the need to accurately delineate their intercompany transactions.

The recalibrated safe harbour margins in case of IT/ITES and KPO sectors are long overdue as India has the highest incidence of TP litigation of IT/ITES sector in India. The Indian captive service providers of foreign multinational companies have been always targeted by tax authorities. The TP adjustments were made considering cost plus mark-ups ranging from 25 per cent to 35 - 40 per cent in some cases. The earlier Safe Harbour Rules which provided a 20 per cent mark-up (for a transaction value of less than Rs 500 crore) and 22 per cent mark-up (for Rs 500 crore and above) for captive software development, information technology enabled
services, and business process outsourcing companies (BPO) and KPO companies were subject to a 25 per cent mark-up. Hence, earlier safe harbour margin failed to attract tax payers.

On the other hand, the applicants from IT/ITES sectors were successfully able to negotiate mark-up between 16 per cent and 18 per cent in APA. Now it is taxpayer’s prerogative to evaluate the impact of the safe harbour rules on their inter-company arrangements and determine the relative benefit in pursuing APA as an option available against safe harbour.

Introducing different mark-ups for KPO services based on the employee cost is an ideal approach however, this would intensify TPO to adopt similar approach for IT/ITES sectors in the upcoming litigation era.

It also covers cross-border transactions of MNC group firms giving loans as well as corporate guarantees.

The financial transactions have their share of litigation and controversy. The outbound loans were benchmarked by tax authorities using State Bank of India’s base rate or prime lending rate whereas LIBOR rates were used to benchmark inbound loans. The guarantees were subject to a high guarantee commission of 3-7 per cent.

The revised safe harbour rules for financial transactions are a big step in this direction. The corporate guarantee charge of 1 per cent seems reasonable for SMEs to avoid. For outbound loans, the safe harbour rates now vary based on currency of loans and credit rating of the AE. The only challenge which arises here is of procuring a credit rating for an overseas AE in case taxpayer desires to opt for safe harbour.

Inclusion of intra-group services within the ambit of safe harbour is a big, bold, and positive move. This is largely in line with the global practices under BEPS Action 10. Intra-group service is a highly targeted area of litigation in the recent years, and it was extremely difficult for the taxpayers to substantiate the benefit derived by them from the intra-group services.

d. Conclusion

India announced its safe harbour rules in 2013 with the intention of reducing TP litigation, resolving TP disputes, facilitating ease of doing business, and bringing the Indian regulations in line with internationally followed practices. However, the high safe harbour margins made the safe harbour provisions a less lucrative option. Hence, the earlier safe harbours did not receive an enthusiastic response from the taxpayers. To overcome this, the Government has issued the revised rules with rationalised safe harbours rates/margins. However, one needs to wait and watch if the revised rules are able to stimulate the target response from the taxpayers. Based on the positions taken by the APA authorities and position given under the revised safe harbour rules the mark-up suggested under both regime seems to be on similar lines. The taxpayers would like certainty in their transfer price for nine years in APA as compared to three years in safe harbour. Thus, taxpayers eligible for applying for safe harbour may still prefer APA over safe harbour rules as it provides certainty in their tax positions for longer period.
Our experience

This section covers certain key considerations on Country-by-Country Reporting compilation

The quest for transparency was essential in the global tax environment. In the spirit of that pursuit, the OECD along with G20 members created the BEPS projects. The main objective of the project was to increase transparency regarding international tax structures and tax attributes that authorities believe may lead to base erosion.

On 19 July 2013, the OECD released various Action Plans under its BEPS project for public discussion and recommendation with a view to address perceived flaws in international tax rules. On 5 October 2015, after two years of negotiation and development, the OECD released the final package containing 15-points Action Reports. Of all the BEPS Action Reports, the final report on Action 13, “Transfer Pricing Documentation and Country-by-Country Reporting (CbCR)”, have gained the most support from governments worldwide.

Many countries already adopted CbCR as a part of their local regulations while other countries are in the process of enacting legislation to bring this into effect. Adhering to varying deadlines and varying requirements from country to country is a time consuming process and a big challenge. The extensive report poses significant challenges for companies to comply.

As a member of G20 counties, Indian tax administration is under an obligation to implement the OECD’s guidance on Action 13. In February 2016, Indian government introduced CbCR regulations in India in the Union Budget. The Indian CbCR Regulations are largely in line with OECD’s BEPS Guidelines.

Background – What is Country-by-Country Reporting?

The Action 13 of BEPS requires every large multinational companies report their business activities using a template on a country-by-country basis. This framework applies to multinational companies with a consolidated group turnover exceeding €750 million.

Reporting requirement

In principle, the report should be prepared and filed by ultimate parent entity ("UPE") of the multinational enterprises ("MNE") Group in its home country. The report would then be automatically shared with the tax authorities of relevant counties where group entities operate. In case where UPE is not required to file CbCR in its home country, or the automatic exchange mechanism does not work in that particular country, then the group must elect surrogate entity in the other country to file CbCR, thereby making use of automatic sharing mechanism by the tax authorities.

Contents of the report

The Action 13 has outlined a three-tiered structure:

A Country by Country Report (‘CbCR’) consists information relating to the global allocation of the multinational corporation’s income, taxes paid, and other economic activity information;

• A Master File contains high-level overview of MNE group’s transfer pricing policies and important arrangements; and

• A Local File referring specifically to material transactions of the local taxpayer.

