GUIDANCE NOTE ON REPORT UNDER SECTION 92E OF THE INCOME-TAX ACT, 1961

(TRANSFER PRICING)

[Based on the law as amended by the Finance Act, 2022]

(Revised 2022)

Committee on International Taxation

The Institute of Chartered Accountants of India

(*Set up by an Act of Parliament*)

New Delhi

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Foreword to the Ninth Edition

The Committee on International Taxation is one of the important non-standing Committees of the Institute of Chartered Accountants of India (ICAI). As a partner in nation building, ICAI through this Committee submits Pre and Post-budget Memoranda pertaining to International Taxation. Apart from the same, the Committee time to time examines the tax laws, rules, circulars, notifications etc. relating to International taxation issued by the CBDT and sends suitable suggestions for improvements. The Committee also submits inputs/submissions to OECD from time to time on behalf of ICAI which have been duly acknowledged by OECD. Besides conducting various activities regularly like Diploma Course on International Taxation, oragnising Workshops/Seminars/ Conferences/ Refresher Courses/ Residential course, and preparing e-learning modules, one of the core activities of the Committee is to release publications relating to international taxation and transfer pricing and to revise its existing publication regularly.

The ICAI through Committee on International Taxation has been issuing guidance for its members in respect of the Report under Section 92E of the Income-tax Act, 1961. The obligation of the members of ICAI is to express opinion on the accounts, records and documentation pertaining to international transactions and specified domestic transactions and therefore, it is expected from the members to have a through knowledge of transfer pricing and recent developments. The Committee has brought out the ninth edition of the Guidance Note on Report under Section 92E of the Income-tax Act, 1961 in which all the amendments made upto Finance Act, 2022, have been incorporated.

I appreciate the efforts of CA. Sanjay Kumar Agarwal, Chairman, CA. Cotha S. Srinivas, Vice-Chairman and other members of the Committee on International Taxation who took timely steps to revise the Guidance Note on Report under section 92E of the Income Tax Act, 1961.

I hope this publication would provide a lot of insight on the reporting requirements expected from members.

Place: New Delhi
Date : 10-10-2022

CA. (Dr.) Debashis Mitra
President, ICAI

Preface to the Ninth Edition

After opening up the economy the Government of India took note of the possibility of manipulation of transfer pricing resulting in shifting of income out of India on the one hand, and inadequacy of the then taxation regulations in dealing with that, on the other hand. Consequently, to deal with such situations in an effective manner, the Government, in 2001, introduced comprehensive transfer pricing regulations as Chapter X of Income-tax Act,1961(the Act), which deals with special anti-avoidance provisions regarding international transaction. One of the innovative measures to ensure self-compliance of the regulations was incorporation of requirement of filing of accountant's report as per section 92E of the Act read with Rule 10E of Income Tax Rules, 1962 in Form 3CEB.

Even though the duty to comply with the transfer pricing regulation rest upon the taxpayer, the responsibility of accountant is to examination of documents and information and provides report thereon. In this revised publication the committee has covered all the important update related to associated enterprises, international transactions, guidance related to selection of most appropriate methods, computation of ALP, adjustment thereof and documentation etc.

In the emerging international transactions, some transactions are made which may not have bearing on profit of the enterprise. In those cases, identification of shifting of profit are to be identified and reported. Similarly, Base Erosion and Profit Shifting (BEPS) Action Plan 8, 9 and 10 which deals with intangible, Risk & Capital and high-risk transactions respectively explain how transfer pricing outcome determined in accordance with the actual conduct of related parties in context of contractual terms of transactions.

Another important development in the area of international taxation, which is likely to impact transfer pricing concepts in future, is BEPS 2.0 pillar two approach recommended by the Organisation for Economic Co-operation and Development (OECD). The major objective of BEPS 2.0 pillar two is to prevent jurisdictions having lower tax and shorter economic activities but gaining higher tax advantages.

In this age of digitalisation of economic activities, long existing concepts of taxation, including arm's length principle are under threat. The way business

is being, and likely to be conducted, there are going to be newer challenges to tax administrations and tax advisors in ensuring true and full compliance of regulations. It is essential for the members of ICAI to be on top of the developments. This Guidance Note may be helpful in achieving this goal.

I would like to express my sincere thanks to CA. (Dr.) Debashis Mitra President, ICAI and CA. Aniket S. Talati, Vice-President, ICAI , for being a guiding force behind all initiatives being taken by the Committee on International Taxation.

I would also like to extend my appreciation to Mr. S. P. Singh (Ex-IRS) who made sincere and timely efforts to update the Guidance Note in a comprehensive manner. His experience as a member of the Expert group constituted by the Government for drafting Transfer Pricing regulations and in implementing the regulations were very useful in updating the Note. He was actively assisted by CA. Ankit Arora. His efforts are highly appreciable. I would also like to thank CA. Dilip Gupta, CA Harpreet Singh, CA. Naman Shrimal, CA. Neha Gupta, CA. Parul Jolly, and CA. Raju Kumar for their contribution in reviewing the revised draft of the publication.

I would also like to thank CA. Cotha S Srinivas, Vice-Chairman, Committee on International Taxation of ICAI for his support in all activities of the Committee. I gratefully acknowledge the assistance provided by the Committee Council members CA. Chandrashekhar Vasant Chitale, CA. Vishal Doshi, CA. Purushottamlal Khandelwal, CA. Mangesh Pandurang Kinare, CA. Priti Savla, CA. Umesh Sharma, CA. Sridhar Muppala, CA. Rajendra Kumar P, CA. Sushil Kumar Goyal, CA. Rohit Ruwatia, CA. Anuj Goyal, CA. Gyan Chandra Misra, CA.(Dr.) Raj Chawla, CA. Pramod Jain, CA. Charanjot Singh Nanda, CA.(Dr.) Sanjeev Kumar Singhal, Shri Ritvik Ranjanam Pandey, *Co-opted members:* CA. Avinash Gupta, CA. Rajat Sharma, CA. Mithilesh Sai Sannareddy, CA. Anup Kumar Sanghai, CA. Kaushik Mukerjee, CA. Nandkishore Chidambar Hegde, CA. Sanjay Bhattacharya, *Special invitees:* CA. Aseem Chawla, CA. Kriti Chawla Khanna, CA. Gaurav Singhal, CA. Sachin Sinha, CA. Manoj Kumar Mittal, CA. Smita Patni, CA. Ajay Rotti, CA. Akshay Kenkre, CA. Akshat Maheshwari, CA. Dilip Gupta, CA. Naman Shrimal, CA. Hari Om Jindal, CA. Deepender Kumar Agarwal, CA. Raju Kumar, CA. Parthasarathi Dasgupta, CA. Tejveer Singh, CA. Raj Kumar Nahata, CA. Parul Jolly, CA. Gaurav Geol, CA. Harpreet Singh, CA. Vikas Gupta, CA. Neha Gupta and CA. Surinder Kumar Kalra.

Last, but not the least, I appreciate the efforts made by CA. Mukta Kathuria Verma, Secretary, Committee on International Taxation and CA. Vikas Kumar, Assistant Secretary for coordinating the project and for rendering technical and secretarial assistance.

I am hopeful that this revised edition will be of immense use to the members.

Place: New Delhi
Date: 10-10-2022

CA. Sanjay Kumar Agarwal
Chairman,
Committee on International Taxation, ICAI

Foreword to the Eighth Edition

The emergence of unprecedented crisis due to Covid-19 pandemic has given rise to significant economic challenges across the world. Amidst the spread of the pandemic and the imposition of social and economic lockdowns, the world has come to an abrupt halt which has impacted production, demand and supply chain significantly.

The delayed closure of books of accounts and availability of limited comparable data in public domain affects a suitable comparable transaction. In the present situation, the use of the comparable data related to last two financial years may not be the most ideal as those years were not disrupted by COVID-19. The existing transfer pricing approach may therefore be reviewed in current scenario which may consider the impact of significant decrease in business activities. The potential comparable transactions, comparability analysis including required adjustment therefore needs to be made appropriately and the same needs to be documented so as to substantiate the results.

In light of the Covid pandemic, the reporting and disclosure requirement towards the international transactions is certainly challenging for the members of Institute of chartered accountants of India (ICAI). The ICAI through its Committee on International Taxation has been issuing guidance for its members in respect of Report under Section 92E of the Income-tax Act, 1961. The Committee has brought out the eighth edition of this Guidance Note in which all the amendments made upto Finance Act, 2020 have been incorporated.

I would like to appreciate the efforts of CA. Nandkishore Chidamber Hegde, Chairman, CA. G. Sekar, Vice-Chairman, and all members of the Committee on International Taxation of ICAI for the initiative taken to revise the said publication in a timely manner for the benefit of the members and other stakeholders at large.

I am sure that this revised and updated publication would be of immense use for our members practising in the area of Transfer Pricing in effectively discharging their professional responsibilities.

Best Wishes,

Place: New Delhi
Date : 10-08-2020

CA. Atul Gupta
President, ICAI

Preface to the Eighth Edition

The objective of transfer pricing is to curb the practices of shifting profits from associated entities in higher tax jurisdiction to associated entities in relatively lower tax jurisdiction through intra-group trade which ultimately reduces an MNE's worldwide taxes. The arm length price is a machinery provision which determines what an independent party would have paid under the same or similar circumstances. The transfer pricing analysis cannot be effective without understanding the associated enterprises, nature of transactions, industry, other regulatory factors. Also unlike many other countries, transfer pricing documentation and reporting is a statutory obligation cast on enterprises under the Income-tax act 1961.

This Guidance Note was last revised in the year 2019. Keeping in view, the changes brought by the Finance Act 2020, the Committee on International taxation thought it was important to keep the members appraised and updated and thus decided to bring out the eighth edition of this Guidance Note. I am confident that this will benefit members and will enable them to discharge their reporting responsibilities.

I extend my thanks to CA. Atul Kumar Gupta, President and CA. Nihar N. Jambusaria, Vice-President of the Institute of Chartered Accountants of India for being a guiding force behind the activities being undertaken by the Committee.

I also whole heartedly acknowledge the efforts undertaken by Mr. S.P. Singh, Ex-IRS in revising this Guidance Note in a timely manner. Notably, Mr. S.P. Singh had been a part of the team that conceptualized Transfer Pricing law was introduced in India. We also appreciate the efforts of CA. Ankit Arora who assisted him in revision of this Guidance Note. I must make a mention of the large number of suggestions were received on the exposure draft of the Guidance Note hosted on ICAI's website. The team lead by Mr SP Singh was pleased to examine each and every suggestion and recommended incorporation as felt necessary. I thank the members who took out their valuable time and shared their inputs/ observations with the Committee.

I am also grateful for the unstinted support provided by Vice-Chairman CA. G. Sekar and also other Committee Council members CA. Tarun Jamnadas Ghia, CA. Chandrashekhar Vasant Chitale, CA. Dayaniwas

Sharma, CA. Rajendra Kumar P, CA. Sushil Kumar Goyal, CA. Anuj Goyal, CA. Kemisha Soni, CA. Satish Kumar Gupta, CA. Hans Raj Chugh, CA. Pramod Jain, CA. (Dr.) Sanjeev Kumar Singhal, CA. Charanjot Singh Nanda, Shri Manoj Pandey, Shri Chandra Wadhwa, Dr. Ravi Gupta; Co-opted members: CA. Sachin Sastakar, CA. T.P. Ostwal, CA. Ujwal Nagnath Landge, CA. B.M. Agrawal, CA. Nidhi Goyal and Special Invitees: CA. Kriti Chawla and CA. Amar deep Singhal .

Last, but not the least, I appreciate the efforts made by CA. Mukta Kathuria Verma, Secretary, Committee on International Taxation and CA. Vikas Kumar, Assistant Secretary for co-ordinating the project and for rendering secretarial assistance.

I am hopeful that this revised edition will be of immense use to the members.

Place: New Delhi
Date: 10-08-2020

CA. Nandkishore Chidamber Hegde
Chairman
Committee on International Taxation, ICAI

Foreword to the Seventh Edition

Borderless economies and free trade order coupled with advancements in information technology tools, have brought to the forefront numerous opportunities for Chartered Accountants in the area of domestic and International taxation. Sections 92A to 92F were inserted for the first time in the Income-tax Act, 1961, in the year 2001. Since the time transfer pricing was introduced in India; the Government is making amendments in the tax laws every year to protect the revenue base.

The Institute of Chartered Accountants of India (ICAI) through its Committee on International Taxation has been issuing guidance note for members to equip them to deal with complexities involved in the laws of transfer pricing which will enable them to effectively discharge their responsibilities towards reporting requirements under section 92E of the Income-tax Act, 1961. The publication "Guidance Note on Report under section 92E of the Income tax Act, 1961 (Transfer Pricing)" has been updated in order to keep our members abreast of changes that have taken place over the period of time.

My sincere appreciation for CA. Nihar N. Jambusaria, Chairman, CA. Pramod Jain, Vice-Chairman and other members of Committee on International taxation for initiating and completing the task of revising this publication in a timely manner for the benefit of members and other stakeholders at large.

I am sure that this revised publication will be immensely useful and beneficial for all the members by providing insight into the intricate issues in discharging the reporting requirements of section 92E of the Act.

Place : New Delhi
Date : November 6, 2019

(CA. Prafulla P. Chhajed)
President

Preface to the Seventh Edition

Globalization is not new, but the pace of integration of national economies and markets has increased substantially in recent years. It has a significant impact on a country's corporate income tax regimes. The increasing participation of multinational groups in economic activities in India has given rise to new and complex issues arising from transactions entered into between two or more enterprises belonging to the same multinational group. Transfer Pricing provisions thus have an important role to play.

In order to facilitate our members in effective discharge of their responsibilities towards the reporting requirements of section 92E, the Committee on International Taxation decided to revise its "Guidance Note on Report under section 92E of the Income tax Act, 1961" The exposure draft of this Guidance Note was hosted on ICAI's website for inputs from members at large. The suggestions so received have been considered and appropriately incorporated.

I extend my thanks to CA. Prafulla Premsukh Chhajed, President and CA. Atul Kumar Gupta, Vice-President of the Institute of Chartered Accountants of India for being a guiding force behind the activities being undertaken by the Committee.

I place on record my deep appreciation for the efforts of CA. Arun Saripalli for his contribution towards this revised seventh edition of the publication. I also extend my appreciation to his team members CA. Hema Panchal, CA. Sunny Bilaney, CA. Abhishek Gupta, CA. Abhay Saboo, CA. Keyur Shah, CA. Mit Gaglani, CA. Bipin Pawar and CA. Prajvit Shetty who supported him in the revision process.

My sincere thanks to CA. Manoj Pardasani who spared his valuable time to review this revised Guidance Note.

I express my gratitude to CA. Pramod Jain, Vice-Chairman of the Committee and also other Committee Council members, CA. Tarun Jamnadas Ghia, CA. Nandkishore Chidamber Hegde, CA. Chandrashekhar Vasant Chitale, CA. Aniket Sunil Talati, CA. Dayaniwas Sharma, CA. G Sekar, CA. Pramod Kumar Boob, CA. Satish Kumar Gupta, CA. Hans Raj Chugh, Shri Sunil Kanoria, Shri Chandra Wadhwa, Dr. Ravi Gupta, co-opted members CA. T.P. Ostwal, CA. Padam Khincha, CA. Ameya Kunte and CA. Yogesh Thar who have contributed towards revision of this Guidance Note by providing their valuable inputs.

I also appreciate the efforts made by CA. Mukta Kathuria Verma, Secretary Committee on International Taxation, CA. Vikas Kumar, Assistant Secretary and team members of the Secretariat of Committee on International Taxation for effectively co-ordinating this project. For sure, this revised seventh edition of the Guidance Note also, will be of immense use to our members, like the earlier ones.

Place: New Delhi
Date : November 5, 2019

CA. Nihar N. Jambusaria
Chairman
Committee on International Taxation of ICAI

Foreword to the Sixth Edition

Since 2001, when sections 92A to 92F were inserted for the first time in the Income-tax Act, 1961, there has been rapid evolvement of the field of Transfer Pricing. Application of the complex provisions of transfer pricing require determination of proper income arising from international transactions where either or both the parties involved happen to be non-resident(s).

Global existence of the multinational enterprises has augmented the number of cross border transactions with the associated enterprises. At the same time, the related law has also evolved and has posed various challenges for stakeholders.

The responsibility of examining the records and issuing the report under section 92E is on our members. Laws in respect of transfer pricing are complex but our members have been discharging their responsibilities ably. ICAI too guides its members in respect of the ever changing complex laws of Transfer Pricing. This Guidance note on Report under section 92E of the Income tax Act, 1961 provides guidance to the members in this regard.

The publication was last revised in the year 2016. However, in order to keep our members updated, the Committee on International Taxation of ICAI took up the task of revising the publication this year also.

It is a pleasure to note that Committee on International Taxation of ICAI has brought out the sixth edition of "*Guidance Note on report under section 92E of the Income-tax Act, 1961 (Transfer Pricing)"* in a timely manner. I compliment CA. Sanjiv K. Chaudhary, Chairman, Committee on International Taxation of ICAI and CA. N.C. Hegde, Vice-Chairman, Committee on International taxation for initiating and completing the task of revising this publication in a timely manner.

The revised edition of the Guidance Note will surely be of immense use to the members as it will assist them in fulfilling their attest function in ably manner.

Place : New Delhi
Date : October 30, 2017

CA. Nilesh S. Vikamsey
President

Preface to the Sixth Edition

Taxation laws pertaining to cross border transactions have always been complex as also interesting. Frequent changes in the taxation laws have made the area more dynamic. Having dynamism and the complexity involved, over a period of time, Transfer Pricing has surfaced as a distinct area of practice for our members.

The onerous responsibility of examining the records and thereafter issuing Report in Form No. 3CEB under section 92E of the Income tax Act, 2017 is being discharged efficiently by our members. Time and again changes in law pose challenges which are to be addressed in a most professional manner. In order to guide and support the members, ICAI through its dedicated Committee on International Taxation takes all efforts in the said direction.

Issuance of this revised version of the "Guidance Note on Report under section 92E of the Income tax Act, 1961" is also a step in the said direction. Even though the Guidance Note was recently revised in the year 2016, considering the changes effected by the Finance Act, 2017 and OECD TP Guidelines (2017), the Committee thought it fit to update the same this year also. The exposure draft of this Guidance Note was hosted on ICAI's website for inputs from members at large. The suggestions so received have been considered and appropriately incorporated.

I extend my heartiest thanks to CA. Nilesh S. Vikamsey, President and CA. Naveen N.D.Gupta, Vice-President of the Institute of Chartered Accountants of India for being a guiding force behind the activities being undertaken by the Committee.

I must place on record my deep appreciation for the efforts of CA. Vijay Iyer and CA. Ashwin Vishwanathan for their contribution consecutively for the third time towards revision of sixth edition. It is worthwhile to mention that they had contributed in the revision of fourth edition and also the fifth edition. I also extend my appreciation to their team members CA. Rahul Bansal and CA. Sriram Soundararajan who supported them in the revision process.

My sincere thanks to CA. Manoj Pardasani and Ms. Esha Tuteja who spared their valuable time to review this revised Guidance Note. For sure the well-timed inputs from all these experts have resulted in timely issuance of this Guidance Note.

I express my gratitude to CA. N.C. Hegde, Vice-Chairman of the Committee and also other Committee Council members, CA. Prafulla Premsukh Chhajed

CA. Tarun Jamnadas Ghia, CA. Nihar Niranjan Jambusaria, CA. Dhinal Ashvinbhai Shah, CA. Madhukar Narayan Hiregange, CA. G. Sekar, CA. Sushil Kumar Goyal, CA. Mukesh Singh Kushwah, CA. Sanjay Kumar Agarwal, CA. Atul Kumar Gupta, Shri Sunil Kanoria and Dr. Ravi Gupta; Co-opted members CA. Dharini Shah, CA. Pinky Mehta, CA.Mahesh P. Sarda, CA G. Karthikeyan and CA. Gopal Choudhury; and special invitees CA. Parul Jolly, CA. T G Suresh, CA. Surabhi Agarwal, CA. Arun Gupta and CA. Vipin Verma who have contributed by giving valuable inputs in revising this Guidance Note.

Last but not the least, I appreciate the efforts made by CA. Mukta Kathuria Verma, Secretary Committee on International Taxation, CA. Vikas Kumar, Assistant Secretary and team members of the Secretariat of Committee on International taxation for effectively co-ordinating this project. For sure, this revised sixth edition of the Guidance Note also, will be of immense use to our members, like the earlier ones.

Place: New Delhi
Date: October 30, 2017

CA. Sanjiv K. Chaudhary
Chairman
Committee on International Taxation of ICAI

Foreword to the Fifth Edition

Change is inevitable when it comes to Indian tax laws. Time and again, frequent changes in laws have presented their own challenges before our members. Increasing cross border transactions, use of technology and the like have added more complexity to the tax laws. With increase in number of multinational companies having subsidiaries and branches all over the world, there has been a tremendous augment in the number of transactions with the associated enterprises.

Our members have an onerous responsibility of examining the documents so maintained by the enterprises operating in India and express an opinion thereof in Form No.3CEB with regard to the compliance of the legal requirements. This Guidance note provides a support to the members in respect of the manner of exercising due diligence while inspecting international transactions and also specified domestic transactions. The document was last revised in the year 2013.Since then many changes have been made in the related rules.

I am pleased to mention that Committee on International Taxation of ICAI has done a commendable task by bringing out with the fifth edition of "*Guidance Note on report under section 92E of the Income-tax Act, 1961 (Transfer Pricing)".* With these little steps, ICAI endeavors to ensure that its members are always well equipped to face challenges in this complex area also.

I compliment CA. Nihar Niranjan Jambusaria, Chairman and CA. Sanjiv K. Chaudhary, Vice-Chairman, Committee on International taxation of ICAI for taking this initiative to revise the publication.

I am sure that the revised edition of the Guidance Note will be immensely useful to the members in discharging their attest function in an effective manner.

Place : New Delhi **CA. M. Devaraja Reddy,**

Date : October 28, 2016 **President**

Preface to the Fifth Edition

With the increased level of cross border transactions and Capital mobility, Transfer Pricing has emerged as a distinct field of practice for our members. In fact, our professionals have been taking up the challenges involved in this area with great spirit. ICAI too is duty bound to support them in respect of the required knowledge up-dation. The Committee on International Taxation of ICAI which is dedicated Committee for this field is making all efforts to update the members in this area.

The recently launched Diploma in International Taxation imparts 60 hours out of 120 hours of Professional training in Transfer Pricing by various experts in the field. The Committee has been regularly contributing in the CA Journal for up-dation of its members. Apart from the above there have been one day or two days programmes that are organized in respect of International Taxation.

One of the important effort made by the Committee for providing guidance to the members in discharging their reporting responsibility in an effective manner is to revise the Guidance Note on Report under section 92E of the Income-tax Act, 1961(Transfer Pricing). This Guidance Note was last revised in August 2013, when Part C was inserted in Form No.3CEB to report specified domestic transactions under section 92BA. Since then there have been various developments in law; identifying some; notification of safe harbor rules in respect of arm's length price under section 92C or section 92CA; notification of provisions/rules for roll back mechanism; range concept and use of multiple year data for determination of arm's length price; increased threshold limit for the applicability of the specified domestic transaction and the like. This revised version of the Guidance Note contains all these important changes for guidance of the members practicing in this area.

My sincere thanks to CA. M. Devaraja Reddy, President and CA. Nilesh Vikamsey, Vice-President of the Institute of Chartered Accountants of India who have been the guiding force behind the revision of this publication.

I have no words to effectively appreciate the untiring efforts of CA. Vijay Iyer and CA. Ashwin Vishwanathan who had not even extended their support in revising the fourth edition but also this fifth edition of the Guidance Note. I am also thankful to CA. Arun Saripalli and CA. Rachesh Kotak who spared

their valuable time to review this revised Guidance Note. The revised edition would not have seen light of the day without their untiring efforts.

I express my gratitude to CA. Sanjiv Kumar Chaudhary, Vice-Chairman of the Committee and also other Committee Council members CA. Tarun Jamnadas Ghia, CA. Hegde Nandkishore, CA. Dhinal Ashvinbhai Shah, CA. Madhukar Narayan Hiregange, CA. G. Sekar, CA. Goyal Sushil Kumar, CA. Agrawal Manu, CA. Soni Kemisha, CA. Sanjay Agarwal, CA. Atul Kumar Gupta, Shri Sunil Kanoria, Ms. Indu Malhotra and Co-opted members CA. Arpan Kiran Mehta, CA. T G Suresh, Ms. Parul Jolly, CA. P V S S Prasad and CA.M V Purushottama Rao who have contributed by giving valuable inputs in revising this Guidance Note.

I appreciate the efforts made by CA. Mukta Kathuria Verma, Secretary Committee on International Taxation and her team for co-ordinating this project. I am sure that this revised guidance note will be useful to our members in responsibly discharging their attest function.

Place : New Delhi
Date : 28-10-2016

CA. Nihar N. Jambusaria
Chairman,
Committee on International Taxation of ICAI

Foreword to the Fourth Edition

Third edition of the Guidance Note on Report under section Sec. 92 E of the Income Tax Act, 1961 (Transfer Pricing) (Based on the Law as amended by the Finance Act, 2012) was approved by the Council on 11th February, 2013.

Under this Guidance note, Chapter 4A related to Specified Domestic Transaction mentioned that if and when a new revised format of Form No. 3CEB is notified, contents of this Guidance Note may need to be reviewed, and an addendum issued, or separate or amended Guidance Note issued.

Subsequent to this, there is a change in Form No. 3CEB for reporting International Transactions between Associated Enterprises. Further Part C of 3CEB has been inserted to report Specified Domestic Transactions u/s 92 BA.

Therefore, urgent need to update the third edition of Guidance Note was widely felt. The Guidance Note is mainly revised to give guidance to the members for reporting the transaction between Associated Enterprises u/s 92E of Income Tax Act, 1961.

I express my appreciation to CA. Dhinal A Shah, Chairman, Committee on International Taxation of ICAI for the initiative taken to revise the publication.

I thank to CA. Vijay Iyer, Mr. Ashwin Vishwanathan, CA. Nehal Sheth, CA. Pradeep A for contribution in giving a concrete shape to this publication.

I am sure that as in the case of the earlier edition, this revised edition of the Guidance Note will be immensely useful to the members in discharging their responsibilities.

Place: New Delhi
Date: 1st August, 2013

CA. Subodh Kumar Agrawal
President, ICAI

Preface to the Fourth Edition

With the increase in Cross Border transactions, particularly between Associated Enterprises, the applicability of transfer pricing provisions under Income Tax Act & other statues gained importance. Further, Finance Act, 2012 also introduced similar transfer provisions for domestic transactions.

This Guidance Note was revised in February, 2013. However no form was prescribed for reporting specified domestic transactions u/s 92BA.

Now, rules relating to Transfer Pricing Provisions & reporting Form no. 3CEB has been amended by Income Tax (Sixth amendment) Rules, 2013. Part-C to Form no. 3CEB has also been inserted by this rule. Further, from Financial Year 2013-14, Form no. 3CEB is required to be filed through e-filing before the due date.

In view of above substantial reporting amendments, this Guidance Note is again revised (Amendments made till 26/07/2013 have been considered) to incorporate this changes & to provide guidance to members to their reporting responsibility.

I am happy to state that CA. Vijay Iyer, Mr. Ashwin Vishwanathan, CA. Nehal Sheth and CA. Pradeep A has readily accepted our request to revise the edition. I place on record our sincere appreciation of the contribution made by each of them.

I express my gratitude to CA. Subodh Kumar Agrawal, President and CA. K. Raghu, Vice-President for their motivation and guidance. I thank CA. Sanjiv Kumar Chaudhary Vice-Chairman, CA. Jay Ajit Chhaira, CA. Tarun Jamnadas Ghia, CA. Nihar Niranjan Jambusaria, CA. Sanjeev Maheshwari, CA. Shiwaji Bhikaji Zaware, CA. S. Santhana Krishnan, CA. G. Sekar, CA. J. Venkateswarlu, CA. Manoj Fadnis, CA. Sanjay Agarwal, CA. Naveen N.D. Gupta, CA. Vijay Kumar Gupta, Shri Manoj Kumar, Shri Bhaskar Chatterjee, CA. T.P. Ostwal, CA. Gurunath Kanathur, CA. Mahesh P. Sarda, CA. Vivek Newatia, CA. Kuntal Dave, CA. Rajneesh Agarwal, CA. Sachin Vasudeva and CA. (Dr.) Girish Ahuja who have contributed by giving valuable inputs in revising this Guidance Note.

I appreciate the efforts made by Mr. Ashish Bhansali, Secretary, Committee on International Taxation for co-ordination and Mr. Govind Agarwal for rendering secretarial assistance.

I am sure that this revised Guidance Note will be immensely helpful to members in discharging their responsibilities.

Place: New Delhi
Date: 1st August, 2013

CA. Dhinal A. Shah
Chairman,
Committee on International Taxation, ICAI

Foreword to the Third Edition

The law relating to transfer pricing is dynamic and the members of the Institute are getting acquainted with the practical implications of the law and the rules relating to transfer pricing. The Finance Act, 2012 has made major Amendments such as Advance Pricing Agreement (APA), Specified Domestic Transaction, Expansion of TPO Power etc.

Guidance has been introduced with regard to how the accountant should exercise due diligence while inspecting international transactions in view of the increased scope of the definition of International Transactions.

Therefore, the Committee on International Taxation decided to bring out this revised edition Guidance Note on Report under Section 92E of the Income-Tax Act, 1961 (Transfer Pricing) for its members.

The legal, Financial and accounting aspects relating transfer pricing are highly complex and have global ramifications. It is indeed a matter of honour to chartered accountants who have been given the onerous responsibility of reporting on International as well as specified domestic transactions. I am sure that the members will discharge this responsibility to the satisfaction of the government.

I express my gratitude and appreciation to CA. Mahesh P. Sarda, Chairman, Committee on International Taxation of ICAI for the initiative taken to revise the publication. I thank CA. Sanjay Agarwal, Chairman, Direct Taxes Committee and CA. Dhinal Shah, Vice-Chairman, Direct Taxes Committee and convener for this publication for immense support provided by them.

I thank to CA. Vijay Iyer, Mr. Ashwin Vishwanathan, CA. Nehal Sheth, CA. Pradeep A, CA. Manoj Pardarsani and CA. Esha Tuteja for contribution in giving a concrete shape to this publication.

I am sure this book will be immensely useful and benefit all its readers by providing an insight into the complex aspects of Transfer Pricing with due clarity on the subject matter and in a simplified manner.

Place: New Delhi
Date: 11th February, 2013

CA. Jaydeep Narendra Shah
President, ICAI

Preface to the Third Edition

In the era of globalization, when multinational Enterprises (MNEs) have branches, divisions, subsidiaries and offices operating across the globe; it is common for them to transact goods and services from one jurisdiction to an associated enterprise in another tax jurisdiction.

The Finance Act, 2012 has made significant changes such as Advance Pricing Agreement (APA), expansion of Transfer Pricing Officer's (TPO's) Power, amendments relating to penalties, etc. Also, the Finance Act, 2012 introduced a new section 92BA in the Income-tax Act. Such provisions deal with the meaning of Specified Domestic Transaction. The proposed new section 92BA provides the meaning of "specified domestic transaction" with reference to which the income is computed under section 92 having regard to the arm's length price.

The members of our profession are expected to do the examination of the information and documentation so maintained and expresses an opinion thereof in Form No.3CEB as to the compliance of the legal requirements. The report also requires opinion to be expressed about the truth and correctness of the particulars given in the annexure to Form No. 3CEB.

Therefore, urgent need to update the publication was widely felt.

I am happy to state that CA. Dhinal Shah readily accepted our request to revise the edition and who has been actively supported by CA. Vijay Iyer, Mr. Ashwin Vishwanathan, CA. Nehal Sheth and CA. Pradeep A. I place on record our sincere appreciation of the contribution made by each of them. I thank CA. Manoj Pardarsani, for carrying out thorough vetting process and who has been supported by CA. Esha Tuteja.

I thank CA. Sanjay Agarwal, Chairman, Direct Taxes Committee and its Committee members for immense support provided by them.

I appreciate the efforts made by Mr. Ashish Bhansali, Secretary, Committee on International Taxation and CA. Mukta K. Verma, Secretary, Direct Taxes Committee for co-ordination and CA. Govind Agarwal for rendering secretarial assistance.

I believe the efforts in bringing out this publication will get amply rewarded if it proves to be useful to members of the Institute. It will be our endeavor to revise the edition more frequently.

Place: New Delhi
Date: 11th February, 2013

CA. Mahesh P. Sarda
Chairman,
Committee on International Taxation, ICAI

Foreword to the Second Edition

The first edition of the Guidance Note on Report on International Transactions under section 92E of the Income-tax Act, 1961 (Transfer Pricing) was published in the year 2002. Subsequent Finance Acts made some significant amendments to the law relating to transfer pricing.

The globalization of the Indian economy has resulted in considerable increase in foreign institutional investments, a huge expansion in the production and service base and also a multiplicity of international transactions. As a result of this development international taxation is assuming great importance. The subject of international transaction covers a wide spectrum like cross border transactions, e-commerce, Double Taxation Avoidance Agreement, transfer pricing etc. Members of the Institute are more and more required to deal with many issues related to transfer pricing.

Since the law relating to transfer pricing is in the process of development, several new issues would naturally arise during the implementation of the requirements of the legislation. Further, this branch of law is relatively new to the Income-tax Act and it would take some time before the law gets settled down.

During the course of about five years the members have gained experience in dealing with the requirements of the law and the rules relating to transfer pricing. It was thought fit that these insights could be incorporated in the guidance note for the benefit of our members.

The Fiscal Laws Committee of the Institute constituted Study Groups in Delhi, Chennai and Bangalore to analyse all the practical issues in-depth and bring out the revised edition of the Guidance Note. I compliment the Chairman, Fiscal Laws Committee CA. G. Ramaswamy for his initiatives in getting the Guidance Note revised. I also record my appreciation for CA. Padam Chand Khincha, Convenor of the Bangalore Study Group, CA. R. Bupathy, Convenor of the Chennai Study Group and CA. Vijay Iyer, Convenor of the Delhi Study Group for their sincere efforts in bringing out this Guidance Note.

Date: 3.2.2008 **Sunil Talati**
Place: New Delhi ***President***

Preface to the Second Edition

Following the enactment of sections 92A to 92F in the Income-tax Act, 1961 providing for the computation of income from an international transaction having regard to arm's length price, by the Finance Act, 2001, some significant amendments were made by the subsequent Finance Acts. These amendments were made to address the issues arising out of the practical implementation of the transfer pricing regulations.

The law relating to transfer pricing is in the process of evolution and the members of the Institute are getting acquainted with the practical implications of the law and the rules relating to transfer pricing. Out of their practical experience some important issues relating to determination of arm's length price, responsibilities of the Assessing Officer to determine the total income of the assessee in conformity with the arm's length price determined by the Transfer Pricing Officer and maintenance and keeping of information and documents relating to international transactions have arisen.

The Fiscal Laws Committee thought it fit to consider the above developments in their proper prospective and incorporate them in the revised edition of the Guidance Note. Accordingly, Study Groups were constituted in Delhi, Chennai and Bangalore under the Convenorship of CA. Vijay Iyer, CA. R. Bupathy and CA. Padam Chand Khincha respectively. The Study Groups considered the matter in-depth and came out with their valuable inputs. I must compliment CA. K. K. Chythanya, CA. Murali Mohan, CA. Nitin Garg, CA. Shikha Gupta and CA. Tarun Arora, for their excellent contributions in the preparation of this Guidance Note.

I express my gratitude to CA. Sunil Talati, President and CA. Ved Jain, Vice-President for their motivation and guidance. I thank CA. K. Raghu, Council Member, CA. Mahesh P. Sarda, Vice-Chairman and other members of the Fiscal Laws Committee who have contributed in giving a concrete shape to this Guidance Note.

I also appreciate CA. R. Devarajan, Secretary, Fiscal Laws Committee and his team comprising Ms. Mukta Kathuria, Sr. Executive Officer and Mr. Y. S. Rawat, Private Secretary for coordinating this project.

I am sure that as in the case of the earlier edition, this revised edition of the Guidance Note will be useful to the members in discharging their responsibilities.

Date: 3.2.2008
Place: New Delhi

G. Ramaswamy
Chairman
Fiscal Laws Committee

Foreword to the First Edition

The Finance Act, 2001 has introduced sections 92 to 92F in the Income-tax Act, 1961 with effect from Assessment Year 2002-2003. These provisions are commonly referred to as transfer pricing regulations.

Such provisions deal with the methods of computation of income from international transactions, the documentation to be maintained by the enterprises, certification by a chartered accountant and penalty for non-compliance thereof. Every person who has entered into an international transaction during a previous year shall obtain a report from a chartered accountant and furnish such report on or before the specified date in the prescribed form.

The legal, financial and accounting aspects relating to transfer pricing are highly complex and have global ramifications. It is indeed a matter of honour to chartered accountants who have been given the onerous responsibility of reporting on international transactions. I am sure that the members will discharge this responsibility to the satisfaction of the government.

The Fiscal Laws Committee has closely involved itself with transfer pricing right from the stage of drafting of transfer pricing rules. It has constituted study groups in Delhi and Bangalore, got the issues closely examined and brought out this guidance note.

I record my appreciation for the initiatives taken by the Fiscal Laws Committee and more particularly I thank Mr. T.N. Manoharan, Chairman of the Committee, Mr. Ved Jain, Convenor of the Delhi Study Group and Mr. Padam Chand Khincha, Convenor of the Bangalore Study Group for their excellent efforts in bringing out this guidance note. I also appreciate Mr. R. Devarajan, Secretary, Fiscal Laws Committee for his coordination of the project.

Place: New Delhi
Date: 2.4.2002

Ashok Chandak
President

Preface to the First Edition

The Finance Act, 2001 has substituted a new section 92 and inserted sections 92A to 92F with a view to compute income from an international transaction having regard to arm's length price. These provisions are intended to facilitate determination of proper income arising from international transactions where either or both the parties involved happen to be non-resident(s). These provisions read with relevant rules 10A to 10E stipulate the maintenance and keeping of information and documents by persons entering into an international transaction. Further, an obligation is cast under section 92E on every such person to obtain and furnish a report from a Chartered Accountant.

The members of our profession are expected to do the examination of the information and documentation so maintained and kept with effect from assessment year 2002-03 and express an opinion thereof in Form No.3CEB as to the compliance of the legal requirements. The report also requires opinion to be expressed about the truth and correctness of the particulars given in the annexure to Form No.3CEB.

The Fiscal Laws Committee has considered it appropriate to bring out this Guidance Note for the benefit of the members so as to enable them to perform their attest function under section 92E of the Income-tax Act in an effective manner.

The inputs for this Guidance Note have been received from the Study Group constituted in Bangalore with Shri Padamchand Kincha as the Convener and from the Study Group constituted in Delhi with Shri Ved Jain as the Convener. I must compliment Sarvshri Arjun Vaidyanathan, K. K. Chythanya, D. Devaraj, S. Ramasubramanian, Rajendra Rao, Sandeep Dinodia, Sanjiv K. Choudhary, K. R. Sekar, Tarun Arora, Vijay Iyer, H. Vishnumoorthi, and the Conveners but for whose contributions the preparation of this Guidance Note could not have fructified. Their devotion to the task has enabled the bringing of the Guidance Note in a timely manner.

I express my gratitude to Shri Ashok Chandak, President and Shri R. Bupathy, Vice-President for their motivation and guidance. I thank Mrs. Bhavna G. Doshi, Vice Chairperson, Shri Sunil Goyal, Shri Jayant Gokhale, Shri Gopal Dokania, members of the Fiscal Laws Committee, and the co-opted members who have contributed in giving a final shape to this Guidance Note. My sincere thanks are due to all the other Council Members, more

particularly, Shri N.V. Iyer for the valuable suggestions given. Many members across the country have also sent in their comments and views for which I remain thankful to them.

I will be failing in my duty if I do not acknowledge the initiative taken by Shri N.D. Gupta, Immediate Past President in ensuring the constitution of study groups during 2001 and for the periodical guidance and persistent follow-up on the progress of the guidance note till date.

Finally, my appreciation is due in abundance to Shri R Devarajan, Secretary, Fiscal Laws Committee and his team comprising of Mrs. Ishita Sengupta, Assistant Director of Studies and Shri Y. S. Rawat, Steno-typist for the methodical and efficient manner in which the bringing out of the guidance note was co-ordinated.

It is fervently desired that this effort of the Fiscal Laws Committee will prove to be of immense use to the members in enabling them to discharge their responsibility justifying the faith and confidence reposed on the profession by the Government.

Date: 9th April, 2002
Place: New Delhi

T. N. Manoharan
Chairman,
Fiscal Laws Committee

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Clarification Regarding Authority Attached to the Documents Issued by the Institute

"Guidance Notes' are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. Guidance Notes are recommendatory in nature. A member should ordinarily follow recommendations in a guidance note relating to an auditing matter except where he is satisfied that in the circumstances of the case, it may not be necessary to do so. Similarly, while discharging his attest function, a member should examine whether the recommendations in a guidance note relating to an accounting matter have been followed or not. If the same have not been followed, the member should consider whether keeping in view the circumstances of the case, a disclosure in his report is necessary".

(Volume I of the Handbook of Auditing Pronouncements - Compendium of Standards and Statements (4th Edition, 2007), page I - 5, Para 5)

Chapter 1
Introduction

Legislative Framework

1.1 In an era of liberalization and globalization of trade and investment and the emergence of digital economy, the perceptible results have been - increase in the number of cross-border transactions and the complexity and speed with which global business can be transacted.

1.2 When transactions are entered into between independent enterprises, the consideration therefore is determined by market forces. However, when associated enterprises deal with each other, it is possible that the commercial and financial aspects of the transactions are not influenced by external market forces but are determined based on internal factors. In such a situation, when the transfer price agreed between the associated enterprises does not reflect market forces and the arm's length principle, the profit arising from the transactions, the consequent tax liabilities of the associated enterprises and the tax revenue of the host countries could be distorted.

1.3 The existence of different tax rates and rules in different countries offers a potential incentive to multinational enterprises to manipulate their transfer prices to recognise lower profit in countries with higher tax rates and vice versa. This can reduce the aggregate tax payable by the multinational groups and increase the after tax returns available for distribution to shareholders.

1.4 In India, the Act for a long time did not deal with this problem in a detailed manner. The erstwhile section 92 sought to determine the amount of profits which may reasonably be deemed to have been derived from a business carried on between a resident and a non-resident which, owing to the close connection between them is so arranged that it produced, to the resident, either no profits or less than the ordinary profits which might be expected to arise in that business in case the transaction would have been entered into between two entities having no close connection. Besides, sections 40A(2); 80IA(10) and 80IB(13) of the Act provide powers to the Assessing Officer to interfere with the pricing or costing of certain transactions in certain cases in order to determine the correct quantum of deduction permissible.

1.5 The Finance Act, 2001, recognised that international transactions between Associated Enterprises may not be subject to the same market forces that shape relations between two independent firms, and therefore introduced a set of provisions in Chapter X of the Act under the title "Special Provisions relating to avoidance of tax". The statutory framework attempts to monitor transfer prices for goods, facilities and services in order to determine that they confirm to the "arm's length principle". Not only has section 92 of the Act been completely recast but new sections 92A to 92F have also been introduced to meet the desired objective of ensuring that the local tax base of a taxpayer is fair.

1.6 The relevant provisions contained in Chapter X (sections 92 to 92F) of the Act and the provisions dealing with the levy of penalties for non-compliance thereof are reproduced in **Annexure I**. The Finance *Act,* 2002 made certain changes to the provisions contained in sections 92A, 92C, 92F and 271F. The Finance Act, 2006 further amended section 92C. Further, the Finance Act, 2007 inserted sub-sections (3A) and (4) in section 92CA. Finance Act 2009 amended the proviso to section 92C, provided for constitution of the dispute resolution panel and empowered the Board to formulate safe harbour rules. Finance Act 2011 amended the allowable variation as per second proviso to section 92C(2) to be notified by the Central Government, and made changes to Section 92CA. The Finance Act 2012 has introduced significant amendments including inter alia clarifying the coverage of the term 'international transactions', expanding the scope of transfer pricing provisions to specified domestic transactions (Section 92BA) and providing an Advance Pricing Agreement framework (Section 92CC and Section 92CD) empowering the transfer pricing officer to determine arm's length price of an international transaction noticed during the course of proceedings before him, even if the said transaction has not been referred by the Assessing Officer, provided such transaction has not been reported by taxpayer as per requirement of Section 92E of the Income Tax Act, 1961 [Section 92CA(2B)] and expanding the scope of penalties and amending Section 147 of the Act to provide that non-reporting of transaction in report as per Section 92E would be deemed to be case of escapement of income.

