

Key aspects relevant for FY 2020-21 TP compliance

December 18, 2021



SCHEMA

- Form 3CEB related
- TP analysis and documentation related

Typical TP analysis process/steps

- ↓ Determination of years to be covered → Single year or multiple year?
- ↓ Broad based analysis of taxpayer's circumstances → Industry, covid impact, etc
- ↓ **Understanding of FAR and selection of tested party → Who and what to test?**
- ↓ Review of existing internal comparables → How was pricing determined?
- ↓ Identifying sources of external comparables considering their relativity
- ↓ **Selection of Most appropriate Transfer Pricing Method → Most important step**
- ↓ Identifying potential comparables
- ↓ **Determining and making comparability adjustments → compare Apple with Apple or any fruit would do?**
- ↓ **Interpretation and use of data collected and determining arm's length price → Conclusion in Form 3CEB**



Form 3CEB related
(emphasis on FY
2020-21)

When is TP applicable?

Section 92E (Form 3CEB):

“Every person who has *entered into an international transaction or specified domestic transaction*

during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date in the prescribed form duly signed and verified in the prescribed manner by such accountant and setting forth such particulars as may be prescribed.”

Key terminologies	Section reference	Applicability threshold	Key TP compliances when TP applicable
Associated Enterprises (AE)	92A	One of the AE to be non – resident	<ul style="list-style-type: none">• Form 3CEB• TP study report (Whether only required when value more than INR 1 crore (INR 10 million)?
International transaction	92B	Even INR 1 transaction requires Form 3CEB?	
Specified Domestic Transaction (SDT)	92BA	INR 20 crores (INR 200 million)	

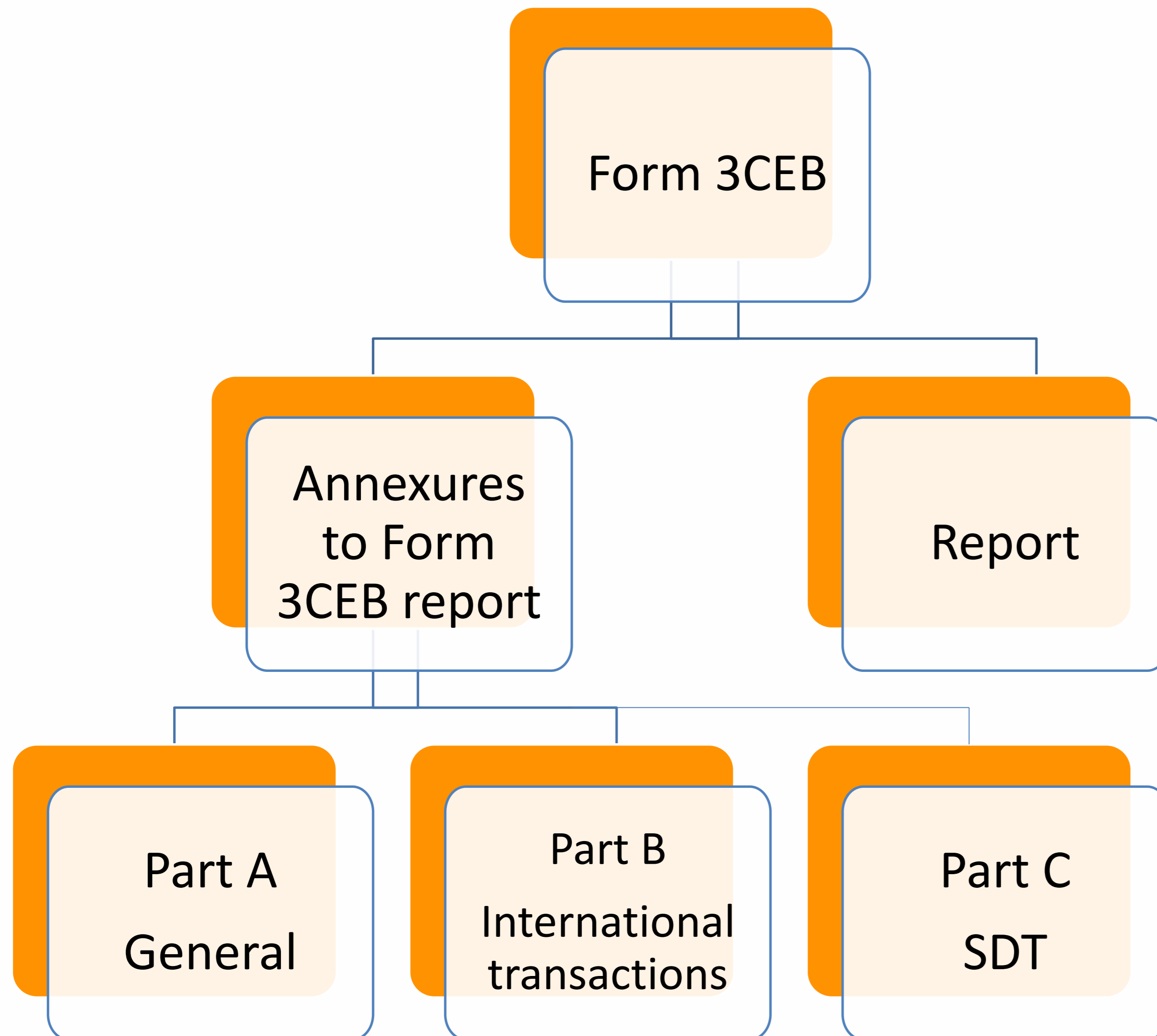
TP applicable, now what? Due dates?

- Taxpayer must **compute the arm's length price** of international transaction and SDT (hereinafter “controlled transaction”) as per the methods prescribed under section 92C
- Burden of proof is on the taxpayer to establish the arm's length price and to maintain documents required under the law – Transfer pricing study report, agreements, etc
- **Key due dates relevant for taxpayers for whom TP is applicable**

Compliance category	Original	Revised (as on date)
TP audit in Form 3CEB	November 30, 2021	January 31, 2022
Tax audit	November 30, 2021	January 15, 2022
Tax return	December 31, 2021	February 28, 2022
Designation of master file – Form 3CEAB	December 1, 2021	January 29, 2022
Master file in Form 3CEAA	December 31, 2021	February 28, 2022
Safe harbor – 3CEFA (if extended)	December 31, 2021	February 28, 2022

What about clause 30A of 3CD dealing with primary and secondary adjustment?