The CbCR template requires multinational companies to report annually and for each tax jurisdiction in which they do business the amount of revenue, profit before income tax, and income taxes paid and accrued. It also requires them to report their total employment, capital, retained earnings, and tangible assets in each tax jurisdiction. Multinational companies are also required to identify each entity within the group doing business in a particular tax jurisdiction and describe the business activities of each. With this, tax authorities across the world will be able to ascertain how multinational companies allocate their income and tax payments to a specific country, and other countries as well. This template would also act as a tool for tax authorities to identify and select companies to scrutinise.
Timing and potential penalties

The different due dates have been laid down among countries by the local tax authorities and hefty penalties for not adhering to CbCR regulations are notified by the tax authorities. The penalties are a frequently used tool to ensure efficient operation of transfer pricing documentation requirements. This leads to the necessity of reviewing the various timing requirements in the various countries.

Practical nuances of CbCR

As controversial as transfer pricing can be in many regards, there is an established set of principles and methods generally agreed upon under the OECD and local regulations. Though lot of discussion focuses on how to effectively and accurately interpret the new disclosure requirements, careful attention should be paid towards the guidance provided by the OECD.

Understanding of MNE’s functions, risks and assets (tangible and intangible) and full value chain of a MNE is the crux of the entire CbCR framework. Strategising the effective approach to conduct an analysis of functions, risks and assets (tangible and intangible) and full value chain is not an easy take, especially for a MNE with complex functions and risk matrices spread across different entities.

The entire CbCR exercise being first of its kind requires extensive discussions and meetings with multiple stakeholders in the MNE. The sudden changes in the regulations affect MNEs in several ways. MNEs are putting in place a robust process of data gathering and information alignment across the global group by leveraging on available technologies to automate the process (wherever feasible). The MNEs are working in an agile manner in building their systems and processes to compile the relevant data for CbCR and data analytics required for conducting transfer pricing risk assessments. MNEs are making significant efforts to comply with the new requirements.

The MNEs are taking cognizance of the potential disclosures which could be required to be made in Table 3 of the CbC report. MNEs are mindful of the clarificatory disclosures in table 3 and conscious of how these disclosures will be interpreted by Tax Administration. MNEs are considering making additional disclosures with respect to the source from where the MNE is compiling the CbC report.

The data heads required to be reported in CbCR are subjective; hence MNEs are resorting to industry practice. The OECD guidelines allow MNEs to choose the data from the consolidation reporting packages, from separate entity statutory financial statements, regulatory financial statements, or internal management accounts. However, mismatch in the financial results between group entities could have significant repercussions on the MNE Group. Most of the data (like no. of employees, taxes paid, etc.) is centrally maintained by parent entity however break down at the jurisdiction level may prove cumbersome.

Thus, while gathering and reviewing this information, one should always be mindful regarding its repercussion in the various tax administrations. It is always recommended to assess as how the information reported in Master File or Local File would be read in conjunction with the information reported in the CbC Report by the various tax authorities.

Though OECD extends flexibility to use a wide variety of sources of financial information to prepare CbCR, the companies would always prefer to reconcile its financial statements with the CbC template as a backup document to maintain defensible trail for future audits. Further, it is essential to align the information of the CbC with the information disclosed in the master file and local file. Moreover, the content of the CbC should also be in line with other sources of information that are available to tax authorities, such as the website, financial statements, tax returns etc.

In order to prepare for the new transfer pricing documentation requirements, the details can be gathered from a variety of sources, publicly available information, tax returns, existing transfer pricing documentation, Advance Pricing Agreement (APAs) etc.

A further complication, which has not been widely reported in the press, arises when companies operate business around the world through Joint Ventures (“JV”). The recently released guidance specifically states that in case the accounting rules require proportionate consolidation, then the financial data of JVs to be included in the CbC at pro-rata basis. The guidance also clearly states that JVs and associates included in the group’s consolidated financial statements under equity accounting rules would not be constituent entities, leaving...
majority of JVs and associates out of the scope of CbCR. The loophole in the approach would be the cases where the results of JVs are included in the consolidation financial statement of their respective JV partners based on equity method and in no circumstances the results of JVs would reflect in CbCR leaving room for many interpretations and many questions remain to be answered.

One more challenge would be complying with the notification requirement. Since, many countries are still in the process of implementing CbCR, the MNE would face numerous practical challenges while complying with these notification requirements. The MNE having numerous group entities will need to carefully evaluate all relevant notification deadlines and monitor any changes or extension.

Efficient and effective implementation of CbCR across would expose MNEs to future potential disputes that might arise due to confidentiality of the information shared with the tax authorities in different countries. The peer review and monitoring process for the transparency framework will be conducted by the Forum on Harmful Tax Practices (FHTP). Peer reviewers will check to see whether the reviewed country is respecting the confidentiality requirements in the various international instruments that provide the legal capacity for exchange.

The time to time guidance issued by OECD would provide greater clarity on the term revenues as well as income tax paid and income tax accrued while also providing more guidance on MNE groups with a short accounting period.

Our experience on assisting the MNEs on CbCR includes providing end-to-end support commencing from thorough assessment of internal systems and processes, understating the data sources, understanding the accounting standards followed, providing comments on determining to most appropriate way of compiling the data, streamlining the process of preparation of financial statements with CbCR compilation, identifying the potential TP risk areas while compiling the CbCR, provide suggestion on defence strategies, provide suggestions on restructuring of transactions between the associated enterprises etc.

The CBDT has also issued draft rules in respect of (1) applicable threshold for filing Country-by-Country (CbC) Report (2) the applicability, contents and filing of Master file by constituent entities, in furtherance of India’s commitment to implement the BEPS Action 13.