Further, changes specifically in respect of arm's length price determination were introduced vide Finance (No. 2) Act 2014 and the Finance Act 2015. The Finance Bill 2014 introduced the use of multiple year data and the Finance Act (No. 2), 2014 introduced range concept for determination of arm's length price and roll-back mechanism for APA. The final rules in

relation to the range concept and use of multiple year data were notified by the Central Board of Direct Taxes in October, 2015.

1.7 Further, section 92B extended application of transfer pricing provisions to transaction entered by an Indian entity with a resident independent third party under specified circumstances. The Finance Act 2015 increased the threshold limit for the applicability of specified domestic transaction from INR 5 crores to INR 20 crores with effect from Financial Year 2015-16.

1.8 The Finance Act 2016, in line with recommendations of the BEPS Action Plan 13, inserted section 286 for furnishing of country-by-country report and inserted proviso to section 92D(1) for maintenance of Master File, with effect from Financial Year 2016-17. Further, relevant rules and forms for country-by-country and Master File were notified on 31 October, 2017.

1.9 Further, the existing penalty provisions have been rationalised along with insertion of additional penalties for non-furnishing/ maintenance of country-by-country report and Master File.

1.10 The Finance Act 2017, amended the applicability of specified domestic transactions compliance by excluding expenditure made to person referred to in Sec. 40A(2)(b) of the Act, from the ambit of the definition.

1.11 Provisions regarding secondary adjustments and limitation on interest deduction were introduced and inserted as new sections (92CE and 94B respectively) vide Finance Act, 2017.Finance Act 2017 also introduced section 271J for levying penalty on accountants for furnishing incorrect information in reports or certificates furnished under any provisions of the Act or the rules made thereunder.

1.12 The Finance (No. 2) Act, 2019 made amendments to section 92CD, 92CE, 92D and 286 of the Act. These amendments are as follows:

- Section 92CD (3) was amended to clarify that in cases where assessment or reassessment has already been completed and modified return of income has been filed by the tax payer under sub-section (1) of section 92CD, the Assessing Officers shall pass an order modifying the total income of the relevant assessment year determined in such assessment or reassessment, having regard to and in accordance with the APA. This amendment is applicable from 1 September, 2019.
- Section 92CE was amended to give clarification with regard to applicability of provision of secondary adjustment and to give an

option to assessee to make one-time payment (discussed in detail at Para 1.27 of this chapter)

- Section 286 of the Act was amended to give clarification regarding definition of the "accounting year" so as to provide that the accounting year in case of the alternate reporting entity ('ARE') of an international group, the parent entity of which is not resident in India, shall be the one applicable to the parent entity of ARE. The said amendment will take effect retrospectively from the 1st April, 2017 and will, accordingly, apply in relation to the assessment year 2017-18 and subsequent assessment years.

1.13 The Finance Act, 2020 made certain amendments to sections 92CB, 92CC, 92F and 94B. These amendments are as follows:

- Section 92CB and 92CC of the Act was amended to include attribution of profits to the PE of a non-resident under clause (i) of sub-section (1) of section 9 of the Act.
- Section 92F of the Act amended the definition of term "specified date" to mean the date one month prior to the due date for furnishing the return of income under sub-section (1) of section 139 for the relevant assessment year.
- Section 94B of the Act was amended to exclude interest paid or payable in respect of a debt issued by a lender which is a permanent establishment in India of a non-resident, being a person engaged in the business of banking.
- On 17 June 2022, Central Board of Direct Taxes ('CBDT') has issued Notification No. 66 /2022/F. No. 370142/26/2022-TPL. Vide this Notification, the CBDT has extended the Safe Harbour Rules ('SHR') to Assessment Year ('AY') 2022-23 relevant to the previous year 2021-22

1.14 Faceless Assessment: The Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 amended section 92CA of the Act and inserted clause (8) to (10) w.e.f from 1.11.2020 to extend the provision of faceless assessment to transfer pricing also.

- Sub-section (9) of the said section further provides that for the purposes of giving effect to the aforesaid scheme, the Central Government may by notification in the Official Gazette direct that any of the provisions of the Act shall not apply or shall apply with such

exceptions, modifications and adaptations as may be specified. It was provide that no direction shall be issued after the 31st day of March, 2022.

- By virtue of Finance Bill, 2022, the last date for issuing directions/notification for faceless determination of arm's length price under section 92CA, faceless Dispute Resolution Panel under 144C, Faceless appeal/proceedings before the Appellate Tribunal under section 253/section 255 of the IT Act have now been extended from March 31, 2022 to March 31, 2024.

1.15 Non filing of repetitive appeals - A new section 158AB has been inserted after section 158AA by the Finance Act, 2022 in order to prevent filing of repetitive appeals. Section 158AB provides as below:

'(1*) Notwithstanding anything contained in this Act, where the collegium is of the opinion that––*

(a) any question of law arising in the case of an assessee for any assessment year (such case being herein referred to as the relevant case) is identical with a question of law arising,— (i) in his case for any other assessment year; or (ii) in the case of any other assessee for any assessment year; and

(b) such question is pending before the jurisdictional High Court under section 260A or the Supreme Court in an appeal under section 261 or in a special leave petition under article 136 of the Constitution, against the order of the Appellate Tribunal or the jurisdictional High Court, as the case may be, which is in favour of such assessee (such case being herein referred to as the other case),

the collegium may, decide and inform the Principal Commissioner or Commissioner not to file any appeal, at this stage, to the Appellate Tribunal under sub-section (2) of section 253 or to the jurisdictional High Court under sub-section (2) of section 260A in the relevant case against the order of the Commissioner (Appeals) or the Appellate Tribunal, as the case may be.

(2) The Principal Commissioner or the Commissioner shall, on receipt of a communication from the collegium under sub-section (1), direct the Assessing Officer to make an application to the Appellate Tribunal or the jurisdictional High Court, as the case may be, in such form as may be prescribed within a period of sixty days from the date of

receipt of the order of the Commissioner (Appeals) or within a period of one hundred and twenty days from the date of receipt of the order of the Appellate Tribunal, as the case may be, stating that an appeal on the question of law arising in the 78 relevant case may be filed when the decision on such question of law becomes final in the other case.

These amendments are also included in the said Annexure. The Rules prescribed in this regard by the Central Board of Direct Taxes are reproduced in **Annexure II**. The relevant extracts from the Memorandum explaining the provisions of the Finance Act, 2001, Finance Act, 2002, Finance Act, 2006, Finance Act, 2007, Finance Act, 2009, Finance Act, 2011, Finance Act 2012, Finance (No. 2) Act 2014, Finance Act 2015, Finance Act 2016, Finance Act, 2017, Finance (No. 2) Act, 2019 Finance Act 2020, The Taxation And Other Laws (Relaxation And Amendment Of Certain Provisions) Act, 2020 and Finance Act, 2022 are given in **Annexure III**. The Central Board of Direct Taxes has issued Circulars explaining the provisions and clarifying certain related aspects. These circulars are given in **Annexure IV.**

Terms and abbreviations used

1.16 In this Guidance Note the following terms and abbreviations occur often in the text. A brief explanation of such terms and abbreviations is given below. Further, reference to a section without reference to the relevant Act means that the section has reference to the Income-tax Act, 1961.

(a) Act

The Income-tax Act, 1961.

(b) Accountant

Accountant means a chartered accountant within the meaning of the Chartered Accountants Act, 1949 and as referred to in section 288 of the Act.

(c) Arm's Length Price (ALP)

ALP as defined under section 92F(ii) of the Act.

(d) AS

The Accounting Standards issued, prescribed and made mandatory by the ICAI or as under section 2(2) of Companies Act, 2013 and the Companies (Accounting Standards) Rules, 2006.

(e) AS (IT)

Income Computation and Disclosure Standards notified by the Central Government under section 145(2) of the Act.

(f) SA

Standards on Auditing prescribed under Section 143(10) of the Companies Act 2013.

(g) Associated enterprises (AEs)

An AE as defined under section 92A of the Act.

(h) APA

Advance Pricing Agreement

(i) BEPS

Base Erosion and Profit Shifting

(j) Board/ CBDT

The Central Board of Direct Taxes constituted under the Central Boards of Revenue Act, 1963.

(k) Circular

A circular or instructions issued by the Board under section 119(1) of the Act.

(l) CUT

Comparable Uncontrolled transaction

(m) CUP Method

Comparable Uncontrolled Price Method

(n) RPM

Resale Price Method

(o) PSM

Profit Split Method

(p) CPM

Cost Plus Method

(q) TNMM

Transactional Net Margin Method

(r) Enterprise

An enterprise as defined under section 92F (iii) of the Act.

(s) ICAI

The Institute of Chartered Accountants of India.

(t) International transaction

International transaction as defined under section 92B of the Act.

(u) OECD

Organisation for Economic Co-operation and Development.

(v) OECD Guidelines

Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations by OECD - provides guidance on the application of the "arm's length principle"

(w) Report

The report of an accountant under section 92E of the Act.

(x) Rules

The Income-tax Rules, 1962.

(y) Specified date

Specified date as stipulated under clause (iv) of section 92F of the Act.

(z) Specified domestic transaction

Specified domestic transaction as defined under section 92BA of the Act.

(za) Transaction

A transaction as defined under section 92F(v) of the Act.

(zb) Transfer Pricing Officer (TPO)

An officer as defined in explanation to section 92CA.

Objective of the Guidance Note

1.17 The provisions relating to computation of income from international transactions between AEs having regard to ALP are applicable with effect from assessment year 2002-03. According to section 92E of the Act, every

person who has entered into an international transaction or a specified domestic transaction[1] 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. An accountant is required to discharge his function in this regard from assessment year 2002-03.

1.18 The object of this guidance note is to provide guidance to accountants in discharging their responsibilities under section 92E of the Act. It intends to:

(i) assist in understanding the respective responsibilities of the taxpayer enterprise and the accountant;

(ii) guide the accountant as to the nature and scope of information to be obtained by him from the taxpayer enterprise to enable him to conduct the examination;

(iii) provide guidance on the verification procedures to be adopted by the accountant for giving the report and the prescribed particulars in the annexure thereto; and

(iv) explain the circumstances where a disclosure or qualification or disclaimer may be required from the accountant while giving his report.

Applicability of the provisions

1.19 The provisions contained in Chapter X of the Act are applicable to an international transaction entered into between two or more AEs either or both of whom are non-residents. Also, in the case of a specified domestic transaction, not being an international transaction as covered as per section 92BA of the Act these provisions are attracted.

1.20 International transaction covers transaction in the nature of purchase, sale or lease of tangible or intangible property or provision of services or lending or borrowing money or any other transaction having a bearing on the profits and income, losses or assets of such enterprises and includes a mutual agreement or arrangement between two or more AEs for the allocation or apportionment of, or any contribution to, any cost or expense

[1] The provisions relating to Specified Domestic Transactions are applicable with effect from assessment year 2013-14.

incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises. Further, the expression 'international transaction' has been clarified vide Finance Act 2012 with retrospective effect from 1 April 2002 to include a wide variety of arrangements.

1.21 According to section 92B(2) of the Act, a transaction entered into by an enterprise with a person other than an AE, shall be deemed to be a transaction between two AEs if there exists a prior agreement in relation to the relevant transaction between such other person and the AE or the terms of the relevant transaction are determined in substance between such other person and the AE. Consequently the provisions of this chapter shall apply even in the aforementioned cases. This provision has been further amended to include transactions irrespective of whether such unrelated person is a resident or non-resident, as long as either the enterprise or the AE is non-resident.

1.22 As per section 92(3), these provisions are not intended to be applied in cases where the effect of application of these provisions reduces income chargeable to tax in India or increases the loss, as the case may be.

1.23 *Safe Harbour (Section 92CB of the Act)*

The Finance Act 2009 empowered the Board to frame safe harbour rules. Safe harbour means circumstances in which the tax authorities shall accept the transfer price as declared by the taxpayer. The safe harbour rules ('SHR') were notified in September 2013. In the rules, safe harbour rates were prescribed for specific nature of international transactions.

The CBDT, vide a notification dated 7 June 2017, revised the existing SHRs in India.

The revised SHRs apply for Assessment Year (AY) 2017-18 and two immediately following AYs i.e. upto AY 2019-20. The earlier SHRs were applicable from AY 2013-14 and four immediately following AYs i.e. upto AY 2017-18. For AY 2017-18, the taxpayer can choose from old or new rules whichever is more beneficial.

CBDT by way of notification dated May 20, 2020 has extended provisions of safe harbour rules to AYs 2020-21 and 2021-22 (Substituted for "assessment years 2020-21 and 2021-22" by the Income-tax (Eighteenth Amendment) Rules, 2022) as well.

1.24 Key highlights

Rationalisation of safe harbour rates -The safe harbour rates for all contract services have been moderated.

Upper turnover threshold of INR 200 crore introduced for all contract service providers [Software Development, (ITeS), KPO, R&D for IT and generic pharmaceutical drugs].

Introduction of safe harbour for receipt of low value adding intra group services- The safe harbour provisions have been extended to receipt of such services by Indian entities under the revised SHRs. The revised SHRs in this regard also lay down a requirement for the applicant to get the method of cost pooling, exclusion of shareholder costs and duplicate costs from cost pool and the reasonableness of the allocation keys used for allocation of costs certified by an accountant. In this regard, the definition of an accountant has also been incorporated in the revised SHRs.

Introduction of safe harbour rates on loans advanced in foreign currency - The revised SHRs have prescribed safe harbour rates based on London Inter-bank Offer Rate (LIBOR) for loans advanced to AEs denominated in foreign currency and based on State Bank of India's marginal cost of funds lending rate for loans advanced to AEs denominated in INR. The revised SHRs have also prescribed staggered rates (spread over the applicable base rates) depending upon the credit rating of the overseas borrower, subject to such credit ratings being approved by CRISIL (formerly Credit Rating Information Services of India Limited)

1.25 The Safe harbour rates as per the old and new rules are tabulated below:

Categories of international transactions	Safe harbour rates - old rules [as per sub Rule (2) of rule 10TD of Income-tax Rules, 1962] applicable from AY 2013-14 to AY 2017-18	Safe Harbour rates - revised rules [as per sub Rule (2A) of rule 10TD] applicable from AY 2017-18 to AY 2019-20 (extended to be applicable for AYs 2020-21 and 2021-22 also)
Provision of Software development services and Information Technology Enabled services (ITeS), with insignificant risks	Operating profit margin to operating expense □ where the aggregate value of such transactions does not exceed a sum of INR500 crore – not less than 20 per cent □ where the aggregate value of such transactions exceeds INR500 crore – not less than 22 per cent.	Operating profit margin to operating expense □ where the aggregate value of such transactions does not exceed INR100 crore – not less than 17 per cent □ where the aggregate value of such transactions exceeds INR100 crore but does not exceed INR200 crore - not less than 18 per cent.
Provision of KPO services, with insignificant risks	Operating profit margin to operating expense not less than 25 per cent	The value of international transaction does not exceed INR200 crore and the operating profit margin to operating expense is – □ Not less than 24 per cent, if the employee cost to operating expense

Categories of international transactions	Safe harbour rates - old rules [as per sub Rule (2) of rule 10TD of Income-tax Rules, 1962] applicable from AY 2013-14 to AY 2017-18	Safe Harbour rates - revised rules [as per sub Rule (2A) of rule 10TD] applicable from AY 2017-18 to AY 2019-20 (extended to be applicable for AYs 2020-21 and 2021-22 also)
		is at least 60 per cent □ Not less than 21 per cent, if the employee cost to operating expense is 40 per cent or more but less than 60 per cent; or □ Not less than 18 per cent, if the employee cost to operating expense does not exceed 40 per cent.
Provision of Intra-group loan to Wholly Owned Subsidiary (WOS)	Interest rate equal to or greater than the base rate of State Bank of India (SBI) as on 30th June of the relevant previous year: □ plus 150 basis points where the amount of loan does not exceed INR50 crore □ plus 300 basis points where	*The threshold of INR50 crore has been removed* Different safe harbour rates have been prescribed for □ **Loan denominated in Indian Rupees (INR)** Refer table 1 below □ **Loan denominated in foreign currency** Refer table 1 below

Categories of international transactions	Safe harbour rates - old rules [as per sub Rule (2) of rule 10TD of Income-tax Rules, 1962] applicable from AY 2013-14 to AY 2017-18	Safe Harbour rates - revised rules [as per sub Rule (2A) of rule 10TD] applicable from AY 2017-18 to AY 2019-20 (extended to be applicable for AYs 2020-21 and 2021-22 also)
	amount of loan exceeds INR50 crore	
Provision of Corporate guarantee to WOS	□ where the amount guaranteed does not exceed INR100 crore - Commission or fee of 2 per cent or more per annum □ where the amount guaranteed exceeds INR100 crore, and the credit rating of the borrower, by a Securities and Exchange Board of India (SEBI) registered agency is of the adequate to highest safety– Commission or fee of 1.75 per cent or more per annum	The differential rates of 2 per cent and 1.75 per cent have been moderated down to a standard rate of 1 per cent irrespective of the amount guaranteed. However the requirement for the credit rating of the borrower to be certified by a SEBI registered agency and such credit rating to be of adequate to highest safety still remains for amount guaranteed exceeding INR100 crore
Provision of specified contract research and	Operating profit margin to operating	The operating profit margin to operating

Categories of international transactions	Safe harbour rates - old rules [as per sub Rule (2) of rule 10TD of Income-tax Rules, 1962] applicable from AY 2013-14 to AY 2017-18	Safe Harbour rates - revised rules [as per sub Rule (2A) of rule 10TD] applicable from AY 2017-18 to AY 2019-20 (extended to be applicable for AYs 2020-21 and 2021-22 also)
development services (Contract R&D services), with insignificant risks, wholly or partly relating to software development	expense not less than 30 per cent	expense not less than 24 per cent, where the value of the international transaction does not exceed INR200 crore.
Provision of contract R&D services, with insignificant risks, wholly or partly relating to generic pharmaceutical drugs	Operating profit margin to operating expense not less than 29 per cent	The operating profit margin to operating expense not less than 24 per cent, where the value of the international transaction does not exceed INR200 crore.
Manufacture and export of: □ core auto components □ non-core auto components where 90 per cent or more of total turnover relates to Original Equipment Manufacturer sales	Operating profit margin to operating expense: □ not less than 12 per cent □ not less than 8.5 per cent	Operating profit margin to operating expense: □ not less than 12 per cent □ not less than 8.5 per cent
Receipt of low value-adding intra-group		Aggregate value of such transactions

Categories of international transactions	Safe harbour rates - old rules [as per sub Rule (2) of rule 10TD of Income-tax Rules, 1962] applicable from AY 2013-14 to AY 2017-18	Safe Harbour rates - revised rules [as per sub Rule (2A) of rule 10TD] applicable from AY 2017-18 to AY 2019-20 (extended to be applicable for AYs 2020-21 and 2021-22 also)
services		(including a mark-up not exceeding 5 per cent), does not exceed INR10 crore. Method of cost pooling, exclusion of shareholder costs and duplicate costs from cost pool and the reasonableness of the allocation keys used for allocation of costs to be certified by an accountant.

Table 1 – Safe harbour rates prescribed for loans advanced to AE

CRISIL credit rating of AE	**Loan in INR** - Interest rate not less than one-year marginal cost of funds lending rate of State Bank of India as on 1 April of the relevant previous year plus basis points as below	**Loan in Foreign currency** - Interest rate not less than six-month London Inter-Bank Offer Rate of the relevant foreign currency as on 30 September of the relevant previous year plus basis points as below
between AAA to A or its equivalent	175 basis points	150 basis points

CRISIL credit rating of AE	**Loan in INR** - Interest rate not less than one-year marginal cost of funds lending rate of State Bank of India as on 1 April of the relevant previous year plus basis points as below	**Loan in Foreign currency** - Interest rate not less than six-month London Inter-Bank Offer Rate of the relevant foreign currency as on 30 September of the relevant previous year plus basis points as below
BBB-, BBB or BBB+ or its equivalent	325 basis points	300 basis points
between BB to B or its equivalent	475 basis points	450 basis points
between C to D or its equivalent	625 basis points	600 basis points
Credit rating not available and aggregate amount of loan advanced to all AEs as on 31 March of the relevant previous year < INR100 crore	425 basis points	400 basis points

Further, safe harbour provisions have also been prescribed for the following specified domestic transactions:

S No.	Nature of specified domestic transaction	Circumstances
1.	Supply of electricity, transmission of electricity, wheeling of electricity referred to [in clause (i), (ii) or (iii) of rule 10THB, as the case may be]	The tariff in respect of supply of electricity, transmission of electricity, wheeling of electricity, as the case may be, is determined [or the methodology for determination of the tariff is approved] by the Appropriate Commission in accordance with the provisions of the Electricity Act, 2003 (36 of 2003).

S No.	Nature of specified domestic transaction	Circumstances
2.	Purchase of milk or milk products referred to in clause (iv) of rule 10THB.	The price of milk or milk products is determined at a rate which is fixed on the basis of the quality of milk, namely, fat content and Solid Not Fat (SNF) content of milk; and- (a) the said rate is irrespective of,- (i) the quantity of milk procured; (ii) the percentage of shares held by the members in the co-operative society; (iii) the voting power held by the members in the society; and (b) such prices are routinely declared by the cooperative society in a transparent manner and are available in public domain.".

To exercise the option of safe harbour, the taxpayer is required to file specified form (Form No 3CEFA for International Transactions and Form 3 CEFB for Specified Domestic Transactions) with the AO on or before due date of furnishing the return of income with required details for:

- the relevant assessment year, in case the option is exercised only for that assessment year; or
- the first of the assessment years, in case the option is exercised for more than one assessment years.

The taxpayer can opt out of the safe harbour regime from the second year onwards, by filing a declaration to that effect with the AO.

The revised safe harbour rules were applicable for a period of three years until AY 2019-20. CBDT vide its power under section 92CB by way of notification dated May 20, 2020 has extended provisions of safe harbour rules to AY 2020-21 and AY 2021-22 as well.

1.26 *APA (Section 92CC of the Act):* Finance Act 2012 introduced APAs wherein the Board, with the approval of the Central Government may enter into APAs with any person to determine the ALP or specify the manner in which the ALP is to be determined, in relation to an international transaction to be entered into by that person. The scope is enhanced by Finance Act, 2020 to include income referred to in clause (i) of sub-section (1) of section 9.

APAs presents a proactive measure for resolving transfer pricing disputes in a cooperative manner. The Indian APA regulations, in short, provide for the following:

(a) Unilateral / bi-lateral/ multilateral APAs - Unilateral APA is an arrangement between the taxpayer and the Indian tax administration (CBDT) whilst a bilateral / multilateral APA involves not only the taxpayer and the Indian tax administration but also the taxpayer's affiliates (with whom he transacts) and their tax administration.

(b) APA would be applicable for existing as well as new transactions. For an existing transaction, the taxpayer seeking an APA needs to file its application before the commencement of the fiscal year for which it seeks to apply.

(c) The provision to provide for a roll back mechanism was brought into the Act vide Finance Act (No. 2) 2014, with effect from 1 October 2014. The Board has announced detailed rules explaining the roll back provisions and the procedure for giving effect to them. The roll back is available for 4 previous years.

(d) There are procedures in place for renewal, amendments, withdrawals and revisions of APA.

1.27 *Roll-back provisions*

The roll back provision was brought into the Act vide Finance (No. 2) Act 2014, with effect from 1 October, 2014. The Board has announced detailed rules explaining the roll back provisions and the procedure for giving effect to them. Apart from that, the Board has made another key amendment, wherein pre-filing consultation has been made optional for the taxpayer.

Roll back is available for four previous years, preceding the first previous year covered in the APA. Further:

- Application requesting for roll back should be made in Form 3CEDA for the relevant roll back years.

- International transactions covered under roll back should be same as covered in the APA.
- Return of income of the applicant for roll back year ought to be furnished on or before the due date for filing return.
- Accountant's Report in Form 3CEB for the roll back years should have been filed on or before the due date.
- Roll back application should cover all the roll back years (i.e., the years falling with the block of four years) in which the international transaction has taken place.
- Roll back provisions shall not be provided, in respect of an international transaction, if the Income-tax Appellate Tribunal has passed an order disposing off an appeal relating to determination of ALP of the international transaction, at any time before signing of the APA agreement; or application of roll back has the effect of reducing total income or increasing the total loss.
- The manner of determining ALP in the roll back years with respect to any particular international transaction will be same as the manner agreed in the regular APA.

1.28 Annual Compliance Report ('ACR') and ACR Audit (Rule 10O and 10P)

- Once the APA is entered into, the assesse is required to furnish ACR to Director General of Income-tax (International Taxation) for each year covered in the APA.
- The ACR is required to be furnished in quadruplicate in Form 3CEF for each year covered in the APA within 30 days from the due date of filing return of income for that year or within 90 days of entering into an APA whichever is later.
- Director General of Income-tax (International Taxation) would send one copy of ACR to competent authority of India, one copy to Commissioner of Income-tax who has jurisdiction over the income-tax assessment of the assesse and one copy to the Transfer Pricing Officer having jurisdiction over the assesse
- Transfer Pricing Officer would carry out compliance audit for each year covered in the APA and shall furnish his compliance audit report to Director General of Income-tax (International Taxation) in case of unilateral APA and to the competent authority in case of bilateral or

multilateral APA within 6 months from end of the month in which ACR is received by Transfer pricing Officer from Director General of Income-tax (International Taxation)

- Regular transfer pricing assessment of transactions covered under APA would not be undertaken by the Transfer Pricing Officer
- CBDT released its Third Report (2018-19)on APA in November 2019 (available at https://www.incometaxindia.gov.in/Lists/Latest%20News/Attachments/360/FINAL_ANNUAL_REPORT_29_11_19.pdf). As per the report a total of 944 unilateral and 211 Bilateral APA were filed till date out of which 271 (i.e. 240 unilateral and 31 bilateral) agreements were signed with the taxpayer while remaining were in process. The agreement signed covered diverse nature of transactions including Provision of Software Development Services, Provision of IT enabled Services, Receipt of Intra-group Services, Provision of Sales /after Sales Support Services, Payment of Guarantee Fee and Merchanting Trade. In majority of cases Transactional Net Margin Method was followed, while there are a few cases where Profit Split Method was followed. Further as per the Press release dated 31st March 2022, 62 APAs were signed in 2021-22, 31 APAs were signed in the year 2020-21 and 57 APAs were signed in 2019-20. (Source CBDT website: https://incometaxindia.gov.in/Lists/Press%20Releases/Attachments/1068/Press-Release-Signing-of-62-Advance-Pricing-Agreements-by-CBDT-in-FY-2021-22-dated-31-03-2022.pdf)

1.29 *Use of multiple year data and the range concept:*

Central Board of Direct Taxes (CBDT) on October 20, 2015 issued the final rules ie, Rule 10B(5) and Rule 10CA to give effect to the use of 'multiple year data' and 'range concept'. These rules are applicable to international transactions and specified domestic transactions that are entered into by taxpayers on or after 1 April, 2014. Rule 10CA contains illustrations of application of the arm's length range concept.

Multiple year data

- Multiple year data (of the comparable companies for the purpose of comparability analysis) is applicable only in cases where Resale Price Method (RPM), Cost Plus Method (CPM) or Transactional Net

Margin Method (TNMM) has been selected as the Most Appropriate Method.

- Thus, in cases where CUP, PSM or Other Method are selected as the Most Appropriate Method, multiple year data of comparable companies cannot be used.
- For each comparable selected (under RPM, CPM or TNMM), the data of the current year is required to be considered. In case such data is not available at the time of furnishing the return of income, data pertaining to upto two preceding financial years may be used.

  To illustrate, say if the current year is Year zero and the financial year preceding that is Year 1 and the year prior to such year is Year 2, then it is worth noting that the rules do not envisage a situation wherein a comparable is selected only if it has data relating to Year 2.
- If a comparable is selected on the basis of preceding year data (say Year 1 and Year 2), but is not found to be comparable for the current year (Year 0) for qualitative or quantitative reasons, then such comparable would need to be rejected from the data set.
- When using multiple year data, data for each comparable shall be the weighted average of the selected years. An illustration explaining the computation is provided below:

	Year 0	Year 1	Year 2	Total	
Operating Profit	250	300	350	900	OP/TC for the comparable would be 900/ 5400 = 16.7%
Total Cost	1700	1800	1900	5400	

- Further, the rules provides that in the event current year data becomes available during the course of the assessment proceedings, then the same shall be used by the TPO for the purpose of the analysis.

Application of range

- As per the rules, the 'range concept' shall be applicable when: (a) the MAM is either; Comparable Uncontrolled Price (CUP) Method, RPM, CPM, or TNMM; and (b) there are at least 6 entries in the dataset. Where these conditions are not fulfilled, 'arithmetic mean' shall continue to apply, as before, along with the tolerance range benefit (3% or 1%)

For determination of the range, the margins in the data set (i.e., set of comparable companies) are required to be arranged in ascending order and the arm's length range would be data points lying between the 35th and 65th percentile of the data set. The computation mechanism of range, is explained by way of illustrations below:

Illustration 1: Where the data set comprises 7 data points (arranged in ascending order), and the percentiles computed are not whole numbers

Percentile	Formula	Result	Value to be selected
35th	Total no. of data points in dataset * 35% = [7 * 35%]	2.45	3rd value*
65th	Total no. of data points in dataset * 65% = [7 * 65%]	4.55	5th value*
Median	Total no. of data points in datasets * 50% = [7 * 0.5]	3.50	4th value*

** Value referred to here is the place value in the data set as arranged in ascending order.*

Illustration 2: Where the data set comprises 20 data points (arranged in ascending order), and the percentiles computed are whole numbers.

Percentile	Formula	Result	Value to be selected
35th	Total no. of data points in dataset*35% = [20 * 35%]	7	Mean of 7th & 8th value
65th	Total no. of data points in dataset*65% = [20* 65%]	13	Mean of 13th & 14th value
Median	Total no. of data points in datasets*50% = [20 * 0.5]	10	Mean of 10th & 11th value

If the transaction price falls within the range, then the same shall be deemed to be the ALP. If the transaction price falls outside the range, the ALP shall be taken to be the Median of the data set.

1.30 *Three* tier *documentation structure*

The three-tiered documentation structure (applicable with effect from Financial Year 2016-17) would consist of a "Master File", "Local File" and "Country-by-Country Report" (CbC Report). The Master File seeks to capture information regarding the taxpayer's global operations and their transfer pricing policies. Rule 10DA prescribes information to be furnished in Master File and related rules. The Local File would capture entity-specific information with reference to the related party transactions. In the Indian

context, the existing transfer pricing documentation requirements as per Rule 10D of the Income Tax Rules, 1962 (the Rules) already encompasses the Local File requirements. The CbC Report would be applicable for large multinational enterprises (MNEs)[2] and would capture key metrics of all entities in the group such as revenue, taxes paid, capital employed, headcount, etc (as defined in section 286 of the Act). Further, Rule 10DB prescribes rules relating to CbC Report.

1.31 *Secondary adjustment*

Secondary adjustment means an adjustment in the books of accounts of the taxpayer and its associated enterprise to reflect that the actual allocation of profits between the taxpayer and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the taxpayer. The taxpayer shall be required to carry out secondary adjustment where the primary adjustment to transfer price:

- has been made suo motu by the taxpayer in his return of income; or
- made by the Assessing Officer or the appellate authority[3], as the case may be has been accepted by the taxpayer; or
- is determined by an advance pricing agreement entered into by the taxpayer under section 92CC. Finance (No. 2) Act, 2019 amended this clause to restrict the secondary adjustment provisions to only those advance pricing agreements which have been signed on or after 1 April 2017. This is a retrospective amendment meant to apply from AY 2018-19; or
- is made as per the safe harbour rules framed under section 92CB; or
- is arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into under section 90 or 90A.

[2] Having annual consolidated group turnover of over INR 5500 Crores million in the immediately preceding financial year

[3] Section 92CE of the Income Tax Act 1961 only refers to Assessing Officer but the notification No GSR 590(E) [52/2017 (F.No. 370142/12/2017-TPL)], dated 15-6-2017 refers to Appellate Authority along with the Assessing Officer. The term Appellate Authority has not been defined in the notification.

Where as a result of primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss, as the case may be, of the taxpayer, the excess money which is available with its associated enterprise, if not repatriated to India within the time as prescribed (see table below), shall be deemed to be an advance made by the taxpayer to such associated enterprise and the interest on such advance, shall be computed as the income of the taxpayer, in the manner as prescribed[4] below.

<table>
<tr><th rowspan="2">Type of primary adjustment</th><th rowspan="2">Time limit for repatriation</th><th colspan="2">Applicable interest rate for delayed receipts</th></tr>
<tr><th>Transaction in INR</th><th>Transaction in foreign currency</th></tr>
<tr><td>Adjustment made by the Indian Tax Authority and accepted by the taxpayer</td><td>On or before 90 days from the date of relevant order</td><td rowspan="3">One year marginal cost of fund lending rate of State Bank of India as of 1 April of the relevant FY plus 325 basis points</td><td rowspan="3">Six month London Interbank Offered rate as of 30 September of the relevant FY plus 300 basis points</td></tr>
<tr><td>Suo-moto adjustment by the taxpayer</td><td rowspan="2">On or before 90 days from the due date of filing return of income (or modified return as may be applicable in case of an APA)</td></tr>
<tr><td>Adjustment pursuant to, Safe Harbour</td></tr>
<tr><td>Adjustment pursuant to APA</td><td>On or before 90 days from:
a) from the date of filing of return of income if the APA has been entered into on or before the</td><td></td><td></td></tr>
</table>

[4] Rules in relation to secondary adjustment provisions have been notified vide CBDT Notification No. 52/2017, F.No.370142/12/2017 -TPL

Type of primary adjustment	Time limit for repatriation	Applicable interest rate for delayed receipts	
		Transaction in INR	Transaction in foreign currency
	due date of filing of return for the relevant previous year (b) from the end of the month in which the APA has been entered into if the said agreement has been entered into after the due date of filing of return for the relevant previous year.		
Adjustment pursuant to MAP	On or before ninety days from the date of giving effect by the Assessing Officer under rule 44H to the resolution arrived at under MAP		

Excess money means the difference between the arm's length price determined in primary adjustment and the price at which the international transaction has actually been undertaken.

Primary adjustment to a transfer price means the determination of transfer price in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the taxpayer.

Finance (No. 2) Act, 2019 further amends section 92CE to:

- enable Assessee to repatriate excess money from any of the Associated enterprises of the Assessee which is not resident in India; and
- provide an option to Assessee to pay additional income-tax at the rate of 18% on such excess money or part thereof which is not repatriated to India, instead of treating it as deemed advance made by the taxpayer to such associated enterprise and calculating the interest income on such advance, as discussed in above table.

Secondary adjustment would not be applicable, if (i) the amount of primary adjustment made in the case of a taxpayer in any previous year does not exceed one crore rupees and (ii) the primary adjustment is made in respect of an assessment year commencing on or before 1 April2016.[5]

[5]Finance (No. 2) Act, 2019, has made it clear that the two conditions relating to applicability of secondary adjustment are alternate conditions by replacing the word "and" with an "or". Further this amendment is retrospective from assessment year 2018-19

Chapter 2
Responsibility of an Enterprise and the Accountant

Responsibility of an Enterprise

2.1 Section 92D provides that every person who has entered into an international transaction or specified domestic transaction, during a previous year, shall keep and maintain such information and documents, prescribed by the Board, as will assist the Assessing Officer/ Transfer Pricing Officer to compute the income arising from that transaction, having regard to the ALP.

2.1.1. Rule 10D prescribes the information and documents required to be kept and maintained under section 92D ie, Local File. Further Rule 10DA prescribes information and document to be kept and maintained under proviso to sub-section (1) of section 92D ie, Master File. Master file needs to be submitted to the prescribed authority on or before the due date for furnishing the return of income as specified under sub-section (1) of section 139.

2.1.2. Section 286 provides that every parent entity or alternate reporting entity (designated by parent) of an international group that is resident in India, shall for every reporting accounting year, furnish a report in the form and manner as may be prescribed, within the due date provided in Rule 10DB(4). In case of a constituent entity resident in India, the parent of which is not resident in India, such entity shall notify whether it is the alternate reporting entity of the international group or the details of the parent entity/ alternate reporting entity and the country of which such entities are resident. Further, Rule 10DB prescribes rules relating to furnishing of CbC Report.

2.2 This responsibility of an enterprise to keep and maintain prescribed documents arises because of its unique position of being in control and custody of information that is necessary to verify whether the international transaction or specified domestic transaction to which it was party was carried out on the arm's length principle.

2.3 OECD in Transfer Pricing Guidelines, 2017 asserts the three main objectives of maintaining transfer pricing documentation:

"1. To ensure that taxpayers give appropriate consideration to transfer pricing requirements in establishing prices and other conditions for transactions between associated enterprises and in reporting the income derived from such transactions in their tax returns;

2. to provide tax administrations with the information necessary to conduct an informed transfer pricing risk assessment; and

3. to provide tax administrations with useful information to employ in conducting an appropriately thorough audit of the transfer pricing practices of entities subject to tax in their jurisdiction, although it may be necessary to supplement the documentation with additional information as the audit progresses."

2.4 The requirement to keep and maintain such information and documents as prescribed in Rule 10D ie, Local File with respect to an international transaction has, however, been waived in the case of those persons who have entered into international transactions the aggregate value of which, as recorded in the books of account, does not exceed one crore rupees - Rule 10D(2).

2.5 Persons who are so exempted from the mandatory requirement of keeping and maintaining information and documents prescribed as per Rule 10D shall, nevertheless, on the basis of the material in their possession, have to substantiate that the income on the international transactions entered into by them has been computed in accordance with the provisions of section 92 -proviso to Rule 10D(2).

2.6 By virtue of sub-section (2) of section 92D, the Board is empowered to prescribe the period for which the assessee must maintain the prescribed information and records. Pursuant thereto, the Board has stipulated that the prescribed information and documents prescribed as per Rule 10D (ie, Local File) and Rule 10DA (ie, Master File) be kept and maintained for a period of eight years from the end of the relevant assessment year - Rule 10D(5) and Rule 10DA(7). For example: For Financial Year 2018-19, an Assessee has to maintain prescribed information and documents for 8 years from the end of the relevant assessment year (2019-20), i.e. until Financial Year 2028-29.

2.7 Under section 92D (3), the Assessing Officer or the Commissioner (Appeals) during the course of any proceeding under the Act may require a person who has entered into an international transaction or specified domestic transaction to furnish any information or document, which he was expected to maintain under section 92D (1). The person shall furnish the

information or document called for within thirty days from the date of receipt of a notice issued in this regard.

2.8 Where, for any reason, the person is unable to produce the required information or documents within the stipulated period of thirty days, the Assessing Officer or Commissioner (Appeals) may, on an application made by the person, extend the period by a further period or periods not exceeding, in all, thirty days.

2.9 Under section 92E, 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. "Specified date" means the date one month prior to the due date for furnishing the return of income under sub-section (1) of section 139 for the relevant assessment year.

The above-mentioned Explanation reads as under:

"In case of an assessee who is required to furnish a report referred to in section 92E, the due date means the 31st day of October of the assessment year."

Accountant's responsibility

2.10 The term "accountant" has been defined in clause (i) of section 92F as under:

> "accountant" shall have the same meaning as in the *Explanation* below sub-section (2) of section 288.

The above-mentioned Explanation reads as under:

> "accountant" means a chartered accountant as defined in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 (38 of 1949) who holds a valid certificate of practice under sub-section (1) of section 6 of that Act, but does not include [except for the purposes of representing the assessee under sub-section (1)]—
>
> (a) in case of an assessee, being a company, the person who is not eligible for appointment as an auditor of the said company in accordance with the provisions of sub-section (3) of section 141 of the Companies Act, 2013 (18 of 2013); or

(b) in any other case,—

(i) the assessee himself or in case of the assessee, being a firm or association of persons or Hindu undivided family, any partner of the firm, or member of the association or the family;

(ii) in case of the assessee, being a trust or institution, any person referred to in clauses (a), (b), (c) and (cc) of sub-section (3) of section 13;

(iii) in case of any person other than persons referred to in sub-clauses (i) and (ii), the person who is competent to verify the return under section 139 in accordance with the provisions of section 140;

(iv) any relative of any of the persons referred to in sub-clauses (i), (ii) and (iii);

(v) an officer or employee of the assessee;

(vi) an individual who is a partner, or who is in the employment, of an officer or employee of the assessee;

(vii) an individual who, or his relative or partner—

(I) is holding any security of, or interest in, the assessee:

Provided that the relative may hold security or interest in the assessee of the face value not exceeding one hundred thousand rupees;

(II) is indebted to the assessee:

Provided that the relative may be indebted to the assessee for an amount not exceeding one hundred thousand rupees;

(III) has given a guarantee or provided any security in connection with the indebtedness of any third person to the assessee:

Provided that the relative may give guarantee or provide any security in connection with the indebtedness of any third person to the assessee for an amount not exceeding one hundred thousand rupees;

(viii) a person who, whether directly or indirectly, has business relationship with the assessee of such nature as may be prescribed;

(ix) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction.

2.10.1 Therefore, the meaning of "accountant" now applies for the definition of an "Authorised Representative" under section 288(2). As a result, in order to be appointed as an Authorised Representative for an assessee for any proceedings under the Act, a Chartered Accountant must have a certificate of practice. However, a Chartered Accountant having any other qualification specified in section 288 may be appointed as an Authorised Representative.

2.10.2 Therefore, after this amendment, a Chartered Accountant who does not satisfy both the following conditions cannot be appointed as an Authorised Representative for an assessee:

- He/she does not have a certificate of practice; and
- He/she does not have any other specified qualification.

2.11 Though the section refers to the accounts being examined by an accountant, which means a chartered accountant as defined above, the examination can also be done by a firm of chartered accountants. This has been a recognised practice under the Act. In such a case, it would be necessary to state the name of the partner who has signed the report on behalf of the firm. The accountant signing the report as a partner of a firm or in his individual capacity should give his membership number below his name.

2.12 As per the decision taken by the Council of the ICAI, all attest functions undertaken by the members have to bear a UDIN issued by the ICAI. The same needs to be mentioned on the document being signed/ attested by the member.

2.13 Section 92E does not stipulate that only the statutory auditor appointed under the Companies Act or other similar statute should perform the examination. The examination can, therefore, be conducted either by the statutory auditor or by any other chartered accountant in practice having certificate of practice.

2.14 The issue of a report under section 92E, being a recurring assignment for expressing a professional opinion, the accountant accepting the assignment should communicate with the accountant who had done the examination in the earlier year, as provided in the Chartered Accountants Act. In the case of a person whose accounts of the business or profession have been audited under any other law (i.e. a company, a co-operative

society, etc. which is required to get the accounts audited under a Statute), it is not necessary to communicate with the statutory auditor if he had not done the examination in the earlier year. Attention of the members is invited to the detailed discussion in the publication of ICAI, "Code of Ethics" under clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949 vide ***Annexure V.***

2.15 The accountant should obtain from the assessee a letter of appointment for conducting the examination as mentioned in section 92E. It is advisable that such an appointment letter should be signed by the person competent to sign/verify the return of income in terms of the provisions of section 140 or by any person who has been authorized by the company to make such an appointment. The accountant should get the statement of particulars, as required in the annexure to the report, authenticated by the assessee before he proceeds to verify the same. The accountant is required to submit his report to the person appointing him viz. the assessee.