Form 3CEB – Various clauses explained...



Annexures to Form 3CEB

Part A:

Clause 1 to 9 – Particulars of the Tax payer

Part B:

Clause 10 to 20 – Particulars regarding international transactions

Part C:

Clause 21 to 25 – Particulars regarding specified domestic transactions

...Form 3CEB – Various clauses explained...

Report/Certificate

FORM NO. 3CEB[See rule 10E]

Report from an accountant to be furnished under section 92E relating to international transaction(s) and specified domestic transaction(s)



e-Filing *Anywhere Anytime*
Income Tax Department, Government of India

1. We have examined the accounts and records of [REDACTED] (name and address of the assessee with Permanent Account Number or Aadhaar Number) relating to the international transaction (s) and the specified domestic transaction(s) entered into by the assessee during the previous year ending on 31-Mar-2021.
2. In our opinion proper information and documents as are prescribed have been kept by the assessee in respect of the international transaction(s) and the specified domestic transactions entered into so far as appears from our examination of the records of the assessee.
3. The particulars required to be furnished under section 92E are given in the Annexure to this Form. In our opinion and to the best of our information and according to the explanations given to us, the particulars given in the Annexure are true and correct.

Observations/Qualifications

Sl. No.	Observations
1	While preparing this form 3CEB, we have relied on the Transfer Pricing study report maintained by the assessee. This form and the annexures to this form should be read with and subject to the notes to the form 3CEB and annexure thereto as submitted along with the physical copy of this form for the assessment year under consideration.

...Form 3CEB – Various clauses explained...

Part A : General

Part A

1. Name of the assessee
2. Address
3. Permanent Account Number or Aadhaar Number
4. Nature of business or activities of the assessee
 - Computer And Related Services
 - BPO services(14006)
 - Other IT enabled services(14005)
5. Status
 - Sub Status
6. Previous year ended
7. Assessment year
8. Aggregate value of international transactions as per books of accounts
9. Aggregate value of specified domestic transactions as per books of

...Form 3CEB – Various clauses explained...

Part B : International transaction

Clause : What disclosure	Details requested in FY 2020-21 Form 3CEB	Key changes in FY 2020-21 from previous year
10 : Associated Enterprises (AE)	<ul style="list-style-type: none"> Name of AE Nature of relationship with AE Brief description of business carried by AE 	No change
11A : Tangible property : Purchase/Sale of raw material consumables, any other supplies for assembling/processing or manufacturing	<ul style="list-style-type: none"> Name of AE Address Type of Unique Identification number (PAN/Tax Identification Number/Other) Type and description of transaction Quantity Unit name Type (paid /Received) Amount as per books Amount as per ALP Method selected Observation (Space for adding notes) 	<ul style="list-style-type: none"> Address: Requires pin code, Incase of Indian address, pin code is auto populated Identification number : New requirements this year Quantity : Needs to be selected from drop down. No alphabets allowed
11B : Tangible property : Purchase/Sale or traded goods		

...Form 3CEB – Various clauses explained...

Part B : International transaction

Clause : What disclosure	Details requested in FY 2020-21 Form 3CEB	Key changes in FY 2020-21 from previous year
11C : Tangible property : Purchase/Sale of any other tangible property	<ul style="list-style-type: none"> Name of AE Address Type of Unique Identification number (PAN/Tax Identification Number/Other) Description of transaction Quantity Type (paid /Received) Amount as per books Amount as per ALP Method selected Observation (Space for adding notes) 	<ul style="list-style-type: none"> Address: Requires pin code, Incase of Indian address, inserting pin code auto populates address Identification number : New requirements this year
12 : Intangible property : Purchase/sale transfer, lease or use of intangible property such as know-how, patents, copyrights, etc	<ul style="list-style-type: none"> Same details as above, except quantity details (however while generating the pdf, quantity details are appearing) 	<ul style="list-style-type: none"> Same changes as above
13 : Services : Availed or provided	<ul style="list-style-type: none"> Same details as above 	<ul style="list-style-type: none"> Same changes as above

...Form 3CEB – Various clauses explained...

Part B : International transaction

Clause : What disclosure	Details requested in FY 2020-21 Form 3CEB	Key changes in FY 2020-21 from previous year
14 : Lending or borrowing of money : includes advance, payments, deferred payments, receivable, non convertible preference shares/debenture, or any other debt	<ul style="list-style-type: none"> • Name of AE • Address • Type of Unique Identification number (PAN/Tax Identification Number/Other) • Nature of financing agreement • Currency of transaction • Lending/borrowing • Interest rate • Type (paid /Received) • Amount as per books • Amount as per ALP • Method selected • Observation (Space for adding notes) 	<ul style="list-style-type: none"> • Address: Requires pin code, Incase of Indian address, inserting pin code auto populates address • Identification number : New requirements this year
15 : Guarantee :	<ul style="list-style-type: none"> • Similar details as above, except lending/borrowing and interest type 	<ul style="list-style-type: none"> • Same changes as above
16 : Marketable security : Purchase/sale of marketable security or equity shares		

...Form 3CEB – Various clauses explained...

Part B : International transaction

Clause : What disclosure	Details requested in FY 2020-21 Form 3CEB	Key changes in FY 2020-21 from previous year
<p>17 : Mutual agreement or arrangement : allocation or apportionment of any cost or expense in connection with any benefit, service or facility, provided or to be provided</p>	<ul style="list-style-type: none"> • Name of AE • Address • Type of Unique Identification number (PAN/Tax Identification Number/Other) • Description of such mutual agreement/arrangement • Type (paid /Received) • Amount as per books • Amount as per ALP • Method selected • Observation (Space for adding notes) 	<ul style="list-style-type: none"> • Address: Requires pin code, Incase of Indian address, inserting pin code auto populates address • Identification number : New requirements this year
<p>18 : business restructuring or reorganization</p>	<ul style="list-style-type: none"> • Name of AE • Address • Type of Unique Identification number (PAN/Tax Identification Number/Other) • Nature of transaction • Terms of business restructuring • Type (paid /Received) • Method selected • Observation (Space for adding notes) 	<ul style="list-style-type: none"> • Same changes as above

...Form 3CEB – Various clauses explained...