The key contents of the draft rules are as under:

CbC Report is to be prepared and filed in case the consolidated revenue of the international group exceeds INR 55,000 Million (USD 840 Million) and CbC Report to be filed on or before the due date for the filing the return of income as specified in Section 139(1) of the Income-tax Act, 1961.

Master File is to be prepared and filed by a constituent entity of an international group, in case:

i. The consolidated revenue of the international group for the immediately preceding previous year exceeds INR 5,000 Million (USD 70 Million); and

ii. (2) [i] The aggregate value of the international transactions exceeds INR 500 Million (USD 7 Million) or (2) [ii] The aggregate value of international transactions involving intangible goods exceeds INR 100 Million (USD 1.5 Million).

The CBDT has sought for recommendations till 16 October, post which, the rules will be finalised.
Facts of the Case

• Dabur India Ltd. (‘taxpayer’) is engaged in the business of manufacturing and trading of various herbal products.

• During the year AY 2006-07, the Assessing Officer (‘AO’) referred the taxpayer’s case to TP Officer (‘TPO’) for determination of ALP of the international transactions.

• The taxpayer entered into an international transaction pertaining to receipt of royalty from Dabur Nepal Ltd, Nepal (‘Dabur Nepal’) and Asian Consumer Care Pvt Ltd, Bangladesh (‘Asian Bangladesh’) amounting to Rs. 5.34 lakhs and Rs. 21.02 lakhs, respectively, for the usage of brand ‘Dabur’ owned by the taxpayer.

• The TPO noticed that in the immediately preceding year, taxpayer had received royalty from Dabur International UAE (‘Dabur UAE’). The TPO called for the agreement between taxpayer and Dabur UAE which specified royalty at 1 per cent. Based on the agreement, the TPO concluded that the agreement is still in force for the relevant assessment year and accordingly, the TPO held that taxpayer did not receive full royalty from Dabur UAE as per the agreement. The taxpayer argued before the TPO that Dabur UAE incurred huge expenditure on development of brand in overseas market. However, the TPO rejected the claim based on the ground that there was no credible evidence for accepting the taxpayer’s claim in respect of such expenditure.

• Thus, the TPO worked out the royalty receivable from Dabur UAE as 4 per cent of sales and from Dabur Nepal as 7.5 per cent of sales and proposed an adjustment of Rs. 544.69 lakhs.

• Aggrieved, the taxpayer filed an appeal before Commissioner of Income Tax (Appeals) (‘CIT(A)’). The CIT(A) provided partial relief to the taxpayer by determining a royalty rate of 2 per cent of FOB sales as the ALP in respect of Dabur UAE as well as Dabur Nepal.

• The taxpayer filed an appeal before Delhi ITAT contending the sustenance of addition while the Revenue filed an appeal against the relief allowed to taxpayer.

Dabur India Ltd vs. ACIT & ACIT vs Dabur India Ltd.
AY 2006-07, Delhi ITAT Bench

From the judiciary

This section focuses on some of the interesting case laws reported on transfer pricing during the quarter, July-September 2017

Dabur India Ltd vs. ACIT & ACIT vs Dabur India Ltd.
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ITAT Observations and ruling

Royalty from Dabur UAE

The Tribunal held that royalty rate of 0.75 per cent would be fair and reasonable to charge for using the brand name of “Dabur” taking into consideration the fact that Dabur UAE had also incurred huge expenses on marketing, advertisement & brand building etc. in UAE in the year under consideration. The Tribunal also mentioned that although the royalty rate of 1 per cent was charged in the preceding year towards usage of brand name, however, in the preceding year the AE did not incur any expenses on marketing, advertisement & brand building etc. hence, the royalty rate of preceding year cannot be applied for the year under consideration.

Royalty from Dabur Nepal

The Tribunal ruled in favour of the taxpayer by observing that Dabur Nepal had incurred huge expenditure in order to penetrate the market and the original agreement was amended w.e.f. April 1, 2004 by which royalty was reduced from 7.5 per cent to 3 per cent. The Tribunal opined that the TPO was not justified in working out the royalty at 7.5 per cent. The Tribunal also noted that 80 per cent of the products of Dabur Nepal were purchased by the taxpayer. The Tribunal remarked that “...it is unbelievable that the taxpayer charged the royalty on the purchases made by it from M/s Dabur Nepal Pvt. Ltd. to increase the cost of purchases.” Accordingly, the Tribunal deleted the adjustment holding that although it was presumed that royalty was to be charged by taxpayer, the same would get added in the purchases and overall impact would be revenue neutral.
Addl. CIT vs. Bestseller United India Pvt. Ltd

AY 2008-09, Supreme Court

Facts of the case:

- The taxpayer, Best Seller United India Pvt. Ltd., is a wholly owned subsidiary of Best Seller AS (“BSAS”) which is an international organisation in the business of trading of clothes under its brand.

- The clothes were primarily manufactured in Asia and sold in Western Europe. BSAS procured readymade garments and apparels from India to sell in Western Europe. BSAS owned several wholesale entities for selling and distributing goods in the domestic market. Its customers comprised of local retailers under Bestseller concept stores as well as independent multi brand retailers.

- The taxpayer was engaged in collecting samples and price estimates from producers in India and forwarding the details to BSAS. The collection of production samples from vendors in India was done as a support service to BSAS in relation to couple of brands only. The styles and designs were picked by BSAS. The taxpayer was also responsible for ensuring that suppliers complied with the Bestseller’s code of conduct and follow-up on suppliers to make sure that they delivered the right quality and complied with the delivery terms in general.