2.16 The appointment of the accountant in the case of a company need not be made at the general meeting of the members. It can be made by the Board of Directors or even by any officer, if so authorised by the Board in this behalf. The appointment in the case of a firm or a proprietary concern can be made by a partner or the proprietor or a person authorised by the assessee. It is possible for the assessee to appoint two or more chartered accountants for carrying out the examination, in which case, the report will have to be signed by all the chartered accountants. In case of disagreement, they can give their reports separately. In this regard, attention is invited to SA – 299(Revised) Joint Audit of Financial Statements, wherein the principle is laid down as under:

The joint auditors are required to issue common audit report, however, where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report. A joint auditor is not bound by the views of the majority of the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in separate audit report in case of disagreement. In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to the separate audit report(s) issued by the other joint auditor(s). Further, separate audit report shall also make reference to the audit report issued by other joint auditors. Such reference shall be made under the heading "Other Matter Paragraph" as per SA 706(Revised), "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report".

The same analogy shall apply to the report to be given under section 92E.

2.17 The Act prohibits a relative or an employee of the assessee being appointed as an accountant under section 92E. Also, as per a decision of the Council (reported in the Code of Ethics under clause (4) of Part I of Second Schedule), a chartered accountant who is in employment of a concern or in any other concern under the same management cannot be appointed as an auditor of that concern. Therefore, an employee of an assessee or an employee of a concern under the same management cannot examine the accounts and records of an assessee under section 92E.

2.18 An accountant responsible for writing or the maintenance of the books of account of the assessee should not examine such accounts. This principle will apply to the partner of such an accountant as well as to the firm in which he is a partner. In view of this, an accountant who is responsible for writing or the maintenance of the books of account, his partner or the firm in which he is a partner should not accept the examination assignment under section 92E in the case of such an assessee.

2.19 In view of the Explanation 2 of section 288 of the Income tax Act, 1961 and provision of Code of Ethics (Revised 2020), an internal auditor of the assessee cannot conduct the examination under section 92E of the Income Tax Act, 1961 whether or not he is an employee of the company. However, an accountant or a firm of accountants appointed as tax consultants of the assessee can conduct the examination under section 92E.

2.20 No separate guidelines have been prescribed for fees under section 92E. The Institute has recommended fees for professional services on the basis of time devoted by the accountant and his assistants. The scale of fees recommended by the Committee for Capacity Building of CA firms and Small & Medium Practitioners for professional assignment is given in ***Annexure VI***. The Council has also clarified that the scale does not include fees chargeable in respect of non-qualified assistants and that the chartered accountants are free to negotiate the terms in respect of such assistants with the clients.

2.21 It will be appreciated that no uniform fees can be recommended for the reporting function exercised under section 92E of the Act. The accountant should charge fees depending upon the responsibility involved and taking into consideration the work involved in such examination. It is necessary that members of the profession should also maintain reasonable standards of professional fees.

2.22 A question may arise whether an accountant appointed under section 92E can be held responsible if he does not complete the examination and give his report before the specified date. The answer to this question will depend on the facts and circumstances of the case. Normally, it is the professional duty of a chartered accountant to ensure that the examination accepted by him is completed before the due date. If there is any unreasonable delay on his part, he is answerable to the Institute if a complaint is made by the client. However, if the delay in the completion of examination is attributable to his client, the accountant cannot be held responsible. In view of the fact that the Act does not give any discretion to the tax authorities to extend the time limit for furnishing of the report, the examination has to be completed within the time limit provided in the Act. It is, therefore, necessary that a chartered accountant should not accept assignments which he cannot complete within the specified date.

2.23 In the case of an examination, the accountant is required to express his opinion as to whether the assessee has maintained the proper information and documents, as prescribed, in respect of the international transactions entered into by him. As regards the statement of particulars to be annexed to the report, he is required to give his opinion as to whether the particulars are true and correct. In giving his report the accountant will have to use his professional skill and expertise and apply such tests as the circumstances of the case may require, considering the contents of the report.

2.24 Section 143 of the Companies Act, 2013 gives certain powers to the auditors to call for the books of account, information, documents, explanations, etc. and to have access to all books and records whether kept at the registered office of the Company or at any other place. The accountant is advised to obtain all the books of accounts, information, documents, explanation etc. from the enterprise to enable him to discharge his responsibility under the Act in a satisfactory manner. If, however, the assessee does not produce any particular record or fails to provide any specific information or explanation called for, the accountant will be required to report the same and accordingly qualify his report.

2.25 The report by the accountant given under section 92E sets forth such particulars as have been prescribed in Form 3CEB. In order that the accountant may be in a position to explain any question which may arise later on, it is necessary that he should keep detailed notes about the evidence on which he has relied upon while conducting the examination and

also maintain all his working papers. Such working papers should include his notes on the following, amongst other matters:

(a) work done while conducting the examination and by whom;

(b) explanations and information given to him during the course of the examination and by whom;

(c) decision on the various points taken;

(d) the judicial pronouncements relied upon by him while making the report;

(e) certificates issued by the client

(f) representation letter issued by the management of the assessee; and

(g) annexure to Form No.3CEB duly filled in and authenticated by the client.

2.26 Attention is also invited to the "SA 230 - Audit Documentation" which provides that documentation should serve as a sufficient and appropriate record of the basis for the accountant's report. Further, the documentation should be prepared on a timely basis and the accountant should document all matters which are important in providing evidence that the examination was planned and performed in accordance with the applicable legal and regulatory requirements.

2.27 While test checks may suffice in the conduct of a statutory audit for the expression of the accountant's opinion as to whether the accounts depict a true and fair' view, the accountant may be required to apply reasonable tests on the total information to be prepared by the assessee in respect of certain items in the prescribed form. While the entity may have to prepare the details for the entire year, the accountant may have to ensure that no items have been omitted in the information furnished and a reasonable test check would reveal whether or not the information furnished is correct. Accountant should exercise professional judgement while placing reliance on the documents, information and evidences provided by the assesse. The Accountant should take an appropriate Management Representation Letter from the assessee.

2.28 The extent of check undertaken would have to be indicated by the accountant in his working papers. The accountant is advised to design his examination programme in such a manner, which will reveal the extent of checking undertaken by the accountant and ensures that adequate documentation in maintained in support of the information being certified by him.

2.29 The accountant may rely upon the audit conducted by an internal auditor or by an outside professional firm appointed as internal auditor, by using his own judgement as to the degree of reliance which he wishes to place on the work of the internal auditor relevant to the examination. The degree of reliance would depend on the areas of work covered by the internal auditor and relevant for purposes of the examination, particularly by reference to working papers/documents of the internal auditor and ensuring that reasonable checks/tests have been applied to transactions covered by the internal auditor, to satisfy himself about the authenticity of the ultimate information.

2.30 It would be in the interest of the accountant to obtain and scrutinise the programme of work and procedures adopted and the relevant working papers and documents obtained by the internal auditor in evidence of the work carried out by him. Further, the accountant will have the sole responsibility for the report issued and the responsibility will not be reduced by the accountant's use of the work of the internal auditors. Further, the accountant shall determine:

(a) Whether the work of the internal auditors is likely to be adequate for the purposes of the examination; and

(b) If so, the planned effect of the work of the internal auditors on the nature, timing or extent of the external auditor's procedures

Reference may be made to the Standards on Auditing: Using the Work of Internal Auditors [SA 610 (Revised)] – vide ***Annexure VII.***

2.31 Primarily, it would be necessary for the accountant to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement. This will help him to reduce the risk of material misstatement to an acceptably low level. Reference may be made to the Standards on Auditing: SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment (and SA 520, Analytical Procedures.

2.32 The accountant must ensure that he receives a standard Management Representation Letter in respect of all oral representations explicitly or implicitly given to him. The letter should indicate and document the continuing appropriateness of the representations made to him and reduce the possibility of any misunderstanding concerning the matters which

are the subject of the representations. Further, in relation to certain transactions, such as deemed international transactions, free of cost services/ goods, etc. the extent of reliance placed by the Accountant on the assessee is higher as compared to transactions such as sales/ purchase of goods, provision of services, etc. In these cases while the Accountant should exercise due professional judgement and care, the onus to identify and disclose such transactions (i.e., deemed international transactions, free of cost services/ goods, etc.) is with the assessee. Therefore in such scenario Accountant is entitled to place reliance on management representation letter issued by the assessee. However, it may be noted that in respect of matters that may be directly verified by the accountant, mere obtaining of a management representation letter will not be sufficient compliance with the Generally Accepted Auditing Standards.

2.33 If the assessee is unable to obtain relevant information in respect of the overseas branches duly certified by the overseas accountant, the relevant facts should be suitably disclosed and reported upon.

2.34 Where Accountant's Report is issued to non-resident assessee and such non-resident is not statutorily required to maintain books of accounts in India under any law, the Accountant should place reliance on Form 26AS, invoices, agreements etc. The Accountant may also place reliance on documents, information and accounts maintained by the Indian assessee with whom the non-resident assessee has entered into international transaction(s).

2.35 Paragraph 3 of Form No. 3CEB requires the accountant to state whether the prescribed particulars are furnished in the annexure to the report and whether in his opinion and to the best of his information and according to the explanations given to him, they are true and correct. The accountant may have a difference of opinion with regard to the particulars furnished by the assessee and he has to bring these differences under various clauses in Form No.3CEB. The accountant should make a specific reference to those clauses in Form No. 3CEB in which he has expressed his reservations, difference of opinion, disclaimer etc. in this paragraph.

2.36 In case the prescribed particulars are given in part or piecemeal to the accountant or the relevant form is incomplete and the assessee does not give the information against all or any of the clauses, the accountant should not withhold the entire report. In such a case, he can qualify his report on matters in respect of which information is not furnished to him. In the absence of relevant information, the accountant would have no option but to state in his report that the relevant information has not been furnished by the

assessee. As a good practice, the Accountant should provide a note detailing the rationale of Accountant. Such note should be provided along with the Accountant's Report.

2.37 Accountant should communicate basis for each position taken to the Enterprise in writing.

Professional misconduct

2.38 When any question relating to professional misconduct in connection with the examination arises, the accountant would be liable under the Chartered Accountants Act, 1949 and the ICAI's disciplinary jurisdiction will prevail in this regard.

2.39 Finance Act 2017 has introduced section 271J for levying penalty on accountants for furnishing incorrect information in reports or certificates furnished under any provisions of the Act or the rules made thereunder. The Assessing Officer or the Commissioner (Appeals), in such cases, may direct the accountant to pay a sum of **ten thousand rupees** for each such report or certificate.

Chapter 3
Associated Enterprises

Associated enterprises and deemed associated enterprises

The term “associated enterprise” is defined in two parts – the term “enterprise” is defined in section 92F (iii) of the Act while the term “associated enterprise” is defined in section 92A of the Act.

Meaning of enterprise:

The term ‘enterprise’ is defined under clause (iii) of section 92F of the Act wherein “enterprise” means a person (including a permanent establishment of such person) who is, or has been, or is proposed to be, engaged in any activity, relating to,

— the production, storage, supply, distribution, acquisition or control of articles or goods, or know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights, or

— the provisions of services of any kind, or

— in carrying out any work in pursuance of a contract, or

— in investment, or

— providing loan or

— in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate,

— whether such activity or business is carried on, directly or through one or more of its units or divisions or subsidiaries, or whether such unit or division or subsidiary is located at the same place where the enterprises is located or at a different place or places.

While the term is defined to mean a person engaged in the past, present or in the future in any activity relating to tangibles, intangibles, facilities or

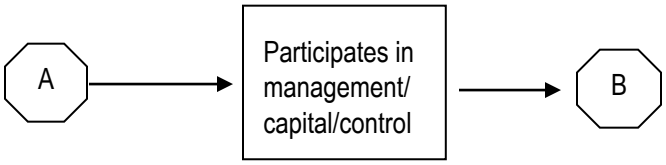
services with widest possible modes, forms or pattern of operation, it also includes a permanent establishment of such person. "Permanent Establishment" referred to in clause (iii)(a) of section 92F of the Act, includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

3.1 Two or more enterprises can be regarded as 'associated enterprises' only if the provisions of section 92A are satisfied. Section 92A defines 'associated enterprise', wherein sub-section (1) provides a source definition, whereas, sub-section (2) provides for deeming provision which enumerates 13 situations, fulfilment of any of which at any time during the relevant previous year would deem to make the two enterprises an associated enterprises.

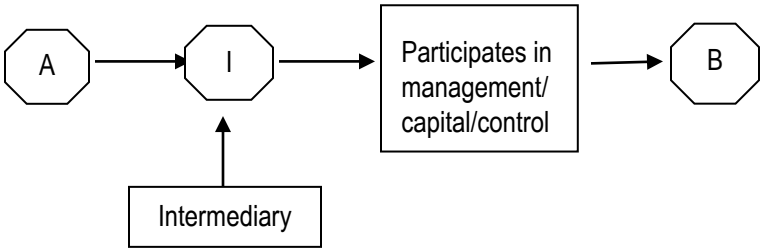
Source definition [Section 92A(1)]

3.2 According to sub-section (1), an enterprise which participates directly or indirectly or through one or more intermediaries, in the management or control or capital of the other enterprise shall be regarded as an associated enterprise. This can be understood as follows:

Situation 1 - Direct Participation:



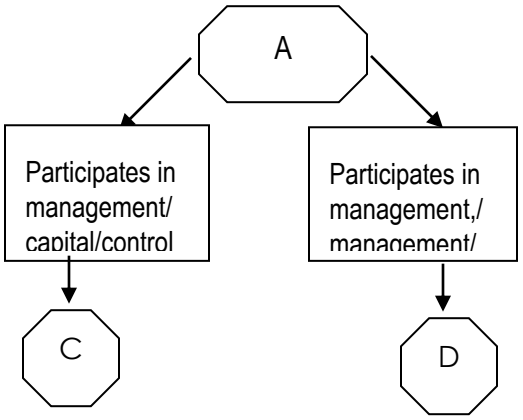
Situation 2 - Participation through Intermediary



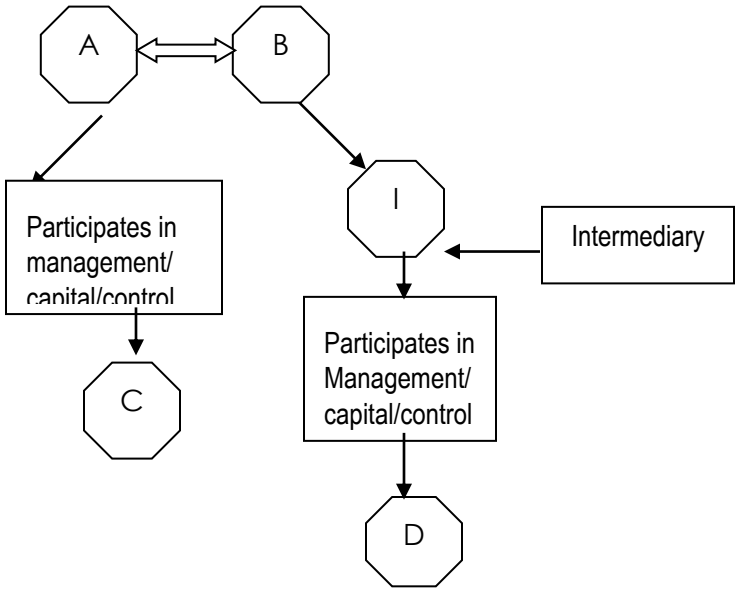
In both the situations detailed above, B will be an associated enterprise of A.

3.3 Similarly, an enterprise in respect of which one or more persons who participate in its management or control or capital, directly or indirectly, or through one or more intermediaries are the same persons who participate in

a similar manner in the management or control or capital of the other enterprise shall be regarded as an associated enterprise. This proposition can be understood by the following diagrammatic presentation:



In the above situation, C and D are associated enterprises by virtue of A participating in the management or capital or control of both C and D.



In the above example, A and B, conjointly and simultaneously, participate in the management, capital and control of C and D. Consequently, C and D are to be construed as associated enterprises.

Deemed definition of Associated Enterprise [Section 92A(2)]

3.4 The Finance Act, 2002 had amended sub-section (2) of section 92A to the effect that **for the purposes of sub-section (1)**, two enterprises shall be deemed to be associated enterprises if, at any time during the previous year any of the conditions mentioned in clauses (a) to (m) are satisfied. The provisions of sub-section (2) of section 92A supplements the definition of associated enterprise given in sub-section (1) by enlisting various situations under which two enterprises shall be deemed to be associated enterprises.

It may be noted that when Finance Act, 2002 had amended sub-section (2) of section 92A, the memorandum to the Finance Bill, 2002 explained the said amendment as under:

> "*It is proposed to amend sub-section (2) of the said section to clarify that the mere fact of participation of one enterprise in the management or control or capital of the other enterprise or the participation of one or more persons in the management or control or capital of both the enterprises shall not make them associated enterprise unless the criteria specified in sub-section (2) are fulfilled.*"

Considering the above, for interpreting the AE relationship provided in sub-section (1), the situations mentioned in sub-section (2) need to be referred. In other words, sub-section (1) is dependent on situations given under sub-section (2) of section 92A.

Each of these situations specified in clauses (a) to (m) of sub-section (2) of section 92A are discussed here below with suitable illustration, wherever considered necessary. It may be noted that for the purposes of these clauses, two enterprises would be associated enterprises if the conditions stipulated therein are fulfilled at any time during the previous year. Besides, in clauses (c) to (m) the words 'directly' or 'indirectly' have not been used which indicates the intention of the legislature that indirect control is not envisaged in these clauses. Therefore, direct relationship between two enterprises is relevant for the purposes of clauses (c) to (m) in order to determine whether they are associated enterprises.

3.5 ***One enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise.***

[Section 92A(2)(a)]

Two enterprises shall be associated enterprises based on the shareholding of one enterprise in the other if the investing enterprise holds shares carrying not less than twenty-six per cent of the voting power in the other enterprise. Holding for this purpose includes indirect holding too.

As the terms used are "shares" and "voting power", it is apparent that this clause applies only to those cases where the investee enterprise is a company. However, the investor enterprise need not be company and could be any person.

Further, this clause uses terms *"….shares carrying not less than twenty-six per cent of the voting power…."*. Accordingly, it is essential that the "shares" should carry voting power. If the shareholding in the investee company does not carry any voting power (for example preference shares with no voting rights) than such shareholding should not be taken into consideration for computing threshold limit of twenty-six per cent.

3.6 *Any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises.*

[Section 92A(2)(b)]

Under this clause, two enterprises are deemed associated enterprises, even though one enterprise may not hold any shares in the other enterprise. This clause comes into play when one person or enterprise simultaneously holds shares carrying not less than twenty-six per cent voting power in each such enterprise.

Hence for this clause to apply:

- both the investee enterprises have to be companies.
- one person or enterprise simultaneously holds shares carrying 26% or more voting power in each of them.
- Both the enterprises need not hold any shares in each other if they have common 26% or more voting right held by a company.
- Shareholding may be direct or indirect.

For example, if AA of UK holds 26% voting power in BB of Germany and also in CC of India, then BB and CC shall be deemed to be associated enterprises. Even for this clause, shareholding may be direct or indirect holding and shares should carry voting power.

3.7 ***A loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one per cent of the book value of the total assets of the other enterprise.***

[Section 92A(2)(c)]

Where the lender enterprise's loans to the borrower enterprise constitute 51% or more of the 'book value' of the total assets of the borrowing enterprise, then both the lender and the borrower enterprises would be treated as 'associated enterprises'. 'Book value' of assets means value of assets appearing in books of account.

It is important to note that requirement is whether the loan advanced is 51% or more of the book value of total assets of the borrower enterprise and not 51% or more of the market value of assets of the borrower-enterprise.

Example:

Suppose Enterprise X gives a loan of $100 million to Enterprise Y on 01-04-2020. At that time, the book value of assets of enterprise B was $200 million. On 26-4-2020, enterprise Y repays $ 10 million. On 31-3-2021, due to booking of impairment losses, the book value of assets of enterprise Y is $ 180 million. At that time, loan outstanding is $ 90 million (i.e., $ 100 million minus $ 10 million repaid).

Loan outstanding on book value of the assets of Y comes out 50% (90/180 x 100 = 50%), However, the requirement is to check the % of loan advanced on book value i.e., 55% (100/180 x 100 = 55%). So, in this case, X and Y will be associated enterprises.

Book value of assets: The term 'book value' has been defined by ICAI in its Guidance Note on Terms used in Financial Statements as the amount at which an item of asset is shown in the books. The term asset is defined in the Framework for Preparation and Presentation of Financial Statements (hereafter referred as "the Framework") issued by ICAI. The following are the features of an asset :

- It is a resource.
- It arises out of past transactions or events.
- It is controlled by the enterprise.
- Future economic benefits are expected from it

Apart from the above, the following are, also, important:

- **Intangible Assets**: Intangible assets are assets so these must be included in book value of assets.
- **Accumulated Losses**: The accumulated losses, shown in assets side only because they have debit balance, are not assets and will not be included in book value of assets because there is no future economic benefits.
- **Deferred Revenue Expenditure**: The enterprise does not control the expected future economic benefits from deferred revenue expenditure. Hence, they are not assets.
- **All the items on asset** side of balance sheet which satisfy the definition of 'assets' in the Framework should be taken at 'book value'. Moreover, the book value of assets only should be taken without deducting book value of liabilities.

3.8 ***One enterprise guarantees not less than ten per cent of the total borrowings of the other enterprise.***

[Section 92A(2)(d)]

Where the guarantor enterprise guarantees 10% or more of the total borrowing of the enterprise seeking guarantee, then they would become 'associated enterprises'.

Rule 10TA(c) provides the definition of term corporate guarantee. Corporate guarantee means explicit corporate guarantee extended by a company to its wholly owned subsidiary being a non-resident in respect of any short-term or long-term borrowing.

> *Explanation.—For the purposes of Rule 10TA (c), explicit corporate guarantee does not include letter of comfort, implicit corporate guarantee, performance guarantee or any other guarantee of similar nature;*

It may be mentioned that as the clause does not specify the nature of guarantee, a view is possible that it includes all types of guarantees.

3.9 ***More than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise.***

[Section 92A(2)(e)]

Where one enterprise has appointed

(a) more than one-half of the board of directors or members of the governing board; or

(b) one or more executive directors or executive members of that board in another enterprise

the two enterprises shall be deemed to be associated enterprises.

This clause refers to "board of directors" and "governing board". As per section 2(10) of the Companies Act, 2013, the term "board of directors" would refer to the "collective body of directors of a company". The term "governing board", correspondingly, would refer to a body or council that has the executive authority to manage the affairs of the enterprise to which it relates. These enterprises could be artificial juridical non-corporate bodies.

For the purposes of this clause, the appointment of even one person to the post of executive director or executive member would make the enterprises associated enterprises.

It is important to note that merely having the power to appoint (50% of directors/one or more executive directors) is not enough. Actual exercise of the power is necessary to make both enterprises associated enterprises.

3.10 ***More than half of the directors or members of the governing board, or one or more of the executive directors or executive members of the governing board of each of the two enterprises are appointed by the same person or persons.***

[Section 92A(2)(f)]

Clause (f) is an extension of the principle laid down in clause (e). This clause is applicable where the same person has:

(a) appointed more than one-half of the board of directors or members of the governing board; or

(b) appointed one or more executive directors or executive members of the governing board of two or more enterprises or

(c) As combination of (a) and (b), same person(s) appoints one or more executive directors or executive members in one enterprise and 50% or more of the directors/ members in the other.

For example, the appointment of seven out of twelve members of board of directors of B Ltd. and six out of ten members of the board of directors of C

Ltd. is controlled and has been made by A Ltd. By virtue of clause (f), B Ltd. and C Ltd. are associated enterprises.

Further, if the appointment of the executive director of B Ltd. and six out of ten members of the board of directors of C Ltd. have been made by A Ltd., then B Ltd. and C Ltd. shall be regarded as associated enterprises.

For the purpose of both the clauses (e) and (f) , two enterprises shall be deemed to be associated enterprises only when one of the enterprise exercises its right and actually appoints one executive director/ member to the board or more than half of the Board of directors at any time during the year.

The mere right to appoint one executive director or executive member or more than half of the Board of directors by one enterprise to the Board of another enterprise, would not make both the entities as associated enterprises.

3.11 ***The manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights.***

[Section 92A(2)(g)]

Two enterprises are deemed to be associated:

- if one is wholly dependent on the other
- for the use of know-how, patents, copyrights etc.
- for the manufacture or processing of goods or articles or business carried on by such enterprise.

It should be noted that such know-how, patents, copyrights etc. must be either owned by the other enterprise or the exclusive rights thereto must vest with the other enterprise. If an Indian enterprise is wholly dependent on the licence granted by a non-resident enterprise for manufacture or processing of goods or articles or business carried out by the Indian enterprise both enterprises shall be deemed to be associated enterprises. The clause will equally be applicable in case where the overseas entity is wholly dependent on the license / brand owned by the Indian entity.

Section 92A(2)(g) applies only if the manufacture or processing of or business carried out by one enterprise is wholly dependent upon the intangible assets of the other. That is, if an enterprise manufactures more than one article or thing and it uses the know-how of the other for one article or thing, manufacture of all the articles or goods carried out by the first enterprise is not wholly dependent on the intangible asset of the other enterprise and hence section 92A(2)(g) does not apply here.

The important phrase here is 'wholly dependent' and hence, it would first be imperative to determine whether a particular enterprise is dependent 'wholly' on the use of intangibles owned by the other enterprise. The word 'wholly' denotes complete dependence and hence, should be distinguished from the word 'mainly'.

Under this clause, all types of manufacturing, distribution and service-related businesses are covered.

3.12 ***Ninety per cent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise.***

[Section 92A(2)(h)]

There are two situations dealt with in this clause and they are as follows:

(i) 90% or more of the raw materials and consumables required for manufacturing or processing of goods or articles are supplied by the other enterprise,

or

(ii) 90% or more of the raw materials and consumables required for manufacturing or processing of goods or articles are supplied by persons specified by the other enterprise,

and

the prices and other conditions relating to supply (by the specified person) are influenced by the other enterprise.

Since this clause relates to manufacture or processing of goods, it is important to note that the 90% criteria should be applied exclusively to raw materials and consumables used for manufacturing and processing only.

3.13 ***The goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise.***

[Section 92A(2)(i)]

Where the goods or articles manufactured and processed by one enterprise, (say, enterprise A) are sold

(i) to another enterprise (say, enterprise B)

or

(ii) sold to another enterprise (say, enterprise C) specified by enterprise B,

and

the prices and other conditions relating thereto are influenced by enterprise B, then enterprises A and B shall be associated enterprises.

While in clause (h), a minimum criteria of 90% has been mentioned, no such quantification has been done in clause (i). It would be imperative to analyze the contractual terms & conditions, actual conduct of parties to the transaction, etc. to conclude whether there exists any influence by an enterprise on another enterprise and hence, whether the said clause is triggered or not. This clause covers only sale of goods manufactured or processed and not the sale of traded goods.

Prima facie, it may be inferred that even when sales of one enterprise to the other enterprise is insignificant (assuming less than 1%) and that other enterprise can influence the prices at which the goods are sold, these two enterprises may be treated as associated enterprises. However, this may not be the intention of the legislation, as this may not give rise to "control" by one of the enterprise over the other, which is *a sine qua non* for invoking the status of associated enterprises under third limb of test laid down by section 92A(1). Therefore, it is important that the test of 'influence' be established with actual conduct and backed up by the documentary evidence.

In this clause, the Seller and buyer are deemed AEs u/s 92A(2)(i) only if buyer's influence on terms of sale is "dominant influence". For deeming buyer and seller enterprises to be AEs under section 92A(2)(i), buyer must have dominant influence over prices and other conditions of sale amounting to de facto control of buyer over seller.

3.14 ***Where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual.***

[Section 92A(2)(j)]

This clause deals with a situation where one enterprise is controlled by an individual and the other enterprise is also controlled by –

(i) such individuals; or

(ii) his relative; or

(iii) jointly by such individual and his relative then both the enterprises shall be deemed as associated enterprises.

The word 'control' can be interpreted to mean that the individual along with his relatives has the power to make crucial decisions regarding the management and running of the two enterprises.

The word 'relative' is defined under section 2(41) of the Act as follows:

"relative", in relation to an individual, means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual"

3.15 ***Where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family, or by a relative of a member of such Hindu undivided family, or jointly by such member and his relative.***

[Section 92A(2)(k)]

This clause envisages control of the two enterprises by the same Hindu undivided family and includes control by -

(i) a member of the Hindu undivided family, or

(ii) by a relative of a member of such Hindu undivided family, or

(iii) jointly by such member and his relatives.

3.16 ***Where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than ten per cent interest in such firm, association of persons or body of individuals***

[Section 92A(2)(l)]

This clause seeks to cover non-corporate bodies like partnership firms, association of persons and body of individuals. Sub-clause (v) of clause (31) of section 2 of the Act defines the term 'person' to include these entities.

In case of partnership firm or association of persons or body of individuals, the other enterprise must hold not less than 10% interest in such firm, association of persons or body of individuals to be regarded as an associated enterprise.

3.17 ***There exists between the two enterprises, any relationship of mutual interest, as may be prescribed.***

[Section 92A(2)(m)]

This residuary clause enables the CBDT to widen the scope by adding any relationship of mutual interest from time to time that will make any two enterprises as associated enterprises. However, no such relationship of mutual interest has yet been prescribed.

3.18 ***If an assessee enters into a transaction where one of the parties to the transaction is a person located in a notified jurisdictional area, then all the parties to the transaction shall be deemed to be associated enterprises within the meaning of section 92A***

[Section 94A(2)(i)]

As per Section 94A(1), the Central Government may, specify a country or territory as a notified jurisdictional area. The Central Government had specified Cyprus as a notified jurisdictional area. However, the same has been rescinded vide notification no. 114 dated 14-12-2016. Therefore, at present there is no such notified jurisdictional area.

This clause seeks to cover transactions with persons located in notified jurisdictional areas where there is a lack of effective exchange of information. The relationship with the "person" is not specified in the section. Accordingly, a person could be a related or an unrelated person and therefore a person could also include an AE [i.e. an enterprise covered under section 92A(1)/(2)]

Relationship between Head Office and Permanent Establishment (Branch Office and any fixed place of business)

3.19 For a foreign enterprise, a branch office in India would qualify to be a permanent establishment ('PE') and considered as a separate enterprise than the foreign enterprise or the head office in terms of section 92F(iii) read with section 92B(1). Accordingly, transfer pricing provisions would apply on transactions between foreign enterprise and PE in India (branch office or any fixed place of the business).

3.20. Attention here is invited to a situation where an Indian enterprise is having a branch office in a foreign jurisdiction. In such a scenario, the definition of permanent establishment as per section 92F(iii)(a) looses its substance and there the transactions between the Indian head office and its foreign branch office (branch office accounts being consolidated in the head office / company-wide accounts) would not be subject to transfer pricing provisions as per Indian Income tax Act. It is important to note that transaction between the foreign branch of India enterprise and other foreign associated enterprise will be subject to transfer pricing provision.

Example: I. Co has a branch in the USA. I. Co also has a subsidiary company the USA, US Co. The USA branch is rendering certain services to the US Co. Since I. Co and USA branch are same legal entity for the application of Indian TP regulation, hence the transaction between US branch and US Co. will be considered as transaction between I. Co and US Co.

Associated Enterprises in relation to 'Specified Domestic Transactions (SDT)'

3.21 Rule 10A(a)(ii) of the Rules defines "Associated Enterprise" for purpose of SDT as follows:

(a) the persons referred to in clause (b) of sub-section (2) of section 40A of the Act in respect of a transaction referred to in section 40A(2)(a) of the Act; (omitted by Finance Act 2017, with effect from 1 April 2017

(b) other units or undertakings or businesses of the same assessee in respect of a transaction referred to in section 80A of the Act or, as the case may be, sub-section (8) of section 80-IA of the Act;

(c) any other person referred to in sub-section (10) of section 80-IA of the Act in respect of a transaction referred to therein;

(d) other units, undertakings, enterprises or business of the assessee, or other person referred to in sub-section (10) of section 80-IA of the Act, as the case may be, in respect of a transaction referred to in section 10AA of the Act or the transactions referred to in Chapter VI-A to which the provisions of sub-section (8) or, as the case may be, the provisions of sub-section (10) of section 80-IA of the Act are applicable;

Associated Enterprises as per OECD and UN Framework

3.22 OECD Framework – The OECD Model tax convention defines Associated Enterprise in Article 9, which reads as under:

1. Where:

(a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

3.23 UN Framework – Para 1 of Article 9 of UN Model Convention defines Associated Enterprise, which reads as under:

1. Where:

(a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

3.24 As can be seen from above, the Indian TP Regulations cast a broad net for two entities to be regarded as associated which is much wider in scope than the definition as per OECD and UN model conventions.

Chapter 4
International Transaction

Definition

4.1 The terms "international transaction" is defined in two steps – the term "transaction" is defined in section 92F(v) of the Act, while the term "international transaction" is defined in section 92B of the Act. Hence, before proceeding to analyse the expression "international transaction", it would be useful to take note of the definition of the term "transaction". The term 'transaction' has been defined in clause (v) of section 92F as under:-

"(v) transaction includes an arrangement, understanding or action in concert:

(i) whether or not such arrangement, understanding or action is formal or in writing; or

(ii) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings".

This definition is an inclusive definition and therefore wider in its scope. As per this definition, a transaction includes any arrangement, understanding or action, whether formal or informal, whether oral or in writing, whether legally enforceable or not.

Therefore, *in order to characterise a "transaction"as "international transaction", it has to be demonstrated that the transaction arose in pursuant to an arrangement, understanding or action in concert. Such an arrangement is between the two parties and not any unilateral action by one of the parties without any binding obligation on the other or without any mutual understanding or contract. If one of the party by its own volition is incurring any expenditure for its own business purpose, then without there being any corresponding binding obligation on the other party or without any such kind of an arrangement actually existing in writing or oral or otherwise, it cannot be characterized as international transaction within the scope and definition of Section 92B (1)." Therefore, necessary factual analysis to be carried out to establish that AEs have* any arrangement, understanding or action in concert.

4.2 Section 92B defines an "international transaction" in the following manner:

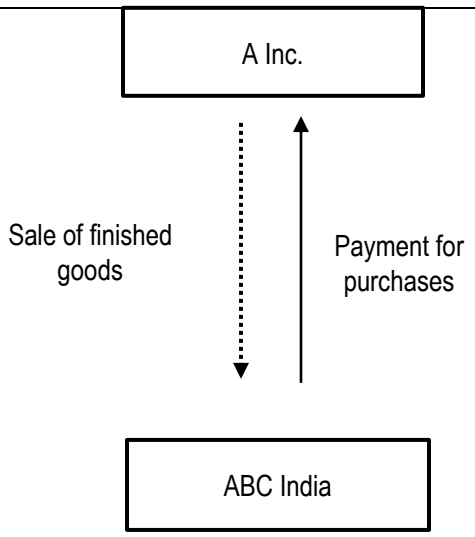
"For the purposes of this section and sections 92, 92C, 92D and 92E, "international transaction" means a transaction between two or more AEs, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money or any other transaction having a bearing on the profits, income, losses or assets of such enterprises and shall include a mutual agreement or arrangement between two or more AEs for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more such enterprises - section 92B(1)".

"*A transaction entered into by an enterprise with a person other than an AE shall, for the purposes of sub-section (1), be deemed to be an international transaction entered into between two AEs, if there exists a prior agreement in relation to the relevant transaction between such other person and the AE; or the terms of the relevant transaction are determined in substance between such other person and the AE where the enterprise or the AE or both of them are non-residents irrespective of whether such other person is a non-resident or not - section 92B(2)".*

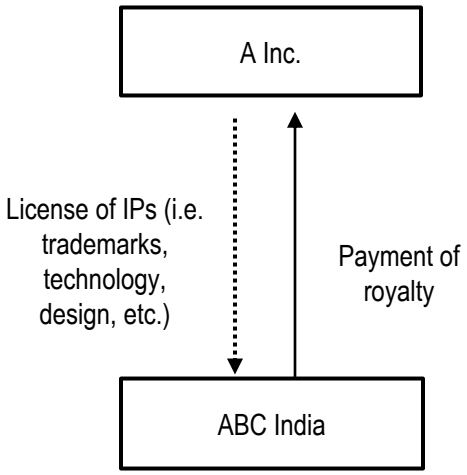
From the above, it can be seen that sub-section (1) of section 92B defines the term "international transaction" in an exhaustive manner; and sub-section (2) of section 92B deems a transaction entered into between two enterprises in certain situations, as an international transaction between AEs.

4.3 The definition of international transaction under the transfer pricing regulations is very wide in its scope and has been further clarified vide Finance Act 2012 with retrospective effect from 1 April, 2002 to include:

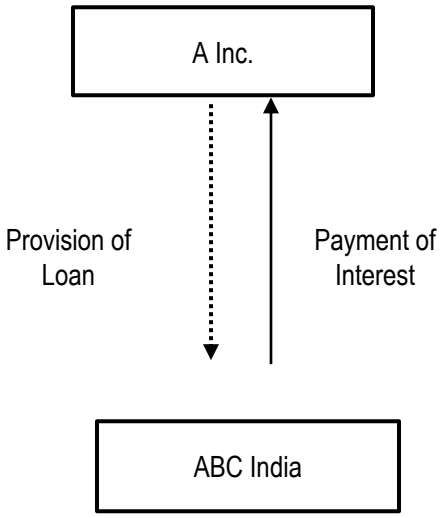
(i) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing; or



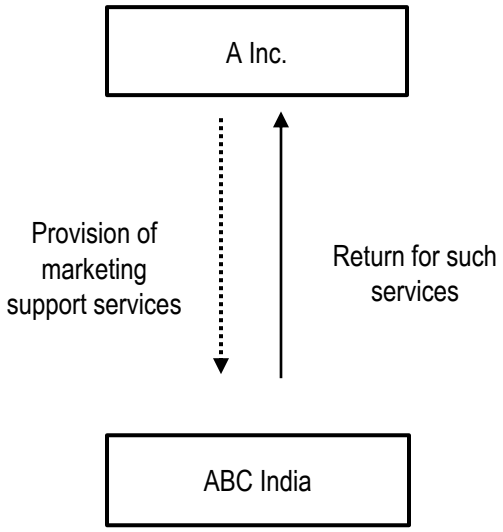
(ii) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature; or



(iii) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business; or



(iv) provision of services, including provision of market research, market development, marketing management, administration, technical services, repairs, design, consultation, agency, scientific research, legal or accounting service; or



(v) a transaction of business restructuring or reorganization, entered into by an enterprise with an AE, irrespective of the fact that it has a bearing on the profits, income, losses, or assets of such enterprises at the time of transaction or at any future date.

4.3.1 It shall also include a mutual agreement or arrangement between two or more AEs for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service, facility provided or to be provided to any one or more such enterprises.

Business Restructuring

4.3.2 It is relevant to note that a transaction of business restructuring or reorganization has been clarified to be an international transaction irrespective of whether it has a bearing on the profits, income, losses or assets of the enterprise. However, the Act does not define business restructuring. In this respect, guidance may be drawn from the OECD guidelines, which defines business restructuring as cross border re-organisation of the commercial or financial relations between AEs including the termination or substantial renegotiation of existing arrangements. Relationships with third parties (e.g. suppliers, sub-contractors, customers) may be a reason for the restructuring or be affected by it.

4.3.3 Restructuring could be in the form of operational change (in functional, asset and risk profile of the entity) or organizational change (in ownership structure/management of the entity). It could include a change in the nature or scope of transactions among controlled entities, a shift in the allocation of risks, a change in responsibility for specific functions or commencement or termination of a relationship, etc.

4.3.4 Explanation to 92B - Clause (i)(e) reads as under:

> *"a transaction of business restructuring or reorganization, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date"*

'Business restructuring or reorganization' has not been defined in the Act, nor any guidance is provided in other income tax legislations (rules, circulars etc.)

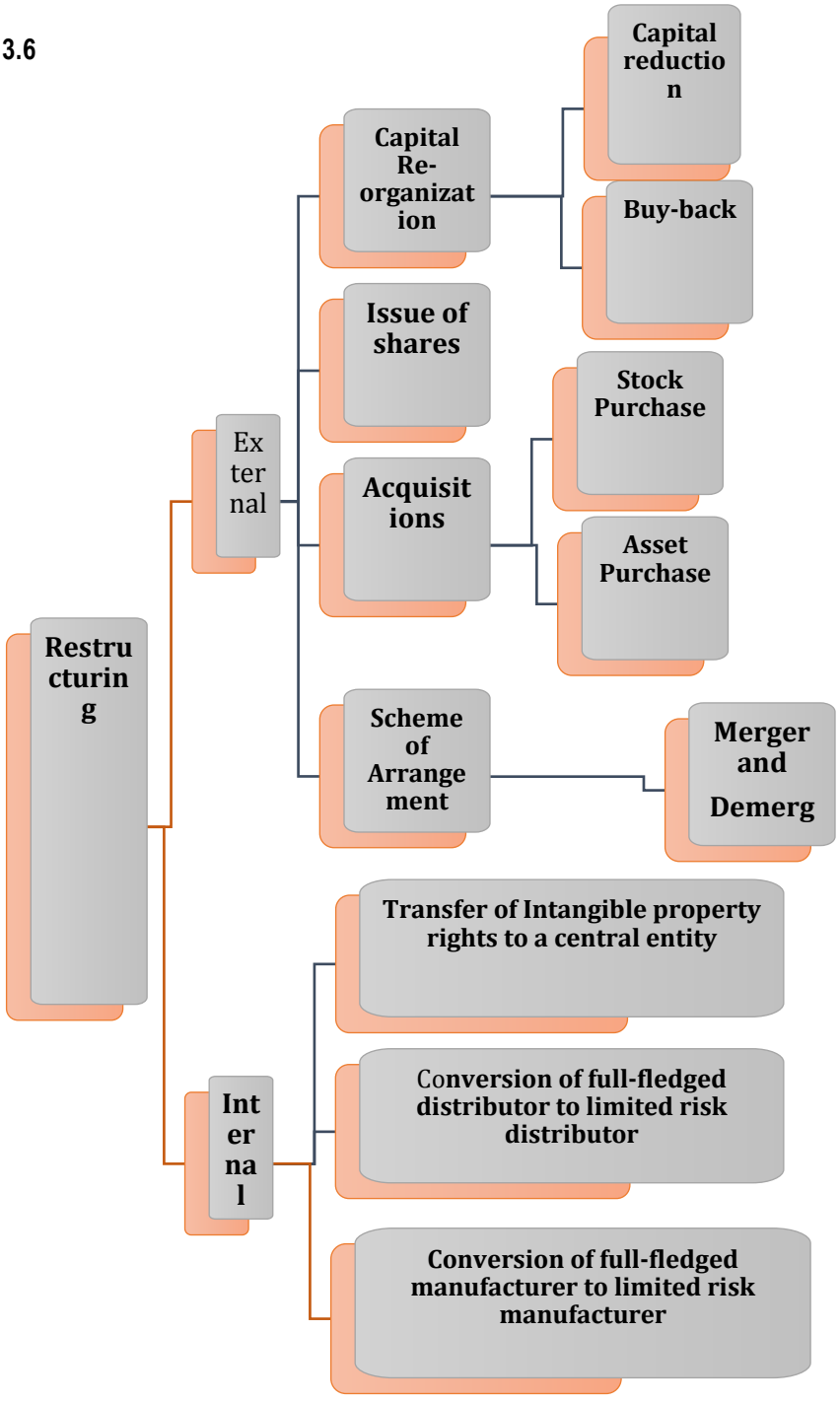
Chapter IX of OECD TP Guidelines – Report on TP aspects of Business Restructuring (July 2010) defines it as

> *"The cross-border redeployment, reallocation of functions, assets or risks among affiliated entities of a MNE"*

4.3.5 **Examples of Business Restructuring (only indicative and not exhaustive):**

- Conversion of a full-fledged distributor into a LRD.
- Conversion of a full-fledged manufacturer into a contract manufacturer
- Transfer of IP rights to a central entity within the group
- Business restructuring may also involve termination or substantial renegotiation of existing arrangements, reallocation of risks/ intangibles, specialisation or de-specialisation of operations i.e. manufacturing sites/ processes, R&D activities, sales activities etc.
- Transfer of valuable intangibles
- Termination or substantial renegotiation of existing arrangements
- Conversion of full-fledged manufacturers into contractors or toll manufacturer
- Conversion of full-fledged distributor into LRD or commissionaires
- Outsourcing of manufacturing to AE in a low cost location
- Centralization of intangibles assets and of risks (eg. to so called “IP Company”) or that of regional management
- Revision of business model rationalization/ specialization/ de-specialization of operations (R&D, manufacturing, sales/ services) including downsizing and closing operations
- The UN practical manual on TP for developing countries defines Business restructuring as the cross-border redeployment of functions, assets and risks by an MNE

4.3.6


Restructuring
External
Capital Re-organization
Capital reduction
Buy-back
Issue of shares
Acquisitions
Stock Purchase
Asset Purchase
Scheme of Arrangement
Merger and Demerg
Internal
Transfer of Intangible property rights to a central entity
Conversion of full-fledged distributor to limited risk distributor
Conversion of full-fledged manufacturer to limited risk manufacturer

4.3.7 To determine whether any kind of compensation is payable at the time of restructuring, it is important to –

- Understand the FAR of the restructured entity before and after restructuring (including any loss of future expected profits on account of the business restructuring)
- Understand the business reasons for and expected benefits from the change
- Evaluate what other options/ alternatives are available to the parties involved
- Consider whether an independent party would be willing to enter into a contract for such restructuring. Independent parties would not enter into a transaction that makes them worse off than their next best option.