Part B : International transaction

Clause : What disclosure	Details requested in FY 2020-21 Form 3CEB	Key changes in FY 2020-21 from previous year
19 : having bearing on profits, income, losses, or assets	<ul style="list-style-type: none"> Name of AE Address Type of Unique Identification number (PAN/Tax Identification Number/Other) Description of transaction Type (paid /Received) Amount as per books Amount as per ALP Method selected Observation (Space for adding notes) 	<ul style="list-style-type: none"> Address: Requires pin code, Incase of Indian address, inserting pin code auto populates address Identification number : New requirements this year
20 : Deemed international transaction		

Insertion of PAN/TIN of the AE is a new requirements that is common in all the clauses of Part B. Whether such new change in Form 3CEB requirements needs to be notified by CBDT?

...Form 3CEB – Various clauses explained...

Part C : Specified Domestic Transaction

Clause : What disclosure	Details requested in FY 2020-21 Form 3CEB	Key changes in FY 2020-21 from previous year
21 : Associated Enterprises Screen	<ul style="list-style-type: none"> Name of AE PAN of AE Aadhar of AE Address of the AE Nature if relationship with AE Brief description of the business carried out 	<ul style="list-style-type: none"> Aadhar of the AE for certain type of AE (Not a compulsory field) Address: Requires pin code, Incase of Indian address, inserting pin code auto populates address
<p>22A: Transfer or acquisition of any goods or services : undertaking/unit/enterprise/eligible business (as referred to in section 80A(6), 80IA(8) or Section 10AA transferred any goods or services to any other business carried out by the assessee</p> <p>22B: Same as above except that the term transferred to be replaced with acquired</p>	<ul style="list-style-type: none"> Name of business to which good or services have been transferred Details of business to which goods or services have been transferred Description of goods or services transferred Amounts as per books Amounts as computed as per ALP Method selected Observation (Space for adding notes) 	<ul style="list-style-type: none"> No change

...Form 3CEB – Various clauses explained...

Part C : Specified Domestic Transaction

Clause : What disclosure	Details requested in FY 2020-21 Form 3CEB	Key changes in FY 2020-21 from previous year
23 : Any business transacted which has resulted in more than ordinary profits to an eligible business to which section 80IA(10) or Section 10AA applies	<ul style="list-style-type: none"> • Name of person with whom transaction has been entered • Type • Description of the transaction • Quantity • Amounts as per books • Amounts as computed as per ALP • Method selected • Observation (Space for adding notes) 	<ul style="list-style-type: none"> • No change
24: Any other transaction : Person entered into SDT with a person referred to in sub-section (6) of section 115BAB which has resulted in more than ordinary profits	<ul style="list-style-type: none"> • Name • Description of the transaction • Amounts as per books • Amounts as computed as per ALP • Method selected 	<ul style="list-style-type: none"> • No change
25 : Any other transaction not covered above	<ul style="list-style-type: none"> • Observation (Space for adding notes) 	

...Form 3CEB – Various clauses explained...

Verification

Name

Membership No.

FRN (Firm Registration Number)

Address

Name

Membership No.

FRN (Firm Registration Number)

Address

Place

123.201.100.213

Date

11-Dec-2021

Form 3CEB for FY 2020-21 : Summary of key changes to form and filing process

- The use of 'xml' type of filings has been done away with and currently only an online Form 3CEB updation is possible.
- To facilitate bulk uploading of data in various clauses, each clause is facilitated with downloadable .csv file that can be updated and uploaded.
- Import of earlier years data/prefill option etc, has not been activated for Form 3CEB of FY 2020-21. → .xml to excel or Jason data importation is not possible as of now.
- In part B of the Form 3CEB, all clauses need either PAN/Tax identification number/other detail for every line entry. → All taxpayers to get such data from their AEs, where not already available.
- The CA, now has the right to accept or reject the request for uploading the Form 3CEB data,
- The taxpayer can view and withdraw the online Form 3CEB at anytime and assign a new CA using the online portal

E-filing of Form 3CEB : Step by step guide

- Tasks to be completed by the Assessee - Step 1
 - Log into <https://eportal.incometax.gov.in/iec/foervices/#/login> using user credentials
 - Go to 'Authorised partners' tab and click on 'My CA'. Thereafter, please click on add CA and fill in the required details. In case CA is already appearing, the assign the requisite Form 3CEB
 - This will trigger an intimation to the CA to accept and upload the Form 3CEB.
- Tasks to be completed by the CA - Step 2
 - Log into <https://eportal.incometax.gov.in/iec/foervices/#/login> using CA credentials
 - Go to 'Pending action' tab or 'Worklist' tab and **first accept the Form 3CEB request.**
 - The CA to then use the link that is created to fill in the required details and upload the Form 3CEB details
 - On completion of all the details, the preview button at end of the form gets activated, which generates a preview. Then proceed to e-verify the details and sign the Form 3CEB.
 - This will trigger an intimation to the CA as well as assessee.
- Tasks to be completed by the Assessee - Step 3
 - Log <https://eportal.incometax.gov.in/iec/foervices/#/login> using user credentials
 - Go to 'worklist' tab and click on 'pending action' tab
 - Fill in details for Form 3CEB for required year and upload the Form 3CEB using digital signature of the authorized personnel.