- The taxpayer was compensated with a markup of 2.5 per cent on cost of goods sourced by the taxpayer. The taxpayer in order to benchmark the international transactions used Transactional Net Margin Method (TNMM) as the most appropriate method with Operating Profit (‘OP’) / Operating Cost (‘OC’) as Profit Level Indicator (‘PLI’) by selecting 8 comparables having mean margin of 12.7 per cent as against the margin of taxpayer at 437 per cent. Thus the taxpayer demonstrated the international transaction to be at arm’s length.

- In appeal, [‘Dispute Resolution Panel’] DRP disagreed with TPO’s conclusion of making comparison with manufacturing companies and held that taxpayer should have been compensated at 5 per cent of the cost including FOB value of goods. The DRP directed TPO to compute ALP accordingly. In pursuance with DRP directions, TPO restricted TP addition to Rs 13.88 cr.

ITAT Observation and Ruling:

- In the backdrop of jurisdictional HC ruling in Li & Fung India Pvt Ltd, ITAT held that TPO/DRP erred in making TP adjustment of Rs 13.88 crores. ITAT noted that the taxpayer’s PLI at 437 per cent is higher than 12.27 per cent of the comparables which were engaged in activities similar to or identical with that of taxpayer and thus deleted the TP adjustment.

HC and SC Observation and Ruling:

- The Revenue filed an appeal in Hon’ble High Court (‘HC’) against the order of ITAT. HC noted that ITAT has provided 21 reasons to support taxpayer’s claim that international transactions are at arm’s length. Further, HC observed that the ITAT decision in case of Li & Fung India Ltd as relied upon by AO/DRP has been reversed by jurisdictional HC. Accordingly, HC in case of taxpayer, held that analysis carried out by ITAT was intensive as well as exhaustive and dismissed the Revenue’s appeal holding that no substantial question of law arises for its consideration.

- Aggrieved by the decision of HC, the Revenue filed an appeal before Hon’ble Supreme Court (‘SC’) which has been admitted. The SC directed to tag taxpayer’s case with Li & Fung appeal.
**Pr. CIT vs. Mitsui & Co India Pvt. Ltd**

**AY 2009-10 and AY 2010-11, Delhi ITAT Bench**

**Facts of the case:**

- The taxpayer, Mitsui & Co India Pvt. Ltd is a wholly owned subsidiary of Mitsui & Co. Ltd. Japan (“Mitsui Japan”), which is one of the leading Sogo Shosha establishments in Japan.

- The taxpayer was engaged in provision of indenting services and trading for resale in India. The taxpayer benchmarked the transactions of provision of indenting services using TNMM as the MAM with the Berry Ratio being the PLI.

- The TPO rejected the taxpayer’s approach of benchmarking as he was of the view that by using Berry Ratio the international transactions relating to sales and services of the commodities have remained out of the PLI.

- The TPO held that as per the provisions of Rule 10B (1)(e) (i), the net profit margin realised by the taxpayer from an international transaction entered into with AEs was to be computed in relation to the costs incurred, sales effected or assets employed by the taxpayer.

- The TPO held that as regards the support services provided by the taxpayer is concerned, the right course would be to treat such services as equivalent to trading and the income received by the taxpayer from such support services was to be considered as income from trading and comparison need to be made accordingly. He applied the gross margin earned from non-AE transactions to the FOB value of goods and determined the arm’s length commission for the indenting segment.

- The taxpayer also placed reliance on the decision of Sojitz India (P) Ltd vs DCIT 24 ITR (Trib) 474 (Del) and decision of Hon’ble Delhi HC in case of Li & Fung India Pvt Ltd vs CIT 361 ITR 85 (Delhi) wherein similar issue was decided in favour of the taxpayer.

- The TPO made adjustment to the value of international transactions.

- The taxpayer filed an appeal with the DRP. The DRP upheld the order of the TPO, and the taxpayer filed an appeal with the ITAT.
ITAT Observation and Ruling:

- The Tribunal held that the nature of indenting transaction was different from trading transaction. The activities of purchase and sale i.e. trading involves risk and finance whereas the activity of support services i.e. intending transaction the taxpayer neither has to incur any financial obligation nor carry any significant risk. Since, no sales have been effected by the taxpayer company it would not be appropriate to take cost of sales for computing margin.
- The Tribunal followed the decision of the Delhi HC in case of Li & Fung India Pvt. Ltd. v. Commissioner of Income Tax (2014)361 ITR 85 (Del.), where an identical issue had come up for consideration and the contention of the tax authorities was rejected.
- Aggrieved by the order of the ITAT, the tax authorities filed an appeal with the HC.
- PLI at 437 per cent is higher than 12.27 per cent of the comparables which were engaged in activities similar to or identical with that of taxpayer and thus deleted the TP adjustment.

HC and SC Observation and Ruling

- The High Court was of the view that the contention of the Revenue in the taxpayer’s case was covered against the Revenue in the aforementioned decision of Li & Fung India (supra).
- The learned counsel for the Revenue pointed out that the said decision has been challenged by the Revenue before the Supreme Court.
- In view of the above, HC held that it was not correct on the part of TPO to consider the cost of sales incurred by the AEs in the denominator while computing the PLI as the taxpayer company is only rendering services.
- Aggrieved by the order of HC, the Revenue filed an SLP with Supreme Court which has been admitted.
Sun Pharmaceutical Industries Ltd.

AY 2008-09, Ahmedabad ITAT Bench

Facts of the case:

- The taxpayer, Sun Pharmaceutical Industries Ltd (SPIL), is engaged in the manufacturing of bulk drugs as well as formulation products. The manufacturing was done at various factories located in India.