Note: The fact that a re-deployment of functions/assets/risks is based on sound commercial reasons does not necessarily mean that its at arm's length

4.3.8 Arm's length Compensation in business restructuring: OECD Guidelines 2022 in Chapter IX (Part I and Part II) discusses Business Restructuring and remuneration of post-restructuring controlled transaction.

This, inter alia, provides the following steps and process:

Step 1: Characterize the transactions entered into by the associated enterprises, taking into account the business environment in which the multinational enterprises (MNE) group is operating. This entails carrying out the following activities:

- identification of the scope of arrangements between the associated enterprises involved in the business restructuring.
- Performance of a functional analysis of the pre- and post-business restructuring activities of associated enterprises affected by the restructuring.
- reference to any relevant contract, including those entered to implement the business restructuring as well as an examination of risks assumed, and functions performed by the associated enterprises.
- Examination of the consistency of the contractual terms with the outcome of the functional analysis of the associated enterprises taking part in the business restructuring, to determine the true nature

of the transactions, including the legal, economic and tax effects thereof.

Step 2: Select the most appropriate transfer pricing methodology or methodologies

- Provided the pricing of the business restructuring itself and of the post-restructuring arrangements are consistent with what would occur under an agreement between independent parties in comparable circumstances the arm's length principle and its requirements are met.
- The consideration may be determined by considering the following:
    - an arm's length outcome is one that makes business sense taking into account the options realistically available for the taxpayer involved in the business restructuring.
    - an independent party dealing at arm's length would seek to protect its economic interest involved in the arrangements or be appropriately remunerated for foregoing such interest.

Step 3: Apply the most appropriate method and determine an arm's length outcome

- A benefit expected at the MNE level from a business restructuring may be any form of economic or commercial advantage. If the examination show that the pricing of the business restructuring does not make commercial sense, then arm's length outcome can be achieved by either –
    - pricing adjustment by reference to the arrangement as entered by the parties.
    - using an arrangement reasonably expected to exist between independent parties dealing at arm's length in comparable circumstances.
    - application of transfer pricing provisions adjusting the consideration receivable or payable by the Commissioner by reference to the arrangement between independent parties dealing in arm's length in comparable circumstances.

4.3.9 Selection and Application of TP Methods to Post-restructuring Transactions with Related Parties

- Post-restructuring-controlled transactions require a robust FAR analysis. Essential to perform pre- and post-restructuring comparability analysis.
- The analysis should go beyond the construed characterisation of the entity.
    - Situation A: an entity characterized as a LRD can sometimes be found to own valuable intangibles
    - Situation B: an entity characterized as a contract manufacturer can sometimes be found to pursue significant R&D activities or to own/ use unique intangibles
- In some cases, pre-restructuring transactions may serve as an internal CUP for post-restructuring-controlled transactions

4.4 Any transaction between an enterprise and a person other than an AE will be deemed to be an international transaction with an AE as per sub-section (2) of section 92B under certain situations.This deeming provision is intended to cover cases where an independent third party (irrespective of whether it is a resident or non-resident) can be interposed by two AEs to remain out of the transfer pricing provisions of the Act.

Deemed International Transaction

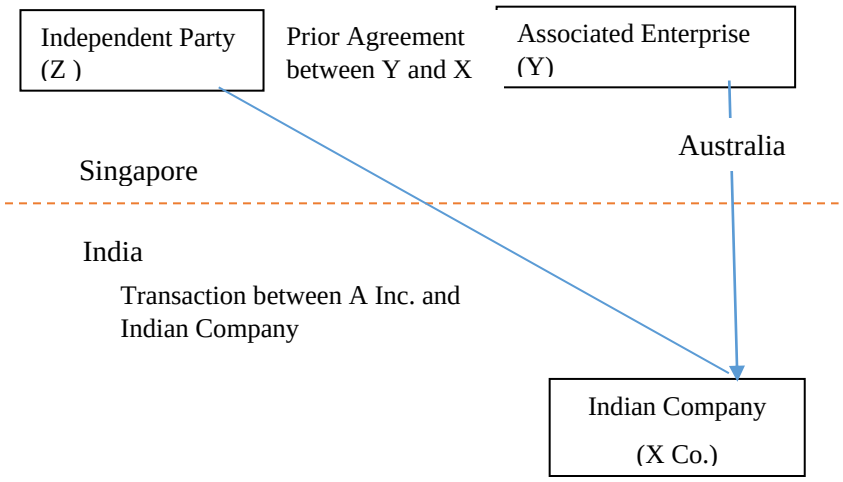
4.5 According to sub-section (2) of section 92B, a transaction between an enterprise and an unrelated person shall be deemed to be a transaction between AEs if in relation to that transaction -

(i) there exists a prior agreement between such other person and the AE; or

(ii) the terms of the relevant transaction are determined in substance between such unrelated person and the AE.

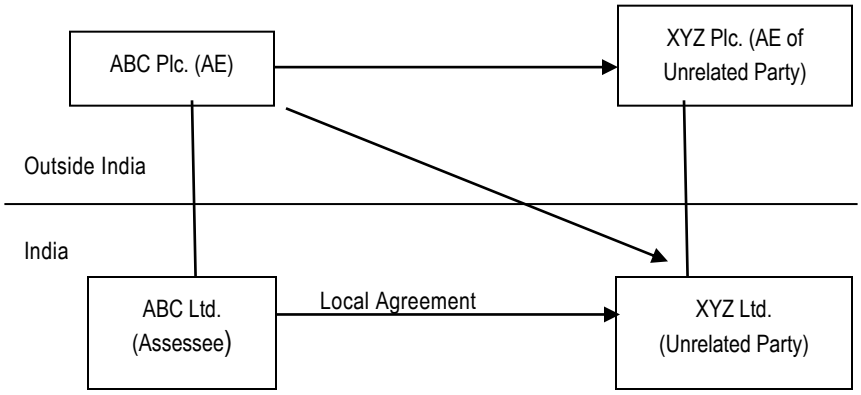
4.6 For example, enterprise X of India and enterprise Y of Australia are AEs. Enterprise Z of Singapore is not an AE of enterprise X. Enterprise Y and enterprise Z enter into an agreement for determining the terms of transactions between enterprise X and enterprise Z. The transaction as may be entered between enterprise X and enterprise Z which is governed by such an agreement existing between Y and Z shall be deemed to be a transaction

between two AEs. In this example the transaction could still be a deemed international transaction if Enterprise Z was an Indian resident.



4.7 Finance Act (No.2) 2014 has amended the said section w.e.f 1-4-2015 to provide that even where the unrelated third party is located in India, the transaction between the Indian entity and the unrelated third party will be deemed as an international transaction between the Indian entity and its AE located overseas. In the above case even if Z is an Indian resident, the transaction between X Co. and Z would be treated as deemed International Transaction.

The amended provisions would certainly cover within its ambit a three party scenario under the provisions of section 92B(2). However, a four party situation would need a detailed analysis / evaluation by the accountant. The same is explained in the form of example below:



In the said case, ABC Plc. which is based outside India enters into an agreement with XYZ Plc. (an unrelated party) to procure (raw material) from XYZ Plc and all its subsidiaries on a global basis.

Pursuant to the said agreement, ABC Ltd. which is a subsidiary of ABC Plc. procures raw material from XYZ Ltd which is a subsidiary of XYZ Plc.

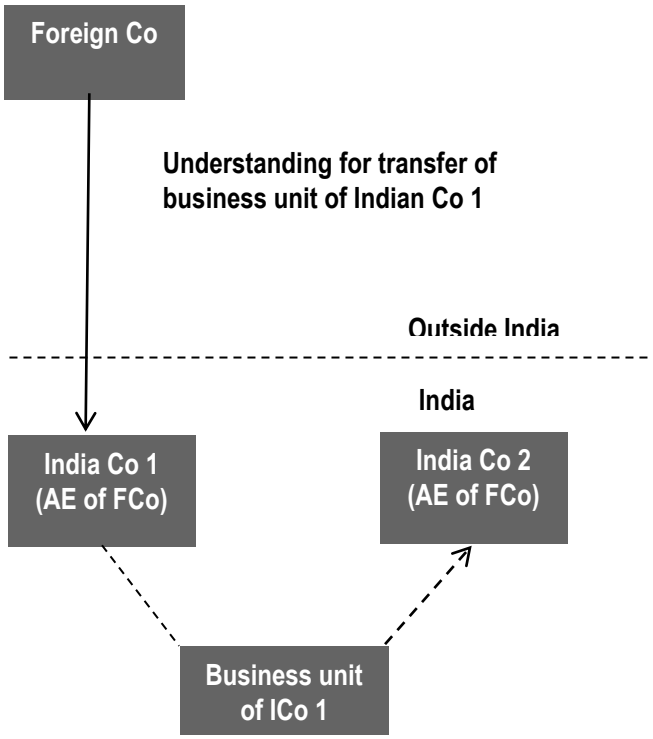
In light of the facts provided above, whether the arrangement between ABC Ltd. and XYZ Ltd. will be deemed to be an international transaction under Section 92B(2) of the Act for ABC Ltd.? Such cases should be analysed in detail by the accountant (having regard to the underlying facts and circumstances) before reaching to a conclusion.

Impact of Amendment

- The tax authorities may evaluate whether the profits earned in India is lower because of the influence of a non-resident AE on that transaction.
- As per the amendment, domestic transactions which are influenced by a Non-resident AE would also be covered within the scope of TP provisions.
- Care should be taken to properly report and disclose such transactions to avoid levy of penalty under Section 271AA.
- Amendment may not cover transaction between two resident parties in India who are AEs. (Meaning of an AE and the scenarios where 2 persons can be regarded as AEs has been defined under section 92A(1) and 92A(2), respectively)

Example of Deemed International Transaction:

Case 1

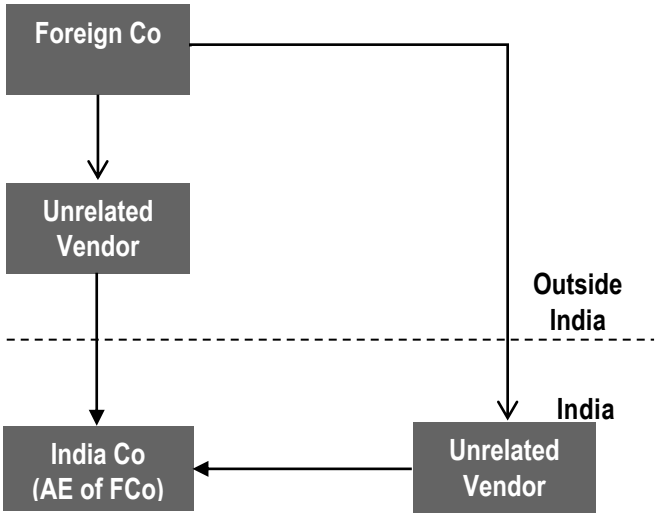


Foreign Co has two subsidiaries in India (I Co 1 and I Co 2). I Co 1 proposed to transfer one of its business undertakings to I Co 2. There is an understanding that I Co 1 has with F Co regarding transfer of this business as well as the terms and conditions of transfer.

Since I Co 1 and I Co 2 are AEs, provisions of section 92B(2) should not apply to the transaction of sale of business unit.

However, sale of a business undertaking can involve termination/ renegotiation of an existing contract, which can be based on an understanding between I Co1 and F Co. In such case, an international transaction of 'business restructuring' can exist between I Co 1 and F Co as per the provisions of section. 92B(1) read with section 92F(v) of the Act.

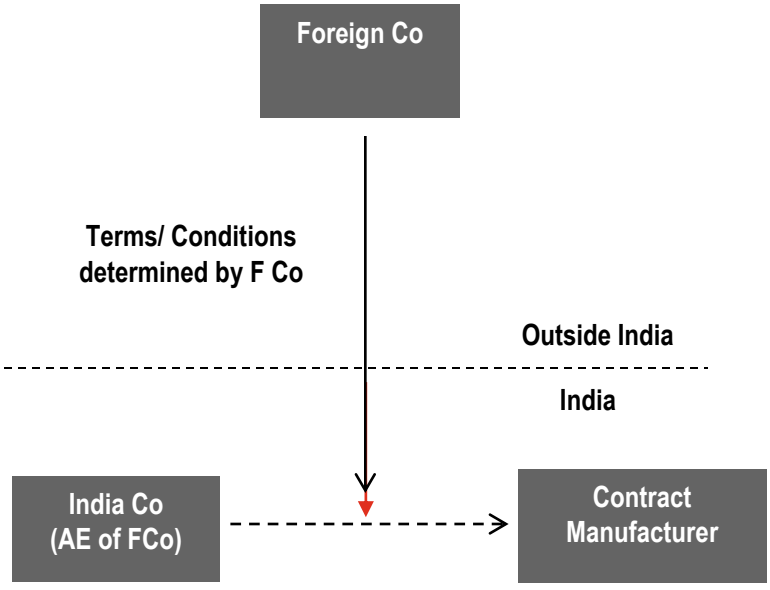
Case 2:



Foreign Co. has a global procurement organization that identifies, appoints, and negotiates with global vendors to supply to Foreign Co's affiliates (including India Co) at terms agreed by Foreign Co and the vendors.

Such transaction would be covered under the amended provision.

Case 3:



Indian Co. enters into an arrangement with a third party contract manufacturer for manufacture & purchase of goods. The terms are determined in substance by Foreign Co.

Such transaction would be covered under the amended provision

Tangible and intangible property

4.8 Tangible property has an existence in physical form. Any property other than tangible is intangible property. *OECD Guidelines 2022 defines intangible as something which is not a physical asset or a financial asset[1], which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances.* OECD guidelines *illustratively lists* patents, know-how, trademarks, names and brands, rights under contracts and government licenses, goodwill, group synergies as intangible items.

4.9 Finance Act, 2012 inserted an explanation to Section 92B of the Act w..e.f 1-4-2012, which clarifies the expression "intangible property" for purposes of the Indian transfer pricing regulations to include-

(i) marketing related intangibles assets, such as, trademarks, trade names, brand names, logos; or

(ii) technology related intangibles assets, such as, process patents, patent applications, technical documentation such as laboratory notebooks, technical know-how; or

(iii) artistic related intangible assets, such as, literary works and copyrights, musical compositions, copyrights, maps, engravings ; or

(iv) data processing related intangible assets, such as proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters; or

(v) engineering related intangible assets, such as industrial design,

[1] According to the OECD Guidelines 2022, a financial asset is any asset that is cash, an equity instrument, a contractual right or obligation to receive cash or another financial asset or to exchange financial assets or liabilities, or a derivative. Examples include bonds, bank deposits, stocks, shares, forward contracts, futures contracts and swaps.

product patents, trade secrets, engineering drawing and schema-tics, blueprints, proprietary documentation; or

(vi) customer related intangible assets, such as, customer lists, customer contracts, customer relationship, open purchase orders; or

(vii) contract related intangible assets, such as, favourable supplier, contracts, licence agreements, franchise agreements, non-compete agreements; or

(viii) human capital related intangible assets, such as, trained and organised workforce, employment agreements, union contracts; or

(ix) location related intangible assets, such as leasehold interest, mineral exploration rights, easements, air rights, water rights; or

(x) goodwill related intangible assets, such as, institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value; or

(xi) methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data; or

(xii) any other similar item that derives its value from its intellectual content rather than its physical attributes.

Given the wide scope of the phrase 'international transaction' and more particularly as regards 'intangible property' the accountant will need to exercise due diligence that all relevant transactions are considered and included in the report, whether these are included in the books of accounts or records of the assessee or not.[2] The accountant should also review the record of any pending or past transfer pricing assessments or appeals of the assessee to identify any transaction not otherwise apparent from the books of accounts or records of the assessee. Where the accountant is unable to verify all such transactions due to any reason, and/ or relies upon explanations/ representations made to it by the assessee, and/ or there is a difference of opinion between the accountant and the assessee, such aspect

[2] It may be mentioned that there may not be exact similarity between the definitions as per transfer pricing principles and accounting principles. In the Indian context 'Intangible' for transfer pricing purposes may be in variation with 'intangible assets' in accounting terms as per AS 26 and/or Ind AS 38.

should be included in the accountant's report as a note or qualification, as appropriate.

4.10 One of the most important aspects is to identify the intangibles, which are owned by the Group and the Indian entity. While, the above explanation provides detailed insights into the kind of intangibles, identification of intangibles, is an intensive process and requires detailed understanding of the industry and business model of the group and the Indian entity. The accountant can refer to the value driver analysis performed in the Master File, key customer contracts, customer relationships, vendor lists, etc. as reference points to identify intangibles, apart from the legally owned intangibles.

4.10.1 An intangible, for transfer pricing purposes, is something which:

- Is not a physical asset or a financial asset
- Is capable of being owned or controlled for use in commercial activities; and
- Whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances
- Legal, contractual, and other forms of protection may affect the value of an item and the returns that should be attributed to it – but the existence of such protection is not a necessary condition for an item to be characterised as an intangible for transfer pricing purposes.

4.10.2 Methods for valuing intangibles in Transfer Pricing

(i) Market Approach:

- Estimates value based on actual market transactions
- Requires the collection of market data from comparable transactions and analysis of the data to estimate the value of the intangible through comparison and correlation.

(ii) Income Approach:

- Considers income and expense data relating to the intangible and based on cash flow projections and discount rates computes a fair market value.
- Includes the discounted cash flow method and the relief from royalty approach, two commonly used valuation methods.

(iii) Cost Approach:

- Values intangible assets based on their 'cost to create' or what it might cost to recreate a similar asset
- The OECD Guidelines note that the use of methods that seek to estimate the value of intangibles based on the cost of intangible development is generally discouraged.

4.10.3 Valuation is an important consideration in the transfer/migration of intangibles

Substance/commercial reasons for transferring intangibles is also critical. Since the ownership of intangibles can represent a major profit driver for a business, the valuation, pricing and supporting reasons for the transfer is paramount, particularly if intangibles ownership is being transferred from a high tax jurisdiction to a low tax jurisdiction.

For the purpose of 92E report, part B of clause 12 in form 3CEB, the disclosure required is pertaining to amount paid/received or payable/receivable for purchase/ sale/transfer/lease/use of each category of intangible property

(i) as per books of account;

(ii) as computed by the assessee having regard to the arm's length price.

Professionals would base their independent opinions based on the valuation reports of other professionals. However, reasonable independent scrutiny and assessment on the following aspects is to be done:

- Existence of such intangible, IP Structuring and Group Policies
- Documentation being maintained
- Prior history and cost base or Capitalisations/ accruals of the company
- Any patents, trademarks or registrations acquired
- Valuation Methodologies, workings, assumptions, and the base/benchmark ratios/ calculations as compared to independent companies in similar industry

Further, As all the intangibles referred to Explanation (ii) to Section 92B may not be separately accounted in the books of accounts (such as customer lists, human capital related intangibles, customer relationship, goodwill, etc), the accountant may need to rely on the transfer pricing documentation

maintained by the assessee under Rule 10D as well as obtain adequate representations from the management stating that all the international transactions relating to intangibles have been disclosed to the accountant.

4.11 There may be outright sale transaction for a consideration between the Associate Enterprises or there may be a License agreement between AEs for use of above intangibles. Intangibles are generally created by the manufacturing activities or Research & Development activities undertaken by the AEs, or there may be a case of marketing intangibles created by marketing, distribution and after sale-service by any AE.

Chapter VI of the Transfer Price Guidelines by OECD (2017) provides guidance specifically tailored to determine ALP for transactions that involve the use/ transfer of intangibles. The BEPS Action Plan 8 of OECD suggests that profits associated with the transfer and use of intangibles is appropriately allocated in accordance with the value creation.

Benchmarking of the use/ transfer of above intangibles between AEs needs to be properly made by the management based on generally accepted approaches for valuation like the Cost Approach, The Market Approach and the Earning Approach. The TP auditor needs to certify the ALP calculated by the assessee by applying any of the TP methods.

4.12 With respect to marketing intangible and particularly advertisement, marketing and promotional ('AMP') expenses, the accountant will need to exercise due diligence to establish whether the AMP expenses are incurred by AE in India to cater to the needs of the customers in the local market and not incurred at the instance or behest of overseas AE nor there was any mutual understanding or arrangement or allocation or contribution by the AE towards reimbursement of any part of AMP expenditure incurred by it for the purpose of its business. For carrying out this exercise cases decided on this should be kept in mind.

Services, finances, and costs etc.

4.13 "Provision of services" refers to trade related services like intellectual property rights and trade related investments. According to the OECD guidelines, there are two main issues while analysing intra-group services:

(i) whether an intra-group service that should be charged for has been provided; and

(ii) what the charge should be in accordance with the arm's length principle.

In this regard, the accountant may refer to the following aspects while determining whether the intra-group services have been rendered:

(a) Benefits test – The basis to decide whether a service has been provided is set out in the guidelines as 'whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in-house for itself. If the activity is not one for which the independent enterprise would have been willing to pay or perform for itself, the activity ordinarily should not be considered as an intra-group service under the arm's length principle'. Services benefiting a group of enterprises as a whole should be allocated amongst the group in a way that matches the benefit received.

(*b) Shareholder activities* – An activity that a group member (usually the parent company or a regional holding company) performs solely because of its ownership interest in one or more other group members i.e in its capacity as shareholder. This type of activity would not be considered to be an intra-group service, and thus would not justify a charge to other group members. This type of activity may be referred to as a "shareholder activity".

Certain illustrative examples for Shareholder activities can be:

(i) juridical structure of the parent company itself such as meetings of shareholders of the parent, issuing of shares in the parent company, stock exchange listing of parent company and cost of supervisory board;

(ii) reporting requirements of parent company including consolidation of reports, parent company's audit of subsidiary's accounts carried out exclusively in the interest of parent company, preparation of consolidated financial statements of the MNE;

(iii) raising funds for the acquisition of its participations and costs relating to the parent company's investor relations such as communication strategy;

(iv) raising funds for the acquisition of its participations and costs relating to the parent company's investor relations such as communication strategy;

(v) ancillary to the corporate governance of the MNE as a whole.

(*c) Duplicative activities* – An activity which is undertaken by one group member that merely duplicate(s) a service that another group member is

performing for itself, or that is being performed for such other group member by a third party(s) are considered to duplicative activities. An exception may be where the duplication of services is only temporary, for example, where an MNE group is reorganising to centralise its management functions. Another exception would be where the duplication is undertaken to reduce the risk of a wrong business decision (e.g. by getting a second legal opinion on a subject). Furthermore, the fact that a company performs, for example, marketing services in-house and also is charged for marketing services from a group company does not of itself determine duplication, since marketing is a broad term covering many levels of activity. The Accountant shall examine the information provided by the taxpayer to determine whether the intra-group services are different, additional, or complementary to the activities performed in-house. The benefits test would then apply to those non-duplicative elements of the intra-group services.

(d) *Incidental Benefits* – There can be some cases where an intra-group services performed by a group member such as a shareholder or coordinating centre relates only to some group members but incidentally provides benefits to other group members. Examples could be analysing the question whether to reorganize the group, to acquire new members, or to terminate a division. These activities could constitute intra-group services to the particular group members involved, for example those members who may make the acquisition or terminate one of their divisions, but they may also produce economic benefits for other group members not directly involved in the potential decision since the analysis could provide useful information about their own business operations. The incidental follow-on benefits that ordinarily would not cause these other group members to be treated as receiving an intra-group service because the activities producing the benefits would not be ones for which an independent enterprise ordinarily would be willing to pay.

Similarly, an associated enterprise should not be considered to receive an intra-group service when it obtains incidental benefits attributable solely to it being part of a larger concern, and not to any specific activity being performed. For example, no service would be received where an associated enterprise by reason of its affiliation alone has a credit-rating higher than it would if it were unaffiliated, but an intra-group service would usually exist where the higher credit rating were due to a guarantee by another group member, or where the enterprise benefitted from deliberate concerted action involving global marketing and public relations campaigns.

Capital financing transactions

4.14 The AEs often enter into transactions of capital financing including borrowing, lending, guarantee arrangements, etc. The pricing of these arrangements will have a bearing on the profits or losses of the AEs and hence are included as part of the definition of 'international transaction'. These transactions of capital financing including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business are expressly covered as international transactions vide Finance Act 2012.The accountant will need to carefully identify and report such transactions and particularly equity and preference capital, debentures, guarantees provided or received, etc. Advance payments received or made and debts arising during the course of business shall need to be carefully considered and reported by the accountant however ensuring that there is no duplication or overlap with reporting of the principal transactions to which such advances or debts relate to, unless the accountant identifies factors which cause such advances or debts as separate transactions.

The OECD has released "OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" in January 2022 incorporating discussion on transfer aspects of financial transactions **in** Chapter X. It seeks to provide guidance for determining whether the conditions of certain financial transactions between associated enterprises are consistent with the arm's length principle. This may be referred to while analysing financial transactions for the purposes of the certificate under section 92E of the Act.

The accountant shall consider disclosing the transactions in relation to advance, payments or deferred payment or receivable or any other debt arising during the course of business either by way of a note in the 'detailed observation/remarks' section of the respective underlying primary transaction to which such balances pertain to or make a separate disclosure of such balances along with a description of the underlying primary transaction to which it is closely linked.

Cost contribution arrangement

4.15 Agreement or arrangement represents understanding, and not a transaction as ordinarily understood as being some business or dealing, which is carried on or transacted between two or more persons. It is

reciprocal to contribute to the cost or incur expenditure for the mutual advantage or to share according to the agreement or the arrangement. Such agreement or arrangement is not in the nature of conveying any property or provision of services or lending or borrowing and is known as 'cost contribution arrangement'.

4.16 The cost contribution arrangements, as aforesaid, are arrangements between business enterprises to share the costs and risks of jointly developing, producing, or obtaining assets, services or rights. Its conditions should be in conformity with arm's length principle and therefore, a participant's contributions must be consistent with what an independent enterprise would have agreed to contribute under comparable circumstances given the benefits it reasonably expects to derive from the arrangement. The accountant should gain an understanding of the transaction and make appropriate reporting for the same.

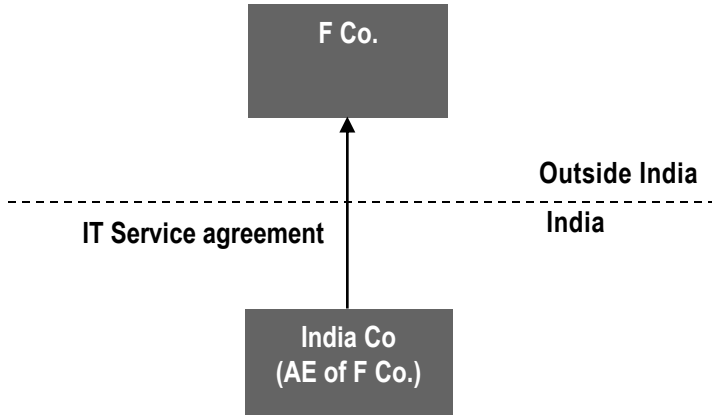
Free of cost transfer of goods or services

4.17 When determining whether or not international transaction exist in the books of accounts or records of the Assessee, the Accountant also need to consider the free of cost goods / services rendered / availed by the Assessee. A reference can also be placed on the positions adopted by the taxpayer under for GST for such free of cost goods / services by the Assessee.

4.18 The Accountant will need to carefully examine the necessary facts/ conditions to assess and identify such transactions not otherwise apparent from books of accounts or records of the Assessee and make appropriate reporting for the same. Where amounts are recognized on a notional basis in the books of accounts due to applicable accounting standards or otherwise, the same should be in conformity with arm's length principle. Examples of such transactions may include free of cost employee stock option plans, free of cost software / software related services, free of cost management services, etc.

4.19 To the extent there is an intentional set-off or where the pricing of the principal transaction is determined (basis functions performed, assets employed and risks assumed) after considering the free of cost transfers, a separate disclosure of such free of cost transfers may not be necessary. However, the fact of such set-off could be included in the accountant's report as a note. Same is the case with 'shareholder activities' and 'incidental benefits' that are not compensable.

Example:



F Co. has entered into a service agreement with India Co. for provision of IT services. As per the inter-company agreement, F Co. provides the necessary software/ tools, provides management oversight, and supervises the work carried out by India Co. The compensation to India Co. is agreed having regard to the roles and responsibilities of both the parties, including the free of cost software/ management services received by India Co. In such a case, a separate disclosure of such free of cost transfers may not be necessary.

4.20 The primary responsibility for the disclosing of such transactions rests with the taxpayer and the Accountant is entitled to place reliance on the representations provided by the taxpayer as to the details / completeness of such transactions.

Cross-border transactions- Interplay of section 9 and section 92A

4.21 For a transaction to be an international transaction, it should satisfy the following two conditions cumulatively:

(a) it must be a transaction between two AEs; and

(b) at least one of the two enterprises must be a non-resident.

4.22 A transaction is considered to be a cross-border transaction if it originates in one country and gets concluded in another country. A cross-border transaction may or may not be an international transaction within the meaning of Chapter X of the Act. Similarly, a transaction which is not a cross-border transaction may still be an international transaction for the

purpose of the said chapter if it falls within the ambit of the definition of "international transaction".

4.23 For example, it may be assumed that there are two US companies which are AEs. If the Indian subsidiary of one such US (holding) company enters into a transaction with the Indian branch or the permanent establishment in India of the other US company, this transaction, even through it has originated, executed and concluded within India, shall be an international transaction as it is between two AEs and one of the party is a non-resident.

4.24 In alternative, assume that there is an Indian company which is the holding company of two Indian (subsidiary) companies. The two Indian companies are AEs since they are subsidiaries of a common holding company. If one such Indian subsidiary company enters into a transaction with the foreign branch of the other Indian subsidiary company, such transaction shall not be regarded as an international transaction. In this case, even though the transaction is between two AEs, both the parties to the transaction are residents. For a transaction to be regarded an international transaction, either or both the parties must be non-residents. An important aspect to be noted here is that even though the above mentioned transaction is not an international transaction but it may be covered under domestic transfer pricing, subject to fulfilment of conditions prescribed under section 92BA, as per the amendements made vide Finance Act 2012 and the ALP would have to be determined having regard to transfer pricing provisions.

4.25 Even where a transaction is between two non-resident AEs, the provisions of chapter X of the Act shall apply so long as the income arising therefrom is assessable within the perview of the Act. It is possible that an international transaction between two AEs, both of whom are non-residents, may not attract the provisions of chapter X of the Act if the income from such transction is not taxable in India and falls outside the scope of total income assessable under the Act.

Chapter 4A
Specified Domestic Transactions

4A.1 Transfer pricing regulations have been extended vide Finance Act 2012 to include transactions entered into with domestic related parties or by an undertaking with other undertakings of the same entity for the purposes of section 40A (now omitted), Chapter VI-A and section 10AA. Domestic transfer pricing provisions are applicable from Assessment Year 2013-14 onwards.

4A.2 All of the compliance requirements relating to transfer pricing documentation, accountant's report, etc shall equally apply to specified domestic transactions as they do for international transactions amongst associated enterprises.

Definition

4A.3 The definition of section 92BA which defines Specified Domestic Transaction (SDT) has been amended vide Finance Act, 2017 to omit transactions in the nature of expenditure for which payment has been made or would be made to persons specified in section 40A(2)(b). The said amendment is applicable for assessment year 2017-18 i.e. previous year 2016-17.

Section 92BA defines SDT which is covered by TP regulationsas under:

"For the purposes of this section and sections 92, 92C, 92D and 92E, "specified domestic transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely:—

- any transaction referred to in section 80A;
- any transfer of goods or services referred to in sub-section (8) of section 80-IA;
- any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;
- any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or

— any business transacted between the persons referred to in sub-section (6) of section 115BAB;

— any other transaction as may be prescribed,

and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of Rupees Twenty Crores.

Threshold Limit

4A.4 The above referred transactions will be regarded as SDT only if the aggregate value of all the above specified transactions exceeds the threshold limit of Rupees 20 Crores (w.e.f 1st April 2016 onwards). If the threshold limit is crossed, the taxpayer will be required to comply with TP requirements with reference to all the transactions regardless of the fact that that the value of transactions under one of the limbs may be very small or nominal. Thus, there is no internal threshold for each limb of the definition.

4A.5 The threshold limit for SDT can be computed either on net basis (i.e. without including indirect tax levies like service tax, VAT, etc.) if the assessee is availing credit of those indirect taxes or on gross basis if the assessee is not availing credit, depending upon the method of accounting regularly followed. A useful reference may be made to the paragraph relating to Sales, Turnover, Gross Receipts under Guidance Note on Tax Audit u/s. 44AB issued by the Institute for the purpose of determining the threshold limit.

4A.6 Transactions covered under section 80A, 80-IA and 10AA

Section 92BA extends to:

(i) any transaction referred to in section 80A;

(ii) any transfer of goods or services referred to in sub-section (8) of section 80-IA;

(iii) any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;

(iv) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable

4A.7 Transactions covered under section 80A

Section 80A applies to deductions to be made in computing total income under Chapter VI-A. Though the reference in section 92BA is to section 80A

in general, on a closer examination, it becomes clear that the reference is merely to sub-section (6) of section 80A and not to any other sub-section since other sub-section of section 80A merely regulates the quantum of deduction and does not involve fair pricing of any transaction. This is also supported by corresponding amendment made to section 80A(6) by Finance Act 2012 to amend the meaning of expression 'market value' referred to in that sub-section and to provide that in case of specified domestic transactions, the market value shall be computed at arm's length price.

4A.8 Section 80A (6) of the Act provides that

"Notwithstanding anything to the contrary contained in section 10A or section 10AA or section 10B or section 10BA or in any provisions of this Chapter under the heading "C— Deductions in respect of certain incomes", where any goods or services held for the purposes of the undertaking or unit or enterprise or eligible business are transferred to any other business carried on by the assessee or where any goods or services held for the purposes of any other business carried on by the assessee are transferred to the undertaking or unit or enterprise or eligible business and, the consideration, if any, for such transfer as recorded in the accounts of the undertaking or unit or enterprise or eligible business does not correspond to the market value of such goods or services as on the date of the transfer, then, for the purposes of any deduction under this Chapter, the profits and gains of such undertaking or unit or enterprise or eligible business shall be computed as if the transfer, in either case, had been made at the market value of such goods or services as on that date.

Explanation — For the purposes of this sub-section, the expression "market value",—

(i) *in relation to any goods or services sold or supplied, means the price that such goods or services would fetch if these were sold by the undertaking or unit or enterprise or eligible business in the open market, subject to statutory or regulatory restrictions, if any;*

(ii) *in relation to any goods or services acquired, means the price that such goods or services would cost if these were acquired by the undertaking or unit or enterprise or eligible business from the open market, subject to statutory or regulatory restrictions, if any;*

(iii) ***in relation to any goods or services sold, supplied or acquired means the arm's length price as defined in clause (ii) of section***

92F of such goods or services, if it is a specified domestic transaction referred to in section 92BA.

4A.9 This provision requires that the inter unit transfer of goods or services between eligible and other units of the same taxpayer should be recognized at market value of such goods or services as on the date of transfer for the purpose of computing deduction admissible to the taxpayer under specified sections of Chapter VI-A. The provision covers income as well as expenditure of the eligible unit. Further, if threshold of INR 20 crore is not crossed the same will continue to be governed by un-amended provisions of section 80A(6) of the Act and FMV will be computed on general principles

4A.10 The provisions currently in force which grant profit linked tax holiday deductions and which are regulated by section 80A(6) and, consequently, subject to Domestic transfer pricing are as follows:-

- 80-IA – Infrastructure development, etc
- 80-IAB – SEZ development
- 80-IAC – Startup business
- 80-IB – Industrial undertakings
- 80-IBA – Development and building house projects
- 80-IC – Industrial undertakings or enterprises in special category states
- 80-ID – Hotels and convention centres in specified area
- 80-IE – Undertakings in North-Eastern states
- 80JJA – Collection and processing of bio-degradable waste
- 80JJAA – Employment of new workmen
- 80LA – Offshore Banking units and International Financial Services Centre
- 80P – Co-operative societies

4A.11 Transfers referred to in section 80-IA(8)

The second limb of section 92BA refers to any transfer of goods or services referred to in sub-section (8) of section 80-IA. Section 80-IA (8) covers inter-unit transfer of goods and services.

Section 80-IA(8) reads as under:

"Where any goods or services held for the purposes of the eligible business are transferred to any other business carried on by the assessee, or where any goods or services held for the purposes of any other business carried on by the assessee are transferred to the eligible business and, in either case, the consideration, if any, for such transfer as recorded in the accounts of the eligible business does not correspond to the market value of such goods or services as on the date of the transfer, then, for the purposes of the deduction under this section, the profits and gains of such eligible business shall be computed as if the transfer, in either case, had been made at the market value of such goods or services as on that date"

Provided that where, in the opinion of the Assessing Officer, the computation of the profits and gains of the eligible business in the manner hereinbefore specified presents exceptional difficulties, the Assessing Officer may compute such profits and gains on such reasonable basis as he may deem fit.

***Explanation**.—For the purposes of this sub-section, "market value", in relation to any goods or services, means—*

(i) the price that such goods or services would ordinarily fetch in the open market; or

(ii) ***the arm's length price as defined in clause (ii) of section 92F, where the transfer of such goods or services is a specified domestic transaction referred to in section 92BA.***

4A.12 The above provision entitles the assessing officer to compute profits and gains of eligible business based on market value of goods and services transferred between an eligible and a non-eligible business only if the consideration for such transfer (if any) as recorded in the books of accounts of the eligible business does not correspond to the market value of the goods or services. By virtue of the amendment made to the above explanation vide Finance Act 2012, on lines of extension of Explanation to section 80A(6) defining market value, the Explanation under this provision has also been expanded to provide that the market value shall be computed at arm's length price if the inter unit transfer constitutes specified domestic transaction.

4A.13 Transfers referred to in section 80-IA(10)

The third limb of section 92BA refers to business transacted between the assessee and any other person as referred to in sub-section (10) of section 80-IA.

4A.14 Section 80-IA(10) reads as under:

"Where it appears to the Assessing Officer that, owing to the close connection between the assessee carrying on the eligible business to which this section applies and any other person, or for any other reason, the course of business between them is so arranged that the business transacted between them produces to the assessee more than the ordinary profits which might be expected to arise in such eligible business, the Assessing Officer shall, in computing the profits and gains of such eligible business for the purposes of the deduction under this section, take the amount of profits as may be reasonably deemed to have been derived therefrom."

*"**Provided that in case the aforesaid arrangement involves a specified domestic transaction referred to in section 92BA, the amount of profits from such transaction shall be determined having regard to arm's length price as defined in clause (ii) of section 92F"***

4A.15 Section 80-IA (10) applies to transactions between the assessee and any other person which results in excessive profits in the hands of the assessee:

(a) either owing to close connection with other person; or

(b) for any other reason.

The dealings between taxpayer and other person get covered by section 80-IA(10) provided the course of business between them is so arranged that the transaction produces more than ordinary profits in the eligible business.

4A.16 Transactions in other provisions to which section 80-IA(8)/(10) apply

Specified domestic transactions as defined in section 92BA also refer to any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of section 80-IA(8) and section 80-IA(10) are applicable.

The following profit linked incentive provisions under Chapter VI-A are also governed by provisions of section 80-IA(8) and section 80-IA(10) and hence will be subject to Domestic TP:-

- 80-IAB- Deductions in respect of profits and gains by an undertaking or enterprise engaged in development of Special Economic Zone.
- 80-IAC- Special provisions in respect of specified business

- 80-IB- Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings
- 80-IBA- Deduction in respect of profits and gains from housing projects
- 80-IC- Special provisions in respect of certain undertakings or enterprises in certain special category States
- 80-ID- Deduction in respect of profits and gains from business of hotels and convention centres in specified area
- 80-IE- Special provisions in respect of certain undertakings in North-Eastern States

4A.17 Transactions between the persons referred to in sub-section (6) of section 115BAB

Section 115BAB was introduced by the Taxation Laws (Amendment) Act, 2019 providing for a concessional tax rate of 15% to a domestic company if specified conditions are satisfied. Sub-section (6) of this section reads as follows:

> *(6) Where it appears to the Assessing Officer that, owing to the close connection between the person to which this section applies and any other person, or for any other reason, the course of business between them is so arranged that the business transacted between them produces to the person more than the ordinary profits which might be expected to arise in such business, the Assessing Officer shall, in computing the profits and gains of such business for the purposes of this section, take the amount of profits as may be reasonably deemed to have been derived therefrom:*
>
> ***Provided** that in case the aforesaid arrangement involves a specified domestic transaction referred to in section 92BA, the amount of profits from such transaction shall be determined having regard to arm's length price as defined in clause (ii) of section 92F:*
>
> ***Provided** further that the amount, being profits in excess of the amount of the profits determined by the Assessing Officer, shall be deemed to be the income of the person.*

Hence, if a company is seeking benefits of lower rate of tax under section 115BAB then the auditor should examine whether transaction would be covered under the first proviso to sub-section (6) as mentioned above and take action accordingly.

Chapter 5
Arm's Length Price

Meaning and determination

5.1 In commercial parlance, an arm's length price is the price at which independent enterprises deal with each other, where the conditions of their commercial and financial relations ordinarily are determined by market forces. Section 92F(ii) of the Act, defines the arm's length price as a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises ('AE'), in uncontrolled conditions.

5.2 The steps involved in the determination of the arm's length price can be summarised as follows:

(i) identification of the "international transaction/(s)" or specified domestic transaction/(s);

(ii) identification of the functions performed, assets employed, and risks assumed ('FAR') by the taxpayer and the AE being parties to the transaction(s);

(iii) deciding the characterisation of the entities who are party to the transaction based on the analysis of functions performed, assets employed and risks assumed;

(iv) deciding if the international transactions or specified domestic transactions are closely linked or not [Rule 10A(d)] and accordingly functional analysis to be done using aggregation of transaction or transaction by transaction approach;

(v) identification / selection of the tested party (for application of resale price method, cost plus method and transactional net margin method);

(vi) identification of the most appropriate method which will, inter-alia, include:

a) identification of an "uncontrolled transaction" - Rule 10A (ab);

— Review of existing internal uncontrolled transaction, if any;

— Determination of available sources of information on external

comparables where such external comparables are needed taking into account their relative reliability.

Identification and comparison of specific characteristics embodied in international transactions or specified domestic transactions and uncontrolled transactions-Rule 10B(2);

b) finding out whether uncontrolled transactions and international transactions or specified domestic transactions can be compared by reconciling/resolving differences, if any - Rule 10B(3);

(vii) ascertaining the most appropriate method by applying the tests laid down - Rule 10C;

(viii) determination of the arm's length price by applying the method chosen - Rule 10B(1).

Please note that step (vi) is a repetitive exercise (in respect of each of the prescribed methods) until a satisfactory conclusion is reached thereby leading to selection of the most appropriate method out of the methods prescribed under Section 92C(1) of the Act. Further, no particular method has been accorded any priority under the Indian Transfer Pricing legislation. The most appropriate method is to be selected having regard to the nature of the transaction(s), functions performed by the parties involved in the transaction(s) and other relevant factors.

Example – ABC India is engaged in distribution of XYZ brand printers in the Indian market, which are manufactured by ABC Inc. (a US based group entity). Apart from the distribution of printers, ABC India also imports printer cartridges and other spares from its group entity ABC Inc, which are used in the after-sales business. The international transactions in this case are import of printers and import of cartridges & spares.