E-filing of Form 3CEB : Issues with online portal (on Dec 17, 2021)

- Too many errors in the online Form 3CEB schema
 - .csv files are not getting imported in entirety. Lots of work needs to be done by taxpayer, even after adding information using the .csv files
 - No drop down options provided in the .csv file. This is resulting in blank information being uploaded, requiring line by line rectification
 - Clause 13 is not accepting transactions pertaining to availing of services by the taxpayer (no preview of Form 3CEB is created, though entry in clause 13 is accepted)
 - After uploading data in various clauses of Form 3CEB, certain clauses are not accepting data appropriately, eg in clause 13 there is a mismatch in pdf data columns. (explained in practical Form 3CEB exercise)
 - Data that has been uploaded gets randomly lost → some points for consideration/do's and don't in this respect are explained in the practical Form 3CEB exercise)

E-filing of Form 3CEB : Issues with online portal (on Dec 17, 2021)

- Earlier years data is not getting imported in this years (FY 2020-21) Form 3CEB. No autofill provided.
- Earlier years .xml files cannot be converted to excel files. Can one convert earlier years pdf to excel?
- Post uploading errors:
 - UDIN not getting recognized in many cases (before appending CA signature). Normally, the UDIN is getting accepted after couple of days
 - The address of the CA (in verification Section) changes to reflect the address of the taxpayer, post uploading of the Form 3CEB.
 - The uploaded file and the draft pdf generated before uploading, look and feel the same. Need to download acknowledgement in every case as a proof that the Form 3CEB is uploaded.
 - The uploaded taxpayer accepted Form 3CEB, disappears from uploaded Form list of the CA. Only appears in taxpayer login. Difficulty in tracing the Form 3CEB in CA login post taxpayer acceptance.

All issues are highlighted to Infosys on a webinar on December 3, 2021. Any issues in filing process can be highlighted by writing a mail to "efilingwebmanager@incometax.gov.in"

E-filing of Form 3CEB : Some Do's and Don't

- For the Taxpayers:
 - Updating the Taxpayer profile (contact details, address, signatories, etc) in their login before starting the filing process → In case one updates the profile after starting the Form 3CEB, it renders the updated Form 3CEB invalid and one has to start with the process all over again.
- For CA
 - After uploading data, ensure that you save every clause and download the .csv file for every clause. The .csv file would be useful for filing the Form 3CEB again, in case the data is lost (for any reason) or useful in next years compliances.
 - Avoid use of cancel/back button at the end of every clause/section of Form 3CEB. Currently, using such button is resulting in deletion of saved data and causing technical errors.
 - Try to fill every clause (without error) and only then save and log out of the CA login. This will save the data appropriately. Leaving errors and abruptly leaving the filing process, renders the Form 3CEB useless in many cases. → Use the save option as much as possible.
 - Process the UDIN at least couple of days in advance. The tax login and UDIN portal are not syncing data continuously. Delay of 2/3 days is noted as of now.



TP analysis and documentation related:
Other key points for consideration in FY 2020-21 TP analysis

Covid related impact...



“Deviyo or sajjano”
Yeah, its March 24, 2020 8pm!
Remember?
When announcement of lockdown
sent shivers down the spine!!!!

Covid related impact : Sailing through the pandemic (India story)

- 1st wave of COVID 19 : Announcement of first countrywide severe lockdown on March 24, 2020
- Stringent travel curbs, quarantine rules, social distancing norms having a nationwide impact on trade and logistics, health, economic affairs, financial hardship etc.
- Strict lockdown of two months in April and May 2020 → uncertainty on the longevity and impact of COVID followed till the 2nd wave in March 2021
- Huge impact on global economies including Indian economy in the form of disrupted business operations, delayed compliances, deadlines and employees caught up at home working day and night....
- No serious financial/economic impact for FY 2019-20 but huge impact during FY 2020-21?
- Also, the impact, has been different for various industries, resulting in mixed financial indicators for FY 2020-21

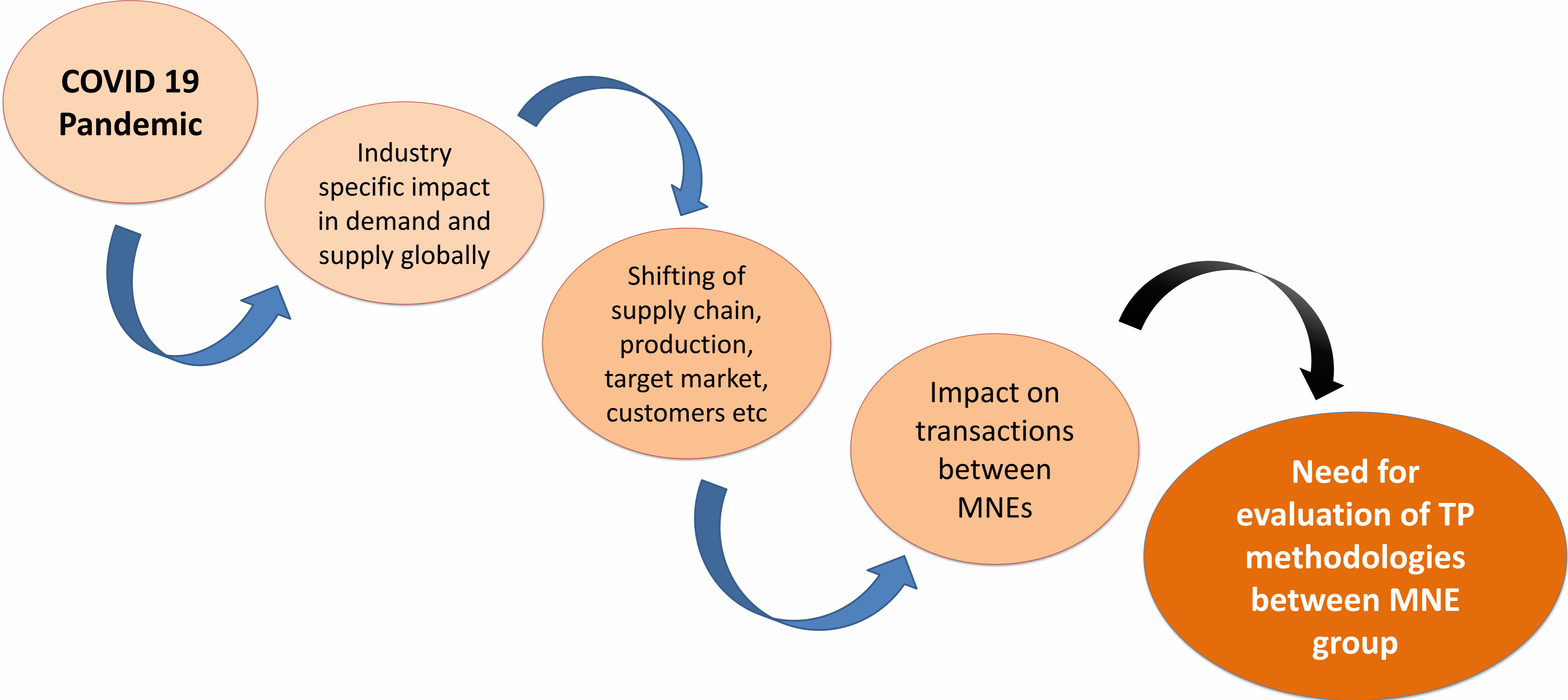
Industries impacted negatively		Industries with positive impact	
<ul style="list-style-type: none">• Automotive• Engineering• Travel and tourism• Electronics	<ul style="list-style-type: none">• Banking and finance• Oil and gas• Real estate	<ul style="list-style-type: none">• Pharma and healthcare• FMCG• E-learning• Social media	<ul style="list-style-type: none">• Technology based industries (aggregators, etc)• Media