- SPIL had a division which carried out research and development ("R&D") activities for Pantoprazole Tablets till February 2007, consequent to which, this R&D division for Pantoprazole Tablets was demerged into a separate Indian company, Sun Pharma Advance Research Company Limited ("SPARC"). Thereafter in 2007 SPARC transferred all IPR to Sun Pharma Global BVI ("SPG") pursuant to sale agreement. Consequent to this, SPG entered into an agreement with SPIL for contract manufacturing of generic drugs as per specifications and technology provided by SPG.

- The other key facts of the case are provided below:
  - SPIL/ taxpayer had sold medicine called Pantoprazole Tablets, manufactured at its US FDA plant to its AE SPG. The taxpayer earned a margin of 21.57 per cent on these sale transactions. SPIL's functions for this transaction was only restricted to manufacturing of Pantoprazole Tablets post the transfer of IPR. The taxpayer has a similar arrangement for contract manufacturing with Eli Lily (third party) which was considered as comparable to benchmark the international transaction with AE and used Transactional Net Margin Method (TNMM) as the Most appropriate method ("MAM"). The taxpayer earned margin of 14.43 per cent from the transaction with Eli Lily.
  - The AE further sold Pantoprazole Tablets to Caraco Ltd the entity responsible for marketing these products in US without any value addition and earned a margin of over 96 per cent.
  - SPG was the owner of the IPRs inclusive of both Abbreviated New Drug Application ("ANDAs") and the technology to manufacture the Pantoprazole tablets. Thus, AE being the substantial owner of IPRs undertook the risks of protecting the IPR against any infringement claims. The ownership of the IPR was substantiated by the fact that immediately after launch of Pantoprazole tablets in US, Pfizer and Takeda instituted litigation against AE claiming huge compensation and damages for violation of US patent rights. This litigation resulted in an out of court settlement between the AE and Pfizer and Takeda for which USD 506 million was paid by SPG.

Proceedings before the TPO

- The TPO rejected the benchmarking approach adopted by the taxpayer. He alleged that taxpayer had undertaken substantial steps in sale transaction, assumed the key risk associated with the sale of the product and was not merely a contract manufacturer. TPO observed that even SPG was the owner of ANDA and technology associated with production of Pantoprazole tablets as per US- FDA, taxpayer had substantial stake in sale of drug and risk carried along with it. Accordingly, TPO adopted Profit Split Method (PSM) as the most appropriate and made a TP-adjustment of Rs 382.52cr with a 50:50 ratio of total profit split.

Proceedings before the Commissioner of Income Tax Appeals CIT(A)

- During the proceedings before the CIT(A), the CIT(A) compared taxpayer’s agreements with SPG and with Eli Lily (third party) which the taxpayer used to benchmark its international transaction with its AE, to determine whether taxpayer was a contract manufacturer. CIT(A) noted that the contract with Eli Lily was in the nature of contract manufacturer since the agreements detailed specific details as to regarding activities to be carried out such as procurement of raw materials, technical specifications on the manufacturing process were covered. CIT(A) observed that no such specifications were mentioned in the agreement with SPG and taxpayer had merely sold goods manufactured at its own plant to SPG which were directly shipped to Caraco. Thus, CIT(A) held that taxpayer was not a contract manufacturer and upheld TPO’s rejection of TNMM.

- Further, CIT(A) rejected the profit allocation method followed by AO/TPO and conducted a revised FAR analysis. Based on the revised FAR analysis, CIT(A) enhanced the profit share from 50 per cent allocable to taxpayer to 80 per cent attributable to taxpayer and 20 per cent to AE (SPG) and proposed a TP-adjustment of Rs 612 cr.
Proceedings before the Tribunal

- To understand the ownership of IPR and technology, ITAT stressed on the need to examine the factual matrix qua the ownership of IPR/ANDA. ITAT noted that SPG purchased technology to manufacture Pantoprazole tablets from SPARC which was demerged from taxpayer. Immediately thereafter, SPG had entered into an agreement with taxpayer for contract manufacturing of Pantoprazole tablets.

- The ITAT noted that SPIL performed only one function i.e. manufacturing, while SPG was the owner of the IPRs carrying risk of litigation, technology obsolescence, etc. Since, SPG was exposed to claim settlement on account of patent infringements for the law suits filed by Pfizer and Takeda for Pantoprazole tablets confirmed that the risks were actually borne by SPG.

- Further, ITAT relied on SC ruling in Vodafone International Holdings B.V. [TS-23-SC-2012] which recognised that MNCs set up subsidiaries for furtherance of their objects and to carry on business smoothly in a competitive world. ITAT has provided certain essential value drivers for classification of a pharmaceutical manufacturer into a contract manufacturer vis-a-vis entrepreneurial manufacturer. The key factors to be taken into consideration are based on the functions performed, risk assumed and the assets employed by the taxpayer. Based on the facts, SPG is owner of the IPR and assumes all risk associated with this IPR which was substantiated by payments of USD 506 million on account of out of court settlement by the AE. Thus, ITAT established that the ownership of IPR/ANDA rights of Pantoprazole Tablets were with SPG.

- On perusal of the agreement between taxpayer & SPG, ITAT observed that it was clearly established that the taxpayer was nothing but a contract manufacturer of AE. ITAT stated that PSM can be applied when the international transaction involved transfer of unique intangibles or in multiple international transactions which are so inter-related that they cannot be evaluated separately for the purpose of determining ALP. Noting that both these criteria were absent in taxpayer’s case, ITAT held that PSM would not be the most appropriate method.