The typical steps involved in determination of the arm's length price in the above example could be as follows:

Identify international transactions
1. Import of printers; and
2. Import of cartridges and spares.

Decide if the transactions are closely linked
In the present case, if ABC India follows a business strategy where it targets to sell the printers to penetrate the market and thereafter get recurring

business through sale of cartridges, then the transaction of import of printers and import of cartridges and spares could be said to be closely linked, and may be evaluated using aggregation approach.

FAR analysis

Undertake an in-depth FAR analysis of ABC India and ABC Inc. For instance, ABC India performs functions in the nature of procurement, quality control, inventory management, marketing and sales promotion (limited) etc., employs assets in the nature of office premises, warehouses etc. and assumes limited market and inventory risks amongst others. On the other hand, ABC Inc. performs functions in the nature of corporate strategy formulation, product research and development, manufacturing, pricing etc., employs assets in the nature of manufacturing know-how, brand, manufacturing facilities, warehouses etc. and assumes product liability, research and development, market risks amongst others.

Characterization of the parties involved in the aforementioned transactions and accordingly selecting the tested party

If after an in-depth FAR analysis of ABC India and ABC Inc, ABC India is characterised as a limited risk distributor and ABC Inc. is characterised as a full-fledged manufacturer and further reliable comparable data for ABC India can be found, then typically ABC India being the entity with the least complex FAR shall be selected as the tested party.

Ascertaining the most appropriate method and determination of the arm's length price

After a careful examination of the facts and circumstances of the case and further after applying the tests laid down in Rule 10C, in the instant case, the resale price method could be selected as the most appropriate method. Further, in case where no internal comparable data is available, external comparable data could be identified through available sources of information and accordingly the arm's length price can be ascertained.

5.3 Section 92C(1) stipulates that the arm's length price is to be determined by adopting any one of the following methods, being the most appropriate method:

- Comparable Uncontrolled Price method (CUP method)

- Resale Price Method (RPM)
- Cost Plus Method (CPM)
- Profit Split Method (PSM)
- Transactional Net Margin Method (TNMM)
- Other Method (OM) as prescribed by the Board and provided in Rule 10AB[1].

5.4 Rule 10C(1) lays down the general guidelines in the selection of the most appropriate method. The Rule states that the method to be selected shall be the one best suited to the facts and circumstances of each international transaction or specified domestic transaction and that provides the most reliable measure of the arm's length price.

5.5 Rule 10C(2) lists the specific factors that should be taken into account in the process of selecting the most appropriate method. These factors are as under:

(i) nature and class of international transactions or specified domestic transactions;

(ii) class or classes of AEs entering into the transaction and the functions performed by them taking into account the assets employed or to be employed and risks assumed by such enterprises;

(iii) availability, coverage and reliability of data necessary for application of the method. For instance, data relating to transactions entered into by the enterprise itself would be more reliable than the data relating to transactions entered into by third parties;

(iv) the degree of comparability existing between the international transaction or specified domestic transaction and uncontrolled transaction and between enterprises entering into such transactions

(v) the extent to which reliable and accurate adjustments can be made to account for the difference between the transactions.

(vi) the nature, the extent and reliability of assumptions required to be made in application of a method.

[1] Rule 10AB vide Notification No. 18/2012 [F. NO. 142/5/2012-TPL] dated 23 May 2012, applicable for assessment year 2012-13 and onwards

5.6 Rule 10C, inter alia, specifies that the availability, coverage and reliability of data and whether reasonably accurate and reliable adjustments could be made as the relevant considerations in selecting the most appropriate method. In actual practice, the choice of most appropriate method depends not only on the nature and character of international transaction or specified domestic transaction but also on the availability of comparable transactions and data. Hence, the selection of most appropriate method is a process of applying both the criteria. It may happen that what appears to be most appropriate method on the basis of nature of international transaction or specified domestic transaction may not be eventually selected because of non-availability of comparable data. The following example would clarify. An enterprise may buy from its AE and resell in India. The transaction itself suggests that the most appropriate method is Resale Price Method (RPM). There may not be any internal comparable transaction available. Even an external comparable may not be available. Even if an external comparable is available, the available data may not be sufficient to determine the Arm's length Gross Profit. Therefore, RPM may not be most appropriate method and some other method is to be chosen. The selection of most appropriate method is a process of continuously evaluating the nature and characteristics of international transactions or specified domestic transactions and the comparable transactions.

5.7 The factors referred to above are to be applied cumulatively in selecting the most appropriate method. The reference therein to the terms 'best suited' and 'most reliable measure' indicates that the most appropriate method will have to be selected after a meticulous appraisal of the facts and circumstances of the international transaction or specified domestic transaction. Further, the selection of the most appropriate method shall be for each particular international transaction or specified domestic transaction. The term 'transaction' itself is defined in rule 10A(d) to include a number of closely linked transactions. Therefore, though the reference is to apply the most appropriate method to each particular transaction, keeping in view, the definition of the term 'transaction', the most appropriate method may be chosen for a group of closely linked transactions. Two or more transactions can be said to be linked when these transactions emanate from a common source being an order or a contract or an agreement or an arrangement and the nature, characteristics and terms of these transactions are substantially flowing from the said common source. For example, a master purchase order is issued stating the various terms and conditions and subsequently,

individuals orders are released for specific quantities. The various purchase transactions are closely linked transactions.

5.8 It may be noted that in order to be closely linked transactions, it is not necessary that these transactions need to be identical or even similar. For example, a collaboration agreement may provide for import of raw materials, sale of finished goods, provision of technical services and payment of royalty. Different methods may be chosen as the most appropriate methods for each of the above transactions when considered on a standalone basis. However, under particular circumstances, one single method may be chosen as the most appropriate method covering all the above transactions as the same are closely linked.

5.9 There is yet another category of transactions which may be identical or similar though not closely linked. For example, independent purchase transactions having identical or similar nature, characteristics, terms and conditions are not closely linked transactions because these transactions do not emanate from a common source. However, under particular circumstances, one single method may still be chosen as the most appropriate method covering all the above transactions.

The following examples, [referred in the OECD Transfer Pricing Guidelines (2017)], may be useful in this regard:

> *"Examples may include 1. Some long-term contracts for the supply of commodities or services, 2. rights to use intangible property, and 3. pricing a range of closely-linked products(e.g. in a product line) when it is impractical to determine pricing for each individual product or transaction." (Para 3.9)*
>
> *"Another example where a taxpayer's transactions may be combined is related to portfolio approaches. A portfolio approach is a business strategy consisting of a taxpayer bundling certain transactions for the purpose of earning an appropriate return across the portfolio rather than necessarily on any single product within the portfolio. For instance, some products may be marketed by a taxpayer with a low profit or even at a loss, because they create a demand for other products and/or related services of the same taxpayer that are then sold or provided with high profits (e.g. equipment and captive aftermarket consumables, such as vending coffee machines and coffee capsules, or printers and cartridges). Similar approaches can be observed in various industries. Portfolio approaches arean*

example of a business strategy that may need to be taken into account in the comparability analysis and when examining the reliability of comparables." (Para 3.10)

5.10 It is not uncommon to notice transactions which are not only dissimilar or unidentical but are also not linked .For example, there may be transactions of purchase, sale and provision of technical service. In such case, wherever internal comparables are available, appropriate method should be used if the circumstances so justify.

5.11 Section 92C(2) provides that most appropriate method referred to in section 92C(1) shall be applied, for determination of arm's length price, in the manner as prescribed in Rule 10B. The first proviso to section 92C(2) provides that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices.

The second proviso to section 92C(2) provides that if the variation between the arm's length price, so determined and price at which the transaction has actually been undertaken does not exceed such percentage as may be notified[2] by the Central Government in the Official Gazette, the price at which the international transaction [or the specified domestic transaction] has been undertaken will be deemed to be the arm's length price. The variation is to be computed with reference to the actual price at which the international transaction [or the specified domestic transaction] has been undertaken. This proviso shall be applicable for assessment or reassessment proceedings pending before an Assessing Officer as on 1 October 2009.

5.12 The aforesaid amended second proviso refers to arm's length price (and not 'arithmetic mean' – as was the case in Finance Act 2002), and a view can be adopted that it is applicable to any 'arm's length price'

[2] Notification dated 13 September 2019, the rate of 1 percent for wholesale trading transaction and 3 percent in all other cases for financial year 2018-19

CBDT has also defined the term "wholesale trading" as "an International Transaction or a Specified Domestic Transaction of trading in goods, which fulfills the following conditions, namely:

a) purchase cost of finished goods is 80% or more of the total cost pertaining to such trading activities; and

b) average monthly closing inventory of such goods is 10% or less of sales pertaining to such trading activities.

determined (whether as a single comparable price, or as arithmetic mean of multiple comparable prices). Notably, only one method out of the 6 methods can be identified as the most appropriate method for a given transaction. Such most appropriate method may lead to a single comparable price or multiple prices. The arm's length price is the single comparable price or arithmetic mean of multiple comparable prices arrived at by application of the most appropriate method.

5.13 The proviso provides that the arithmetical mean of such prices shall be the arm's length price

A. ALP determined by assesse		`
CUT1	ALP1	INR 7,600
CUT2	ALP2	INR 7,380
CUT3	ALP3	INR 7,320

Arithmetic mean as per proviso	INR 7,433
ALP determined	INR 7,433

Assuming that the Indian taxpayer sells a product to its AE, in the above example, if the transfer price is equal to or above INR 7,433, it would be treated as being arm's length from an Indian transfer pricing perspective.

However, if the transfer price was less than INR 7,433, then it could vary from ALP only to the extent of the notified percent (not exceeding 3 percent) of the actual value of international transaction. An example to illustrate this is as follows:

Scenario 1: Transfer Price is INR 7,000 and ALP is INR 7,433

Difference between the transaction price and arm's length price	INR 433
3% of the transaction value	INR 210
Since the difference between the transaction price and the arm's length price is more than 3% of the transaction price, the transaction will be considered not to be at arm's length	

In case of a wholesale distributor, instead of 3%, 1% of the transaction price will be considered.

Scenario 2: Transfer Price is INR 7,250 and ALP is INR 7,433	
Difference between the transaction price and arm's length price	INR 183
3% of the transaction value	INR 218
Since the difference between the transaction price and the arm's length price is less than 3% of the transaction price, the transaction will be considered to be at arm's length	

In case of a wholesale distributor, instead of 3%, 1% of the transaction price will be considered.

5.14 A third proviso to this section has been inserted vide Finance (No. 2) Act 2014 stating that "where more than one price is determined by the most appropriate method, the arm's length price in relation to an international transaction or specified domestic transaction undertaken on or after the 1st day of April, 2014, shall be computed in such manner as may be prescribed and accordingly the first and second proviso shall not apply". With the introduction of the new mechanism, the provisions of first and second proviso (i.e. arithmetic mean and tolerable range) shall not apply.

CBDT vide Notification No. 83/2015 has introduced the use of the range concept as well as the use of multiple year data. Detailed discussion on the same in provided in Chapter 1 of this publication.

Uncontrolled transaction

5.15 Rule 10A(ab) defines an "uncontrolled transaction" to mean "a transaction between enterprises other than associated enterprises, whether resident or non-resident". When an uncontrolled transaction has been entered into, it could be said that it has been contracted under "uncontrolled conditions".

5.16 An uncontrolled transaction can be between:

- a resident and a non-resident; or
- a resident and a resident; or
- a non-resident and a non-resident.

5.17 While selecting, uncontrolled transaction / companies, due care should be taken to identify / make appropriate adjustment for the differences between the international transaction [or specified domestic transaction]

being evaluated and the comparable transaction so selected to ensure an appropriate comparison.

Comparable uncontrolled transactions

5.18 Rule 10B(2), lays down the criteria for comparability between international transactions [or specified domestic transactions] and uncontrolled transactions. This process is not quantitative but qualitative and involves exercise of judgment. The criteria listed in Rule 10B(2) are:

- distinctive nature of the property transferred or services provided;
- functions performed taking into account the assets employed or to be employed;
- risks assumed by the respective parties;
- contractual terms of the transaction;
- market conditions.

Distinctive nature of the property and services

5.19 The following are some of the characteristics to be assessed vis-à-vis the property transferred or service provided:

In the case of transfer of tangible property:

- the physical features of the property;
- its quality and reliability; and
- the availability and volume of supply.

In the case of provision of services:

- the nature and extent of the services.

More specifically for financing services in the nature of intra-group funding/ loan transactions, corporate guarantee loan arrangements, etc., the following characteristics needs to be assessed:

- the nature/ type of the financial transaction;
- the purpose of the transaction; and
- the duration and covenants of the financial transaction; etc

In the case of intangibles:

- the form of the transaction (eg. licensing or sale);

- the terms of the transaction;
- the type of property (eg. patent, trademark or know-how);
- the duration and extent of protection;
- anticipated benefits from the use of the property etc.

The following examples, taken from New Zealand transfer pricing guidelines, may be referred to

- An alkaline battery would sell at a premium to a standard (zinc carbon) battery, because the superior quality alkaline battery would be expected to last significantly longer than the standard battery.
- A battery with a known brand would sell for more than an unknown brand, even if the quality of the two batteries were identical. Other things being equal, consumers would be expected to prefer the battery with an established reputation for reliability.
- A multi coloured battery may sell for more than an equivalent black battery, depending on the extent to which consumer's preference is influenced by packaging.

Whether the transactions as illustrated in the aforesaid examples can be taken as comparable transactions or not would depend on the availability of data for making the reasonably accurate adjustments for the differences that affect prices / profits in the open market.

5.20 Further, the following guidance, from the OECD Transfer Pricing Guidelines (2017), may also be referred to:

> *"Para 1.108Depending on the transfer pricing method, this factor must be given more or less weight. Among the methods described at Chapter II of these Guidelines, the requirement for comparability of property or services is the strictest for the comparable uncontrolled price method. Under the comparable uncontrolled price method, any material difference in the characteristics of property or services can have an effect on the price and would require an appropriate adjustment to be considered. Under the resale price method and cost plus method, some differences in the characteristics of property or services are less likely to have a material effect on the gross profit margin or mark-up on costs. Differences in the characteristics of property or services are also less sensitive in the case of the transactional profit methods than in the case of traditional transaction methods. This however does not mean that the question of*

comparability in characteristics of property or services can be ignored when applying these methods, because it may be that product differences entail or reflect different functions performed, assets used and/or risks assumed bythe tested party.

Para 1.109 In practice, it has been observed that comparability analyses for methods based on gross or net profit indicators often put more emphasis on functional similarities than on product similarities. Depending on the facts and circumstances of the case, it may be acceptable to broaden the scope of the comparability analysis to include uncontrolled transactions involving products that are different, but where similar functions are undertaken. However, the acceptance of such an approach depends on the effects that the product differences have on the reliability of the comparison and on whether or not more reliable data are available. Before broadening the search to include a larger number of potentially comparable uncontrolled transactions based on similar functions being undertaken, thought should be given to whether such transactions are likely to offer reliable comparables for the controlled transaction."

Analysis of functions performed

5.21 Functions are defined as the activities that each of the entities engaged in a particular transaction perform as a part of its operations This functional analysis seeks to identify the economically significant activities and responsibilities undertaken, assets used or contributed, and risks assumed by the parties to the transactions. To illustrate, provided below are some typical functions undertaken in the context of manufacturing, research & development and distribution:

- raw material procurement
- production scheduling
- manufacturing of the products
- inventory management of raw materials and finished goods
- product research, design and development
- developing and administering budgets
- production planning and scheduling
- quality control
- packaging and labelling of products

- warehousing
- sales and marketing
- technical services
- shipping of products to customers
- administrative services
- after sales support

Analysis of assets employed

5.22 Transactions that are proposed to be compared should be analysed for the assets employed. In this context, some of the following points may be noted;

a) Whether assets are owned or leased

b) Whether activity is capital or labour intensive

c) Presence or absence of intangibles

d) Are the assets unique in nature (like an Intellectual Property)

Typical intangible assets could be as follows:

- Patents
- Unpatented technical know-how
- Formulae
- Trademarks and brand names
- Trade names
- Copyrights
- Technical information
- Customer list
- Franchises
- Marketing channel
- Highly qualified personnel

5.23 Intangibles can be ordinarily divided into two categories: manufacturing and marketing. Manufacturing intangibles are characterised as one of the two types – patents or non-patented technical know-how – and arise out of either research and development activity or the production engineering activities of the manufacturing plant.

5.24 Marketing intangibles include trademarks, corporate reputation, the distribution network and the ability to provide services to customers before and / or after the sale.

5.25 While carrying out the above analysis, it is necessary to assess whether the assets employed in the respective transactions significantly affect their comparability.

5.26 Further, it is not necessary that the assets are recorded in the balance sheet for it to have significant value for transfer pricing purposes. Even in cases where the assets (say intangibles) are not recorded in the balance sheet, due consideration should be given to the same while undertaking the functional analysis.

Analysis of risks assumed

5.27 An entity's return is usually reflective of the risks assumed by it – higher the risks, higher are the returns.

5.28 Transactions that are proposed to be compared should be analysed for the risk-content. Some of the significant risks present in a normal transaction are:

Nature of risks	Particulars
1. Financial risk	a. Capital contribution b. Method of funding c. Funding of losses
2. Product risk	a. Design and development ofproduct b. Up-gradation of product c. After Sales Service d. Risks associated with R & D e. Product liability risk f. Intellectual property risk if any
3. Market risk	a. Development of market including advertisement and product promotion etc. b. Business volume risk c. Assured sales risk d. Fluctuations in demand and prices.
4. Credit risk	a. Risk of bad debts

Nature of risks	Particulars
5. Foreign exchange risk	a. Risk on account of fluctuation of foreign currency exchange rates
6. Capacity utilisation risk	a. Risks on account of under-utilisation of capacity

5.29 It is important to align the ability to control and manage risk based on the actual activities. One cannot bear the risk contractually if there is no ability to control and manage such a risk. For example: A Co cannot be considered to be assuming risks in a scenario where it does not have the ability to control the decisions that lead to arising of such risks or it does not have financial wherewithal to withstand the loss arising from such risks.

5.30 Further, sometimes the risk profile within the AEs may be contractual and also backed by substance and it might be difficult to identify third parties with identical risk profile. For example: Capacity utilisation risk might not be borne by the customer in a third party scenario which might be the case in the transaction with the AE. In such a situation, adjustment for difference in risks should be considered for comparability and arm's length price computation purposes.

Characterisation

5.31 Characterisation is the process of assessing and determining the nature of the transacting entity (in a given international transaction or specified domestic transaction) as a licensed manufacturer / contract manufacturer / entrepreneur distributor / low risk distributor etc., based on the functional analysis which facilitates the process of selection of the tested party which in turn assists in the choice of the most appropriate method and also in the identification of the uncontrolled transactions for comparability purposes.

5.32 Characterisation of the related parties is an important component to a transfer pricing analysis and is used as the foundation in conducting the economic analysis. Characterisation of an entity (for transfer pricing purposes) refers to the process by which an entity is classified in a particular category based on the analysis of the functions, assets and risks of the said entity. For eg. based on an analysis of the functions, assets and risks of a given entity it could be classified as a manufacturer (entrepreneur, contract, toll etc.) or as a distributor (entrepreneur, normal risk, low risk etc.) or as a service provider.

5.33 In a typical scenario, a manufacturer and a distributor can be characterised as follows:-

a) Manufacturing set-up

Having regard to illustrative functions / risk / asset, the manufacturer could be characterized as follows:

Parameters	Full Fledge Manufacturer	Licensed Manufacturer	Contract Manufacturer	Toll Manufacturer
Produces on	Own behalf	Own behalf	Principal	Principal
Intellectual Property	Owns the IP	Does not own the IP but uses the IP owned by Principal on license basis	Does not own	Does not own
Materials	Owns	Owns	Owns	Does not own
Production scheduling	Does for own	Does for own	Done by Principal	Done by Principal
Selling and distribution function	Performs	Performs	Does not perform	Does not perform
Bears market risk	Yes	Yes	Limited	Limited
Bears inventory risk	Yes	Yes	Limited	No
Bears capacity utilisation risk	Yes	Yes	No	No
Bears credit risk	Yes	Yes	No	No

b) Distribution set-up

Having regard to illustrative functions / risk / asset, the distributor could be characterized as follows:

Parameters	Commission agent	Limited risk distributor	Normal risk distributor	Entrepreneur distributor
Takes title	No	Yes	Yes	Yes
Credit risk	No	Limited	Yes	Yes
Inventory risk	No	Limited	Yes	Yes
Marketing responsibilities	No	Limited	Limited	Yes
Foreign exchange risks	No	No	Yes	Yes

Tested party

5.34 Comparable Uncontrolled Price Method is a two sided method i.e., either of the parties to the international transaction [or the specified domestic transaction] can be selected as the tested party. However, for the application of Cost plus Method, Resale Price Method or Transactional Net Margin Method, it is necessary to choose one of the parties to the transaction as the tested party whose profitability needs to be tested (i.e. mark-up on costs, gross margin, or net profit margins) and compare the profitability of the tested party's transactions with uncontrolled internal or external comparables, as the case may be. On the other hand, profit split method, may require combination of one sided or two-sided method depending upon methodology used.

5.35 The choice of the tested party should be consistent with the functional analysis of the transaction, and the characterisation of the entities.

5.36 The tested party generally would be the less complex party to the controlled transaction and should be the party in respect of which most reliable data for comparability is available. It may be possible that the tested party could be the group entity (AE) which is party to the transaction. To illustrate, say in a transaction pertaining to the sale of goods by a US company (an entrepreneur and owner of significant Intellectual Property) to its India subsidiary (a limited risk distributor), the Indian entity should be selected as the tested party since its functions are less complex as compared to the US company and data of comparable distributors will be more easily available for the purpose of benchmarking.

5.37 While making such an analysis, even the foreign entity could also be selected as the tested party. For instance where an Indian entrepreneur sells goods to its US subsidiary which acts as a low risk distributor, the US entity should be selected as the tested party. In such scenarios, the members should check if detailed information / analysis is maintained by the Company.

Contractual terms

5.38 The important contractual terms of the transactions should be ascertained to determine whether transactions as well as the transaction pricing / margin are comparable or not. Some of the contractual terms that need to be examined are:

- terms of delivery
- CIF, C&F, FOB
- terms of payment
- discount, if any
- credit period
- warranty period
- installation services

5.39 An example of how contractual terms may affect transfer pricing may be seen in the following example, which has been taken from Para B.2.3.2.7 of the United Nations Practical Manual on Transfer Pricing for Developing Countries (2017).

"Consider Company A in one country, an agricultural exporter, which regularly buys transportation services from Company B (its foreign subsidiary) to ship its product, cocoa beans, from Company A's country to overseas markets. Company B occasionally provides transportation services to Company C, an unrelated domestic corporation in the same country as Company B. However, the provision of such services to Company C accounts for only 10 per cent of the gross revenues of Company B and the remaining 90 per cent of Company B's revenues are attributable to the provision of transportation services for cocoa beans to Company A. In determining the degree of comparability between Company B's uncontrolled transaction with Company C and its controlled transaction with Company A, the difference in volumes involved in the two transactions, volume discount if any, and the regularity with which these services are provided must be taken

into account where such factors would have a material effect on the price charged."

5.40 It should be noted that in practice, information concerning the contractual terms of potentially comparable uncontrolled transactions may not be available, particularly where external comparables are used for the analysis. The effect of deficiencies in the information in establishing comparability will differ depending on the type of transaction being examined and the transfer pricing method applied.

5.41 Further, the revised OECD Transfer pricing guidelines, 2017 provides for a vigilant approach for testing the arm's length nature of an international transaction by not just evaluating the on-paper agreement or the contractual terms, but also by scrutinizing the actual business conduct of the transacting parties, the commercial viability of the transaction, the practical feasibility considered by geographical locations, employment of assets, assumption of risks, etc.

5.42 The following example from Para 1.44 of the OECD Transfer Pricing Guidelines (2017) illustrates the concept of clarifying and supplementing the written contractual terms based on the identification of the actual commercial or financial relations. "*Company P is the parent company of an MNE group situated in Country P. Company S, situated in Country S, is a wholly-owned subsidiary of Company P and acts as an agent for Company P's branded products in the Country S market. The agency contract between Company P and Company S is silent about any marketing and advertising activities in Country S that the parties should perform. Analysis of other economically relevant characteristics and in particular the functions performed, determines that Company S launched an intensive media campaign in Country S in order to develop brand awareness. This campaign represents a significant investment for Company S. Based on evidence provided by the conduct of the parties, it could be concluded that the written contract may not reflect the full extent of the commercial or financial relations between the parties. Accordingly, the analysis should not be limited by the terms recorded in the written contract, but further evidence should be sought as to the conduct of the parties, including as to the basis upon which Company S undertook the media campaign."*

5.43 To the extent possible, adjustments should be attempted to even out the difference between the comparables and the tested party. In the event such adjustments are not possible or where the situation requires too many adjustments, the reliability of the method used as well as the analysis

performed may require a revisit and probably it would be relevant to use an alternate method.

Market conditions

5.44 The market conditions in which uncontrolled transactions and international transactions [or the specified domestic transaction] are conducted must be evaluated to judge their comparability. Some of the different market conditions are:

- geographical location and size
- regulatory laws and government orders
- cost of labour and capital
- level of competition
- nature of market whether wholesale/retail
- overall economic development

5.45 Many of the above conditions are not amenable to reasonably accurate adjustments. The market conditions would be more relevant in determining the comparability only and therefore, unless transactions take place in the same market conditions, they will not be comparable.

5.46 An example of impact of the aforesaid differences is provided below:

The taxpayer is engaged in the manufacturing and trading of pharmaceutical products. The taxpayer has sold Product A to its AE in Thailand and also to a third party in Vietnam. The details are provided below:

Particulars	Sale to an AE	Sale to a third party
Country	Thailand	Vietnam
Quantity exported	30,000	1,000
Average selling price per unit (in USD)	10	20
Usage	Wholesale Trading	Retail Trading

Prima facie, one may say that the sale of Product A to the AE in Thailand is not at arm's length since the same product has been sold to a third party in Vietnam at a much higher price. However, one has to analyse the following factors before arriving at a conclusion:

a) Geographical differences, market conditions and size of the markets

The price at which a product is sold in one country cannot be compared with the price at which the same product is sold in another country because of the impact on account of geographical differences i.e. country specific demand/ supply factors, market conditions, regulations and government orders in force, level of competition, availability of substitute products, consumer purchasing power, etc. which could have a bearing on the price.

b) Volume

It is essential to evaluate the impact of the difference in volumes transacted with an AE and an independent third party respectively and accordingly make a suitable adjustment to eliminate the difference. For instance, in the above example, the quantity exported to the AE is 30,000 units vis-à-vis 1,000 to the third party. In an arm's length scenario, any third party would ideally ask for a volume discount. Therefore, unless it is demonstrated that the volume has no impact on the pricing of the transaction under consideration, an appropriate adjustment should be made.

c) Laws and government orders in force

The Government orders which are prevalent in Thailand and Vietnam would also be relevant and may need to be examined.

d) Level of market

Export prices of the same product sold to an AE and a third party respectively are bound to be different if the AE and the third party are at different levels of market in the entire value chain. In other words, in the above example, the AE operates as a wholesale trader which is the second level in the entire value chain whereas the third party operates as a retail trader which is the third level in the entire value chain.

As stated above, it would be critical to evaluate if reliably accurate adjustment on account of the aforesaid differences could be made to eliminate the differences, and in the absence of such an adjustment the transaction cannot be considered as comparable.

Business strategies, commercial considerations and economic principles

5.47 Economic principles and prevailing business conditions are fundamental to any transfer pricing evaluation. Therefore, business

strategies adopted by enterprises and market conditions faced by taxpayers are relevant factors for determining comparability with uncontrolled transactions/margins, and must be carefully considered during the comparability analysis. While the Indian TP regulations do not specifically recognize / provide for analysis of the business strategies, the OECD Guidelines duly recognize the need to analyse the business strategies while undertaking the comparability analysis. Some examples where business strategies/ economic realities could be relevant are:

- market strategies such as entry strategies, market penetration, loss leadership etc. followed by some companies may result in losses in the initial /interim years, as a part of a bigger strategy of building market share and reaping subsequent benefits therefrom.
- In case of start up operations, enterprises are generally not able to recover their initial set-up costs etc. during the initial few years of operations. It is not appropriate in such cases to compare the taxpayers profit/ margins with the margins earned by established comparables that are at a different stage of operations.

5.48 It is not necessary that all the criteria specified in Rule 10B(2) should be cumulatively applied while selecting comparable transactions. The relevance of these criteria depends on the method chosen as most appropriate method. For instance, when CUP is chosen as the most appropriate method, the nature of the property and service, the functions performed, risk undertaken and the terms of contract become critical in choosing the comparable transaction. It can generally be stated that criteria mentioned in rule 10B(2) need to be applied with more rigour when comparability is done at transactional level. But when the comparability is done at enterprise level, it becomes difficult to apply the criteria like contractual terms, nature of products or services etc. In other words, a rigorous analysis of functions performed, assets used and risk taken (FAR) is difficult when enterprise level comparisons are made in CPM, RPM, TNMM or PSM.

5.49 The above analysis is carried out to determine whether the uncontrolled transactions and international transactions or specified domestic transaction are comparable. Rule 10B(3) states that an uncontrolled transaction shall be comparable to an international transaction or specified domestic transaction if:

(i) none of the differences between transactions or enterprises are likely to materially affect the price or cost charged or paid in or profit arising from, such transactions in the open market; or

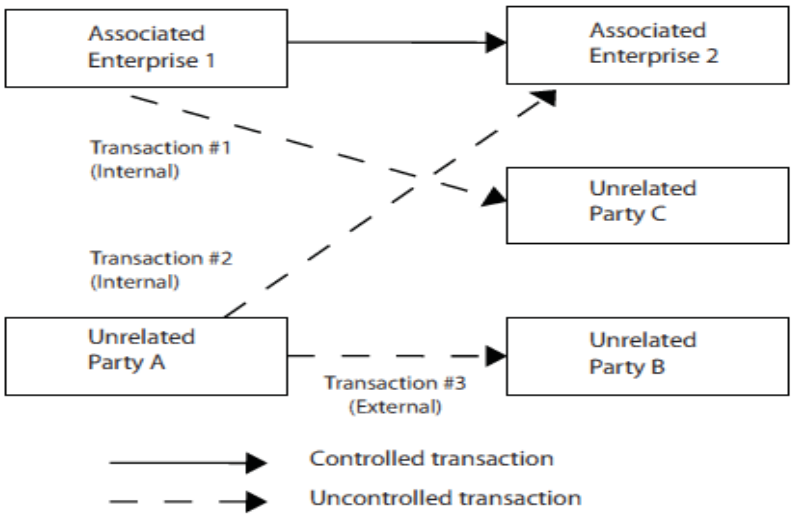
(ii) reasonably accurate adjustments can be made to eliminate material effects of differences.

5.50 If there are no differences, the transactions are comparable straight away. If the differences can be adjusted with reasonable accuracy, then the transactions are comparable, subject to adjustments. If, however, the differences cannot be adjusted with reasonable accuracy, the transactions are to be ignored and the search for comparable transactions would need to commence all over again. For instance, under TNMM where margins are to be compared, the margin of a 1,000crore company cannot be compared with that of a 10 crore company. The two most obvious reasons are the size of the two companies and the relative economies of scale under which they operate. The fact that they operate in the same market on a "level playing field" may not make them comparable enterprises. Some of the other factors/ criteria which could be considered for the purpose of comparability analysis, in order to identify the uncontrolled transactions are:

- level of fixed assets as a percentage of total sales, level of operating expenses as a percentage of sales;
- level of investment in intangible assets; and
- differences in the level of risks assumed by the parties viz. market risk, human resources, quality, contract risk, credit/ collection risks etc.

5.51 It is important to note that the transactions entered into by AEs with unrelated party ("internal comparables") would provide more reliable and accurate data as compared to transactions by and between third parties ("external comparables").OECD's Guidelines on Transfer Pricing recognize the fact that external comparables are difficult to obtain and, also, it may be incomplete and difficult to interpret. Hence for these reasons, internal comparables are preferred to external comparables.

5.52 To illustrate say, the controlled transaction involves the sale of watches by AE1, a watch manufacturer in Country1, to AE2, a watch importer in Country 2, which purchases, imports and resells the watches to unrelated watch dealers in Country 2.



In the above example, one can identify the following comparable transactions (assuming the characteristics of the products are same in all the scenarios)

(a) Internal comparables

The price charged for watches sold in a comparable uncontrolled transaction between AE 1and Unrelated Party C (i.e. transaction #1);

The price charged for watches sold in a comparable uncontrolled transaction between AE 2and Unrelated Party A (i.e. transaction #2)

(b) External comparables

The price paid for watches sold in a comparable uncontrolled transaction between Unrelated Party A and Unrelated Party B (i.e. transaction #3)

5.53 The analysis of the uncontrolled transactions is made to assess their comparability with the international transaction or specified domestic transaction.

5.54 A question arises as to what should be the number of comparable uncontrolled transactions to be selected. In other words, is it sufficient to have just one CUT or is it necessary that a reasonable number of CUTs should be selected? Both the Act and the Rules do not prescribe the number of CUTs to be chosen. An analysis of section 92C(2) read with the proviso thereto and Rule 10B(1) would show that selection of even one CUT is permissible. The proviso to section 92C(2) uses the expression “provided

that where more than ***one price*** is determined by the most appropriate method.....". This indicates that selection of multiple CUTs is not required as a rule and if an assessee adopts multiple CUTs the proviso would be applicable. This is further strengthened by the language adopted in Rule 10B(1) which clearly permits adoption of even a single CUT. For example, Rule 10B(1)(a)(i) uses the expression *".....in a comparable uncontrolled transaction, or a number of such transactions..." (emphasis supplied*). Similar expression is used in other clauses of Rule 10B(1). It is possible to have a single most appropriate CUT. Therefore, it may be said that if one most appropriate CUT is selected, such CUT would represent ALP. However, if more than one CUT is available the proviso to section 92C(2) would be applicable.

5.55 Rule 10B(4) provides that the data to be used in analysing the comparability of an uncontrolled transaction with an international transaction [or a specified domestic transaction] shall be the data relating to the financial year in which the international transaction [or the specified domestic transaction] has been entered into. Within the same financial year, the CUT may precede or succeed an international transaction.

5.56 The proviso to Rule 10B(4), further states that data relating to a period of not more than 2 years preceding such financial year may also be considered, if such data reveals facts which could have an influence on the determination of the transfer prices in relation to transactions being compared. Multiple year data has been permitted to be used vide Finance (No. 2) Act 2014.CBDT vide Notification No. 83/2015 has issued detailed guidance on the use of the multiple year data for the purpose of comparability analysis. Discussion on the same is detailed in Chapter 1 of this publication.

5.57 Further, the OECD in its Transfer Pricing Guidelines (2017) in Para 3.76 to 3.79 also supports the use of multiple year data. It states that in order to obtain a complete understanding of the facts and circumstances surrounding the controlled transaction, it generally might be useful to examine data from both the year under examination and prior years. The analysis of such information might disclose facts that may have influenced (or should have influenced) the determination of the transfer price. For example, the use of data from past years will show whether a taxpayer's reported loss on a transaction is part of a history of losses on similar transactions, the result of particular economic conditions in a prior year that increased costs in the subsequent year, or a reflection of the fact that a

product is at the end of its life cycle. Such an analysis may be particularly useful where a transactional profit method is applied. Multiple year data can also improve the understanding of long-term arrangements. Multiple year data will also be useful in providing information about the relevant business and product life cycles of the comparables. Differences in business or product life cycles may have a material effect on transfer pricing conditions that needs to be assessed in determining comparability. The data from earlier years may show whether the independent enterprise engaged in a comparable transaction was affected by comparable economic conditions in a comparable manner, or whether different conditions in an earlier year materially affected its price or profit so that it should not be used as a comparable. Multiple year data can also improve the process of selecting third party comparables for example by identifying results that may indicate a significant variance from the underlying comparability characteristics of the controlled transaction being reviewed, in some cases leading to the rejection of the comparable, or to detect anomalies in third party information.

5.58 The Other Method (OM) offers more flexibility and permits comparison by use of a "price which has been charged or paid, or would have been charged or paid" thereby allowing use of bonafide quotations, bids, proposals as comparable transactions or prices, and also economic and commercially justifiable models and similar approaches.

Power of Assessing Officer

5.59 According to section 92C(3), the Assessing Officer may himself proceed to determine the arm's length price if any of the following conditions are satisfied:

(i) the price charged or paid in an international transaction or specified domestic transaction has not been determined on the basis of the most appropriate method.

(ii) any information and document relating to an international transaction or specified domestic transaction has not been kept and maintained as mandated.

(iii) the information or data used in computation of the arm's length price is not reliable or correct.

(iv) the assessee had failed to furnish, within the specified time, any information or document which he was required to furnish.

5.60 If any of the above conditions are satisfied, the power to determine the arm's length price may be exercised in any proceeding for the assessment of income. The Assessing Officer also, is required to determine the arm's length price in accordance with section 92C(1) and (2) only, which states that the arm's length price will have to be arrived at on the basis of the most appropriate method. The Assessing Officer may determine the arm's length price on the basis of the material or information or document available with him. Even where such determination is made by the Assessing Officer, if more than one price may be determined by the most appropriate methods, the arm's length price shall be taken to be arithmetical mean of such prices.

5.61 The information, which the assessee may be called upon to furnish, in the absence of which the Assessing Officer would have power to substitute the arm's length price, should be that which the assessee has in his possession and is capable of being furnished.

5.62 The substitution of the arm's length price by the Assessing Officer shall be preceded by an opportunity of hearing being given to the assessee to show cause why such substitution of the arm's length price should not be made.

5.63 When the Assessing Officer substitutes the arm's length price on the basis of material or information or document in his possession, he may accordingly re-compute the total income of the assesse .No deduction under section 10A or 10B or Chapter VIA shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced. The restriction on the admissibility of an exemption / deduction is only under sections 10A or 10AA or 10B or Chapter VI-A. It appears that deduction under section 10C may be available on the enhanced income.

5.64 The income of one of the AEs may be recomputed by substituting the actual price paid/charged to another AE for any property or service with the arm's length price. When this substitution takes place it results in a re-computation of the total income of such AE. This re-computation would, however, not entitle the other AE to demand a re-computation of its total income. Consequently, it would not be entitled to a refund of any tax. For example, if XYZ Ltd. has paid royalty of INR 100 to its AE ABC Ltd., it would have deducted INR 20 as tax under section 115A read with section 195 and remitted the balance of INR 80 to ABC Ltd. If the Assessing Officer computes the arm's length price of royalty to be INR 75 and substitutes it for the actual amount paid, i.e. INR 100, ABC Ltd., will not able to demand either a re-

computation of the royalty income received by it or a refund of tax in excess of what is due on the basis of the arm's length price.

5.65 Section 92CA(2A) inserted by Finance Act 2011 with effect from 1 June 2011 provides that where an international transaction not referred to the Transfer Pricing Officer by the Assessing Officer comes to the notice of the Transfer Pricing Officer, then such international transaction can be examined by the Transfer Pricing Officer as if it was referred to him. Further, section 92CA(2B) inserted by Finance Act 2012 with retrospective effect from 1st June 2002 provides that where an assessee has not furnished an accountant's report under section 92E and an international transaction comes to the notice of the Transfer Pricing Officer, then such international transaction can be examined by the Transfer Pricing Officer as if it was referred to him.

Chapter 6
Methods of Computation of Arm's Length Price

Meaning of relevant terms

6.1 The various methods of computation of arm's length price are prescribed in Rule 10B.For this purpose, certain terms are defined in Rule 10A as under:

Rule 10A - Meaning of expressions used in computation of arm's length price.

For the purposes of this rule and rules 10AB to 10E-

(a) 'uncontrolled transaction' means a transaction between enterprises other than AEs, whether resident or non-resident;

(b) 'property' includes goods, articles or things, and intangible property;

(c) 'service' includes financial services; and

***(d) 'transaction' includes a number* of closely linked transactions.**

Further, Section 92F(v) of the Act defines the term 'transaction' as below:

'Transaction' includes an arrangement, understanding or action in concert -

(A) whether or not such arrangement, understanding or action is formal or in writing; or

(B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceeding.

6.2 Rule 10B stipulates the methods of determination of arm's length price. The relevant portion of the rule dealing with each of the methods prescribed is extracted here below and suitable explanations thereof are given along with illustrations encompassing several adjustments for enabling better understanding of the principles involved and the type of working called for.

Comparable Uncontrolled Price Method (CUP Method)

6.3 ***Rule 10B(1)(a) - Comparable uncontrolled price method, by which,-***

(i) the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;

(ii) such price is adjusted to account for differences, if any, between the international transaction [or the specified domestic transaction] and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the price in the open market;

(iii) the adjusted price arrived at under sub-clause (ii) is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction [or the specified domestic transaction].

6.4 The comparable uncontrolled price method is considered as one of the traditional transaction methods of determining the arm's length price. Two other traditional transaction methods are the Resale Price Method and the Cost Plus Method.

6.5 Typical transactions in respect of which the comparable uncontrolled price method may be adopted are:

(a) Transfer of goods;

(b) Provision of services;

(c) Royalty for use of Intangibles;

(d) Interest on loans.

6.6 The OECD in its Transfer Pricing Guidelines (2022) observes as under:

> *Para 2.14 "The CUP method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances. If there is any difference between the two prices, this may indicate that the condition of the*

commercial and financial relations of the AEs are not at arm's length, and that the price in the uncontrolled transaction may need to be substituted for the price in the controlled transaction."

6.7 Comparable uncontrolled transactions which involve a transaction between one of the enterprises and an uncontrolled party, are referred to as internal comparables. Comparable uncontrolled transactions which involve a transaction between two parties, neither of which is an associated enterprise, are called external comparables.

6.8 Further, OECD Transfer Pricing Guidelines (2022) has additionally incorporated the application of quoted prices under the CUP methodology while establishing arm's length nature of commodities' transfer between AEs. The guidelines have broadened the applicability of the CUP method and have alleviated the arm's length determination for commodity transactions.

Para 2.19 of the guidelines asserts, "*Under the CUP method, the arm's length price for commodity transactions may be determined by reference to comparable uncontrolled transactions and by reference to comparable uncontrolled arrangements represented by the quoted price*".

The following para are also relevant:

Para 2.20: *For the CUP method to be reliably applied to commodity transactions, the economically relevant characteristics of the controlled transaction and the uncontrolled transactions or the uncontrolled arrangements represented by the quoted price need to be comparable. For commodities, the economically relevant characteristics include, among others, the physical features and quality of the commodity; the contractual terms of the controlled transaction, such as volumes traded, period of the arrangements, the timing and terms of delivery, transportation, insurance, and foreign currency terms. For some commodities, certain economically relevant characteristics (e.g. prompt delivery) may lead to a premium or a discount. If the quoted price is used as a reference for determining the arm's length price or price range, the standardised contracts which stipulate specifications on the basis of which commodities are traded on the exchange and which result in a quoted price for the commodity may be relevant. Where there are differences between the conditions of the controlled transaction and the conditions of the uncontrolled transactions or the conditions determining the quoted*

price for the commodity that materially affect the price of the commodity transactions being examined, reasonably accurate adjustments should be made to ensure that the economically relevant characteristics of the transactions are comparable.

2.23: *A particularly relevant factor for commodity transactions determined by reference to the quoted price is the pricing date, which refers to the specific time, date or time period (e.g. a specified range of dates over which an average price is determined) selected by the parties to determine the price for commodity transactions.*

6.9 The steps involved in the application of this method are:

(i) Identify the price charged or paid in comparable uncontrolled transactions;

(ii) The above price should be adjusted for transaction level differences on the basis of functions performed, assets used and risks taken (FAR) analysis and enterprise level differences if any;

(iii) The adjusted price is the arm's length price;

6.10 On the aspect of comparability for application of the CUP method, the United Nations ('UN') in its Practical Manual on Transfer Pricing for Developing Countries (2021) has observed as under:

"B.4.2.2.3. Product comparability should be closely examined in applying the CUP Method. A price may be materially influenced by differences between the goods or services transferred in the controlled and uncontrolled transactions. The CUP Method is appropriate especially in cases where an independent enterprise buys or sells products that are identical or very similar to those sold in the controlled transaction or in situations where services are rendered that are identical or very similar to those rendered in the controlled transaction.

