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India's 2014 Budget Includes Transfer Pricing Proposals

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By Samir Gandhi and Manisha Gupta (Mumbai)

India's Finance Minister Arun Jaitley on July 10 unveiled Narendra Modi's government's first budget, which included some transfer pricing items from taxpayers' wish list.

Transfer pricing regulations were introduced in India in 2001. Since then, taxpayers have called for the introduction of the multiple-year data and arm's length range concepts. Finally, taxpayers may be in for the "Acche Din" or good days the Modi administration has promised.

Introduction of range concept

India's Income Tax Act, 1961, provides that when more than one price is determined using the most appropriate method, the arm's length price will be the arithmetic mean of such prices and the variation, if any, should not exceed 1 percent for wholesale traders and 3 percent in other cases.

In his speech, the finance minister proposed the introduction of the range concept to determine an arm's length price, to align with international best practices. International guidance such as the OECD transfer pricing guidelines, the UN Transfer Pricing Manual, and the transfer pricing regulations of developed countries adopt the concept of the interquartile range, whereby the results of the bottom quarter and the top quarter of the data set are discarded. If the price of the transaction under examination falls within the two quarters left, then the transfer price is said to adhere to the arm's length standard.

However, it is interesting to note that the finance minister mentioned that the arithmetic mean will not be done away with completely, and will continue to apply when the number of comparables is inadequate. The minister mentioned that the relevant data is under analysis and that detailed rules in this regard will be issued in due course. Taxpayers will have to wait for the rules to be issued for more clarity on the implementation of the range and mean concept.

Hopefully, the prescribed regulations will apply the concept of full range or interquartile range, rather than a restricted range for various industries/activities, such as the current 1 percent for wholesale trading and maximum of 3 percent for all other cases.

Multiple-year data

Current rules require that the data to be used for determining an arm's length price compulsorily must pertain to the year in which the international transaction is entered into, unless a taxpayer can provide evidence that the data for the prior two years has a bearing on the transfer price. This created significant issues for taxpayer, because some industries may be cyclical, prices are generally set based on the past year's data, and current-year data may not be available at the

time documentation is prepared,.

The finance minister proposed to amend the regulations to allow the use of multiple-year data, which is in line with international guidance and international best practices. However, no further details were provided in the Finance Bill or the Explanatory Memorandum. Again, taxpayers will have to wait for the rules/notifications to be issued for more clarity regarding implementation.

Rollback of Advance Pricing Agreements

In another welcome move that should help prevent and resolve disputes for open tax years and provide some certainty, the finance minister proposed a rollback mechanism under the current APA scheme, effective 1 October 2014.

The rollback will be available for a period of four years preceding the first year to which the APA applies. For example, if the APA has been agreed from FY 2015-16 onwards, then the agreement may also cover the prior four years -- from FY 2011-12 to FY 2014-15. The explanatory memorandum provides that conditions, procedures, and the manner of the rollback will be issued.

Clear guidance should be provided on how the pending audit and appellate proceedings for the years covered under the rollback would work during the APA negotiation stage.

Deemed International Transactions

Under the existing provision, a transaction between an enterprise and another person that is not an Associated Enterprise (AE) would be deemed an international transaction when there exists a prior agreement between such other person and AE of the enterprise or when the terms of the relevant transaction are determined in substance between such other person and the AE. There have been tribunal judgments that have held that at least one of the parties to the transaction must be nonresident. The Finance (No.2) Bill 2014 proposes to amend the definition, effective for transactions entered into from FY 2014-15, to clarify that for a transaction to be deemed an international transaction the unrelated party may or may not be nonresident. The bill has further amended the rules to clarify that either the enterprise (that is, the assessee) or the associated enterprise must be a nonresident for purposes of the applicability of the deemed international transaction.

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