- The ITAT was of the view that TNMM can be applied in the taxpayer’s case to benchmark its international transaction. ITAT noted that taxpayer’s margin from the transaction with AE resulted in a margin of 21.57 per cent on sales transactions as compared to 14.43 per cent earned from transaction with Eli Lily. Thus the international transaction between the AE and the taxpayer were at arm’s length.

- Regarding Revenue’s contention that agreement with Eli Lily established that it was a mere contract manufacturer but agreement with taxpayer did not fulfil conditions of a contract manufacturer, ITAT opined that the revenue authorities has only considered the relevant clauses of the agreement. However, the revenue should also have considered the functions performed by the taxpayer for classification. Further, ITAT stated that absence of certain terms and conditions in the agreement with AE would not by itself deny the status of contract manufacturer to taxpayer. ITAT reiterated that taxpayer had performed only 1 function i.e. manufacturing of Pantoprazole tablets and the ownership of ANDA and the technology for manufacturing of Pantoprazole tablets was clearly established to be with SPG. Accordingly, ITAT upheld the application of TNMM over PSM thereby deleting TP-adjustment of Rs. 612.03 crores.
The taxpayer, Bechtel India Private Limited ("Bechtel India") is a captive service provider, providing services in nature of engineering design, financial and accounting support and IT infrastructure support to its AEs.

The TPO, during the assessment proceedings held that the taxpayer provided extended credit period to its AE on the sales made to it. Accordingly, adjustment was made on account of receivable balance using Comparable Uncontrolled Price ("CUP") method taking normal credit period of 30 days and interest rate of 14.88 per cent.

The adjustments made by the TPO were upheld by the DRP. Aggrieved by the directions of the DRP, the taxpayer appealed before the Delhi.

Decision of the Tribunal:
In relation to the adjustment made on delayed receivable, taxpayer contends:
Taxpayer has not earned any interest on any advances to third party except for return on fixed assets.
• Cost of funds blocked in the credit period are factored in the sale price.
• Taxpayer is a debt-free company

The Tribunal held that in case where a company is debt free, it is not justifiable to presume that, borrowed funds have been utilised to pass on the facility to its AEs, thereby no separate adjustment for interest on receivable is warranted. Further, it noted that the revenue failed to bring on record that taxpayer has paid interest to its creditors or suppliers on delayed payments.

Decision by the Delhi HC:
Aggrieved by the decision of the Tribunal, the revenue filed its appeal before the HC. The HC held that the Tribunal has returned a detailed finding of facts that taxpayer is a debt-free company and question of receiving any interest on receivable balance did not arise. Thus, the HC dismissed the appeal on the ground that no substantial question of law arose in this matter.

Decision by the Supreme Court:
Aggrieved by the decision of HC, the Revenue had filed a petition before the Hon'ble Supreme Court (SC). The SC dismissed the appeal relying on the findings of the Tribunal.
a. Notifications/ press releases

India notifies Multilateral Competent Authority Agreement (‘MCAA’) for automatic exchange of CbCR

India, being a party to the Convention on Mutual Administrative Assistance in Tax Matters, had signed the MCAA at Beijing on May 12, 2016. In exercise of powers u/s 286(9)(b) of the Act, the Ministry of Finance has notified the said agreement. The notification also includes the text of the MCAA.

ICAI releases draft Sec 92E Guidance Note updated with Finance-Act 2017 amendments for comments

The draft incorporates amendments by the Finance Act 2017 like secondary adjustment, removal of expenditure for which payment is made to specified persons u/s 40A(2)(b) from the ambit of specified domestic transactions, etc. Further, the draft also provides comparison of safe harbour rules under old and new notification and also tabulates safe harbour rules for specified domestic transactions.

b. Advance pricing agreement (“APA”) updates

Indian APA regime moves forward with signing of 15 APAs by CBDT during the quarter

The CBDT has signed 15 APAs signed during the quarter ended September 2017 taking the APA tally to 177. The first APA with taxpayer in Oil and Gas sector was signed during the period.

<table>
<thead>
<tr>
<th>S.No</th>
<th>APAs signed till date</th>
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<tr>
<td>Bilateral APA</td>
<td>13</td>
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<tr>
<td>Unilateral APA</td>
<td>164</td>
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c. Grant Thornton Publications

Arm’s length attribution of profits to PE (Part I): Evolution in Indian Jurisprudence

The article provides a perspective on the attribution of profits in case of permanent establishments with reference to Indian jurisprudence.

Revised OECD TP Guidelines - the new anatomy of Chapter VIII - Cost Contribution Arrangements (‘CCA’)

The article talks about the revision of guidelines on CCA as an outcome of the BEPS project of the OECD.

Offshore Marketing Hubs – Standing up to scrutiny?

The article analyses the compliance guidance for offshore marketing hubs issued by the Australian Tax Office and potential scrutiny by the Indian tax authorities.

Source: Ministry of finance, Govt. of India
Press release: I Press release: II
Global corner

This section highlights the TP environment worldwide to give a wider perspective on what is happening around the world. For this issue we have selected United Kingdom (‘UK’), focusing on the evolving TP regime, along with other significant updates.

a. Updates from United Kingdom

1. UK signing Multilateral Convention to implement Tax Treaty related measures to prevent BEPS

UK signed the OECD’s multilateral convention to implement tax treaty related measures to prevent base erosion and profits shifting, known as the multilateral instrument, along with 68 countries at a ceremony in Paris, while another eight jurisdictions have expressed their intent to sign shortly.