B.4.2.2.4. Although product comparability is important in applying the CUP Method, the other comparability factors should not be disregarded. Contractual terms and economic conditions are also important comparability factors. Where there are differences between controlled and uncontrolled transactions, adjustments should be made to enhance reliability".

6.11 Given that the CUP Method compares the prices of the products, it is warranted that high degree of similarity on all aspects (such as products / services, terms of the transaction etc.) be established between the products being compared.

The UN in the Practical Manual on Transfer Pricing for Developing Countries (2021) observes as under:

B.4.2.2.5 Reasonably accurate adjustment may be made for differences in:

- *The type and quality of the products. (E.g. unbranded Kenyan coffee beans as compared with unbranded Brazilian coffee beans);*
- *Delivery terms. (e.g.AE 1 sells similar bicycles to AE 2 and Unrelated Party C. All relevant information on the controlled and uncontrolled transactions is available to AE1, and hence it is probable that all material differences between the transactions can be recognized. The uncontrolled price can be adjusted for the difference in delivery terms to eliminate the effect of this difference on the price);*
- *Volume of sales and related discounts. (E.g.AE 1 sells 5000 bicycles to AE 2 for US$90 per bicycle, while it sells 1000 similar bicycles to Unrelated Party C. The effect of the differences in volume on price should be analysed, and if the effect is material, adjustments should be made perhaps based on volume discounts in similar markets);*
- *Product characteristics. (E.g. the uncontrolled transactions to an unrelated party involve bicycles on which modifications have been made. However, the bicycles sold in the controlled transactions do not include these modifications. If the product modifications have a material effect on price, then the uncontrolled price should be adjusted to take into account this difference in price);*
- *Contractual terms. (E.g. AE 1 sells the bicycles to AE 2 offering a 90 day credit term but the contract terms dictate that all sales to Unrelated Party C are Cash On Delivery);*
- *Risk incurred. (E.g. AE 1 is exposed to inventory risk related to sales by AE 2 and the risk that customers of AE 2 will default on their bicycle purchase loans; whereas in the transaction between AE 1 and Unrelated Party C, the latter is exposed to the inventory risk and the risk of its customers' default. This difference in risk allocation must be analysed and its effect on price quantified before AE 2's prices and Unrelated Party C's prices can be considered comparable); and*

- *Geographical factors. (E.g. AE 1 sells bicycles to AE 2 located in South Africa, while Unrelated Party C, to which it also sells the same bicycles, is located in Egypt. The only material difference that could be identified between the controlled and uncontrolled transactions concerns the locale. To perform adjustments to account for this difference one might have to consider, for example, differences in inflation rates between South Africa and Egypt, the competitiveness of the bicycle market in the two countries and differences in government regulations if relevant).*

B.4.2.2.6. Reasonably accurate adjustments may not be possible for:

- *Unique and valuable trademarks. (E.g. assuming AE 1 is engaged in manufacturing high value branded goods, and attaches its valuable trademark to the goods transferred in the controlled transaction, while uncontrolled transaction concerns the transfer of goods that are not branded. The effect of the trademark on the price of a watch may be material. However, it will be difficult, if not impossible, to adjust for effect of the trademark on price since the trademark is an intangible asset that is unique. If reasonably accurate adjustments cannot be made to account for a material product difference the CUP Method may not be the appropriate method for the transaction); and*
- *Fundamental differences in the products. (E.g. if the products being sold are significantly different from the products sold in the proposed comparable transaction it may not be possible to adjust for the product differences).*

  In such events, CUP method should not be used for the purpose of the analysis.

B.4.2.2.7. Notwithstanding the difficulties often associated with adjustments to address the sources of non-comparability described above, the need to make adjustments should not automatically prevent the use of the CUP Method. It is often possible to perform reasonably accurate adjustments. If reasonable adjustments cannot be performed the reliability of the CUP Method is decreased. In these circumstances another transfer pricing method may be more appropriate.

Examples where it may not be possible to make reasonably accurate adjustments are given below:

- Difference in the position of the entity in the value chain: (E.g. AE 1 sells bicycles to AE 2 as also to Unrelated Party C. Further, AE 2, after purchasing the bicycles from AE 1 sells the same bicycles to Unrelated Party D.

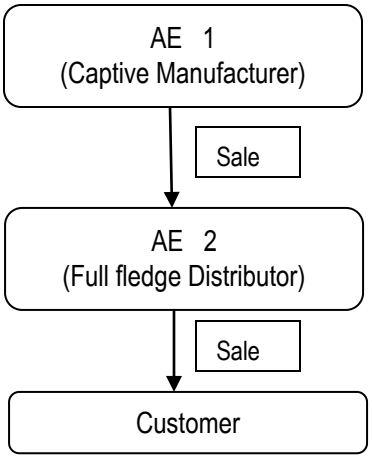
  When the bicycles are sold by AE 1 to Unrelated Party C, they are sold to the final customers for their own use, whereas the bicycles sold to AE 2, are not for the use of AE 2, but for further sales to Unrelated Party D.

  From the above, it can be seen that there is an added level in the entire value chain, when the sales are to AE 2 vis-a-vis the sales made by AE 1 to Unrelated Party C. The position of an entity in the value chain impacts the price at which a product is sold due to the additional functions that may be performed by the said entity.

  In such a case, it may not be possible to compare the transaction of sale of bicycles by AE 1 to Unrelated Party C with the transaction of sale by AE 2 to Unrelated Party D, due to the unavailability of accurate and reliable data pertaining to the margin earned by AE 1 from the sales to Unrelated Enterprise C.

- Difference in the characterization of the entity: (E.g. AE 1 is a captive manufacturer engaged in the manufacturing of bicycles for AE 2. AE 2 is a full fledge distributor engaged in the distribution of the bicycles to the customers. The pricing for the sale made by AE 2 to the customers is governed by the prevailing market conditions.

  In such a case, it may not be possible to compare the transaction of sale of bicycles by AE 1 to AE 2 with the transaction of sale of bicycles by AE 2 to the customers, due to the differences in the functions performed, assets employed and the risks undertaken by AE1 and AE 2 and the consequent difference in their characterisation and position in the value chain with respect to the transaction of sale of bicycles.)



6.12 The application of the CUP method can be understood with the following example:

AE1 Ltd., is an Indian company. The shareholding pattern of AE1 Ltd., is as follows:

Shareholder's name	Status	% holding
AE2 Ltd.	Foreign Company	30
AE3 Ltd.	Indian Company	30
Financial Institutions	Indian Company	10
Public		30

AE1 Ltd., is a manufacturer of compact disc (CD) writers and its customers, inter alia, include AE2 Ltd, and M Ltd, an unrelated party.

AE1 Ltd., during the year has supplied 10,000 nos. of the product to AE2 Ltd. at a price of INR 2,000 per unit and 200 nos. of the same product to AE3 Ltd., at a price of INR 2,750 per unit. AE1 Ltd., has sold 100 units of the same product to M Ltd.at INR 3,000 per unit.

Comparison of the international transaction vis-a-vis comparable uncontrolled transaction

Particulars	International transaction (with AE2 Ltd.)	Comparable uncontrolled transaction (with M Ltd.)	Remarks
Terms	Freight on Board ('FOB')	Cost Insurance and Freight ('CIF')	Freight and insurance INR 550
Quantity discount	Yes	No	Quantity discount of INR 10 per product and a free gift (CD) of INR 20
Credit	One month	Cash and carry	Cost of credit 1.25% per month
Warranty	No warranty	Six months warranty	Cost of warranty is INR 250 per unit

Factors to be considered while determining ALP:

(a) In the CUP method, one has to start from the price charged in the case of the comparable uncontrolled transaction.

(b) In this illustration one has to start with the price charged by AE1 Ltd., to M Ltd.

(c) The price charged to M Ltd., will have to be increased by the value of credit which is at the rate at 1.25% p.m. (i.e. 15% p.a.).If the similar credit were offered to M Ltd., the price charged to M Ltd. would have been higher, after factoring this cost.

(d) The price charged to M Ltd., will have to be reduced by the following;

  (i) INR 550 representing the freight and insurance –This is for the reason that if the price to M Ltd., had been on FOB basis, it would have been less by INR 550.

  (ii) INR 250 per unit representing the estimated cost of warranty execution for a period of six months on the basis of a technical analysis and past experience - This is for the reason that if the warranty was not given, the price to M Ltd. would have been lower, without factoring this cost.

(iii) INR 10 representing the cost of each CD – This is for the reason that if similar gift had been offered to M Ltd., the effective price to M Ltd., would have been less.

(iv) INR 20 representing a quantity discount - This is for the reason that if similar discount had been offered to M Ltd., the effective price to M Ltd., would have been less.

Computation of arm's length price under the comparable uncontrolled price method

The following points are to be noticed:

(i) All adjustments in the course of applying this method are to be made to the price charged in the uncontrolled transaction. The presence or absence of any specific features in the uncontrolled transaction as compared to the international transaction [or the specified domestic transaction] is to be adjusted for. These features are to be evaluated in monetary terms. This is a subjective process based on objective facts.

(ii) Only differences that would materially affect the price in the open market are required to be adjusted. Two points may be noted. Firstly, materiality would have to be judged in the light of various circumstances. If there are numerous adjustments, which are individually not material but collectively material, the necessary adjustments are required to be made. Secondly**,** the term 'open market', though not defined, would mean a transaction between a knowledgeable and a willing purchaser and a knowledgeable and willing seller where neither of them is influenced or compelled to act in a particular manner.

Resale Price Method (RPM)

6.13 ***Rule 10B(1)(b) resale price method, by which,-***

(i) The price at which property purchased or services obtained by the enterprise from an AE is resold or are provided to an unrelated enterprise, is identified;

(ii) such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar

services, in a comparable uncontrolled transaction, or a number of such transactions;

(iii) the price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;

(iv) the price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;

(v) the adjusted price arrived at under sub-clause (iv) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the AE.

6.14 Typical transactions where RPM may be adopted are distribution of goods involving little or no value addition. Also, it is pertinent to note that while CUP method is a two sided method (wherein the said method can be applied using details / data of either of the transacting parties), RPM is a one sided method wherein only the margins earned by one of the transacting party i.e., the distributor, can be analysed / evaluated.

6.15 The OECD in its Transfer Pricing Guidelines (2022) has observed as under:

> *Para 2.35 - An appropriate resale price margin is easiest to determine where the reseller does not add substantially to the value of the product. In contrast, it may be more difficult to use the resale price method to arrive at an arm's length price where, before resale, the goods are further processed or incorporated into a more complicated product so that their identity is lost or transformed (e.g. where components are joined together in finished or semi-finished goods). Another example where the resale price margin requires particular care is where the reseller contributes substantially to the creation or maintenance of intangible property associated with the product (e.g. trademarks or trade names) which are owned by an AE. In such cases, the contribution of the goods originally transferred to the value of the final product cannot be easily evaluated.*

Para 2.36 - A resale price margin is more accurate where it is realised within a short time of the reseller's purchase of the goods. The more time that elapses between the original purchase and resale the more likely it is that other factors – changes in the market, in rates of exchange, in costs, etc. – will need to be taken into account in any comparison."

6.16 On application of RPM, the UN in the Practical Manual on Transfer Pricing has observed as under:

"4.3.4.3 While product differences may be more acceptable in applying the Resale Price Method as compared to the CUP Method, the property transferred should still be broadly similar in the controlled and uncontrolled transactions. Broad differences are likely to reflect differences in functions performed, and therefore gross margins earned, at arm's length.

4.3.4.4 Example:

The compensation for a distribution company should be the same whether it sells washing machines or dryers, because the functions performed (including risks assumed and assets used) are similar for the two activities. It should be noted, however, that distributers engaged in the sale of markedly different products cannot be compared. The price of a washing machine will, of course, differ from the price of a dryer, as the two products are not substitutes for each other. Although product comparability is less important under the resale price method, greater product similarity is likely to provide more reliable transfer pricing results. It is not always necessary to conduct a resale price analysis for each individual product line distributed by the sales company. Instead, the resale price method can be applied more broadly, for example based on the gross margin a sales company should earn over its full range of broadly similar products."

From the above, it can be observed that RPM is more tolerant as compared to CUP toward product differences. RPM thus focuses on functional comparability. A similar level of compensation is expected for performing similar functions across different activities.

6.17 The UN in the Practical Manual on Transfer Pricing has explained that RPM can be used even for a commission agent:

> *4.3.1.5 Other approaches are possible. For example, if the associated enterprise acts as a sales agent that does not take title to the goods, it is possible to use the commission earned by the sales agent (represented as a percentage of the uncontrolled sales price of the goods concerned) as the comparable gross profit margin.*

6.18 The steps involved in the application of this method are:

(i) identify the international transaction [or specified domestic transaction] of purchase of property or services;

(ii) identify the price at which such property or services are resold or provided to an unrelated party (resale price);

(iii) identify the normal gross profit margin in a comparable uncontrolled transaction whether internal or external. The normal gross profit margin is that margin which an enterprise would earn from purchase of the similar product from an unrelated party and the resale of the same to another unrelated party;

(iv) deduct the normal gross profit from the resale price;

(v) deduct expenses incurred in connection with the purchase of goods;

(vi) adjust the resultant amount for the differences between the uncontrolled transaction and the international transaction [or the specified domestic transaction]. These differences could be functional and other differences including differences in accounting practices. Further these differences should be such as would materially affect the amount of gross profit margin in the open market;

(vii) the price arrived at is the arm's length price of the international transaction [or the specified domestic transaction];

6.19 The application of RPM can be understood with the following example:

AE1 Ltd., is an Indian company. The shareholding pattern of AE1 Ltd., is as follows;

Shareholder's name	Status	% holding
AE2 Ltd.	Foreign Company	30
AE3 Ltd.	Indian Company	30

Shareholder's name	Status	% holding
Financial Institutions	Indian Company	10
Public		30

AE1 Ltd., trades in compact disc (CD) writers. AE1 Ltd., procures CD writers both locally and in the international market. Its imports consist of CD writers purchased from AE2 Ltd. as well as other manufacturers (Non AEs).

AE1 Ltd., during the year purchased 100 CD writers from AE2 Ltd. at INR 2,900 per unit. These are resold to A Ltd., an unrelated party, at a price of INR 3,000 per unit.

AE1 Ltd., has also purchased similar products from an unrelated supplier, viz. K Ltd., and has resold the same to M Ltd., who is also an unrelated party and has earned a gross profit of 15% on sales.

Analysis of the sales transactions

Particulars	Sales to A Ltd.	Sales to M Ltd.	Impact on GP
Price	Ex shop	FOB Destination with cost of freight and insurance estimated at 2% of GP	Impact of Freight and insurance on GP is 2% as the sale price increases but corresponding expenses are not debited to trading account but to profit and loss account
Quantity discount	Yes - the cost of the same is estimated at 1% of GP	No	Impact of quantity discount on GP is 1%
Free gifts	No	One CD pack for every CD writer with no change in sale price	As cost of gift is not debited to trading account but to P &L Account, there is no impact

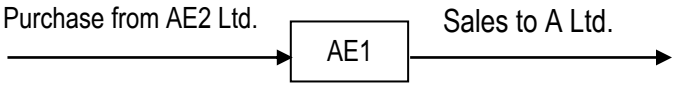
Particulars	Sales to A Ltd.	Sales to M Ltd.	Impact on GP
			on GP
Warranty	No	6 months warranty (without change in sale price) - cost of warranty is estimated at INR 250 per unit	As cost of warranty is not debited to trading account but to P&L Account, there is no impact on GP

Analysis of the purchase transactions

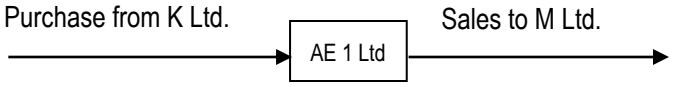
Particulars	Purchase from AE2 Ltd. (International transaction)	Purchase from K Ltd.	Impact
Customs duty	INR 25 per unit	INR25 per unit	No impact
Freight inwards	INR 10 per unit	Nil	Cost of purchase from K Ltd., is lower
Quantity discount	INR 15 per unit	Nil	Cost of purchase from K Ltd., is higher
Warranty	Nil	6 months warranty purchase price remaining unchanged	No impact

Factors to be considered while determining ALP:

(a) In the above example, the international transaction is the purchase transaction entered into by AE1 Ltd., with AE2 Ltd. which should be determined on the basis of arm's length price;



(b) The comparable uncontrolled transaction is the purchase transaction entered into by AE1 Ltd., with K Ltd.



(c) The starting point for arriving at the ALP of such purchase transaction is the resale price charged to A Ltd. viz. INR3,000 [Rule 10B(1)(b)(i)].

(d) From the said resale price, the normal gross profit margin which AE1 Ltd., would earn in a comparable uncontrolled transaction should be reduced. In this example, the actual gross profit margin earned by AE 1 Ltd., in respect of its purchase from K Ltd, and its resale to M Ltd, is 15%.

(e) The following adjustments are made to arrive at the normal GP;

Actual gross profit margin with M Ltd.	15%
Less:	
1. Difference between Ex-shop and FOR prices	2%
2. Difference due to quantity discount	1%
Normal gross profit margin with M Ltd.	12%

Note: While arriving at normal gross profits from the actual gross profits, only the differences in the sale transactions of AE1 Ltd., with A Ltd., and M Ltd., have been taken. The differences in the purchase transactions of AE 1 Ltd., with AE2 Ltd. and K Ltd., affecting the gross profits are taken separately as provided in sub rule (iv).

(f) The resale price of INR3000. to M Ltd., is reduced by the normal gross profit margin of 12%. The resultant cost of sales is INR2640 (i.e. 3000-360) [Rule 10B(1)(b)(ii)].

(g) The cost of sales so arrived at is reduced by the expenses incurred in connection with the purchase (international transaction) i.e. freight of INR 10 and customs duty of INR25. The resultant amount is INR 2605 (i.e. 2640-25-10) [Rule 10B(1)(b)(iii)].

(h) The above amount is further adjusted to take into account functional and accounting differences between the international transaction and the comparable uncontrolled transaction with AE2 Ltd the purchase

transaction with K Ltd., which will affect the amount of gross profit margin as explained below.

(i) The aforesaid amount of INR 2605 should be increased by INR10 being the freight incurred by AE1Ltd., in the case of purchase from AE2Ltd., but not incurred in case of purchase from K Ltd., This is for the reason that if a similar freight had been paid in respect of transaction with K Ltd, the gross profit margin from K Ltd., would have been lower and the resultant price would have been higher.

(j) A decrease by INR15 representing the quantity discount allowed by AE2 Ltd., is to be made. This is for the reason that if a similar discount had been allowed in respect of transaction with K Ltd, the gross profit margin from K Ltd., would have been higher and the resultant price would have been lower.

Determination of arm's length price under RPM

1. AEs : AE1 Ltd. and AE2 Ltd.
2. Other enterprises : K Ltd. and M Ltd.
3. International transaction : AE1 Ltd. and AE2 Ltd.
4. Bought from AE2Ltd. and resold to : A Ltd.
5. CUT is purchase from K Ltd. and sales to M Ltd.

Details	INR /unit
Price paid to AE2 Ltd.(FOB)	2,900
Quantity	100
Purchases cost (actual) (A)	2,90,000
Actual GP Margin on sales to M Ltd.(%)	15
Normal GP Margin on sales to M Ltd.(%)	12
Price charged to A Ltd.	3,000
Less: Normal GP margin	360
Balance	2640
Less: Expenses connected with purchase (freight & customs duty paid)	35
Price before adjustment	2,605

Add:	
Freight incurred in case of purchase from AE2 Ltd.	10
Sub total	10
Less :	
Quantity discount allowed by AE2 Ltd.	15
Sub total	15
Arm's length price	2,600
Adjusted purchase cost (B)	2,60,000
Income increases by (A-B)	30,000

The following points are to be noticed:

(i) RPM is to be adopted only when goods purchased from an AE are resold to unrelated parties.

(ii) In contrast to the CUP Method, the reliability of RPM is influenced by factors that have less effect on the price of a product than on the costs of performing functions. Such differences could affect gross margins [e.g. the composition of Cost of Goods Sold ('COGS')]. These factors could include cost structures (e.g. accounting practices), business experience (e.g. start-up phase or mature business) or management efficiency.

(iii) As provided in Rule 10B(1)(b)(iii), the expenses incurred in connection with the purchase from AE are to be reduced from cost of sales. In RPM, the arm's length purchase price is arrived at reducing the normal gross profit margin from the resale price as the first step. If the computation is stopped at this step itself, the derived purchase amount would be inclusive of such expenses. It is therefore necessary to reduce such expenses in arriving at the arm's length purchase price.

(iv) Adjustments have to be made also for accounting practices apart from functional and other differences. Differences in accounting practices may be because:

  (a) sales and purchases have been accounted for inclusive of taxes or exclusive of taxes;

  (b) method of pricing the goods namely, FOB or CIF;

  (c) fluctuations in foreign exchange.

(v) The comparability analysis should try to take into account whether the reseller has the exclusive right to resell the goods, because exclusive rights may affect the resale price margin.

(vi) In actual practice, the resale in any financial year may be also out of opening stock. Similarly, the goods purchased during the said year may remain in closing stock. Under the RPM, the arm's length price of purchases from AE during the financial year should be determined. The process of determination under Rule 10B(1)(b) culminates in the cost of sales rather than value of purchase during the year. This 'cost of sales' should be converted into 'value of purchase'. For this purpose, the closing stock of goods purchased from AE should be added and the opening stock of purchases from AE should be deducted. The focus here is to identify cost of goods sold and make adjustment therein rather than amount of purchases only.

(vii) Further, it may not possible to reliably compute the gross margin of the comparables since in India at this point of time there is no uniform accounting convention which is applicable for computing the gross margin. The companies could follow different accounting principles while recording a particular expense item. Hence, it is not possible to ensure that all the expense items have been uniformly accounted by all comparables while computing the gross margin. For example – Reporting of discounts, transportation cost, insurance and warranty cost, valuations of the inventory, etc. As a result, application of RPM using external comparable transaction could be a challenge considering the availability of the reliable data.

6.20 It is important to understand the characterization of the AEs (based on the detailed functional analysis) before one selects RPM as the most appropriate method. This can be explained by way of an example provided below:

ABC Inc. owns valuable patents to manufacture the bicycles and has a valuable trade name. ABC Inc.'s subsidiary i.e. ABC Ltd purchases the bicycles from ABC Inc. and resells the bicycles to unrelated dealers in India. The bicycle is new in the Indian market and is not known to the Indian consumers. Further, it is assumed that comparable uncontrolled transactions are not available. The financial data under two scenarios is provided below:

Particulars	Case 1	Case 2
Sales to third parties	1,000	1,000
Cost of goods sold	700	700
Gross Profit	300	300
Gross Profit / Sales ratio	30%	30%
Value added expenses ('VAE')	50	250
VAE / Sales	5%	25%

In this case, it is important to analyse the following aspects before selecting the most appropriate method:

Case 1

- It is important to analyse the functions performed, assets employed and the risks undertaken by ABC Inc. as well as ABC Ltd. with respect to the transaction of purchase of bicycles by ABC Ltd. from ABC Inc., to determine the characterisation of the above entities and identify the tested party.
- ABC Inc. owns valuable intangibles, performs R&D activities and generally has operations that are more complex than those of the sales company (i.e. ABC Ltd).
- On the other hand, ABC Ltd is engaged in purchase of bicycles and selling it to the third parties without undertaking any significant value addition on its own.
- VAE/Sales maybe an important factor to evaluate the intensity of functions as advocated in Sony Ericsson Mobile Communications India Pvt. Ltd (ITA No 16/2014) Ruling by the High Court.
- Since the VAE in case 1 is only 5% of the sales, it can be said that the marketing spend needed create customer awareness to facilitate sale of product in the Indian market is borne by ABC Inc. and the VAE incurred by ABC Ltd is with respect to normal selling function.
- It should be noted that a foreign entity may be selected as the tested party if it is the less complex entity and if reliable data in respect of the international transaction under consideration is available.
- From the above functional analysis, ABC Ltd can be characterised as a normal risk bearing distributor and ABC Inc. is the entrepreneurial

entity. As seen from the characterisation, ABC Inc. is more complex entity and therefore, it cannot be considered as a tested party. As result, ABC Ltd has been selected as a tested party in this case.

- Since comparable uncontrolled transactions are not available, the CUP Method cannot be applied as the most appropriate method.
- ABC Ltd is engaged in purchase of bicycles from ABC Inc. are further selling it to a third party without any significant value addition. The gross profit realised by ABC Ltd can be compared using RPM as the most appropriate method in this case.

Case 2

- The VAE in case 2 is significant i.e. 25% of the sales. It can be said that ABC Ltd is engaged in developing the marketing intangible in the Indian market for ABC Inc.
- This is the case where the reseller contributes substantially to the creation or maintenance of intangible property associated with the product (e.g. trademarks or trade names) which are owned by an AE. In such cases, the contribution of the goods originally transferred to the value of the final product cannot be easily evaluated.
- Further, this activity of brand building may require to be separately evaluated for testing the arm's length nature. In case the activity of reselling and brand building are inextricably inter linked and cannot be separately evaluated, there may arise a need to evaluate a different method for testing the arm's length nature of the aforementioned closely linked transactions.
- In such cases, RPM may not be the most appropriate method and one has to take recourse to other methods prescribed under the Act.

6.21 Further, one should also evaluate the pricing mechanism, contractual terms, roles and obligations as well as the functional profile of the parties to a transaction, before the determination of the most appropriate method to benchmark the international transaction [or the specified domestic transaction].

For example – A distributor could be awarded a net profit on sales for performing the routine distribution functions. However, in such a scenario RPM may not be the most appropriate method since RPM takes into account

the gross margin earned by the distributor. In such a situation, TNMM could be considered as the most appropriate method.

Typically, RPM may be the most appropriate method in case of a normal risk distributor, who is awarded a reasonable level of gross margin for the functions performed.

Cost Plus Method (CPM)

6.22 ***Rule 10B(1)(c)cost plus method, by which,-***

(i) the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an AE, are determined;

(ii) the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;

(iii) the normal gross profit mark-up referred to in sub-clause (ii) is adjusted to take into account the functional and other differences, if any, between the international transaction [or the specified domestic transaction] and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;

(iv) the costs referred to in sub-clause (i) are increased by the adjusted profit mark-up arrived at under sub-clause (iii);

(v) the sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise.

6.23 Typical transactions where CPM may be adopted are:

(a) provision of services;

(b) joint facility arrangements;

(c) transfer of semi finished goods;

(d) long term buying and selling arrangements.

6.24 The OECD in its Transfer Pricing Guidelines (2022) states as follows:

Para 2.45 "This method probably is most useful where semi finished goods are sold between associated parties, where associated parties have concluded joint facility agreements or long-term buy-and-supply arrangements, or where the controlled transaction is the provision of services."

2.46 The cost plus mark-up of the supplier in the controlled transaction should ideally be established by reference to the cost plus mark-up that the same supplier earns in comparable uncontrolled transactions ("internal comparable"). In addition, the cost plus mark-up that would have been earned in comparable transactions by an independent enterprise may serve as a guide ("external comparable").

UN Practical Manual on Transfer Pricing for Developing Countries (2021) states as under:

4.4.8.1 The CPM is typically applied in cases involving the intragroup sale of tangible property where the related party manufacturer performs limited manufacturing functions or in the case of intragroup provision of services.

The method usually assumes the manufacturer or service provider has low risks, because the level of the costs will then better reflect the value being added and hence the market price.

4.4.8.2 The CPM is also generally used in transactions involving a contract manufacturer, a toll manufacturer or a low risk assembler which does not own product intangibles and assumes little risk. The related customer involved in the controlled transaction will generally be much more complex than the manufacturer (or service provider) in terms of functions performed (e.g. conducting marketing and selling functions, coordination of production and sales, giving instructions to the contract manufacturer about the quantity and quality of production, and purchasing raw materials in some cases), risks assumed (e.g. market risk, credit risk and inventory risk) and assets used or contributed (e.g. product or other intangibles). The contract manufacturer is thus the less complex and as such should be the tested party in the transfer pricing analysis.

4.4.8.3 The CPM is usually not a suitable method to use in transactions involving a fully-fledged manufacturer which owns or develops unique and valuable product intangibles as it will be very difficult to locate independent manufacturers with comparable product intangibles. That is, it will be hard to establish a profit mark-up that is required to remunerate the fully-fledged manufacturer for its unique and valuable intangibles. In a typical transaction structure involving a fully-fledged manufacturer and related sales companies (e.g. commissionaires), the sales companies will normally be the less complex entities involved in the controlled transactions and will therefore be the tested party in the analysis. The RPM is typically more easily applied in such cases

Also, it is pertinent to note that similar to RPM, CPM is also a one sided method wherein the margins earned by the manufacturer / service provider can be tested under this method.

6.25 The steps involved in the application of this method are:

(i) Determine the direct and indirect cost of production in respect of property transferred or service provided to an AE.

(ii) Identify one or more comparable uncontrolled transactions for same or similar property or service.

(iii) Determine normal gross profit mark-up on costs in the comparable uncontrolled transaction. Such costs should be computed according to the same accounting norms. In other words, the components of costs of comparable uncontrolled transaction should be the same as those of international transaction [or the specified domestic transaction].

(iv) Adjust the gross profit mark-up to account for functional and other differences between the international transaction [or the specified domestic transaction] and the comparable uncontrolled transaction. Such adjustments should also be made for enterprise level differences.

(v) The direct and indirect cost of production in the international transaction [or the specified domestic transaction] is increased by such adjusted gross profit mark-up.

(vi) The resultant figure is the arm's length price.

6.26 With respect to CPM, The UN in the Practical Manual on Transfer Pricing states as below:

> *"As with the RPM, and for the same reasons, close similarity of products in the controlled and uncontrolled transactions is less important under the Cost Plus Method than under the CUP Method, while functional comparability (including comparability of risks assumed and assets used) is more important. However, because significant differences in products may necessarily result in significant differences in the functions, the controlled and uncontrolled transactions should ideally involve the manufacturing of products within the same product family. (para 4.4.5.2)*

6.27 An example on importance of functional similarity is provided below:

A Limited is engaged in manufacturing of pet bottles and sales to third party customers in the Indian market. It is also engaged in selling the manufactured pet bottles to the AE outside India. The AE further sells the pet bottles to third party customers in their respective markets.

The functional profile of A Limited with respect to sales to third parties in domestic market and AE is provided below:

Functions performed	Domestic business (Unrelated)	Export business (AE)
Manufacturing function	√	√
Marketing and distribution function	√	X
After sales support	√	X
Inventory management	√	X

Risks assumed	Domestic business	Export business
Market risk	√	X
Credit risk	√	X
Foreign exchange risk	X	√
Inventory risk-	√	X

From the above, one could see that there are differences in the functional profile of A Limited with respect to sales made to third parties in the domestic market and to AEs. Owing to such differences, while CPM can be used for

analyzing the transaction pertaining to export to the AE (by A Limited), however the gross margins earned by A Limited from such exports cannot be compared with the gross margin earned by A Limited from sale to third party customers in the Indian market.

6.28 The OECD in its Transfer Pricing Guidelines (2022) has stated the following in relation to application of CPM:

> *2.51 For this purpose, it is particularly important to consider differences in the level and types of expenses – operating expenses and non-operating expenses including financing expenditures – associated with functions performed and risks assumed by the parties or transactions being compared. Consideration of these differences may indicate the following:*
>
> *a) If expenses reflect a functional difference (taking into account assets used and risks assumed) which has not been taken into account in applying the method, an adjustment to the cost plus mark-up may be required.*
>
> *b) If the expenses reflect additional functions that are distinct from the activities tested by the method, separate compensation for those functions may need to be determined. Such functions may for example amount to the provision of services for which an appropriate reward may be determined. Similarly, expenses that are the result of capital structures reflecting non-arm's length arrangements may require separate adjustment.*
>
> *c) If differences in the expenses of the parties being compared merely reflect efficiencies or inefficiencies of the enterprises, as would normally be the case for supervisory, general, and administrative expenses, then no adjustment to the gross margin may be appropriate.*
>
> *2.55 In principle historical costs should be attributed to individual units of production, although admittedly the cost plus method may overemphasize historical costs. Some costs, for example costs of materials, labour, and transport will vary over a period and in such a case it may be appropriate to average the costs over the period. Averaging also may be appropriate across product groups or over a particular line of production.*

Further, averaging may be appropriate with respect to the costs of fixed assets where the production or processing of different products is carried on simultaneously and the volume of activity fluctuates. Costs such as replacement costs and marginal costs also may need to be considered where these can be measured and they result in a more accurate estimate of the appropriate profit.

6.29 The application of CPM can be understood with the following example:

AE1 Ltd., is an Indian company. The shareholding pattern of AE1 Ltd., is as follows:

Shareholder's name	Status	% holding
AE2 Ltd.	Foreign Company	30
AE3 Ltd.	Indian Company	30
Financial Institutions	Indian Company	10
Public		30

AE1 Ltd., an unrelated party, develops software for various customers, who include AE2 Ltd. and M Ltd.

AE1 Ltd., during the year billed AE2 Ltd. INR 2,00,000. The total cost (direct and indirect) for executing this work was INR 1,75,000.

AE1 Ltd., provided similar services to M Ltd., and earned a gross profit (GP) of 50% on costs.

Analysis of transactions

Particulars	Transactions with AE2 Ltd.	Transactions with M Ltd.
Technology support received	Yes	No - value of technology support incurred by AE1 Ltd., is INR 17,500
Discount offered	Yes – Discount offered is INR 8,750	No
Expenses incurred by AE1 towards marketing	No	Yes – expenses incurred INR 13,125
Credit	Yes – Cost of credit is estimated at INR 2,625	No

Factors to be considered while determining ALP:

(a) In CPM, one has to start with the gross profit mark-up which the enterprise earned in a comparable uncontrolled transaction. In this example, the comparable uncontrolled transaction is between AE1 Ltd., and M Ltd.

(b) Such gross profit (GP) markup needs to be adjusted for the following:

- As AE1 Ltd., did not receive the technology support from M Ltd., it has priced its services higher resulting in it earning a higher GP with M Ltd.. The value of technology support of INR17,500 received from AE2 Ltd. is 10% of cost. Therefore, the GP with M Ltd., has to be reduced by 10%.
- AE1 Ltd. did not provide discount to M Ltd., as volume of business from M Ltd., was not as high as that from AE2 Ltd. Had AE1 Ltd., offered similar discount to M Ltd., the GP with M Ltd., would have been lower. The discount of INR 8,750 offered to AE2 Ltd. is 5% of cost. Therefore, the GP with M Ltd., has to be decreased by 5%.
- AE1 Ltd., has incurred INR 13,125 towards marketing functions in respect of its transactions with M Ltd., which is 7.5% of its cost. However, in its transactions with AE2 Ltd. the said functions are assumed by AE2 Ltd. Had AE1 Ltd., not incurred similar expenses with M Ltd., it would have settled for a lower GP. Therefore, the GP with M Ltd., has to be reduced by 7.5%.
- The cost of credit of INR 2,625 provided by AE1 Ltd., to AE2 Ltd. is 1.5% of its cost. However, in its transactions with M Ltd., such credit is not provided. Had AE1 Ltd., provided similar credit to M Ltd., it would have increased its price resulting in a higher GP. Therefore, the GP with M Ltd., has to be increased by 1.5%.

(c) The resultant gross profit mark-up is the arm's length gross profit mark up.

(d) The costs of AE1 Ltd., in its transactions with AE2 Ltd. should be increased by the arm's length gross profit mark up to arrive at the arm's length income.

Determination of arm's length price under costs plus method

1. AE	:	AE2 Ltd.
2. Other unrelated enterprise	:	M Ltd
3. International transaction	:	AE1 Ltd and AE2 Ltd
4. Comparable uncontrolled transaction	:	AE1 Ltd. and M Ltd

Determination of arm's length gross profit mark up

Details	%
Gross profit mark up in case of M Ltd.	50.00%
Less :	
1. Technology support from AE2 Ltd.	10.00%
2. Quantity discount to AE2 Ltd not to M Ltd.	5.00%
3. Marketing functions performed by AE1Ltd., in respect of M Ltd.	7.50%
Sub total	22.50%
Add :	
1. Cost of credit to AE2. Ltd.	1.50%
Sub total	1.50%
Arm's length gross profit mark up	29.00%

Determination of arm's length price

Details	Amount/ %
Direct and indirect costs incurred by AE1 Ltd. in respect of transactions with AE2 Ltd.	1,75,000
Arm's length gross profit mark up	29.00%
Arm's length income (A)	2,25,750
Actual price charged to AE2 Ltd. (B)	2,00,000
Income increases by (A-B)	25,750

6.30 It is also important to note that the cost plus pricing is different from CPM. This could be explained by way of the following example:

A Limited is a captive service provider working with an assured return of 10% on the total cost incurred in connection with provision of such services to the Group. In this case, one could see that though the pricing is based on the cost plus mark-up, the same cannot itself lead to a conclusion that CPM is the most appropriate method. The costs that A Limited would be recovering from the Group may involve costs incurred below the gross profit level and thus, CPM may not be applicable in such a scenario.

The following points are to be noticed:

(i) In this method, the direct and indirect costs of production are to be determined. The terms 'direct' or 'indirect' costs are however not defined. A reference may therefore be made to the industry practice as well as the pronouncements of the ICAI.

OECD Transfer Pricing Guidelines (2022) mentions about direct and indirect costs as under:

2.53: *While precise accounting standards and terms may vary, in general the costs and expenses of an enterprise are understood to be divisible into three broad categories. First, there are the direct costs of producing a product or service, such as the cost of raw materials. Second, there are indirect costs of production, which although closely related to the production process may be common to several products or services (e.g. the costs of a repair department that services equipment used to produce different products). Finally, there are the operating expenses of the enterprise as a whole, such as supervisory, general, and administrative expenses.*

2.54: *The distinction between gross and net profit analyses may be understood in the following terms. In general, the cost plus method will use mark ups computed after direct and indirect costs of production, while a net profit method will use profits computed after operating expenses of the enterprise as well. It must be recognised that because of the variations in practice among countries, it is difficult to draw any precise lines between the three categories described above. Thus, for example, an application of the cost plus method may in a particular case include the consideration of some expenses that might be considered operating expenses, as discussed in paragraph 2.52.*

2.59: *Example of the application of cost plus method*

A is a domestic manufacturer of timing mechanisms for mass- market clocks. A sells this product to its foreign subsidiary B. A earns a 5% gross profit mark up with respect to its manufacturing operation. X, Y, and Z are independent domestic manufacturers of timing mechanisms for mass- market watches. X, Y, and Z sell to independent foreign purchasers. X, Y, and Z earn gross profit mark ups with respect to their manufacturing operations that range from 3% to 5%. A accounts for supervisory, general, and administrative costs as operating expenses, and thus these costs are not reflected in cost of goods sold. The gross profit mark ups of X, Y, and Z, however, reflect supervisory, general, and administrative costs as part of costs of goods sold. Therefore, the gross profit mark ups of X, Y, and Z must be adjusted to provide accounting consistency.

It may also be noted that determination of direct and indirect cost of manufacturing is not mandated under the mandatory format of financials under the Companies Act. This results in difficulty in applying CPM for the external comparables and therefore, CPM as the most appropriate method may fail.

Further, in the Indian scenario, it is not possible to reliably compute the gross margin of the comparables since there is no uniform accounting convention which is applicable for computing the gross margin. The companies could follow different accounting principles while recording a particular expense item. Hence, it is not possible to ensure that all the expense items have been uniformly accounted by all comparables while computing the gross margin. For example – Reporting of R&D costs, valuations of the inventory, etc. As a result, application of CPM using external comparable transaction could be a challenge considering the availability of the reliable data.

Further, reliability of CPM may also be adversely affected by factors such as cost structures, business, management efficiency and lack of reliable external comparable data etc.

(ii) In determining the direct and indirect cost, the following factors have to be borne in mind:

(a) if the plant has been under utilised the costs may have to be suitably adjusted;

(b) absorption costing method is normally to be preferred.

(iii) This method is to be adopted only in cases of supply of property or services to an AE. This method is not to be applied when the enterprise is in receipt of property or services from an AE. However, in such cases, one may still evaluate the applicability of CPM as the most appropriate method by considering the AE as the tested party.

Profit Split Method (PSM)

6.31 ***Rule 10B(1)(d) profit split method, which may be applicable mainly in international transactions [or specified domestic transactions] involving transfer of unique intangibles or in multiple international transactions [or specified domestic transactions] which are so inter-related that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which-***

(i) the combined net profit of the AEs arising from the international transaction [or the specified domestic transaction] in which they are engaged, is determined;

(ii) the relative contribution made by each of the AEs to the earning of such combined net profit, is then evaluated on the basis of the function performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;

(iii) the combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under sub-clause (II);

(iv) the profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction [or specified domestic transaction]:

Provided that the combined net profit referred to in sub-clause (i) may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction [or specified domestic transaction] in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual

net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution in the manner specified under sub-clauses (ii) and (iii), and in such a case the aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction [or specified domestic transaction].

6.32 Typical transactions where the profit-split method may be used are transactions involving:

(a) integrated services provided by more than one enterprise for e.g., in case of financial service sector, where the activities performed by Indian company and foreign AEs in relation of a merger and acquisition transaction are so interrelated that it may not possible to segregate them;

(b) transfer of unique intangibles, for e.g. two AEs contribute their respective intangibles to develop a new product or process and earn income from such product or process.

6.33 The observations of the OECD, in its Transfer Pricing Guidelines (2022), on this method are as follows:

2.114 The transactional profit split method seeks to establish arm's length outcomes or test reported outcomes for controlled transactions in order to approximate the results that would have been achieved between independent enterprises engaging in a comparable transaction or transactions. The method first identifies the profits to be split from the controlled transactions—the relevant profits—and then splits them between the associated enterprises on an economically valid basis that approximates the division of profits that would have been agreed at arm's length. As is the case with all transfer pricing methods, the aim is to ensure that profits of the associated enterprises are aligned with the value of their contributions and the compensation which would have been agreed in comparable transactions between independent enterprises for those contributions. The transactional profit split method is particularly useful when the compensation to the associated enterprises can be more reliably valued by reference to the relative shares of their

contributions to the profits arising in relation to the transaction(s) than by a more direct estimation of the value of those contributions.

2.115 References to "profits" should be taken as applying equally to losses.

6.34 **Determining the combined profits to be split**

In this regard, the OECD in its Transfer Pricing Guidelines (2022) observes as under:

2.130 The combined profits to be split in a transactional profit split method are the profits of the associated enterprises from the controlled transactions in which the associated enterprises are engaged. The combined profits to be split should only be those arising from the controlled transaction(s) under review. In determining those profits, it is essential to first identify the relevant transactions to be covered by the transactional profit split. Where a taxpayer has controlled transactions with more than one associated enterprise, it is also necessary to identify the parties in relation to those transactions and the profits to be split among them.

2.131 In order to determine the combined profits to be split, the accounts of the parties to the transaction to which a transactional profit split is applied need to be put on a common basis as to accounting practice and currency and then combined. Because accounting standards can have significant effects on the determination of the profits to be split, accounting standards should be selected in advance of applying the method and applied consistently over the lifetime of the arrangement.

2.133 If the profit split method were to be used by associated enterprises to set transfer pricing in controlled transactions (i.e. an ex ante approach), then each associated enterprise would seek to achieve the division of profits that independent enterprises would have expected to realize from engaging in comparable transactions. Depending on the facts and circumstances, profit splits using either actual or projected profits are observed in practice.

6.35 There are two approaches to this method, namely, total profits split and residual profit split.

6.36 Total profits split: The steps involved are as follows:

(i) Determine the combined net profit of the AEs arising from the international transactions [or the specified domestic transaction] in which they are engaged. Such profits represent the profits earned from third parties due to the combined efforts of the AEs. It may be noted that the 'combined net profit' referred to in the rule is not the aggregate of entire profits earned by the AEs. Example:AE1 may earn profits from certain transactions wherein there is no contribution by AE2and vice versa. Such profits do not enter into the determination of combined net profit. Only those profits that are earned as a result of joint efforts of AE1 and AE2 should be taken as combined net profit.