Covid related impact : Sailing through the pandemic (India story)

- Industry statistics for impact on profitability

Sector	Companies for which data is available for March 31, 2021 in Prowess as on December 17, 2021	Operating profit trend in FY 20-21 vis-à-vis FY 19-20 Positive impact: GREEN Negative impact: RED
Hotel and tourism	113	94% (% of companies whose profits dropped as compared to earlier year)
Automobile and auto ancillary	255	69% (same as above)
Banking and finance	99	42% (neutral impact)
IT and ITES	305	54% (% of companies whose profits increased as compared to earlier year)
Pharmaceuticals and drug	206	70% (Same as above)

Covid related impact : TP impact



Covid related impact : TP guidance worldwide...

- OECD released guidelines on December 18, 2020. Important factors in such guidelines
 - Comparability analysis : Evaluation of important aspects such as forecasted financial information, application of more than one method, use of loss making and existing set of comparables, timing of information of comparables (single year vs multiple year data) etc..
 - Losses and the allocation of COVID-19 specific costs : Allocation and comparability aspects of operational or exceptional costs between related parties, impact of the force majeure clauses on the allocation of losses.
 - Government assistance programmes : Analysis of economic relevant characteristic of the government assistance in the local and counterparty jurisdiction, Effect of the receipt of government assistance on the comparability analysis and pricing & allocation of risk of a controlled transaction.
 - APAs : Impact on existing APAs, and APAs under negotiation during pandemic period

...Covid related impact : TP guidance worldwide...

- Singapore – IRAS

- Detailed TP documentation stating impact of COVID on specific industry, FAR profile, change in contractual arrangement during COVID period if any etc.
- Term testing allowed - considering multiple year data for tested party.
- Clarification on how it is applied and consider it as one off event. Substantiation for need of such application of term testing required by taxpayers.

- ATO – Australian tax office

- Analysis and impact of COVID 19 on TP documentation
- No specific guidance on benchmarking

- Other countries like Canada, Malaysia also released certain similar guidelines.

...Covid related impact : TP guidance in India

Govt of India in wake of pandemic launched various schemes in industrial sectors, MCA has relaxed/amended extended various provisions, CBDT has pushed several compliance/assessment/appeal deadlines but **no specific guidance on TP matters as of date. Whether specific guidance needed?**

Guidance from existing rules/regulations:

Rule/Section reference	Enabling provision	Enabler
Rule 10B (clause 1e, Clause 3)	Application of any method and adjustments	<ul style="list-style-type: none">• Profit margin/price computed for a controlled transaction can be adjusted to take into account differences with the uncontrolled transaction which could have material impact on the same• Reasonably accurate adjustments can be performed to eliminate the differences
Rule 10B (clause 5)	Comparable data	<ul style="list-style-type: none">• Use of single year or multiple year data of comparable companies basis the data availability and impact of multiple years on transaction pricing

...Covid related impact : TP guidance India

- Typical issues faced:
 - Difficulties in use of contemporaneous data in comparability analysis,
 - Dealing in low profitability/ loss environments,
 - Impact of pandemic related costs and treatment for it
- ***Road ahead for taxpayers– any practical solutions?***

Solution	Enabler
Use of single year data or multiple year data of comparables OR	<ul style="list-style-type: none"> • Multiple year data used for COVID impacted year 2020-21 may not result in appropriate comparability. Whether use of single year data for tested party and comparables more appropriate? Data availability for comparables for FY 2021 as of now i.e. before filing of Form 3CEB?
Term testing for tested party?	<ul style="list-style-type: none"> • Use of weighted average data for tested party also? Whether it fits the India regulations and will it be accepted by TPO during assessment?
Adjustments to the tested party	<ul style="list-style-type: none"> • Economic adjustments can be performed to the margin/price of international transaction to make it comparable to the uncontrolled transaction (Rule 10B) • Various judicial precedents provide guiding principles for adjustments that can be performed on comparable companies. Whether adjustment can be made to tested party?

...Covid related impact : TP guidance India

Solution	Enabler
ICAI guidance note	<ul style="list-style-type: none">• As per ICAI guidance note on COVID 19, the audited financial statements should provide note gauging the impact of pandemic on that particular entity. This would contain details such as explanatory notes, details of impairment of assets, material uncertainties, details of fall in revenue due to a decrease in market demand, an increase in sales return, a decrease in volume discount, higher price discounts, etc.,• This would help in identifying specific impact for tested party or comparable companies whether it is present and if yes how to accommodate the same in the economic analysis.• Impact of extra ordinary costs /reduction in sales incurred during COVID affected period can be identified and accordingly carved out to arrive at appropriate profitability of tested party
Advanced pricing agreements	<ul style="list-style-type: none">• Finalised APAs – post COVID scenario – renegotiation? - Existing IT rules allow revision(Rule 10Q) under specific circumstances. Justification/linking of COVID scenario and change in critical assumptions would be important for such revision• APAs not yet signed /in process– If the critical assumptions undergo change or impacted due to COVID scenario; Filing of new APA application by withdrawing the earlier filing (Rule 10J) can be considered
Impact on cost plus entities or limited risk entities	<ul style="list-style-type: none">• Reduction in remuneration or exclusion of extra ordinary costs pertaining to COVID specific impact for charging mark-up. Detailed documentation necessary to justify the position taken before the Tax authorities

