



## India Finance (No 2) Bill 2014 contains proposed amendments to transfer pricing provisions

### Executive summary

On 10 July 2014, the Indian Finance Minister (FM) presented the Finance (No.2) Bill, 2014 (FB 2014), as a part of the Union Budget 2014-15, before the Indian Parliament. In his speech, the FM expressed that transfer pricing (TP) is a major area of litigation for both resident and nonresident taxpayers. In an endeavor to reduce TP litigation and provide certainty and clarity to the taxpayer community, the FM has proposed amendments that include, among others:

- ▶ Introduction of roll-back provisions to the Advance Pricing Agreement (APA) regime
- ▶ Strengthening the administrative set up of APA to expedite processing of applications
- ▶ Introduction of the range concept and use of multiple year data to determine the arm's length price
- ▶ Changes to the definition of the term deemed international transactions
- ▶ Empowerment of the Transfer Pricing Officers (TPOs) to levy penalties

This Tax Alert summarizes the proposed amendments to the Indian TP regulations.

### Detailed discussion

#### APA related provisions

APA provisions were introduced in the Indian tax law by the Finance Act, 2012. The provisions in their current form enable taxpayers to enter into an APA only for a prospective period up to a maximum of five consecutive years. Presently, the provisions do not provide for a "roll-back" mechanism.

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With a view to reduce protracted TP litigation, the FB 2014 includes a proposal to introduce a “roll-back” provision in the APA regime so that an APA entered into covering a future period may also be applied to international transactions entered into by a taxpayer during any prior periods (not exceeding four years) preceding the first year for which the prospective APA is applicable. The conditions, procedure and manner of covering the APA results for the prior periods under the roll-back mechanism are yet to be prescribed. This amendment is proposed to take effect from 1 October 2014. It is also proposed that the administrative set up of APA will be strengthened to expedite processing of the applications.

#### **Determination of arm's length price (ALP)**

Under the current provisions, where more than one price is determined using the most appropriate method, the ALP shall be taken to be the arithmetic mean of such prices. The provisions also provide a tolerance band as may be notified; but in any case not exceeding 3% from the price of the international transaction.

The FM in his budget speech indicated that the TP Rules would be amended to recognize the use of a range concept in appropriate cases. The FM indicated that use of arithmetic mean as a statistical tool would continue where the number comparable companies are inadequate. Promulgation

of the amendment to the Rules is necessary to see how these provisions will be implemented.

#### **Use of multiple year data**

Indian TP Rules provide that the data to be used in analyzing the comparability of uncontrolled transactions with the related party transactions shall be the data relating to the relevant tax year in which the related party transaction was entered into. However, data relating to a period not more than two years prior to such tax year may also be considered for comparability analysis, if such data reveals facts that could have an influence on the determination of the transfer price in relation to the international transaction being compared.

The FM in his speech has proposed to amend the provisions to allow use of multiple year data for comparability analysis. It is still uncertain how this proposal will be implemented in the amended Rules.

#### **Changes to the definition of the term deemed international transaction**

Under the existing provisions, the term international transaction is defined to mean a transaction between two or more Associated Enterprises (AEs) where either or both the parties are nonresidents. Further, the deeming provision extends the scope of the term international transaction to cover a transaction entered into with an unrelated person, if there exists a prior agreement or the terms of the transaction are determined in substance between such unrelated

person and the AE. The provisions as they are presently worded provide that a transaction between two or more enterprises may not qualify as an international transaction (or deemed international transaction), if neither of them are nonresidents.

It is proposed to amend the relevant provisions to provide that in the case of deemed international transaction as referred to above, where either the enterprise or the AE or both of them are nonresidents, then such transaction shall be deemed to be an international transaction whether or not such other person is a nonresident. This is proposed to take effect from the tax year 2014-15 onwards.

#### **Empowering the TPO to levy penalties**

Under the current Indian TP regulations, the Assessing Officer or First Appellate Authority has powers to levy penalties up to 2% of the value of international transactions for failure to furnish TP documentation or any information as may be required. Given that TP audits are generally undertaken by TPOs, FB 2014 has proposed to empower the TPOs as well to levy a penalty in such cases. This amendment is proposed to take effect from 1 October 2014.

#### **Implications**

The FM has recognized that TP is a major area of litigation for taxpayers and has proposed to introduce provisions to provide certainty and clarity.

Generally speaking, an incentive for some taxpayers seeking APAs is the prospect of a roll-back of the result developed in an APA to resolve past open tax years. A roll-back may provide a cost-effective way to resolve an ongoing TP dispute. The absence of roll-back provisions in the Indian APA rules since its launch in 2012 has often been stated as a concern by many taxpayers. Hence, the proposal to enable roll-back of APAs is welcomed and may go a long way in further enhancing the benefits of the Indian APA program. The proposal

to permit use of the range concept and multiple year data in a TP analysis can be expected to provide taxpayers with greater flexibility in defending the arm's length nature of their transfer pricing arrangements.

The aforesaid proposals will be placed before the lower house and upper house of the Parliament for passing of the bill. Once the bill is passed by the Parliament, it would be submitted to the President of India for his assent following which the bill is enacted.

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