Transfer pricing

Financier Worldwide canvasses the opinions of leading professionals around the world on the latest trends in transfer pricing.
Q. In your opinion, do companies pay enough attention to the challenges and complexities of maintaining compliant transfer pricing policies?

MITRA: Generally, while many multinational corporations (MNCs) have been conscious of maintaining largely compliant transfer pricing policies, their approach has been biased toward jurisdictions which have more stringent regulations. MNCs need to appreciate that a pricing policy which may be compliant in the headquarter jurisdiction may not be compliant with local benchmarks and regulations. Every jurisdiction has its own regulations and thus MNCs must ensure that their transfer pricing policies adhere to local laws as well. Usage of local comparables and databases, reliance on safe harbour rules where available, and knowledge of the jurisprudence prevailing in other countries are just a few of the factors which MNCs should keep in mind while framing their transfer pricing policies. Such complexities and challenges are compelling MNCs to look for bilateral dispute resolution mechanisms like advance pricing arrangements (APAs) and mutual agreement procedures (MAPs). The pragmatic approach of the Indian government and tax policy administrators
The Indian tax authorities have placed greater importance on the issue of transfer pricing in recent years, and increased their monitoring and enforcement activities. This has been reinforced by progressive measures such as the adoption of global best practices related to BEPS, the introduction of safe harbour rules, the APA programme, following a risk based tax scrutiny approach and the newly introduced ‘faceless’ assessment procedure. These measures demonstrate the increased focus on transfer pricing in India.

**Q. To what extent have the tax authorities in India placed greater importance on the issue of transfer pricing in recent years, and increased their monitoring and enforcement activities?**

**MITRA:** Transfer pricing has been a key focus area for Indian tax authorities, as has been demonstrated by some of the steps taken over the years. Progressive measures such as the adoption of global best practices related to BEPS, the introduction of safe harbour rules, the APA programme, following a risk based tax scrutiny approach and the newly introduced ‘faceless’ assessment procedure, reinforce the fact that transfer pricing holds a prominent place in the tax policy framework. Over the years, the tax authorities have strengthened their policy frameworks with the introduction of new specialist cells for APAs and country-by-country reporting (CbCR), hiring more officers for transfer pricing and opening exclusive dispute resolution forums, like the dispute resolution panel, which comprises three commissioner level officers hearing transfer pricing and international tax disputes. The use of technology and data analytics is another aspect wherein the tax authorities are upskilling themselves to handle increasing volumes of data and to analyse complex MNC structures.

**Q. What steps should companies take if they become the subject of a tax audit or investigation?**

**MITRA:** At the outset, it is imperative to note that until 2016, the threshold for a taxpayer to be subjected to a transfer pricing audit in India was very low – any company engaged in international transactions worth more than $2m was selected for investigation. In such a scenario, the number of MNCs subjected to audits in a single year was huge. However, with certain tax policy reforms, the approach of the tax authorities has changed and now the focus is more on the complex transactions relating to intangibles, intra-group charges, financing transactions and the existence of permanent establishments (PEs). Previously, many MNCs have been apprehensive about sharing data with the tax authorities that leads to tax adjustments. A more reasonable approach would be to work conjointly with the tax authorities and make them understand any complex tax positions being taken by the taxpayer.

**Q. What kinds of challenges arise in calculating appropriate transfer prices, both for tangible and intangible assets? How crucial is it to have consistent supporting documentation?**

**MITRA:** The core issue of setting up transfer prices for tangibles and intangibles lies not in their valuation but where they fit in the supply chain of the organisation. Calculating appropriate transfer prices based on comparable companies is a much less complex issue now. The focus of MNCs should be on understanding the key value drivers of the business, how the local subsidiary fits into the value chain and the key aspects of intangibles and their ability to be monetised. Supporting documentation plays a crucial role and it needs to be understood that the documentation should be prepared and maintained on a real-time basis rather than after the fact. India has stringent documentation...
compliance regulations and the tax authorities often take a stringent view on a lack of supporting documentation. MNCs should look at supporting documentation as a ‘must have’ and not a ‘good-to-have’.

Q. Have you seen an increase in transfer pricing disputes between companies and tax authorities in India?

MITRA: Transfer pricing has been the key focus area for tax administrators in India since the introduction of the regulation in April 2001. However, liberalisation reforms and radical changes in business models have resulted in India’s significant contribution toward global transfer pricing jurisprudence. The early years of Indian transfer pricing saw significant litigation as tax authorities aggressively scrutinised all forms of international transactions, with issues ranging from simpler topics on comparables to more complex economic concepts. Such an approach resulted in voluminous and large-scale tax adjustments, which have adversely impacted the sentiments of MNCs and large conglomerates operating in India. The large tax adjustments resulted in tax uncertainty, increased tax cash outflows and cautioned MNCs about their inbound investments. Being cognisant of the ripple effects of such adjustments, the Indian government undertook the necessary steps to alleviate the concerns of the MNCs. However, the introduction of safe harbour rules and risk-based assessments, along with the success of the APA regime, has been instrumental in reducing the number of transfer pricing disputes in India.

Q. Could you outline the role and influence of the Organisation for Economic Co-operation and Development (OECD) on transfer pricing regulation in India, including the latest developments on base erosion and profit shifting (BEPS)?

MITRA: India’s active participation in the G20 initiative and adoption of the BEPS Actions 8-10 and Action 13 demonstrates its commitment toward the applicable guidelines and information requirements. However, some of the concepts ascribed in Action 8-10 are not new to India’s audit topography and are merely an enforcement of what tax officers have adopted in past audits, particularly audits conducted during the hyperactive phase from 2008 to 2013. Some of the recent questionnaires issued by tax authorities during assessment proceedings and rulings include citations and concepts included in the BEPS guidelines. Concepts like ‘substance over form’, evaluation of intangibles using development, enhancement, maintenance, protection and exploitation (DEMPE) analysis, and focus on significant people function are gaining importance with the tax authorities. Going forward, taxpayers may want to keep an eye out for the application of other concepts laid down under the BEPS actions. The rise in digital businesses will lead to newer business models which will require the application of newer rules and concepts provided under Action 1. With most of these models requiring transfer pricing solutions, it will be interesting to see how the Indian tax authorities will interpret and thereafter implement such rules and concepts in cases.
Q. In general, what advice would you give to companies on reviewing and amending their transfer pricing policies and structures?

MITRA: The field of transfer pricing is rapidly changing. The BEPS initiative, the introduction of multilateral instruments (MLIs) and a slew of policy and procedural-level changes at the local level are a few of the aspects which are forcing MNCs to review and amend their existing structures. The general advice to MNCs in these changing times would be to keep their tax policies simple, consistent and compliant. Maintaining supporting documentation is key, and works in favour of the taxpayer if a pricing policy is undergoing a change. MNCs should also not be wary of sharing their data and policies with tax authorities and should be transparent in their dealings with the tax authorities.

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