Comparability analysis : Typical process/steps

- ↓ Determination of years to be covered → Single year or multiple year?
- ↓ Broad based analysis of taxpayer's circumstances → Industry, covid impact, etc
- ↓ **Understanding of FAR and selection of tested party → Who and what to test?**
- ↓ Review of existing internal comparables → How was pricing determined?
- ↓ Identifying sources of external comparables considering their relativity
- ↓ **Selection of Most appropriate Transfer Pricing Method → Most important step**
- ↓ Identifying potential comparables
- ↓ **Determining and making comparability adjustments → compare Apple with Apple or any fruit would do?**
- ↓ Interpretation and use of data collected and determining arm's length price → Conclusion

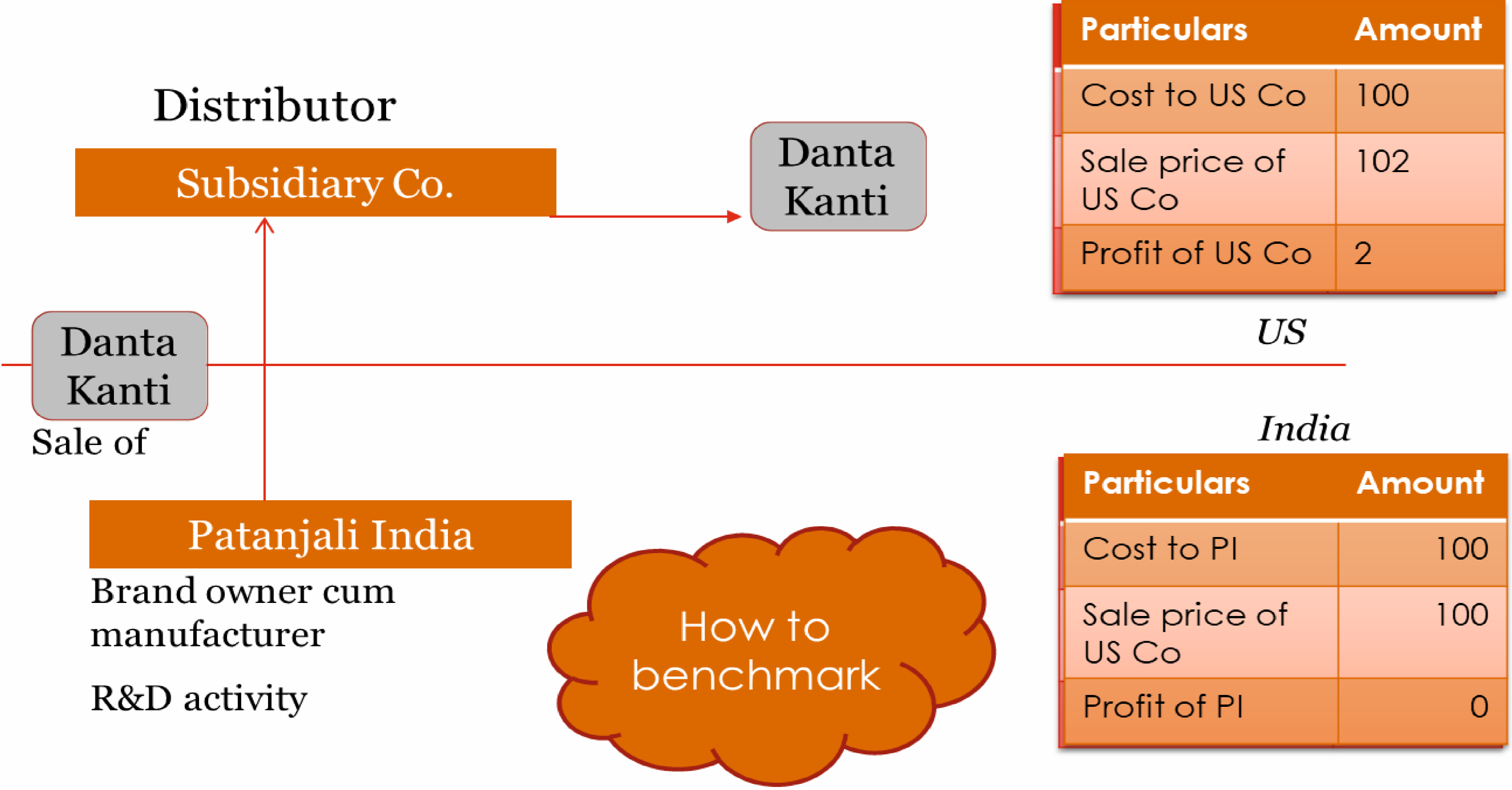
Other key TP aspects : Characterisation

- Characterisation is the process of classifying the entities/transactions depending on their functional profile
- The underlying principle being, more the functions, more significant the assets and more the risks, the greater the return and vice-versa. → Or should it be more dynamic/fluctuating the return?
- Typical characterisations are summarized below:

Type of function	Limited	Normal	Full fledged
Manufacturing	Contract/Toll	Licensed	Entrepreneur
Trading/Distribution	Limited risk distributor	Distributor	Marketer distributor
Service	Captive units	Licensed	Entrepreneur

Greater the functions, assets and risks the more the return/the more dynamic/fluctuating the return

Other key TP aspects : Tested Party



Tested party : Concept

- A Transaction has two transacting parties – Which one needs to be tested / evaluated?
- Selection of the Tested Party is based on the functional analysis and characterization of entities
- Usually, the tested party is the
 - least complex entity
 - for which reliable data is available for conducting comparability analysis
 - Few adjustments are required to make the data comparable
- Tested party and Most Appropriate Method (MAM) – depends on availability of reliable data

This is one of the most crucial steps that is normally misjudged by the taxpayers/consultants. Incorrect selection of tested party would primarily lead to incorrect TP analysis.