(ii) Evaluate relative contribution made by each entity involved in the transaction on the basis of:

(a) functions performed;

(b) assets employed;

(c) risks assumed;

(d) the reliable external market data indicating how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances. It may be noted that reference to 'external market data' indicates comparable uncontrolled transactions. The use of word 'external' does not preclude use of internal CUT. In the process of choosing CUTs, the function performed, assets used and risks taken (FAR) of the uncontrolled transactions would have been compared with the FAR of the international transactions [or the specified domestic transaction].When the FAR of the international transaction [or the specified domestic transaction] and CUT are similar, the relative contribution adopted in the CUT should be applied to the international transaction [or the specified domestic transaction]. Any significant differences between the two should be suitably adjusted.

(iii) Thereafter, split the combined net profit in proportion to the relative contribution determined as above.

(iv) The profit so apportioned is taken to arrive at the arm's length price in relation to the international transaction [or the specified domestic transaction]. The profits so apportioned to the AE when added to the

costs incurred by it in relation to international transaction [or the specified domestic transaction] would result in arm's length price.

Residual profit split approach

6.37 In this approach, firstly, a basic return is determined for each of the enterprises and profits of each such enterprise is ascertained. This amount is reduced from the combined net profits. Residual profits are allocated on the basis of relative contribution.

Steps involved in this approach are as follows:

(i) Determine the combined net profit of the AEs arising from the international transactions [or the specified domestic transaction] in which they are engaged.

(ii) At the first stage, depending on functions performed, assets employed and risks assumed, determine the basic return appropriate to the respective activities. Allocate the combined net profit on the basis of above. This step results in a partial allocation of the combined net profit to each enterprise. For this purpose, the allocation is undertaken with reference to margins of comparable uncontrolled entities.

(iii) the balance of the combined net profit is allocated on the basis of the evaluation of the relative contribution.

(iv) the total net profit from such two-tier allocation is taken to arrive at the arm's length price. The profits so apportioned to the AE when added to the costs incurred by it in relation to international transaction [or the specified domestic transaction] would result in arm's length price.

6.38 The application of PSM can be understood with the following example:

AE1 Ltd., is an Indian company. The shareholding pattern of AE1 Ltd., is as follows;

Shareholder's name	Status	% holding
AE2 Ltd.	Foreign Company	30
AE3 Ltd.	Foreign Company	30
Financial Institutions	Indian Company	10
Public		30

AE1 Ltd., is an investment advisory company, which in association with AE2 Ltd. assists its clients with foreign acquisitions.

AE3 Ltd., which is based in U.S.A., has worldwide presence.AE1 Ltd. is approached by M, an unrelated party for identifying potential target companies for acquisitions in the USA. In order to serve M, AE1 Ltd. and AE3 Ltd., have each contributed integrally to identification of potential target and assisting M with the acquisition process. For the above, AE1 Ltd., received consideration of US$ 50,000.The financials are as follows;

Particulars	AE1 Ltd.	AE3 Ltd.
Revenue	30000	20000
Cost	20000	8000
Profit	10000	12000

Factors to be considered:

(a) The normal basic return is ordinarily calculated as a percentage of the costs incurred or gross revenues or capital employed. In this example, it is assumed as a percentage of the cost.

(b) Based on the FAR analysis, the basic return for AE1 Ltd., and AE3 Ltd., are determined to be 15% and 10% on cost respectively. Accordingly, the normal basic return for AE1 Ltd. in India for the aforesaid operation is US$ 3000.The similar returns for AE3 Ltd., US$ 800.The total basic return, thus, is US $ 3,800.

(c) On the basis of functions performed, risks assumed and assets employed, the relative contribution may be taken at 70%, 30% for AE1 Ltd. and AE3 Ltd., respectively.

Determination of arm's length price under PSM:

First Approach: Total Profit Split Method

1. AEs	:	AE1Ltd. and AE3 Ltd.
2. Ultimate delivery of product is	:	By AE3 Ltd. to M Ltd.
3. International transaction	:	Between AE1 Ltd. and AE3 Ltd.

Details	US$
Price charged by AE1 Ltd from M Ltd	50,000
AE3 Ltd share of revenue	20,000
AE1 Ltd share of revenue	30,000
Combined total profits	22,000
Evaluation of relative contribution	
AE1 Ltd : India return – 70%	15,400
AE3 Ltd : US return – 30%	6,600
Total	22,000
Total return for AE1 Ltd	15,400
Total cost of AE1 Ltd	20,000
Income of AE1 Ltd on arm's length price (A)	35,400
Actual revenue (B)	30,000
Increased income (A-B)	5,400

Note: In this example, the basic return is not required to be taken into account.

Second Approach: Residual profit split method

Details	US$
Price charged by AE1 Ltd from M Ltd	50,000
AE3 Ltd share of revenue	20,000
AE1 Ltd share of revenue	30,000
Combined total profits	22,000
1. Basic return	
AE1 Ltd : India return	3,000
AE3 Ltd : US return	800
Total	3,800
2. Residual net profit	18,200
AE1 Ltd: India return – 70%	12,740
AE3 Ltd: US return – 30%	5,460
Total	18,200
Total return for AE1 Ltd (12740 + 3000)	15,740

Details	US$
Total cost of AE1 Ltd.	20,000
Income of AE1 Ltd. on arm's length price (A)	35,740
Actual revenue (B)	30,000
Increased income (A-B)	5,740

The following points are to be noticed:

(a) It is the profit from a transaction with the AE that needs to be ascertained. If there are other transactions, which contribute to the profits, then the profits from transactions with AE may have to be arrived at on some approximation.

(b) The rule itself provides an alternative method to arrive at the arm's length price being the two-tier PSM;

(c) If in either of the alternatives, a range of figures is available, the arithmetical mean of such figures may be adopted as the arm's length price. It may however not be possible to adopt the arithmetical mean of the two alternatives.

(d) Under the two-tier split-method, the basic rate of return may have to be adopted having regard to the profits compared to the net worth of the enterprise. Such rate of return may not be uniform for all the AEs involved in the transaction.

(e) This is the only method for which the Rule itself has prescribed the types of transaction to which it may be applicable.

(f) Even though the computation proceeds with the profits from a transaction, the purpose is only to arrive at the arm's length price of a transaction. It is only by substituting the arm's length price for the price in the international transaction [or the specified domestic transaction] that an adjustment may be made to the income returned.

Transactional Net Margin Method (TNMM)

6.39 ***Rule 10B(1)(e) transactional net margin method, by which,-***

(i) the net profit margin realised by the enterprise from an international transaction **or the specified domestic transaction** ***entered into with an AE is computed in relation to costs incurred***

or sales effected, or assets employed or to be employed by the enterprise or having regard to any other relevant base;

(ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

(iii) the net profit margin referred to in sub-section (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction **[or the specified domestic transaction]** ***and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;***

(iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii);

(v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction **or the specified domestic transaction.**

6.40 Typical transactions where the transactional net margin method may be adopted are:

(a) provision of services;

(b) distribution of finished products where RPM cannot be applied;

(c) transfer of semi-finished goods where CPM cannot be applied;

(d) transactions involving intangibles where PSM cannot be applied.

6.41 The steps involved in the application of this method are:

(i) Identify the net profit margin realised by the enterprise from an international transaction [or the specified domestic transaction]. Where the assessee also has transactions, segments or businesses where the international transactions [or the specified domestic transaction] with AEs are not relevant, then the net profit margin to be considered for the purposes of this TNMM method should be such net profit margin as is derived only from the transactions, segments or businesses related to the international transaction [or the specified

domestic transaction]. The net profit margin may be computed in relation to costs incurred or sales effected or assets employed or any other relevant base.

For example,

- In case where the assessee acts as a distributor and the transaction pertains to import, the revenue may be used as base.
- In case the transaction involves export of services/goods, costs may be taken as base provided the exporting entity acts as a contract service provider / contract manufacturer.
- Return on capital employed or Return on assets are typically used in case of a capital intensive manufacturing set-ups where the tangible operating assets have a high correlation to profitability. For example: Return on capital employed or Return on assets could be used in case of a leasing company.

(ii) Identify the net profit margin from a comparable uncontrolled transaction or a number of such transactions having regard to the same base; In practice, net profit margin is ascertained at segment level where segment data are available. The unallocated expenses are allocated on a reasonable basis and the segmental net profit is determined. Where segment data are not available, net profit is normally determined at enterprise level. Where internal CUT is available transaction level net profit may be determined.

(iii) In case internal CUT is not available, external CUT is taken. In such case, as discussed above, net profit margin should be taken at enterprise level (segmental or enterprise as a whole) of comparable companies. A search should be carried out to identify comparable companies on the basis of information and data available with the assessee. Where such information and data are not available, search may be carried out with reference to database in public domain.

(iv) The net profit margin so identified is adjusted to take into account the transaction level and enterprise level differences if any. The differences should be those that could materially affect the net profit margin in the open market;

(v) The adjusted net profit margin is taken into account to arrive at the arm's length price in relation to the international transaction [or the specified domestic transaction].

6.42 The unavailability of reliable data for comparables in case of gross profit based methods such as CPM and RPM may pose difficulties in selecting them as the most appropriate method. In such circumstances, TNMM may be considered as the most appropriate method, subject to other parameters such as degree of comparability, comparability factors, functional profile, etc.

6.43 However, this should not be construed as TNMM being a residual method or method of last resort. Though, TNMM is more tolerant to differences in the product comparability as compared to the traditional methods, the comparability standard to be applied to the TNMM requires a high degree of similarity in several factors between the tested party and the independent enterprises that may adversely affect the net margins. For example: contractual terms and conditions, functions performed, risks assumed and assets employed, pricing mechanism, availability of the comparable data, etc.

6.44 Net margins may be affected by factors that have no effect or less significant effect on gross margins or prices due to the variation of operating expenses between companies. These factors may be unrelated to transfer pricing. For example – Difference in the capacity utilisation level of the tested party vis-a-vis the comparables.

6.45 Specific factors that may affect net margins include, but are not limited to:

- Barriers to entry in the industry;
- Competitive position;
- Management efficiency;
- Individual business strategies;
- Threat of substitute products;
- Varying cost structures;
- Difference in the working capital level;
- Difference in the import vs. domestic content;
- Difference in the capacity utilisation level;

- Difference in the business model: say outsourcing of some manufacturing processes vs. in-house manufacturing of all the processes;
- Difference in the functions: say undertaking own market / distribution channels vs. distribution through individual distributors.

6.46 If material differences between the tested party and the independent enterprises are affecting the net margins, reasonably accurate adjustments should be made to account for such differences.

6.47 The application of the transactional net margin method may be understood with the following example:

AE1 Ltd., is an Indian company

AE1 Ltd., manufactures compact disc (CD) writers and sells the same to AE2 Ltd., which is an AE of AE1 Ltd.

As AE1 Ltd., does not have similar transaction with a non AE, no internal CUT is available. As AE1 Ltd., does not have information and data to identify a comparable company, it has used the databases in public domain for carrying out the search. The result of the search may be summarised as follows:

		No. of companies
Search on the basis of following keywords:		
(a)	Computer	800
(b)	Computer hardware	250
(c)	Computer peripherals	66
Sub total		1116
Elimination process :		
Companies with different activities		800
Companies with duplication when multiple database are used		75
Companies with no financials		90
Companies having significant operations like sales or purchases with related party		100
Companies reporting no operations		50
Sub total		1115
Company/companies selected – Z Ltd.		1

Note: The search criteria and filters adopted above should be taken as illustrative only.

The comparison between AE1 Ltd., and Z Ltd., is carried out as follows:

Financials	**AE1 Ltd. INR (in crores)**	**Z Ltd. INR (in crores)**
Sales	130	200
Other income	5	10
Total Income	135	210
Operating expenses	85	120
Interest	5	7
Depreciation	10	12
Loss on sale of undertaking	5	0
Expenses relating to non operating income	1	3
Total expenditure	106	142
Net profits	24	58

Operating margin	**AE1 Ltd. INR (in crores)**	**Z Ltd. INR (in crores)**
Sales	130	200
Gross revenue	130	200
Operating expenses	85	120
Interest	5	7
Depreciation	10	12
Total operating cost	100	139
Operating profit	30.00	61.00
Operating margin (before interest and depreciation)	52.94	66.67
Operating margin (after depreciation but before interest)	36.84	51.52

6.48 TNMM is less reliable when applied to the aggregate activities of a complex enterprise engaged in various different transactions or functions. The TNMM should thus generally not be applied on a company-wide basis if the company is involved in a number of different transactions or functions which are not properly evaluated on an aggregate basis. However, it may be possible to apply TNMM when the aggregate activities/transactions are sufficiently interlinked, as for example when similar sales functions are conducted for products in similar product lines.

6.49 The Delhi High Court in the case of Sony Ericsson Mobile Communications India Pvt. Ltd (ITA No 16/2014) has upheld that TNMM could be effective and reliable when applied to closely-linked or continuous transactions. The following example explains that segregation of advertisement, marketing and promotion ('AMP') expenses as an independent transaction would lead to absurd results:

Particular	Case 1	Case 2	Variation
Sales	1,000	1,000	1,000
Purchase price	600	500	500
Gross margin	400	500	500
AMP expense	50	150	50
Overhead expense	300	300	300
Net profit	50	50	150
TP adjustment			100
Add: Mark-up of 15%			15
Total profit			265 (115+150)

6.50 In case 2, a distributor having significant marketing functions incurred substantial expenditure on AMP, three times more than in case 1, but the purchase price being lower, the taxpayer got adequately compensated and hence, no adjustment. If the AMP in case 2 was INR 50, i.e, identical to case 1, and AMP of INR 100 was incurred as a separate transaction, this would be absurd if the TPO makes an adjustment, leading to a net profit of 26.5%, which seems absurd.

Thus, it may be appropriate to aggregate the transaction of purchase and marketing efforts leading to higher AMP expenses in the instant case.

6.51 However, it is important to compute profit from the international transaction [or the specified domestic transaction] if the activities are not interlinked and are separate. This can be achieved by using the segmental profitability based on appropriate assumptions and scientific allocation keys. However, in cases where such segmental profitability is not possible, differences in the profitability at the entity level cannot be loaded entirely on the international transactions [or the specified domestic transaction] and this would require application of the 'principle of proportionality'.

Particular	Taxpayer profitability	Third party profitability
Sales to AEs	40	150
Sales to Non AEs	60	
Purchases	80	90
VAE	10.50	30
Net profit	9.50	30
Net profit / Cost	10.50%	25%

6.52 From the above, it can be seen that the profitability of the taxpayer is lower by 14.50% (25%-10.50%). The entire difference cannot be attributable to the sales since the sales to AEs accounts for only 40% of the total sales. Therefore, adjustment may need to be restricted to 40% of the difference.

6.53 Rule 10B(e)(iii) requires that transaction level and enterprise level differences should be adjusted if such differences materially affect the amount of net profit margin.

In this example, following enterprise level differences could be visualised;

(a) Working capital – There may be differences in stock holding, debtors and creditors. Appropriate adjustment to eliminate the impact of above difference may be made by taking the prevailing interest rate. For this purpose, useful reference may be made to the guidelines issued by Internal Revenue Service of USA. However, in this example, it is assumed that the difference in the working capital is not significant requiring any adjustment.

(b) Cost of capital – There may be difference in the manner of funding such as equity, preference, debenture, inter corporate loans etc. In order that such difference does not impact the net profit, the operating margin on operating cost before interest is taken as profit level indicator.

(c) Assets employed – There may be difference in assets employed and the method of providing depreciation. In order that such difference does not impact the net profit, the operating margin on operating cost before depreciation is taken as profit level indicator.

(d) Assured or risk bearing business – There may be a difference in the customer/ revenue model of the assessee vis-à-vis the comparables. For example, the comparables identified may be entrepreneurs bearing the market risks of business volume, customer continuity, etc and the assessee's international transaction [or the specified domestic transaction] is in the nature of captive service provider or contract manufacturer with assured volumes and/or assured compensation and/or assured business period, etc. Such differences may be eliminated by making appropriate adjustment for low-risk or risk free business.

(e) Difference in the capacity utilisation – There may be difference in the utilisation of capacity by the tested party and the comparables. For example: The taxpayer has utilized only 41.39% of its installed capacity (i.e. 58.61% of the fixed overheads remained unabsorbed), whereas the capacity utilized by the comparables is 80.90%.As a result, the unabsorbed fixed costs, debited to the profit and loss account due to existing accounting practices, has, in fact skewed the profit level indicator of the taxpayer for the period under consideration. As a result, it would be important to compute the profitability from manufacturing activity after removing unabsorbed fixed costs (to bring the capacity utilisation of the taxpayer in line with that of the comparables) with a view to achieve meaningful comparison.

6.54 In the above table, the transaction level differences cannot be noticed. However, some transaction level differences may exist and the same may be adjusted if requisite information is available. Some of the common transaction level differences may be as follows;

(a) Free gifts

(b) Extended warranty (in addition to the normal one-year)

(c) Marketing risks

(d) Pricing - Ex-Shop or FOR-destination.

(e) Quantity discount

Table 5: Computation of arm's length price under the transactional net margin method

1. AE	:	AE2 Ltd.
2. International transaction	:	Between AE1Ltd. and AE2 Ltd.
3. Comparable uncontrolled company	:	Z Ltd.

	%
Net profit margin of Z Ltd.- i.e. operating margin on cost before interest and after depreciation	51.52
Adjustments for transaction level differences	0.00
Arm's length net profit margin	51.52

	(INR in crores)
Operating costs before interest and after depreciation	95.00
Arm's length sale revenue	143.94
Actual sales	130.00
Income increases by	13.94

The following points are to be noticed:

(a) Different bases of determining the net profit margin [i.e. profit level indicators (PLI)] are recognised. The same basis of arriving at the net profit margin is to be adopted year after year, unless circumstances justify an alternate base;

(b) Whichever base is selected in determining the net profit margin in an international transaction [or the specified domestic transaction], the same basis is to be adopted for arriving at the net profit margin in the comparable uncontrolled transaction;

(c) It is recommended that operating profit margin may be used instead of net profit margin. Operating profit margin would eliminate the non-operating items (the items of revenue and costs which do not result from routine business operations such as profit on sale of assets, dividend etc.).

Further, the operating profit margins should be computed on the basis of financial statements of the assessee and the comparable company.

(d) The accounting treatment of expenses and depreciation is also a critical factor in computing the arm's length price. Unlike the preceding methods, the rule does not explicitly provide for adjustment on account of differing accounting practices. Nevertheless, such differing practices should also be factored in;

(e) It is not uncommon to find purchase transaction being an international transaction [or the specified domestic transaction] where TNMM is used. TNMM requires the determination of the net profit margin from an international transaction [or the specified domestic transaction] and purchase transaction as such does not result in net profit. However, as purchase is inextricably linked to earning net profit, TNMM may be used for establishing arm's length purchase value. In such case, comparable operating margin should be appropriately used to work back the arm's length purchase cost. This may be illustrated as follows:

Illustration 1:

1. Actual Profit and loss account of the assesse

	INR in lakhs		**INR in lakhs**
Opening stock-AE purchases	100	Sales of AE purchases	800
Opening stock-Non AE purchases	150	Sales of Non AE purchases	1200
Purchases from AE	500	Closing stock-AE purchases	120
Purchases from Non AE	1000	Closing stock-Non AE purchases	160
Gross profit	530		
	2280		2280
Expenses	200	Gross profit	530
Net profit	330		
	530		530

2. Comparable operating margin (PLI being operating profit on sale) 35%

3. Profit and loss account - recast to compute arm's length price of purchase

	(INR in lakhs)		(INR in lakhs)
Opening stock-AE purchases	100	Sales of AE purchases	800
Purchases from AE(balancing figure)	460	Closing stock-AE purchases	120
Gross profit (brought back)	360		
	920		920
Expenses-allocated (in the ratio of sales)	80	Gross profit (worked back)	360
Net profits (applying TNMM margin on AE sales)	280		
	360		360

4. Arm's length value of purchase is INR 460 as against actual value of INR 500. Therefore, income increases by INR 40.

Illustration 2 :

1. Profit and loss account of the assessee – Actual

	INR in lakhs		INR in lakhs
Opening stock of raw material (AE purchases)	100	Sale of finished goods	2500
Opening stock of raw material (Non-AE purchases)	150	Closing stock of raw material (AE purchases)	120
Purchases of raw material from AE	500	Closing stock of raw material (Non-AE purchases)	160
Purchases of raw material from Non-AE	1000	Closing stock of finished goods	500
Manufacturing costs	400		

Admin, selling and finance expenses	200		
Net profit	930		
	3280		3280

2. Comparable operating margin (PLI being operating profit on sale) 45%

3. Profit and loss account - recast:

	INR in lakhs		**INR in lakhs**
Opening stock of raw material	150	Sale of finished goods	2500
(Non-AE purchases)			
Cost of purchase from AE (net of stock)	405	Closing stock of raw material	160
(balancing figure)		(Non-AE purchases)	
Purchases of raw material from Non AE	1000	Closing stock of finished goods	500
Manufacturing costs	400		
Admin, selling and finance expenses	200		
Net profit	1125		
(arrived on basis of TNMM margin)			
	3280		3280

Arm's length Purchase value :	
Cost of purchase from AE (net of stock)	405
Add : Closing stock of Raw Material	120
Add : Closing stock of Raw Material in finished goods (see Note 1 below)	20
Less : Opening stock	100
Arm's length Purchase value	445
Actual purchase	500
Excess price paid	55

Notes: 1. In the above example, the raw material cost (of purchases from AE) built into closing stock of finished goods is assumed to be INR 20.

2. It is assumed that there is no opening stock of finished goods.

Other Method (OM) of determination of arm's length price

6.55 The CBDT has inserted a new Rule 10AB by notifying the "Other Method" apart from the five methods already prescribed.

For the purposes of clause (f) of sub-section (1) of section 92C, the Other Method for determination of the arms' length price in relation to an international transaction* [or the specified domestic transaction] *shall be any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-AEs, under similar circumstances, considering all the relevant facts.

6.56 The introduction of the Other Method as the sixth method allows the use of 'any method' which takes into account (i) the price which has been charged or paid or (ii) would have been charged or paid for the same or similar uncontrolled transactions, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts. The various data which may possibly be used for comparability purposes could be:

(a) Third party quotations/ invoices;

(b) Valuation reports;

(c) Tender/Bid documents;

(d) Documents relating to the negotiations;

(e) Standard rate cards;

(f) Commercial & economic business models; etc.

6.57 It is relevant to note that the text of Rule 10AB does not describe any methodology but only provides an enabling provision to use any method that has been used or may be used to arrive at price of a transaction undertaken between non AEs. Hence, it provides flexibility to determine the price in complex transactions where third party comparable prices or transactions

may not exist. The wide coverage of the Other Method would provide flexibility in establishing arm's length prices, particularly in cases where the application of the five specific methods is not possible due to reasons such as difficulties in obtaining comparable data due to uniqueness of transactions such as intangibles or business transfers, transfer of unlisted shares, sale of fixed assets, revenue allocation/splitting, guarantees provided and received, etc. However, it would be necessary to justify and document reasons for rejection of all other five methods while selecting the 'Other Method' as the most appropriate method. The OECD Guidelines also permit the use of any other method and state that the taxpayer retain the freedom to apply methods not described in OECD Guidelines to establish prices, provided those prices satisfy the arm's length principle.

6.58 The application of the sixth method may be understood with the following examples:

Illustration A

AE1 Ltd. is an Indian Company.

AE1 Ltd. owns certain registered patents which it has developed by undertaking research and development.

It is a subsidiary of AE2 Ltd., a foreign company.

AE1 Ltd. has sold its registered patents to AE2 Ltd., for `50 crores. The price has been determined based on a valuation report obtained from an independent valuer.

The sale of patents is a unique transaction and AE1 Ltd or AE2 Ltd. has not entered into similar transactions with third parties and hence no internal or external CUP is available.

AE1 Ltd. may select the Other Method as the most appropriate method and use the independent valuation report for comparability purposes.

Illustration B

An Indian Company (I Co) buys back its equity shares issued to its foreign AE (AE Co). I Co obtains a valuation report from an external firm identifying the fair market value of these shares. I Co purchases the shares at the value determined in the valuation report. This value denotes a price that would have been charged if a third party would have bought the same shares. Hence, I Co could use Rule 10AB and rely upon the valuation report to demonstrate this transaction to be arm's length.

Illustration C

An Indian Company (I Co) incurs hotel and travel expenses for the employees of its foreign AE (AE Co) visiting India for a global seminar, These expenses are paid by I Co directly to third party vendors on behalf of AE Co and recovered on a cost-to-cost basis from AE Co. Further, such activity does not entail a service element for I Co and hence does not necessitate a mark-up. Hence, I Co may select the Other Method and rely upon such back-to-back arrangement to demonstrate this recovery transaction to be arm's length.

Illustration D

An Indian Company (I Co) deputes some of its employees to its foreign AE (AE Co) through secondment. AE Co takes these individuals onboard by issuing letter of employments and is responsible for payment of the salary of the employees. I Co frequently facilitates payment of salaries to the overseas accounts of the seconded employees purely for administrative convenience. In this case, salary costs are reimbursed by AE Co to I Co on a cost-to-cost basis. Hence, I Co may select the Other Method and rely upon such back-to-back arrangement to demonstrate transaction to be arm's length.

Illustration E

Another example where this method could be used is in cases of cost allocation arrangements where a taxpayer benefits from certain services provided by a central entity of the group and has to pay a portion of the total cost incurred by the service provider. These costs are generally allocated on the basis of allocation keys like headcount, time spent, revenues etc. and a third party outside the group may not have the capability to provide identical services. Hence, in the absence of comparable prices or transactions, Rule 10AB may be applied and the cost allocation arrangement could be justified appropriately.

Most appropriate method

6.59 ***(1) For the purposes of sub-section (1) of section 92C, the most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction*** **[or the specified domestic transaction],** ***and which provides the most reliable measure of an arm's length price in relation to the international transaction*** **[or the specified domestic transaction].**

(2) In selecting the most appropriate method as specified in sub-rule (1), the following factors shall be taken into account, namely:-

(a) the nature and class of the international transaction **[or the specified domestic transaction]*;***

(b) the class or classes of AEs entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;

(c) the availability, coverage and reliability of data necessary for application of the method;

(d) the degree of comparability existing between the international transaction **[or the specified domestic transaction]** ***and the uncontrolled transaction and between the enterprises entering into such transactions;***

(e) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction **[or the specified domestic transaction]** ***and the comparable uncontrolled transaction or between the enterprises entering into such transactions;***

(f) the nature, extent and reliability of assumptions required to be made in application of a method.[Rule 10C].

6.60 No particular method is suitable in every possible situation. It is not possible to provide specific rules that will cover every case. While selecting the most appropriate method, the factors prescribed in section 92C of the Act and Rule 10C(2) should be considered.

Amongst these factors, the functions performed by AEs (including assets employed and risks assumed) should be given due consideration. It is also important to ascertain the extent and reliability of the uncontrolled data that is available. The nature of the available data, and especially the amount and reliability of detail on the factors entering into a comparability analysis, are very important issues in the selection and application of a methodology.

Although it is difficult to prescribe general principles for choice of most appropriate method, the following broad categorisation may be considered as already indicated under each of the respective methods:

(i) CUP method may be used in case of loans, service fee, transfer of tangibles, sale and purchase of goods/ commodities, etc;

(ii) RPM is most useful in case of marketing operations of finished products, especially in case of distributors not performing significant value addition to the product;

(iii) CPM is normally used where raw materials or semi-finished goods are sold; where joint facility agreements or long-term buy-and-supply arrangements, or the provision of services are involved;

(iv) PSM is normally used in cases where the transactions involve provision of integrated services by more than one enterprise. For example – One enterprise holds technology and the other enterprise holds the distribution network and both are the key intangibles for the overall success of the Group; freight forwarders and supply chain specialists.

(v) Transactional net margin method could be used in case of manufacturing operations, sale of raw materials or semi-finished goods where CPM is not the most appropriate method, and marketing operations of finished products where RPM is not the most appropriate method.

(vi) Other method may be used in case of royalties, commodities, transfer of intangibles and shares, etc.

6.61 For the purposes of sub-rule (1) of Rule 10B, the comparability of an international transaction [or the specified domestic transaction] with an uncontrolled transaction shall be judged with reference to the following namely:-

(a) the specific characteristics of the property transferred or services provided in either transaction;

(b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;

(c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

(d) conditions prevailing in the markets in which the respective parties to the transaction operate, including the geographical location and size of the markets, the laws and government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

6.62 While evaluating each method the distinctive aspects of computation should be borne in mind. For instance, RPM requires functional and other differences including accounting practices to be adjusted to the price whereas CPM and TNMM require such differences to be adjusted to the margin.

6.63 Different methods may be chosen as most appropriate method for different transactions of the assessee as long as the rationale for each of such choices are adequately documented. Also, different methods may be chosen for the same transaction in different years as long as the rationale for each such choice made in each year is adequately documented.

Multiple Year Data and Range Concept

6.64 Appreciating that Transfer Pricing is not science but is influenced by several factors the authorities decided to move away from single year concept. At the same time, it was appreciated that with the data bases becoming robust time has come to adopt range concept for the determination of the arm's length price. Consequently, as mentioned in para 1.26 of this book, Central Board of Direct Taxes (CBDT) on October 20, 2015 issued the final rules ie, Rule 10B(5) and Rule 10CA to give effect to the use of 'multiple year data' and 'range concept'. These rules are applicable to international transactions and specified domestic transactions that are entered into by taxpayers on or after 1 April 2014. Rule 10CA (which forms part of Annexure II of this book) contains illustrations of application of the arm's length range concept. This is exhaustive and must be analysed to appreciate the approach recommended.

Vide Notification No. 124/2021[F. No. 500/1/2014-APA-II] dated 29th October, 2021 it was notified that where the variation between the arm's length price determined under section 92C and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed one per cent. of the latter in respect of wholesale trading and three per cent of the latter in all other cases, the price at which the international transaction or specified domestic transaction has

actually been undertaken shall be deemed to be the arm's length price for Assessment Year 2021-2022.

In essence, this extended the approach applied for the earlier years.

It was, further clarified that for the purposes of the notification, "wholesale trading" means an international transaction or specified domestic transaction of trading in goods, which fulfils the following conditions, namely:-

(a) purchase cost of finished goods is eighty per cent. or more of the total cost pertaining to such trading activities; and

(b) average monthly closing inventory of such goods is ten per cent. or less of sales pertaining to such trading activities.

6.65 Transfer Pricing Adjustments (Economic Adjustments) In terms of Rule 10B(3) appropriate comparability adjustments are required to be made while computing the arm's length Rule 10B(3) of the rules provides that:

"An uncontrolled transaction shall be comparable to an international transaction if—

(i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or

(ii) *reasonably accurate adjustments can be made to eliminate the material effects of such differences*."

Arguably, the most common adjustments are working capital adjustment and capacity utilization adjustment. These are discussed hereunder, in brief.

Further Statutory provisions suggest various adjustments under various methods

Methods	Adjustments suggested
CUP Method [Rule 10B(1)(a)(ii)]	Price of uncontrolled transaction is adjusted to account **for differences**, if any, between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the price in the open market.
RPM [Rule 10B(1)(b)(iv)]	The resale price arrived at is adjusted to take into account **the functional and other differences, including differences in accounting practice**s, if any, between the

Methods	Adjustments suggested
	international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market.
CPM [Rule 10B(1)(c)(iii)]	The normal gross profit mark-up is adjusted to take into account **the functional and other differences**, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market.
TNM method [Rule 10B(1)(e)(iii)]	The net profit margin arising in comparable uncontrolled transactions have to be adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market.

Thus, rule 10B prescribes two types of adjustments:

- Enterprise level differences
- Transactional differences

These adjustments have to be based on the specific characteristics of the property transferred or services provided in relation to transaction and the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions. Rule 10B suggests the following Enterprise level and Transaction level adjustments:

- Functional differences
- Assets differences
- Risks differences
- Geographical location
- Size of the markets
- Wholesale or retail market

- The laws and Government orders in force
- Costs of labour
- Cost of capital in the markets
- Overall economic development
- Level of competition
- Accounting practices

These factors should be considered while searching for comparable. However, it is not always possible to get the accurate comparables. Hence, one has to choose the nearest possible comparable and adjust the differences which materially affect the price of comparable.

There is no specific guidance, on numbers and amount of adjustments, either in Indian Laws or in OECD and UN Guidelines. The OECD TPG 2022 [para 3.47 to 3.54] provides the following guidance:

- Comparability adjustments should be considered if (and only if) they are expected to increase the reliability of the results and are expected to improve comparability.
- Relevant considerations in this regard include the materiality of the difference for which an adjustment is being considered, the quality of the data subject to adjustment, the purpose of the adjustment and the reliability of the approach used to make the adjustment.
- It bears emphasis that comparability adjustments are only appropriate for differences that will have a material effect on the comparison.
- It should be noted that the need to perform numerous or substantial adjustments to key comparability factors may indicate that the third-party transactions are in fact not sufficiently comparable.

Therefore, it is provided that where there are numerous or substantial adjustments to key comparability factors, it may indicate that the third-party transactions are in fact not sufficiently comparable.

However, differences in the use of assets can sometimes be eliminated or reduced to a significant extent by making comparability adjustments on account of working capital or capacity utilization[1].

[1] UNTPM 2021

6.65. Working Capital Adjustments:

In a competitive environment[2], money has a time value. If a company provided, say, 60 days trade terms for payment of accounts, the price of the goods should equate to the price for immediate payment plus 60 days of interest on the immediate payment price. By carrying high accounts receivable a company is allowing its customers a relatively long period to pay their accounts. It would need to borrow money to fund the credit terms and/or suffer a reduction in the amount of cash surplus which it would otherwise have available to invest. In a competitive environment, the price should therefore include an element to reflect these payment terms and compensate for the timing effect.

Working capital[3] is a financial metric which represents operating liquidity available to a business. Along with fixed assets such as plant and equipment, working capital is considered a part of operating capital. Net working capital is calculated as current assets minus current liabilities. If current assets are less than current liabilities, an entity has a working capital deficiency, also called a working capital deficit. Current assets and current liabilities include three accounts which are of special importance. They are: accounts receivable (current asset)/inventory (current assets), and/accounts payable (current liability). These accounts represent the areas of the business where managers have the most direct impact.

Working capital adjustments are typically performed when applying the TNMM, Cost-plus and Resale price methods. They account for the fact that there is an opportunity cost and notional finance cost associated with the holding of working capital.

Working Capital = [accounts receivable + inventory] - accounts payable

By performing working capital adjustments, operating profit that measures profit before accounting for explicit interest expenses or income can be corrected for the implicit interest embedded in sales and cost of goods sold to increase the comparability of the transactions.

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[2] OECD TPG 2022 - Annex to Chapter III- Example of a Working Capital Adjustment

[3] Demag Cranes & Components (India) (P.) Ltd. v Dy. CIT [2012] 17 taxmann.com 190 : [2012] 49 SOT 610 : [2012] 144 TTJ 320 (Pune) : (2012) 31 CCH 0486 PuneTrib.

OECD Guidance on WCA

If there are material differences between the controlled and uncontrolled transactions, adjustments should be made if the effect of such differences on prices or profits can be ascertained with sufficient accuracy to improve the reliability of the results. The OECD re-iterates that working capital adjustments should only be considered when the reliability of the comparables will be improved, and reasonably accurate adjustments can be made. (See OECD 2017 Annex to Chapter III para 1)

For instance, in the OECD's 2017 Transfer Pricing Guidelines (TPG), its states at 2.87 that "in those cases where there is a correlation between credit terms and sales prices, it could be appropriate to reflect interest income in respect of short-term working capital within the calculation of the net profit indicator and/or to proceed with a working capital adjustment." Similarly, in the case of the comparable uncontrolled price method, differences in contractual terms e.g., sales or purchase volumes and credit terms, may require working capital adjustments to the comparable prices.

Relevant market evidence of third-party behaviour that supports adjusting prices or returns for the differences in working capital seems vital, as does an analysis of the payment terms and practices used by the tested party and comparables.

The reliability of a WCA should be considered in other ways as well. For instance, a WCA involves adding or removing a notional cost of funds (which could be represented as the cost of debt or equity) to/from a comparables prices or financial results, but that notional cost could in fact be constrained by commercial factors impacting the level and cost of debt that a company is able to carry. In some cases, a comparable or tested party however may not be able to access the level of funds that a WCA may imply. Further, the arm's length level and cost of debt, or equity of a firm would need to use that source of funds, will need to be calculated as well, possibly impacting interest expenses claimed if the tested party is being adjusted (say, to an arm's length level of working capital).

There may also be questions about whether the tested party or the comparables are the entities whose prices or margins need to be adjusted. For instance, it may be a concern that the tested party has adopted working capital policies that aren't arm's length, due to the control of the parent over the tested party in more ways than just pricing. Before adjusting the comparables to meet the level of working capital reported by the tested party, additional review would be necessary to understand the reasons for the

tested party's working capital. It may be appropriate, where non-arm's length payable terms have been adopted, to adjust the tested party for that feature and then consider anew the need for a WCA. A review of comparables from the tested party's industry and dealing in similar products might provide insight both into arm's length capital structures as well as insights into pricing behaviour and the nature of competition in the tested party's industry.

There are other issues that might impact on the reliability of working capital adjustments including:

- Differences in seasonal vs non-seasonal capital needs of the tested party and comparables, based on different economic circumstances, markets, product or service offerings that impact prices reported;
- Differences in reported working capital balances due to different reporting dates, which can be relevant when tested party and comparables reporting periods don't align; and
- Merger and acquisition or other events that suddenly shift tested party's or comparables' working capital levels.

As noted above, an appropriate interest rate (preferably operational interest rate of the tested party jurisdiction) to apply to a difference in working capital must be chosen.

Working capital - type adjustments are also sometimes proposed to make an adjustment for differences in functions, assets, and risks, in relation to inventories; or in business strategies, particularly those relating to the provision of finance to customers.

The following hypothetical illustration [UN TPM, 2021] is provided merely to demonstrate how a working capital adjustment can be calculated. It should not be construed as the only way in which such an adjustment may be calculated.

Particulars	Tested Party	Comparable Party
Sales (A)	100	120
Earnings before interest and taxes (EBIT) (B)	5	7
operating profit margin (PLI) (A/B in %) (C)	5%	5.8%

Net Working Capital (NWC)		
Accounts receivable (D)	100	110
Inventory (E)	20	40
Accounts payable (F)	50	50
Net working capital (G) (D+E-F)	70	100
Net working capital to sales	70%	83.3%
Difference between net working capital to sales of		-13.3%
tested and comparable party (H)		
Interest rate on NWC (I)		5%
Adjustment (J) (I*H)		-0.7%
Working capital adjustment –		
Re-computing the PLI for the comparable (C-J)		5.1%

Various Tribunal and High Court judgements have held that there is need to eliminate differences between the comparable companies and the Assessee on account of economic circumstances by making working capital adjustment and market risk and growth adjustment.

6.65. Capacity utilization adjustment

In the starting phase of any business, it is not easy to get business but minimum infrastructure having regard to nature of business have to be created. Some of the facilities are of fixed nature and some are of variable nature. Building for office, factory and machineries have to be taken even the production may not be possible at 100% of the capacity. Rent of the building is generally of fixed nature even the production start at just 20% of the capacity. Thus, 80% rent is relating to excess capacity. If the comparable is operating at 80% or 100% capacity, then it would not be a proper comparable unless some adjustments have been made.

In accounting terminology, fixed costs will broadly include almost all costs (expenses) which are not included in cost of goods sold, and variable costs are those captured in costs of goods. The implicit assumption required to make the equivalence between the accounting and economics terminology is that the accounting period is equal to the period in which fixed costs do not vary in relation to production. In practice, this equivalence does not always

hold, and depending on the period under consideration by management, some overhead expenses (eg, sales, general and administrative expenses) can be adjusted by management, and the specific allocation of each expense to each category will be decided under cost accounting.

The issue of capacity utilisation can arise in the following situations:

- Start-up phase
- Expansion phase
- Economic recession phase
- Under-utilisation or over utilisation of resources

Entities differ in size as well as in levels of activities so do the available comparables for the purpose of transfer pricing determination. Extent of capacity utilization is an accepted adjustment to improve comparability to overcome the differences mentioned above. This adjustment finds support in the OECD TP Guidelines and the United Nations TP Manual (including the India chapter).

By definition, capacity utilization is the extent to which an enterprise actually uses its installed productive capacity. It is the relationship between actual output using the installed infrastructure, and the potential output which could arise, if capacity was fully used. Typically expressed as a percentage, this factor becomes an important comparability factor as it helps measure productive efficiency and cost effectiveness, i.e., extent of output vis-à-vis investment in or costs associated with the underlying infrastructure (the costs are generally referred to as "fixed costs" in cost accounting terms). By virtue of its definition, the concept of capacity utilization assumes most relevance in the case of manufacturing concerns.

It is Important to address two critical questions in relation to this adjustment, viz.,

(i) whether the adjustment should be made to the tested party or to comparables?

(ii) how to compute the adjustment?

Further, particularly in light of the fact that there is no mechanism specified under the Act or the Rules for computing the amount of capacity utilization adjustment. Even the OECD TP Guidelines and the United Nations TP Manual do not address the second question.

The rationale to eliminate capacity under-utilization when applying the TNMM is that the TNMM may be more acceptable than the other prescribed methods under the Income-tax Act, 1961 ('the Act') as the differences in the levels of absorption of indirect fixed costs would affect the net profit margin and not the gross margin / gross mark-up on cost.

The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, prescribe the making of adjustments to eliminate differences in capacity utilization or idle capacity adjustments. Also, Rule 10B(1)(e)(iii) of the Income-tax Rules, 1962 ('the Rules') stipulates that an adjustment to the net profit margin can be made for "capacity underutilization". Capacity under-utilization by enterprises is a factor affecting net profit margin because lower capacity utilization results in higher per unit costs, which, in turn, results in lower profits at a transactional or unit level. There is no debate on the need for adjustments, however the issue is as to the reasonable accuracy in the mechanism for such adjustments, so long as a reasonable adjustment mechanism can be employed, objections to the adjustment won't hold.

In this context, it is useful to recall the observations of the Hon'ble Delhi High Court in Sony Ericsson Mobile Communication India Pvt. Ltd. [March 2015]: "It must be stated that transfer pricing is not an exact science but a method of legitimate quantification which requires exercise of judgment on the part of the administration and the taxpayer. It is method and formula based and therefore is rational and scientific". At present there is no authoritative guidance relating to capacity utilization adjustments but the decision of the Delhi Bench of the Income Tax Appellate Tribunal's ('the Tribunal') in the case of Claas India Private Limited [ITA No. 1783/Del/2011], has put forth useful observations and guidelines on capacity utilization adjustment.

Since neither the Act nor the Rules provide the mechanism for computing capacity utilization adjustment, but in this judgment the Tribunal has laid down the following important principles:

- It is essential to ascertain the percentage of capacity utilization by the taxpayer and the comparables when applying the TNMM.
- The difference in the percentage of capacity utilization of the taxpayer vis-à-vis comparables should be given effect to in the operating profit of comparables by adjusting their respective operating costs.

The Tribunal explained that operating costs can be either fixed, variable or semi-variable:

- Semi-variable costs need to be split into fixed and variable part.
- The variable costs and the variable portion of the semi-variable costs remain unaffected due to any under or overutilization of capacity.
- The fixed operating costs and the fixed part of the semi-variable costs are scaled up or down by considering the percentage of capacity utilization by the taxpayer and such comparable.

In regard to capacity utilization re-emphasizes the need for maintaining credible and accurate information for transfer pricing purposes. The decision is indeed welcome and perhaps seminal, addressing the concerns of industry and professionals alike and providing much needed guidance to the Revenue and taxpayers when making capacity utilization adjustments.

However, in case there are some differences between the comparables and the assessee, then the effect of such differences should be ironed out by making suitable adjustment to the operating profit margin of comparables. That is the way for bringing both the transactions, namely, the international transaction and the comparable uncontrolled transactions, on the same platform for making a meaningful and effective comparison. The above analysis overtly transpires that the law provides for adjusting the profit margin of comparables on account of the material differences between the international transaction of the assessee and comparable uncontrolled transactions. It is not the other way around to adjust the profit margin of the assessee. In other words, the net operating profit margin realized by the assessee from its international transaction is to be computed as such, without adjusting it on account of differences with the comparable uncontrolled transactions. The adjustment, if any, is required to be made only in the profit margins of the comparables.