The multilateral instrument has received a largely positive welcome from UK tax professionals, with Chartered Institute of Taxation (‘CIOT’) commenting that it was an example ‘that international co-operation of this kind is far better than unilateral action by individual states’.

The CIOT has also commented that as far as UK companies are concerned, many of the BEPS prevention measures have already been implemented into domestic law, or are expected to be implemented in the near future, and these domestic measures are likely to have a more significant impact than the multilateral convention.

The UK has also indicated that it will not implement the convention where existing treaty provisions or domestic law already provides suitable protection against BEPS.

Furthermore, some key countries will not (yet) be signatories, and many others will not adopt all of the possible measures. For example, the proposed extension to “permanent establishment” definitions which would make businesses entering new countries liable for local tax much sooner than before, could be a potential drag on international trade and for that reason it is not supported by the UK.

2. Newly introduced guidance on Cash Pooling

On 6 February 2017, the HMRC (‘HM Revenue & Customs’) published guidance on cash pooling arrangement covering TP matters related to the cash pooling. This guidance explains by way of examples the potential challenging areas associated with a cash pooling arrangement.

The HMRC guidance through various parts/chapters provide guidance on the cash pooling arrangement for a UK cash pool leader or participant.

<table>
<thead>
<tr>
<th>Parts / Chapters</th>
<th>Relevant information</th>
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<tbody>
<tr>
<td>Introduction to Cash pooling</td>
<td>• This chapter contains a brief overview of how cash pooling arrangements work. Also, it explains the operational benefits of a cash pooling arrangement.</td>
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<tr>
<td>Legal and commercial arrangements</td>
<td>• This chapter explains the difference between a notional and zero balancing pooling arrangement and attaches lot of importance for the need to review legal documentation to determine the specific nature of the pooling that is taking place. Also, it explains the concept of cross guarantees and its impact on risk on the depositors to the pool.</td>
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<td>Setting interest rates for participants on an arm’s length basis</td>
<td>• This chapter explains the basis upon which benefits are allocated within most cash pooling arrangements (i.e. through the use of borrowing and deposit rates). This chapter also considers cost plus remuneration as an alternative for the cash pool leader. The key considerations in applying the arm’s length principle to cash pooling arrangements are covered in this chapter. The chapter deliberates on the recent OECD Report on Aligning TP Outcomes and Value Creation (October 2015). It also discusses on how group synergies should be shared within a group.</td>
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<tr>
<td>Topic</td>
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<td><strong>Short term and long term balances held in the cash pool</strong></td>
<td>This chapter explains the aspects of cash pooling arrangements that could have an impact on the pricing considerations. Also, this chapter provides illustrations pertaining to scenarios where the activities of participants to a cash pooling arrangement may differ from those existing between independent parties.</td>
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<td><strong>UK company as long term depositor in the cash pool</strong></td>
<td>This chapter explains a scenario whereby a UK company having significant deposits in a cash pool for longer than 12 months and further explains the aspects (viz. funding needs, funding costs, reasons for deposits for long time, functions performed etc.) one should take into considerations while analysing such a scenario.</td>
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<td><strong>Also, it talks about the pricing considerations having nexus with cross guarantee arrangements and the potential merits of splitting the pool benefits by using the profit split approach.</strong></td>
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<td><strong>UK company as long term borrower in the cash pool</strong></td>
<td>This chapter states that to the extent that UK companies are structural borrowers in the cash pool, this does not present a significant tax risk to the UK from a rate perspective, as it is likely that the interest rate being charged is less than the rate that would be charged based on the arm’s length principle, which is an expected benefit of participation as a borrower.</td>
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<td><strong>However, the quantum of debt should still form part of the overall assessment as to whether the company is thinly capitalised (an excessive level of debt compared to the amount that it would have as an independent enterprise).</strong></td>
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<td><strong>UK company as the cash pool header</strong></td>
<td>This chapter provide details of the additional considerations for a UK cash pool header, over and above the spread between borrowing and deposit rates within the pool. This includes holding excess deposits /having a net funding position and liquidity risk associated with short term deposits / long term borrowing being funded from the pool.</td>
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<tr>
<td><strong>UK company as the cash pool header and the arm’s length principle</strong></td>
<td>This chapter discusses on the monitoring requirements for a UK cash pool header to ensure short term balances do not become long term in nature along with other considerations. Also, this chapter describes the need to re-price balances for instances where the substance of the arrangement differs from its legal form (i.e. that a long term balance which is legally described as a short term balance).</td>
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<td><strong>Netting considerations</strong></td>
<td>This chapter mentions that one of the relevant considerations is whether balances should be netted off, and if so, at what level. The issue was considered in Bombardier, a Danish tax case regarding a cash pool member (DK: Admin. Tax. Ct., 21 Oct. 2013, Case 12-0189459). That case concluded that interest should be calculated on the net position, if the cash pool participant has both deposits and borrowings in the cash pool. In terms of country netting (e.g. different subsidiaries in the same country having a cash pool locally), unless this is part of the legal/commercial arrangements, there is no perceived obligation on tax authorities to consider separate taxpayers in the same tax jurisdiction on a “net basis”. However, in practical terms, if the overseas subsidiaries were in a parent/subsidiary relationship, on a without prejudice basis, there may be arguments for assessing their respective deposit/borrowing positions on a net basis.</td>
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<td><strong>Another consideration would be whether one can net between different currencies – as interest rates can differ significantly depending on the currencies being deposited/borrowed, it may not be appropriate to net the balances of different currencies. Whether or not a group can net currencies will depend on its commercial arrangements with its third party bank. If netting is permitted, clearly this should be respected under the TP arrangements as well.</strong></td>
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<td><strong>Risk assessment / compliance check</strong></td>
<td>This chapter lists the key documents the caseworker should assess to identify whether there is a cash pool, what the role of the UK entities are within the cash pool (depositor, borrower, cash pool header, etc.), and how rates are set. It also discusses the documentation requirements per the OECD Guidelines with respect to pricing of the pool.</td>
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3. Criminal Finances Act, 2017

In April 2017, in the UK a new Criminal Finances Act 2017 [the Act] introduced corporate offences for failing to prevent the facilitation of UK and offshore tax evasion by an associated person. It has recently been confirmed that this new Act will be effective from 30 September 2017.