Tested party : Practical issues and judicial precedents

- Availability of financial information of least complex party → Taxpayers may not want to share the data of the foreign company(s)
- Availability and cost of foreign databases → Access to the foreign database, and their costs could be a hinderance for smaller companies
- Non acceptance of the broader concept by Indian courts → Non availability of data of comparables has been the key reason for rejection of foreign tested party

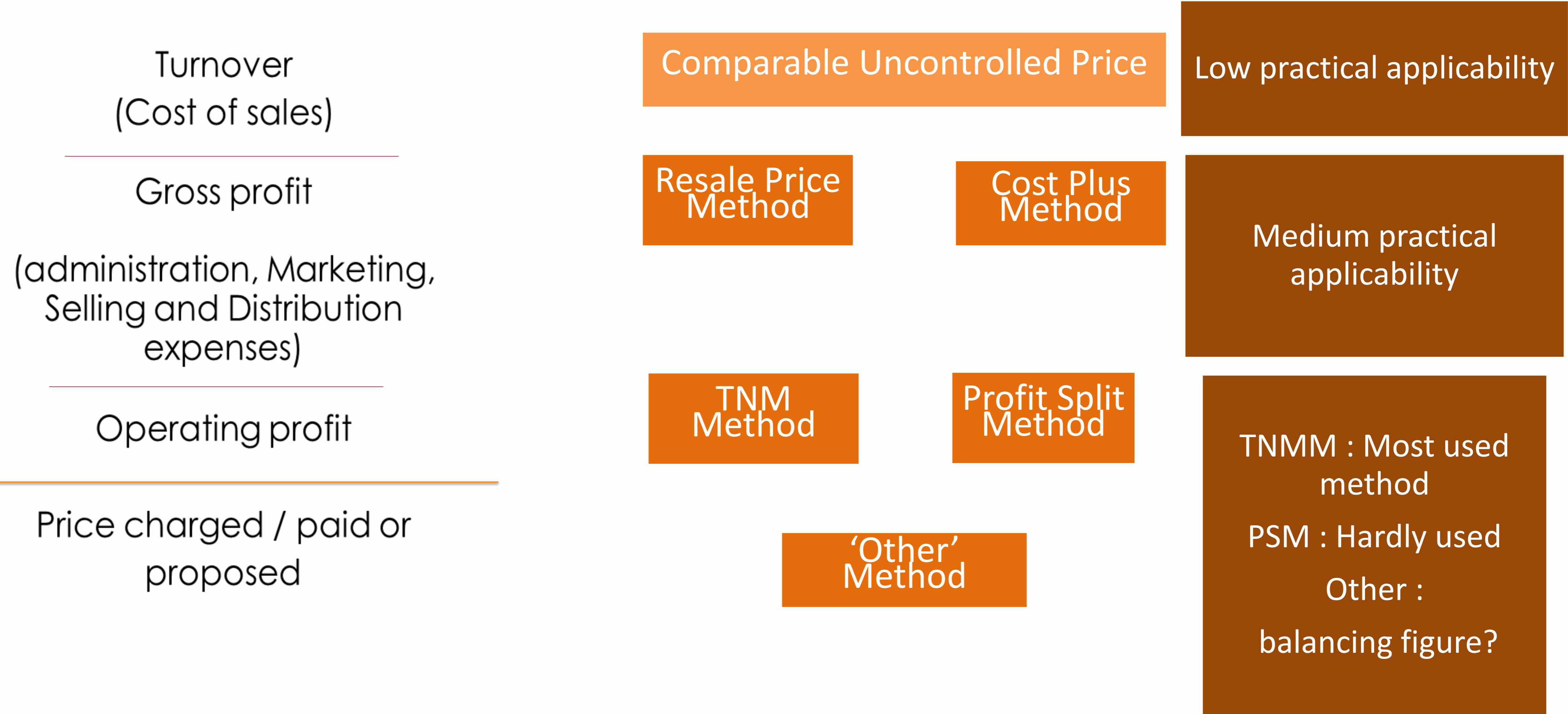
Key rulings in favor of Assessee

- Ranbaxy Laboratories Ltd vs ACIT [2008] 110 ITD 428 (del)
- Development Consultants (P) Ltd vs DCIT [2008] 23 SOT 455 (Kol)
- General Motors India Private Limited vs DCIT TS-215-ITAT-2013-(Ahd)-TP
- Mastek Ltd vs Ad CIT [2012] 53 SOT 111 (Ahd)

Key rulings against the Assessee

- Onward Technologies Limited TS-94-ITAT-2013(Mum)
- Global Vantage (P) Ltd vs DCIT [2010] 37 SOT 1 (Del)
- Aurionpro Solutions Ltd vs Ad CIT [2013] 33 taxmann 187 (Mum)

Other key TP aspects : Most Appropriate Method (MAM)

