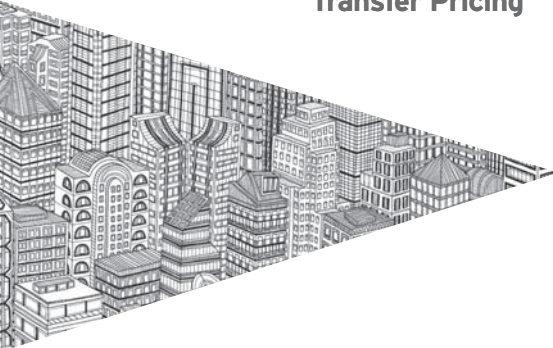


# International Tax Alert

News and views from  
Transfer Pricing



## Key amendments to transfer pricing provisions in India's Finance Bill, 2011

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### Background

The Indian Union Budget for 2011-12 was presented by the Finance Minister on 28 February 2011. The Finance Bill, 2011 (FB 2011) which was introduced in parliament as part of the Budget Proposals contains some proposals that seek to amend the transfer pricing provisions of Indian tax law (ITL). The Finance Minister also reinforced the intent of the government to enact the Direct Taxes Code, 2011 (DTC) with effect from 1 April 2012. This Alert highlights the key transfer pricing provisions contained in the FB 2011.

### Key amendments

#### Determination of arm's length price

- ▶ ITL prescribes various methods for determining the arm's length price (ALP) and requires application of the most appropriate method (MAM) and, where more than one price is determined by application of the MAM, the ALP will be taken to be the arithmetic mean (AM) of such prices. ITL was amended by the Finance Act (No. 2), 2009 to provide that if the variation between the arithmetic mean of the comparable prices and the taxpayer's transfer price is not more than five percent of the latter, the transfer pricing would be accepted as the ALP. However, if such difference is greater than five percent, the taxpayer would not get the benefit of the five percent range and the arithmetic mean computed shall be deemed to be the ALP.
- ▶ The FB 2011 proposes to amend ITL to provide that instead of a variation of five percent, the allowable variation will be such percentage as may be notified by the Central Government. According to the

memorandum explaining the provisions of the FB 2011, the rationale for the amendment is that a fixed margin of five percent across all segments of business activity and range of international transactions has outlived its utility. The amendment will be effective for the financial year 1 April 2011 onwards.

### **Powers of the transfer pricing officer**

- ▶ As per the provisions of the ITL, a transfer pricing audit starts with a referral made by the tax officer to the transfer pricing officer (TPO) for determination of the ALP of the transaction reported by the taxpayer and referred to the TPO by the tax officer.
- ▶ FB 2011 proposes to provide jurisdiction to the TPO to extend the determination of the ALP to international transactions the TPO identifies during an audit proceeding. These international transactions would be in addition to the international transactions referred to the TPO by the tax officer.
- ▶ Under current law, TPOs have wide powers to request information for purposes of determining the ALP during audit proceedings. The TPOs have the powers of:
  - Discovery and inspection
  - Enforcing the attendance of any person, including any officer of a banking company and examining him under oath
  - Compelling the production of books of account and other documents

- Issuing commissions
- The right to require any person to furnish information, statements of accounts and affairs and also giving information in relation to such points or matters as may be relevant to any enquiry or proceeding under the ITL

- ▶ The TPOs, however, do not have the power of survey, i.e., the power to enter the premises of the taxpayer for collecting documents.
- ▶ FB 2011 proposes to broaden the powers of the TPO to enable the TPO to also exercise the power of survey to conduct on-the-spot enquiries and verification.

The above amendments are effective from 1 June 2011.

### **Extension of the due date for statutory compliances**

- ▶ According to the ITL, every person who has entered into international transactions should keep and maintain prescribed information and documentation and also file an Accountant's Report along with the tax return. The information and documentation should, as far as possible, be contemporaneous and exist by the specified date of filing of the tax return, which is 30 September following the end of the financial year. Further, the data to be used in analyzing the comparability of uncontrolled transactions to related-party transactions will be the data relating to the relevant financial year in which the related-party transaction was entered.

- ▶ When transactional profit methods are used, a practical problem arises that the data relating to the relevant fiscal year may not be available by the due date for preparation of the documentation and the Accountant's Report. FB 2011, therefore, proposes to extend the due date of filing the tax return to 30 November following the end of the financial year. This amendment will be effective for the financial year 2010-11.

### **Assessment procedures**

The ITL provides time limits for the completion of audits. While computing the period of limitation for completion, certain time periods are excluded. Presently, the time taken for obtaining information from tax authorities in jurisdictions outside India as per tax treaties and/or tax information exchange agreements is not excluded. FB 2011 proposes to exclude the period commencing from the date on which a reference for exchange of information is made by the competent authority under a tax treaty and/or tax information exchange agreement and ending with the date on which the information so requested is received by the tax officer or a period of six months, whichever is less.

### **Application of transfer pricing to transactions with persons located in a notified jurisdictional area**

FB 2011 introduces an anti-avoidance provision in the ITL to discourage transactions with persons located in countries or territories that do not effectively

exchange information with India. This provision is envisaged to take effect from 1 June 2011. The amendment is proposed to strengthen the system of collection of information from foreign tax jurisdictions; it provides a tool box of counter measures to discourage transactions with entities located in non-cooperative jurisdictions (Notified Jurisdictional Area or NJA) as designated by the government. The provisions, inter alia, provide that if a taxpayer enters into a transaction where one of the parties to the transaction is a person located in a notified jurisdiction or country, then all the parties to the transaction will be deemed to be the associated enterprises and the transaction will be deemed to be an international transaction and, accordingly, transfer pricing regulations will be applicable.

## Implications

Timing issues with respect to collecting comparability data have been a challenge often faced by taxpayers in India as availability of information on contemporaneous uncontrolled transactions is limited in practice at the time of filing of tax returns. The amendment extending the due date for maintenance of transfer pricing documentation and related tax filings may therefore be welcomed by taxpayers as it could improve their ability to satisfy the contemporaneous documentation requirement. However, the proposal to remove the five percent range may allow taxpayers far less latitude when determining the arm's length nature of their transfer prices. While the amendment enables the government to designate a range, taxpayers are likely to face some degree of uncertainty.

One of the stated priorities of the government is to increase enforcement in the areas of undisclosed income. The introduction of the transfer pricing provisions with persons located in a NJA is one such step toward this objective. This will have some practical difficulties and challenges. Nonetheless, the proposal - consistent with global trends - demonstrates the continuing efforts of the government to tackle tax evasion and promote mutual exchange of information, especially with jurisdictions that may be considered as tax havens.

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