The offence of failing to prevent UK tax evasion applies to all companies and partnerships regardless of the jurisdiction they are formed in. Failing to prevent an equivalent offence under foreign law applies to:

- UK companies or partnerships
- Foreign companies and partnerships with a place of business in the UK
- Foreign companies and partnerships where the act of facilitation has taken place in the UK

Prior to the Act, it was already illegal to evade tax, or assist a taxpayer in doing so. The key difference between Act and previous legislation is that the Act now makes a firm criminally liable if an employee or associated person facilitates tax evasion, regardless of whether the employer’s management were even aware or involved in the act. Associated persons are defined broadly and include employees, agents or other persons performing services for or on behalf of the company or partnership. This means that risks posed by suppliers, contractors and intermediaries must be considered. Importantly an individual does not necessarily need to have a contract with the firm in order to be classified as an associated person. This can represent practical difficulties in identifying who your associated persons are.

Ignorance of the crime on the part of the taxpayer’s management, or a lack of intent is not sufficient to prevent being charged with failure to prevent the facilitation of tax evasion. Tax payers instead need to demonstrate that they have implemented reasonable controls and preventative procedures against facilitation offences within their organisation in order to defend a potential prosecution. HMRC have issued draft guidance in October 2016 setting out its six guiding principles:

- Risk assessment
- Proportionality of risk-based prevention procedures
- Top level commitment
- Due diligence
- Communication (including training)
- Monitoring and review

The penalties for a business (if someone acting their behalf commits an offence of facilitating tax evasion) can include:

- An unlimited fine
- Ancillary orders such as confiscation orders or serious crime prevention orders

There is an emerging need to better understand how these new rules could impact taxpayers business so that adequate risk assessment could be conducted to ensure that the taxpayers have reasonable controls and procedures so that they can avail themselves of the statutory defence.

b. Updates from OECD

Action 13: CbCR and TP documentation

1. OECD updates guidance on implementation of CbC reporting

The guidance addresses two specific issues:

- Treatment of an entity owned by two or more unrelated MNE groups: clarifies that if applicable accounting rules require an entity to be consolidated into the consolidated financial statements of an MNE Group, the financial data of such an entity should be reported in the CbC report of the MNE Group
- Reporting of data on aggregated or consolidated basis in Table I of CBRC table: clarifies that if the jurisdiction of the Ultimate Parent Entity has a system of taxation for corporate groups which includes consolidated reporting for tax purposes data may be reported on consolidated basis

Further guidance was released in September providing clarification of treatment of certain revenue and tax items. Further, the guidance provided for transitional relief to MNEs with short accounting periods.

2. Guidance on appropriate use of CbCR

OECD has issued guidance on appropriate use of information filed in CbCR. This guidance highlights the consequences of non-compliance with the appropriate use condition and also recommends approaches that could be followed by tax administrations to ensure the appropriate use of information disclosed in the CbCR.
## Citations

<table>
<thead>
<tr>
<th>Case law</th>
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<td>Addl. CIT vs. Bestseller United India Pvt. Ltd</td>
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<td>Bechtel India Private Limited</td>
<td>TS-691-SC-2017-TP</td>
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<tr>
<td>Pr. CIT vs. Mitsui &amp; Co India Pvt. Ltd</td>
<td>TS-602-SC-2017-TP</td>
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<tr>
<td>Dabur India Ltd vs. ACIT</td>
<td>TS-512-ITAT-2017(Del)-TP</td>
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<tr>
<td>Sun Pharmaceutical Industries Ltd.</td>
<td>TS-596-ITAT-2017(Ahd)-TP</td>
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# Glossary

<table>
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<th>Abbreviations</th>
<th>Full name</th>
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<tr>
<td>AE</td>
<td>Associated enterprises</td>
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<td>ALP</td>
<td>Arm’s length price</td>
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<td>AMP</td>
<td>Advertisement Marketing and Promotion</td>
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<td>AO</td>
<td>Assessing officer</td>
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<td>APA</td>
<td>Advance Pricing Agreement</td>
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<td>Taxpayer Representative</td>
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<td>AV</td>
<td>Assessment Year</td>
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<td>BEPS</td>
<td>Base erosion and profit shifting</td>
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<td>CbCR</td>
<td>Country-by-country report</td>
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<td>CBDT</td>
<td>Central Board of Direct Taxes</td>
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<td>Cost Contribution Agreement</td>
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<td>CIOT</td>
<td>Chartered Institute of Taxation</td>
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<td>CUP</td>
<td>Comparable uncontrolled price</td>
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<td>DRP</td>
<td>Dispute Resolution Panel</td>
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<td>Double Taxation Avoidance Agreement</td>
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<td>FAR</td>
<td>Functions, assets and risks</td>
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