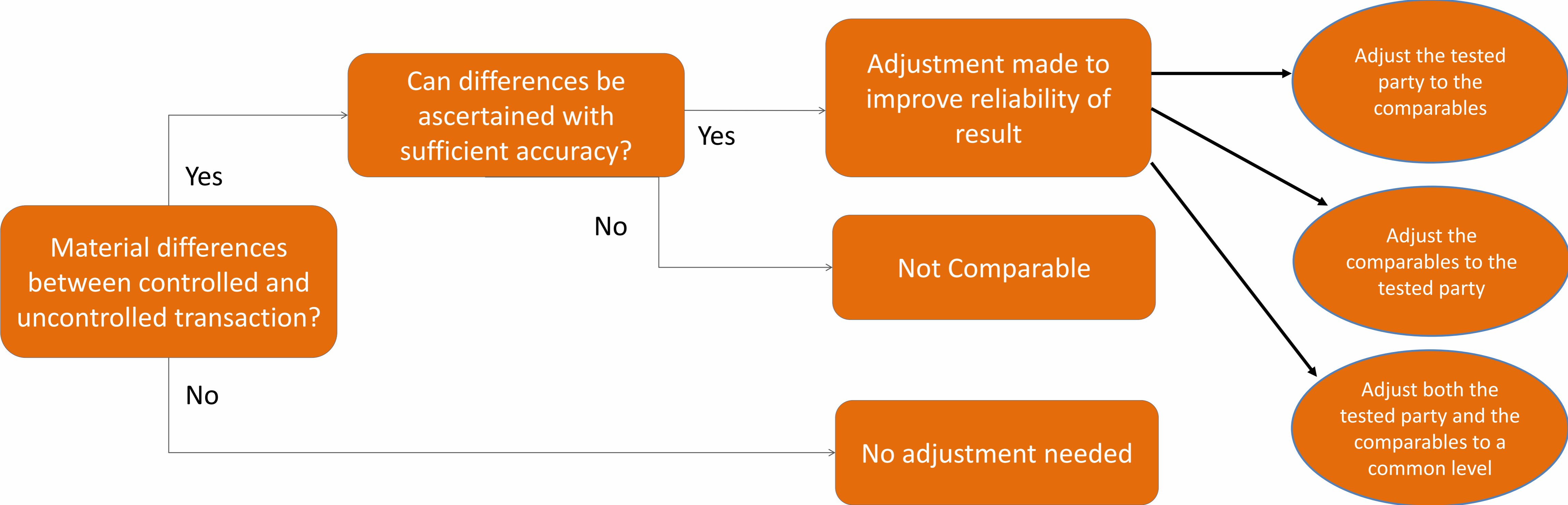


Other key TP aspects : Selection of Most Appropriate Method (MAM)

Method	Transaction Type
CUP	Loans, Royalties, Service fee, transfer of tangibles , guarantee fees
RPM	Marketing operations of finished products, where distributor is not performing any significant value addition to the product
CPM	Sale of finished / semi-finished goods or services
PSM	Transactions involving provision of integrated services by more than one enterprise or involving unique intangibles
TNMM	Provision of services, manufacture / distribution of finished goods and guarantee fees
Other	Purchase of second hand capital goods involving chartered engineer's certificates, buy-back of shares as per the valuation report of independent accountants

Other key TP aspects : Comparability adjustments

- Adjustment made to uncontrolled transactions/ comparable companies to enhance comparability with the controlled transactions/ tested party
- Reasonably accurate adjustments should be made to eliminate the effect of any differentiating factors



Comparability adjustments : Support in Indian TP law

Rule 10B(3)

- An uncontrolled transaction shall be comparable to an international transaction if:
- There are no differences that *materially* affect price/margin; or
- *Reasonably accurate* adjustments to account for such differences can be made
- Adjustments made to be documented in the TP Study report
- Comparability adjustments required for each methodology and selection of most appropriate method
- Adjustments for ‘differences which could materially affect price or margin in open market’
- Factors to be considered for making adjustments:
 - Quality of data being adjusted
 - Purpose of the adjustment performed
 - Reliability of the approach used to make the adjustment
 - Documentation

Comparability adjustments : Types

Type of comparability adjustment : What it means	Details on the same	Acceptability by Indian tax authorities
<p><u>Working capital adjustment</u> : Working capital adjustments aim to enhance and increase comparability of third party comparables to the tested party by adjusting for differences in asset and liabilities between the companies that might not be reflected in the income statements.</p>	<ul style="list-style-type: none"> • 3rd party comparable companies may provide more/less levels of service due to increased/decreased capital investment. For example, a company with high levels of accounts receivable is providing a credit extension service to its customers in addition to its main operations • Normally, in a working capital adjustment, the margin of the comparables is adjusted to match the working capital cycle of the tested party 	<ul style="list-style-type: none"> • Widely accepted by tax authorities
<p><u>Capacity utilization adjustment</u> : Capacity utilization risk arises when the installed capacity for a manufacturer or service provider is not optimally utilized and the companies have to bear fixed costs associated with such excess capacity</p>	<ul style="list-style-type: none"> • Capacity underutilization by enterprises especially start ups, is an important factor affecting net profit margin in the open market because lower capacity utilization results in higher per unit costs, which, in turn, results in lower profits • As the fixed costs of comparable companies is not available in public data, such adjustment is done on tested party results. • Post 2012, data of installed capacity for companies is not disclosed in the financials. Practical difficulty to identify comparables capacity utilisation 	<ul style="list-style-type: none"> • Usually accepted when the adjustment is done to margin of comparables

Above two are ideal adjustments for FY 2020-21, specifically in the light of Covid related financial impact.

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<p><u>Depreciation adjustment</u> : Depreciation adjustment accounts for the difference of accounting treatments between comparable companies and tested party with regard to depreciation.</p>	<ul style="list-style-type: none"> • Differences in Depreciation between tested party and comparable companies can arise in the following scenarios: <ul style="list-style-type: none"> ➤ Depreciation charged on higher rates by tested party vis-à-vis comparables; ➤ Different methodology adopted by tested party and comparable companies such as WDV vs Straight Line; ➤ Operational reasons such as higher number of shifts, new asset base, etc • In case of differences in depreciation rates between tested party and comparable companies, under similar method of charging depreciation, adjustment can be made to comparables. • If no reliable adjustments can be made, use of Cash Profit/ Sales as PLI can be considered, where Cash Profit = Operating profit + Depreciation? 	<ul style="list-style-type: none"> • Not accepted by tax authorities widely. However, courts have been allowing such adjustments in appeals.
<p><u>Foreign exchange adjustment</u> : Forex risk is the risk that profits will change if forex rates fluctuate. Realized vs unrealized.</p>	<ul style="list-style-type: none"> • Adjustment for significant change/volatility in the foreign exchange needs to be adjusted for. This adjustment only possible, for risk bearing entities, i.e. captive units/cost plus units would broadly be immune to such fluctuations. • Whether just excluding foreign exchange gain/loss while calculating operating profits is enough? 	<ul style="list-style-type: none"> • Low acceptability. Need strong back-up documentation to demonstrate the forex impact

Some other important points to be noted

- While filing the Form 3CEB, keep a tab for unreported transactions that normally would not form part of related party schedule like:
 - Free of cost goods received/given
 - Royalty not charged
 - Free of cost guarantee not provided
 - Interest free loan
- Check for the residential status of the directors (who also qualify as AE). Transactions with them also need to be reported in the Form 3CEB.
- In case of qualifications, in case the space provided in the online Form 3CEB is not sufficient, then physical notes/annexures can be prepared and filed within 15 days of uploading the Form 3CEB with jurisdictional AO.

Thank You

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