Importance and impact of capacity utilisation adjustment is also explained by way of an example in Dy. CIT v Petro Araldite (P.) Ltd. [2013] 35 taxmann.com 590 (Mumbai - Trib.)[4].

[4] Dy. CIT v Petro Araldite (P.) Ltd. [2013] 35 taxmann.com 590 (Mumbai - Trib.), upheld by Bombay HC wide CIT v Petro Araldite (P.) Ltd. [2018] 93 taxmann.com 438 (Bombay).

Installed capacity in monetary terms	INR 10 crore	INR 10 crore	INR 10 crore
Capacity utilisation	50%	60%	80%
Sales	Rs 5 crore	Rs 6 crore	Rs 8 crore
Variable overheads at 50%	Rs 2.5 crore	Rs 3 crore	Rs 4 crore
Fixed overheads	Rs 2 crore (40%)	Rs 2 crore (33.33%)	Rs 2 crore (25%)
Net profit	Rs 0.5 crore	Rs 1 crore	Rs 2 crore
Profit margin (OP/Sales)	10%	16.67%	25%

The above example shows that the profitability changes with the change in the level of capacity utilization with higher profitability at higher utilization and lower profitability at lower realization. This happens mainly because of higher allocation or absorption of fixed overheads at lower capacity utilization which comes down as the level of capacity utilization goes up. For instance, as given in the above example, the rate of allocation or absorption of fixed overheads to sales is 40% at 50% capacity utilization while it becomes 33.33% at 60% capacity utilization and 25% at 80% capacity utilization giving more profit margin of 16.67% at 60% capacity utilization and 25% at 80% capacity utilization as against profit margin of 10% at 50% capacity utilization. The difference in capacity utilization thus materially affects the profit margin and if there is a difference in the level of capacity utilization of the assessee and the level of capacity utilization of the comparable companies, adjustment is required to be made to the profit margin of the comparables on account of difference in capacity utilization as per clause (e)(iii) of sub-rule (1) of Rule 10-B of the Income Tax Rules, 1962.

The adjustment thus can be made to the profit margin of the comparables by allocating fixed overheads at the same rate at which fixed overheads are allocated in the case of the tested party.

For example, in the case of a comparable having 80% capacity utilization, the rate of allocation of fixed expenses is 25% of the sales as against the rate of allocation of fixed overheads of 40% in the case of the tested party working at 50% capacity. Hence, adjustment needs to be made to make it comparable. Therefore, margin of comparable need to be computed by taking absorption rate of 40% instead of 25% rate of actual absorption.

Chapter 7
Documentation and Verification

Type of information and documents

7.1 Rule 10D(1) lays down thirteen different types of information and documents that a person has to keep and maintain in relation to the international transactions undertaken in a given financial year. Broadly, these information and documents may be classified into three types:

(i) enterprise-wise documents – These are documents that describe the enterprise, the relationships with other associated enterprise, the nature of business carried out, etc. This information is, largely, descriptive [clauses (a) to (c)].

(ii) transaction-specific documents – These are documents that explain the international transaction in greater detail. It includes information with regard to each transaction (nature and terms of the contract, etc.), description of the functions performed, assets employed and risks assumed by each party to the transaction, economic and market analyses, etc. This information is both descriptive and quantitative in nature [clauses (d) to (h)].

(iii) Computation related documents – These are documents which describe and detail the methods considered, actual working assumptions, policies etc., adjustments made to transfer prices and any other relevant information, data, document relied for determination of arm's length price [clause (i) to (m)].

7.2 The documentation requirements prescribed in section 92D read with Rule 10D applies not only to international transactions between associated enterprises but also to the deemed international transactions covered under Section 92B(2) of the Act as well as the specified domestic transactions covered under Section 92BA of the Act.

7.3 It is pertinent to note that the list of documents provided under Rule 10D are prescriptive in nature and it is not essential that each of the document be maintained in respect of each international transaction. While the documents like the one mentioned in point (i) and (ii) above needs to be maintained in respect of each international transaction/ specified domestic

transaction, need for maintaining documents mentioned in point (iii) should be critically analysed and maintained for each of the transaction and member may exercise his professional judgement regarding the same.

Ownership, profile and business

7.4 ***A description of the ownership structure of the Assessee enterprise with details of shares or other ownership interest held therein by other enterprises.[clause (a), Rule 10D(1)].***

7.5 It may be noted that the term "other enterprise" should refer to an associated enterprise with which the taxpayer has undertaken an international transaction undertaken in a given financial year. If this term were to be given the meaning provided in section 92F(iii), then it would virtually include every member in the register of members. No purpose would then be served by duplicating the contents of that register. Where the person is a company, the names of members who are associated enterprises, the number of shares held by each of them and the percentage of their holding to the total holding has to be stated.

7.6 However, where the number of members is very large, a generic classification of the ownership structure may be given, namely, holdings by Government (Central, State), Government companies, public financial institutions, nationalised and other banks, mutual funds, venture capitalists, foreign holdings, bodies corporate, directors and relatives, others. The holdings of associated enterprises must, in any case, be shown separately.

7.7 Where the person is a firm or an association of persons, the names of the partners of the firm or members of the association of persons and their profit sharing ratios have to be stated. Similar details, to the extent applicable, need to be furnished when the person is a body of individuals, trust, Hindu undivided family, etc. The description of the ownership structure should be stated as at the day on which one person became an associated enterprise of another and as at every other day on which there was change in the ownership interest of that other enterprise.

7.8 For example, assume that A Ltd., India and X Inc., USA, are associated enterprises, and the holdings of X Inc. in A Ltd. were as under:

(a)	Total number of 10, fully paid equity shares, issued by and subscribed in A Ltd.	100,000
(b)	Total number of shares of 10, fully paid up, held by X Inc. on 1st April, 2001	50,000

(c)	Total number of shares of Rs.10, fully paid up, acquired by X Inc. on 24th November, 2001 (by private purchase)	10,000
(d)	Total number of shares of Rs. 10, fully paid up, disposed of by X Inc. on 24th February, 2002 (by private sale)	25,000

Under this clause, A Ltd. will have to report the holdings of its Associated Enterprise, as follows:

Details		Details of ownership structure					
		Period from1.4.2001 to23.11.2001		Period from24.11.2001to23.2.2002		Period from24.2.2002 to31.3.2002	
		No. of shares	%	No. of shares	%	No. of shares	%
(a)	Directors, relatives and others	50,000	50	40,000	40	65,000	65
(b)	X Inc., USA (Associated Enterprise)	50,000	50	60,000	60	35,000	35

Where the ownership structure is complicated, the above tabular statement may be supplemented by a suitable diagrammatic representation of the ownership interest held by associated enterprises in the Assessee.

7.9 The regulations require the Assessee to maintain information regarding the shareholding pattern. Though there is no prescribed format for this information, following is the format that the Accountant may suggest to the Assessee.

S. No.	List of shareholders	Shareholding (%)

Further, ownership interest held by enterprises in the Assessee enterprise, directly or indirectly through intermediaries, also needs to be maintained by the Assessee. Accordingly, the identification of the ownership and the relationship with the associated enterprises is the primary responsibility of the Assessee.

7.10 The Accountant shall verify that the Assessee maintains information regarding enterprises having direct or indirect ownership interests, through intermediaries, in the Assessee enterprise. The Accountant is required to vouch the associated enterprises relationship as governed by Section 92A(1)(a); 92A(1)(b) and 92A(2) of the Income-tax Act, using his professional judgement. The Accountant may rely on the financial statement including the representation from the management with regard to the veracity of the same.

7.11 ***A profile of the multinational group of which the Assessee enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions or specified domestic transactions, as the case may be] have been entered into by the Assessee, and ownership linkages among them. [clause (b), Rule 10D(1)].***

7.12 As part of the profile of the multinational group, it may be advisable to maintain, amongst other things, corporate brochures, catalogues and other similar printed and / or electronic material that describe:

- The principal line(s) of business in which the group is engaged, such as manufacturing of electronic goods, trading in chemicals, wholesale trade in food grains, pharmaceuticals, etc.;
- Geographical areas in which the group one operates;
- Summarised global financials and other details such as capital invested, assets employed, turnovers achieved, incomes earned, profits made / losses incurred, etc.

7.13 With respect to each of the associated enterprises/ specified persons in the group with whom the Assessee has entered into international transaction / specified domestic transaction, the following specific details must be maintained:

- Name;
- Address;
- Legal status (company, limited liability partnership, firm, etc.);
- Country of tax residence;
- Ownership linkages between the Assessee and the associated enterprise.

Sometimes, the establishment of ownership linkages between the Assessee and other associated enterprises is a problem for the reason that sufficient reportable information is not available. In such cases, the Assessee will have to provide only the information that is available with him.

7.14 For example, A Ltd., India, is a 100% subsidiary of H Ltd., U.K., which itself is a 100% subsidiary of R Inc., USA.R Inc, also, has another subsidiary, C Ltd., Argentina. If, A Ltd. transacts with C Ltd., it will have to report the ownership linkage between itself and C Ltd. However, this information may not be available or even forthcoming from the ultimate holding company, R Inc.

7.15 However, some of these details would also be required to be reported by the ultimate holding company under the BEPS recommended three-tiered approach to TP documentation, consisting of master file, local file and CbC reporting. The assesse could source required data from such master file or CbC report, wherever applicable.

7.16 The Assessee is required to maintain a document that describes the profile of the multinational group. The member may exercise his professional judgment to determine whether the profile prepared by the Assessee provides sufficient information regarding the group, pertinent to transfer pricing. Some of the information that may be contained in the profile are as follows:

- the name and place of incorporation of the immediate parent company;
- the name and place of incorporation of the ultimate parent company;
- the major product lines, services offered by the group;
- a brief description of the technology, brands or other intangibles owned by the group;
- name(s) of major competitors.

Any other information regarding the group that may be pertinent to the transfer pricing analysis.

7.17 The Accountant has to verify if such a profile has been prepared and based on his understanding of the business of the Assessee and a test check of the documents and records of the Assessee, he is required to determine that the information contained in the profile is correct. In this regard, the

Accountant may place reliance on the master file of the Assessee, if applicable, to verify that the information contained in the report is correct.

7.18 The Assessee is also required to provide a list of associated enterprises / specified persons from within the group, with whom the Assessee has entered into international transactions / specified domestic transactions. The following details are required to be maintained by the Assessee:

- name of the group entity (associated enterprise / specified person)
- address of the group entity
- legal status
- nature of relationship
- country of tax residence.

7.19 The Accountant should obtain written representation from management (of the taxpayer) providing him with name, address**,** legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions or specified domestic transactions have been entered into by the Assessee, and ownership linkages among them. He shall exercise his professional judgement and due diligence to verify that the same is *prima facie* correct. The Accountant should place reliance on the evidence/documents provided by the Assessee to satisfy himself as to the accuracy of these facts. The Accountant could verify the data from master file or CbC report, wherever applicable and prepared by the Assessee.

7.20 The Accountant shall perform certain checks in regard to the various categories and situations in which the two enterprises are associated enterprises as provided in section 92A(1) and clause (a) and (b) of section 92A(2).A reference should be made to the tax audit report. He should also check the register of members maintained by the Assessee under section 88 of the Companies Act, 2013and the voting rights corresponding to the shares of the associated enterprise / specified persons.

7.21 ***A broad description of the business of the Assessee and the industry in which the Assessee operates, and of the business of the associated enterprises with whom the Assessee has transacted [Clause (c), Rule 10D (1)].***

7.22 Under this clause, a general explanation of the business carried out by the Assessee and the associated enterprise/ specified person with whom

it has transacted has to be stated. Where the Assessee/ associated enterprise / specified person are engaged in more than one line of business, the explanation will have to cover all businesses.

7.23 This explanation could typically cover areas such as:

- the business model used;
- technologies employed;
- products manufactured/traded;
- markets addressed and competition faced;
- geographic dispersion of manufacturing facilities etc.

7.24 The broad description of the industry in which the Assessee operates will include reports about the industry, which are available in the public domain. This could be material published in business newspapers, trade journals and magazines, etc. all of which provide a macro-economic perspective to the industry.

Associated Enterprises relationship with the Assessee

7.25 The Assessee has to determine whether by virtue of clauses (c) to (m) of section 92A(2) certain enterprises shall be deemed as associated enterprises. The Accountant shall conduct the following checks to verify if the Assessee has conducted due diligence in determining whether an entity is an associated enterprise or not.

Clause (c)*:* The Accountant should check the register of loans and investments maintained by the Assessee under section 186 of the Companies Act, 2013.

Clause (d): The Accountant shall obtain details of all the guarantees pertaining to the borrowing from the management and representation for its completeness thereof.

Clause (e): The Accountant shall obtain a representation from management detailing composition and appointment of the members of board of directors or governing board, Executive Directors and Executive Member of the governing board. Further the member shall check the Register of Directors maintained by the company under section 170 of the Companies Act, 2013

Clause (f): The Accountant shall obtain a representation from the management detailing composition and appointment of the members of board of directors or governing board, Executive Directors and Executive Member of the governing board. Further the member shall check the Register of Directors maintained by the both companies under section 170of the Companies Act, 2013

Clause (g): The Accountant shall obtain a representation from the management to the fact that enterprise is wholly dependent upon the intangible assets such as know-how, patents, copyrights, trademarks, licenses, franchises, or other commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or has exclusive right.

Clause (h): The Accountant shall obtain the details of all the purchases of raw material and consumable requirement made by the Assessee and compute the party wise share of business i.e. party-wise purchases. He shall obtain representation from the management to the fact that the information provided is correct and complete.

Clause (I): The Accountant shall obtain a representation from the management to the fact that enterprise sold the goods or articles manufactured or processed by it, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise

Clause (j) (Individual): The Accountant shall obtain a representation from management providing details of controlling interests in all the affiliated parties so as to determine the common controlling interest in two companies.

Clause (k) (HUF): The Accountant shall obtain a representation from management providing details of controlling interests in all the affiliated parties so as to determine the common controlling interest in two companies.

Clause (l): The Accountant shall obtain the partnership/AOP/BOI agreement in order to determine whether any enterprise holds not less than ten per cent interest in other firm, association of persons or body of individuals.

Clause (m): The Accountant shall obtain a representation from management to the effect that there exists or does not exist between the two enterprises, any relationship of mutual interest in case any such relationship is prescribed

by CBDT. The Accountant shall exercise his professional judgement and due diligence to verify that the same is prima facie correct.

7.26 The Accountant should obtain written representation by management detailing the overview of the business of the Assessee and a description of the business of the associated enterprises / specified persons with whom the Assessee has transacted.

7.27 Following is the illustrative checklist to carry out business analysis of the Assessee:

(a) year of establishment/incorporation;

(b) name and residence of the parent company (holding company);

(c) details of the place/s (units) from where services are rendered (including area occupied, infrastructure, etc.);

(d) activity in brief (if there is more than one unit, details of activities in each unit);

(e) stake-holding of the parent company;

(f) legal environment of the industry;

(g) key value drivers of the industry;

(h) major players in the industry;

(i) share of business in the industry;

(j) trends in profitability, turnover, market share etc;

(k) Intangibles of the business.

A similar description of the business of the associated enterprises with whom the Assessee has undertaken international transactions, is also to be prepared by the Assessee. The Accountant shall verify if such description is also maintained.

Herein, it may be noted that transactions with parties under section 94A, will also come within the purview of section 92A

Details of international transactions / specified domestic transactions

7.28 ***The nature and terms (including prices) of international transactions [or specified domestic transactions, as the case may***

be]entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction [clause (d), Rule 10D(1)].

7.29 The list of individual international transactions / specified domestic transactions entered into by the Assessee with each of its associated enterprises/ specified persons is required to be stated here. For ease in comprehension and verification, the details may be compiled and presented in a tabular form giving the details required.

7.30 While the data may be classified in any convenient manner, for the purpose of facilitating the study of comparability, it is suggested that the nature of the property transferred or service provided be used as the primary key.

7.31 In addition to the standard inclusions such as name of associated enterprise / specified person, product transferred or service provided, quantity, price per unit of measurement etc., the data should, also, provide information on matters such as:

- form and time of payment;
- discounts;
- shipment;
- purchase commitments;
- product returns by the customer;
- supportive services; etc.

The listing should, also, include transactions where the property has been transferred or service has been provided "free of cost". The Accountant may also obtain written representation detailing the services provided / received by associated enterprises.

7.32 The Accountant should examine the details of nature and terms (including prices) of international transactions/ specified domestic transactions entered into with each associated enterprise / specified person, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction. The Accountant should verify the information provided by the Assessee, by using standard examination procedures from the books of accounts maintained by the Assessee and information/explanations obtained during the course of such examination.

7.33 ***A description of the functions performed, risks assumed and assets employed or to be employed by the Assessee and by the associated enterprises involved in the international transaction[or specified domestic transaction, as the case may be][clause (e), Rule 10D(1)].***

7.34 The Assessee is required to undertake and describe the results of a detailed functional analysis of the business process involved in the transaction with the associated enterprise / specified person. In analysing of the business process, the study should not only cover the activities of the resident enterprise but, also, the activities of the non-resident enterprise. In other words, it is the business process that it analysed and not the enterprise.

7.35 The functional analysis should be made from the perspective of the "functions performed", "assets employed" and "risks assumed". Simply put, a 'functional analysis' is a study to determine what economically significant acts were performed in accomplishing the transactions in question and who performed them.

7.36 The role of functional analysis is to:

(a) determine the facts with respect to a given transaction between the related parties; and

(b) set the stage for the choice of tested party followed by the choice of the pricing method by providing the framework within which comparable transactions may be determined

7.37 The Assessee shall undertake a detailed functional analysis of the company and its associated enterprise / specified person in order to determine the functions performed, risks assumed and assets employed by the Assessee and by the associated enterprises / specified persons involved in the international transaction / specified domestic transaction. A functional analysis is a method of finding and organizing facts about a business in terms of its functions, risks and intangibles in order to identify how these are divided up between the companies involved in the transaction under review. The functions and risks are analyzed to determine the degree of risks undertaken, the value of the intangibles provided and whether the profits (or losses) earned by the entities are commensurate with the functions performed. Functional analysis thus helps in assessing the correct characterization of the parties to the transaction which in turn helps in

selecting the appropriate tested party and consequentially the most appropriate methods and the comparables.

7.38 A functional analysis attempts to identify all value added activities. The identification of the relevant value added activity helps in identifying the specific risks associated with the transaction. In addition, functional analysis identifies specialized business assets that increase the chances of success (such as key employees or marketing intangibles).

7.39 To conduct a full functional analysis, it is necessary to gather information. To execute this, the company shall either interview or get questionnaires filled by the key personnel related to the various functions performed by the company.

7.40 The Accountant shall obtain a representation from management to the effect that the functional analysis so done is complete and covers all the functions performed by the company.

Records having a bearing on international transaction / specified domestic transaction

7.41 ***A record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the Assessee for the business as a whole and for each division or product separately, which may have a bearing on the international transactions or specified domestic transactions, as the case may be] entered into by the Assessee [clause (f), Rule 10D(1)].***

7.42 Whereas under clause (c) in para 7.27, above, study need to be carried out about the business in which the Assessee operated (macro). At the same time, under this clause, study of the business in which the Assessee operates (micro), so be carried out.

7.43 Where Assessees, in the normal course of their business, use general and financial and management tools (such as market analyses, marginal and absorption costing, capital and revenue budgeting, variance analysis, etc.) to control and run their business, the data captured in the process may be used to ascertain whether the arm's length principle has been complied with.

However, where these techniques are not in use, historical data cannot be used as a substitute.

7.44 The Accountant shall obtain copies of budgets or forecasts, if any, from the management and shall exercise his professional judgement to ensure its correctness and validity. He shall also obtain the representation from management to the effect that all the budgets and forecasts prepared are being provided. The Accountant is not required to comment on the appropriateness or otherwise of the details prepared or maintained by the Assessee. The Accountant with due care has to place reliance on the management of the Assessee to satisfy himself as to the accuracy of these facts.

It may so happen that the company is not in the practice of preparing any forecast, budgets or other financial estimates. The Accountant should then disclose this fact suitably.

7.45 ***A record of uncontrolled transactions taken into account for analysing their comparability with the international transactions or specified domestic transactions, as the case may be] entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions [or specified domestic transactions, as the case may be] [clause (g), Rule 10D(1)].***

7.46 This record is a compilation of the uncontrolled transactions that were identified and taken for analyzing whether they would pass the test of comparability. This is no more than raw data, prior to processing. In the process of creating this record, the enterprise has to prove the integrity of the following two critical parameters:-

(i) The enterprise must establish that the uncontrolled transactions listed include transactions in only those products or services in respect of which the enterprise has dealt with associated enterprises / specified persons.

Assume that the enterprise manufactures various types of caustic soda (e.g., industrial grade, commercial grade, membrane grade, etc.).Also, assume that transactions with associated enterprises have been in respect of only one type of caustic soda (say, membrane grade).Then, when the required list is being prepared, the enterprise must ensure that the uncontrolled transactions that have been included must be only of that membrane grade and not include other types, which are irrelevant. This is especially relevant in cases where Comparable Uncontrolled Price Method is used as the most

appropriate method for analysis the arm's length nature of the concerned international transaction. However, where other methods are used, say Cost Plus Method, Resale Price Method, some relaxation in the comparability parameters (evaluated for the purpose of the analysis) could be adopted whereby overall basket of products (say caustic soda in the above example) could be considered as comparable. The yardstick could be further relaxed in case Transactional Net Margin Method is used whereby companies dealing in similar products and having similar functional profiles could be considered as comparable. To illustrate, in the above example, in case Transactional Net Margin Method is used as the most appropriate method, manufacturers of chemicals (having similar functional profile as the tested party) could be considered as comparables.

(ii) The enterprise must also confirm that the listing of uncontrolled transactions is complete and that no similar or identical transactions have been omitted.

7.47 For example, if the enterprise is dealing in electronic components (integrated circuits and printed circuit boards) and its transactions with associated enterprises have been conducted throughout the year, the enterprise must establish that the database from which the list has been compiled at least covers the period during which transactions with the associated enterprise took place.

The enterprise should maintain / provide detailed reasons as to why particular set of data points can be or cannot be considered as comparable to the international transaction / specified domestic transaction under consideration.

7.48 In order to conduct an analysis the enterprise is required to collect data regarding comparable uncontrolled transaction or comparable companies engaged in similar business. The enterprise has to prepare a search memo detailing the process of identification of comparable uncontrolled transaction and/or comparable companies. The enterprise has to provide information regarding the databases used for the search and economic rationale for the selection/rejection of transaction/companies. The summary of the selection/rejection process has to be documented through a search matrix. Further, the enterprise should demonstrate that the analysis undertaken to determine the comparables is scientific and does not represent a cherry picking. In summary, the enterprise must prove that the rationale

used by it in the process of searching for and including/excluding uncontrolled transactions is correct, logical and complete. For the said purpose, the Assessee may place reliance on the global transfer pricing guidelines[1].

7.49 The Accountant shall examine details of the comparable transactions/data compiled by the enterprise. Further, exercising his professional judgement, the Accountant should verify that the data used to determine / analyse the arm's nature of the price of the international transaction/ specified domestic transaction is in tune with the findings of the functional analysis. This would ensure the authenticity of the price so arrived on the basis of the data.

7.50 ***A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction [or specified domestic transaction, as the case may be] [clause (h), Rule 10D (1)].***

7.51 The process to be described under this clause (record of analysis of data) is the naturally corollary to the process described in immediately preceding clause, clause (g) (record of compilation of data).

7.52 In trying to arrive at the comparability between uncontrolled transactions and international transactions / specified domestic transactions, the enterprise has to, amongst other things, carryout the process of resolving any differences that may exist between them. These differences could be for the reasons stated in Rule 10B (2) or for any other reason also. Under this clause, the enterprise has to detail the analysis that he has conducted on each of the uncontrolled transactions in determining whether or not it is comparable to an international transaction / specified domestic transaction.

7.53 The Accountant needs to report the details of the method adopted by the Assessee to benchmark the transaction. In this regard, Accountant is not obligated to ascertain whether the method adopted by the Assessee is the most appropriate method (the selection of the most appropriate method is the responsibility of the Assessee; Accountant is not required to assess / comment on the appropriateness of the same). Rather, the Accountant should check the facts and the method stated has indeed been applied by the Assessee to the benchmark the transaction.

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[12]. *OCED guidelines / UN TP Manual*

Description of methods considered and working thereof

7.54 ***A description of the methods considered for determining the arm's length price in relation to each international transaction [or specified domestic transaction, as the case may be] or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case [clause (i), Rule 10D(1)].***

7.55 When ascertaining the "most appropriate method", the provisions of section 92C(1) and Rule 10C must be kept in mind. Given that the law envisages selection of the "most appropriate method" for ascertaining the arm's length nature of the international transaction or specified domestic transaction, it is required that each of the six prescribed methods are duly analysed before selecting one as the most appropriate.

7.56 Under this clause, the Assessee has to describe the nature of the international transaction / specified domestic transaction, explain why the method chosen is the most appropriate method (may be, even, explaining why other methods were excluded) and then detail the manner in which the method was applied to the transaction under examination. In detailing the manner in which the method was applied, a numerical exercise is not expected. This is because the detailing of the arithmetic process is included under clause (j), infra.

7.57 The OECD, in their Transfer Pricing Guidelines has set out the optimal conditions under which a particular method is more suited than another. For example, the cost plus method is "probably is most useful where semi-finished goods are sold between associated parties, where associated parties have concluded joint facility agreements or long-term buy-and-supply arrangements, or where the controlled transaction is the provision of services."

By using these guidelines and analysing the intrinsic nature of the international transaction /specified domestic transaction, it may be possible to determine which is the most appropriate method to be applied to each transaction.

7.58 This exercise has to be carried out once for every type of international transaction / specified domestic transaction; and

7.59 As stated in para 7.53 above, the primary responsibility for selection of the most appropriate method is the responsibility of the Assessee. The Accountant is not required to assess or comment on the appropriateness of the same. It needs to report the details of the method adopted by the Assessee to benchmark the transaction.

7.60 ***A record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction [or specified domestic transaction, as the case may be]and the comparable uncontrolled transactions, or between the enterprises entering into such transactions [clause (j), Rule 10D (1)].***

7.61 Once the enterprise has compiled the raw data [clause (g)], analysed the data for comparability [clause (h)] and chosen the most appropriate method [clause (i)], the next step would be to perform the actual exercise of arriving at the arm's length price. This is the process that is contemplated under this clause.

7.62 Here, the enterprise will have to detail all the mathematical iterations and steps that have been undertaken to arrive at the arm's length price. Where any assumptions have been made, or where any critical factors have affected the determination of the arm's length price, the numerical effect of these factors have not only to be stated but computed. The actual listing of these assumption, factors, etc. is required to be done under the provisions of clause (k), infra. Also, detailed working in respect of the adjustments undertaken by the enterprise needs to be detailed.

7.63 In assigning numbers to qualitative factors such as policies, price negotiations, etc. there may be an element of subjectivity. The enterprise may have to conclusively establish that no element of bias has entered the computational process.

7.64 The documentation on economic analysis shall also provide for the details of the data used and data rejected with reasons thereof. Also, different companies follow different accounting policies and there may be differences in respect of terms of sale etc., these variations call for certain adjustments in the financial to make the data comparable. The reasons and the adjustments so made should also be recorded.

7.65 The Accountant should examine the correctness of such working and the adjustments made with reference to the relevant information and data.

7.66 *The assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price [clause (k), Rule 10D (1)].*

7.67 This part requires the enterprise to render a narrative description of the various assumptions, policies, price negotiations that have been considered in determining the arm's length price.

7.68 An example of an assumption affecting the determination of the arm's length price could be the buyer's commitment to purchase certain specified quantities of the product.

7.69 Examples of a policy affecting the determination of the arm's length price could be

- the enterprise's decision to make his borrowings in overseas markets (where the rates are lower than as compared with indigenous banks) and reduce the interest component in his product cost sheet
- market penetration strategy, wherein the products/ services of the enterprise could be priced lower than the market in order to create a market for itself. This could also lead to the enterprise making operating losses in the start-up phase i.e. first few years of its operations.
- credit policy of the enterprise, which would lead to different working capital cycles between enterprises operating in the same industry, thereby also affecting prices and sales realization
- sales being made by the enterprise to its associated enterprise in order to make optimal use of its production capacity (which has no alternate use) whereby the concept of marginal costing rather full costing is used to derive the transfer price

7.70 An example of a price negotiation affecting the determination of the arm's length price could be the manner in which the supplies are paid for. For example, a supply to an associated enterprise in China may get a better price if the payment is received in US Dollars instead of Chinese Yuan. Another example could be where an associated enterprise in Nigeria may get a better price if the letter of credit is accepted by a UK Bank rather than a local bank.

7.71 The Accountant shall obtain information about the assumptions, policies and price negotiations, if any, including understanding of the business/commercial reasons which influenced the determination of the arm's length price by way of representation from the management of the Assessee. The Accountant shall examine the functional analysis and the results of the economic analysis to determine the assumptions, policies and price negotiations that have been considered for determining the arm's length price and shall verify if the enterprise has maintained a document explicitly stating these assumptions, policies and price negotiations.

7.72 *Details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under these rules and consequent adjustment made to the total income for tax purposes [clause (l), Rule 10D(1)].*

7.73 This process requires the enterprise to prepare a reconciliation statement detailing how the actual transaction value can be compared with the arm's length price. This is a critical process in order to ensure a like to like comparison (to the extent possible). This is a two-stage process, detailed below.

7.74 Where the international transaction has certain characteristics that are absent in the uncontrolled transaction, the value of these characteristics has to be computed and reduced from the value of the international transaction.

7.75 Correspondingly, where the international transaction/ specified domestic transaction does not have certain characteristics that are present in the uncontrolled transaction, the value of these characteristics has to be computed and included in the value of the international transaction / specified domestic transaction.

Some common adjustments that are carried out to achieve the above are:

- Working capital adjustment
- Risk adjustment
- Idle capacity adjustment/ Start-up cost adjustment
- Depreciation adjustment

The enterprise would need to maintain detailed workings demonstrating the computation of the adjustments, the basis used to arrive at the same as well the source of data used to obtain financial information for the computation of such adjustment.

7.76 In case there is a difference between the transaction price and the arm's length price, the transaction price is required to be aligned to the arm's length price.

7.77 The Accountant shall review the adjustments (whenever required) made to transfer price / benchmarking analysis of the company so as to align it with the arm's length prices / transfer price, as determined under these rules and verify that consequent adjustment is made to the total income for tax purposes.

7.78 ***Any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price [clause (m), Rule 10D (1)].***

7.79 This is a residuary clause that allows the enterprise to use any other extraneous reasons that may have affected its judgement in the process of complying with the arm's length principle.

7.80 An example of such a situation could be when a loss-making enterprise sells goods to an associated enterprise at less than the "arm's length price" only because this is the only way in which the enterprise may be able to absorb fixed costs/ overheads.

7.81 Where any other information, data or document has been considered relevant for the determination of arm's length price by the Assessee, the Accountant shall by placing reliance on the written representation from the management of the Assessee review the correctness of the same.

Relief from maintenance of specific records

7.82 ***Nothing contained in sub-rule (1) in so far as it relates to an international transaction shall apply in a case where the aggregate value, as recorded in the books of account, of international transactions entered into by the Assessee does not exceed one crore rupees:***

Provided that the Assessee shall be required to substantiate on the basis of material available with him, that income or expenses as the case may be arising from international transactions entered into by him has been computed in accordance with section 92. [Rule 10D(2)]

7.83 The ceiling limit of INR 1 crore is with reference to an Assessee and not with reference to any undertaking or unit. The limit applies with reference to all the international transactions entered into during a previous year. The amount is reckoned on the basis of the aggregate value of international

transaction as recorded in the books of account of the Assessee. In case of Assessees who fall within this category in a particular previous year, relief given is from maintaining the specific records and detail documents prescribed in rule 10D. There is no exemption for such Assessees in obtaining and furnishing audit report under section 92E of the Act.

7.84 It requires to be mentioned that even in such cases, the onus lies on the Assessee to substantiate that income or expense as the case may be arising from international transaction has been computed on the basis of arm's length price. It is, therefore, necessary for those Assessees to maintain such materials or records as may enable them to discharge the burden of proof cast on them. The Accountant, in such cases, is required to examine the records so maintained and satisfy himself that the material in the possession of the Assessee is relevant and proper for the purpose of expressing his opinion in the report to be issued in Form No.3CEB.

Supporting documents

7.85 ***The information specified in sub-rule (1) and 2A shall be supported by authentic documents, which may include the following:***

(a) official publications, reports, studies and data bases from the Government of the country of residence of the associated enterprise or of any other country;

(b) reports of market research studies carried out and technical publications brought out by institutions of national or international repute;

(c) price publications including stock exchange and commodity market quotations;

(d) published accounts and financial statements relating to the business affairs of the associated enterprises;

(e) agreement and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions or the specified domestic transactions as the case may be;

(f) segmented financial statements in accordance with the Accounting standards as prescribed;

(g) letters and other correspondence documenting any terms negotiated between the Assessee and the associated enterprise;

(h) documents normally issued in connection with various transactions under the accounting practices followed.

[Rule 10D(3)]

7.86 Rule 10D(3) provides that the information compiled, kept and maintained by the enterprise, under clauses (a) to (m) of sub-rule (1), shall, to the extent possible, be further supported by "authentic" documents that provide additional information of the nature specified therein. Most of the information required to be provided is global or macro in nature.

7.87 The above documents are required to substantiate the functional and economic analysis performed by the enterprise. The Accountant shall review the contents of the functional and economic analysis and shall verify whether the enterprise has maintained back-up data listed above to substantiate the facts and figures given in the documents listed in Rule 10D(1).

Contemporaneity of data

7.88 ***The information and documents specified under sub-rules (1), (2), and (2A), should, as far as possible, be contemporaneous and should exist latest by the specified date referred to in clause (iv) of section 92F:***

Provided that where an international transaction or specified domestic transaction continues to have effect over more than one previous year, fresh documentation need not be maintained separately in respect of each previous year, unless there is any significant change in the nature of terms of the international transaction or specified domestic transaction, in the assumptions made, or in any other factor which could influence the transfer price, and in case of such significant change, fresh documentation as may be necessary under sub-rules (1), (2) and (2A) shall be maintained bringing out the impact of the change on the pricing of the international transaction or the specified domestic transaction.[Rule 10D(4)]

The information and documents specified in sub-rules (1), (2) and (2A) shall be kept and maintained for a period of eight years from the end of the relevant assessment year[Rule 10D(5)].

7.89 The Accountant may design a questionnaire and conduct interviews with the client personnel (wherever necessary) to understand if the enterprise has taken due diligence with regard to maintaining documentation. The Accountant should determine whether any changes have occurred in the business conditions under which the enterprise was operating. The enquiries may cover the following areas:

- changes in business and pricing strategy;
- changes in market conditions [demand / supply] in India and in the country where the associated enterprise is located;
- changes in the "key" value drivers of the industry;
- changes in the critical success factors that influence the company's position in the market;
- changes in competition;
- changes in terms of contract;
- changes in sales volumes / total revenues arising as a result of the international transactions.

7.90 The above exercise would assist the Accountant in evaluating the appropriateness of the functional / economic analysis undertaken by the Assessee.

7.91 In case the changes above, are not likely to influence the economic analysis conducted in the earlier year/years, the enterprise's role may be limited to the following:

- examine whether comparability analysis of the earlier year continues to be applicable [a comparable uncontrolled transaction in the earlier year may now have become a controlled transaction due to certain changes in the business conditions; a comparable company selected in the earlier year may now have started transacting with associated enterprises; etc.].This is more relevant for transactions whose pricing basis as well the computation mechanism remain changed over a period of time (say royalty arrangements).
- update the financial analysis using the fresh list of comparables [after rejecting companies / transactions that are no longer comparable] and using the financial information for the current year [this is because, the Indian economy cannot still be considered a stable

economy and prices and profit levels may fluctuate significantly from year to year].

- determine the arm's length price for the current year using the result of the financial analysis conducted in the current year.

7.92 Rule 10D (4) provides that the data, information and documents on the basis of which the arm's length price has been determined should, as far as possible, be contemporaneous. At any rate, they should exist by no later than the specified date by which the report under section 92E is required to be furnished. Where the international transaction / specified domestic transaction has longevity that spans one or more previous years, the enterprise need not prepare fresh documentation in respect of the transactions conducted in every subsequent previous years.

7.93 However, when there is a significant change in the nature or terms of the international transaction or specified domestic transaction, in the assumptions made, or in any other factor, which could influence the transfer price, then fresh documentation, as appropriate, should be made to bring out the impact of the changes on the pricing of the international transaction.

7.94 The information and documents required to be maintained under section 10D shall be preserved for a period of eight years from the end of the relevant assessment year. This provision assumes significance in view of the penal and other consequences attracted due to non-production of the information and documents kept and maintained. Reference is drawn to CBDT Circular No.12 dated 23.08.2001 **(Annexure IV)** relaxing this requirement for transactions entered into during the period from 1.4.2001 to 31.8.2001.

Master File[2]

7.95 Further Rule 10D(A) was inserted by IT (Second Amendment) Rules, 2020, w.e.f. 1-4-2020 to provide for rules relating to applicability and preparation of master file. The said rule provides as below:

[2] As the Guidance Note is only in respect of section 92E of the Act, discussion on Master File is avoided. To learn more on this other materials may be studied.

10DA. *(1) Every person, being a constituent entity of an international group shall,—*

(i) *if the consolidated group revenue of the international group, of which such person is a constituent entity, as reflected in the consolidated financial statement of the international group for the accounting year, exceeds five hundred crore rupees; and*

(ii) *the aggregate value of international transactions,—*

(A) during the accounting year, as per the books of account, exceeds fifty crore rupees, or

(B) in respect of purchase, sale, transfer, lease or use of intangible property during the accounting year, as per the books of accounts, exceeds ten crore rupees

keep and maintain the following information and documents of the international group, namely:—

a) a list of all entities of the international group along with their addresses;

b) a chart depicting the legal status of the constituent entity and ownership structure of the entire international group;

c) a description of the business of international group during the accounting year including,—

(I) *the nature of the business or businesses;*

(II) the important drivers of profits of such business or businesses;

(III) a description of the supply chain for the five largest products or services of the international group in terms of revenue and any other products including services amounting to more than five per cent of consolidated group revenue;

(IV) a list and brief description of important service arrangements made among members of the international group, other than those for research and development services;

(V) a description of the capabilities of the main service providers within the international group;

(VI) details about the transfer pricing policies for allocating service costs and determining prices to be paid for intra-group services; DD

(VII) *a list and description of the major geographical markets for the products and services offered by the international group;*

(VIII) *a description of the functions performed, assets employed and risks assumed by the constituent entities of the international group that contribute at least ten per cent of the revenues or assets or profits of such group; and*

(IX) *a description of the important business restructuring transactions, acquisitions and divestments;*

d) a description of the business of international group during the accounting year including,—

e) a list of all entities of the international group engaged in development and management of intangible property along with their addresses;

f) a list of all the important intangible property or groups of intangible property owned by the international group along with the names and addresses of the group entities that legally own such intangible property;

g) a list and brief description of important agreements among members of the international group related to intangible property, including cost contribution arrangements, principal research service agreements and license agreements;

h) a detailed description of the transfer pricing policies of the international group related to research and development and intangible property;

i) a description of important transfers of interest in intangible property, if any, among entities of the international group, including the name and address of the selling and buying entities and the compensation paid for such transfers;

j) a detailed description of the financing arrangements of the international group, including the names and addresses of the top ten unrelated lenders;

k) a list of group entities that provide central financing functions, including their place of operation and of effective management;

l) a detailed description of the transfer pricing policies of the international group related to financing arrangements among group entities

m) a copy of the annual consolidated financial statement of the international group; and

n) a list and brief description of the existing unilateral advance pricing agreements and other tax rulings in respect of the international group for allocation of income among countries.

The information and document specified under sub-rule (1) shall be furnished to the Joint [3a] **[***Director***]** *referred to in sub-rule (1) of rule 10DB, in Form No. 3CEAA on or before the due date for furnishing the return of income as specified under sub-section (1) of section 139.*

The constituent entity shall furnish Part A of Form No. 3CEAA even if the conditions specified under sub-rule (1) are not satisfied.

Country by Country Reporting (CbCR)[3]

7.96 Section 286 read with Rule 10DB contains detail provision with respect preparation and submission of CbCR. The provision requires every constituent entity of an international group having turnover of 6400 crores or more to furnish following information:

(a) whether it is the alternate reporting entity of the international group; or

(b) the details of the parent entity or the alternate reporting entity, if any, of the international group, and the country or territory of which the said entities are resident.

Sub-section (2) of the said section provides that every alternate reporting entity or the parent entity needs to furnish a report within 12 months from the end of accounting year. Subsection (4) also provide that any entity other than entity referred to in subsection (2) also needs to furnish the said report in cases where.

(a) where the parent entity is not obligated to file the report of the nature referred to in sub-section (2);

(aa) with which India does not have an agreement providing for exchange of the report of the nature referred to in sub-section (2); or

[3] As in respect of Master File

(b) there has been a systemic failure of the country or territory and the said failure has been intimated by the prescribed authority to such constituent entity:

7.97 Rule 10DB provides rules in respect of furnishing of Report

The various requirements for filing the report are as per the various sub-rules of Rule 10DB:

"(1) The income-tax authority for the purposes of section 286 shall be the Joint Director as may be designated by the Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems), as the case may be.

(2) The notification under sub-section (1) of section 286 shall be made in Form No. 3CEAC two months prior to the due date for furnishing of report as specified under sub-section (2) of said section.

(3) Every parent entity or the alternate reporting entity, as the case may be, resident in India, shall, for every reporting accounting year, furnish the report referred to in sub-section (2) of section 286 in Form No. 3CEAD.

(4) The period for furnishing of the report under sub-section (4) of section 286 by the constituent entity referred to in that sub-section shall be twelve months from the end of the reporting accounting year:

Provided *that in case the parent entity of the constituent entity is resident of a country or territory, where, there has been a systemic failure of the country or territory and the said failure has been intimated to such constituent entity, the period for submission of the report shall be six months from the end of the month in which said systemic failure has been intimated*.

(5) The information required to be conveyed under proviso to sub-section (4) of section 286 regarding the designated constituent entity shall be furnished in Form No. 3CEAE.

The report required to be furnished shall include following:

(*a*) the aggregate information in respect of the amount of revenue, profit or loss before income-tax, amount of income-tax paid, amount of income-tax accrued, stated capital, accumulated earnings, number of employees and tangible assets not being cash or cash equivalents, with regard to each country or territory in which the group operates;

(*b*) the details of each constituent entity of the group including the country or territory in which such constituent entity is incorporated or organised or established and the country or territory where it is resident;

(*c*) the nature and details of the main business activity or activities of each constituent entity; and

(*d*) any other information as may be prescribed.

Chapter 8
Penalties

Introduction

To ensure the compliances with regard to transfer pricing provisions, various penalty provisions are provided in the law. As per Para 4.5 of OECD TP Guidelines 2017, the three aspects which often impact on how tax administrations determine their administrative response to ensure compliances with their own transfer pricing rules are: examination practices, the burden of proof, and penalty system. Para 4.19 of OECD TP Guidelines 2017 provides that no-fault penalty is against the principles of legal systems of many jurisdictions. The Indian Income-tax Act provides the following penalties for non-compliance of transfer pricing provisions.

Penalty for concealment of income or furnishing inaccurate particulars thereof[1]

8.1 The erstwhile section 271(1)(c)(iii) provides that if the Assessing Officer or the Commissioner (Appeals) or the Principal Commissioner or Commissioner is satisfied that any person has concealed the particulars of his income or furnished inaccurate particulars of such income, he may direct that such person shall pay by way of penalty, in addition to any tax payable by him, a sum which shall not be less than, but which shall not exceed three times, the amount of tax sought to be evaded by reason of the concealment of particulars of his income or the furnishing of inaccurate particulars of such income.

8.2 Explanation 7, was inserted to the aforesaid section by Finance Act, 2001 with effect from April 1, 2002.This explanation is invoked only when any amount is added or disallowed in computing the total income under section 92C(4).The explanation provides that the amount added/disallowed under this section (i.e., any addition on account of international transaction) shall be deemed to represent the income in respect of which particulars have been concealed or inaccurate particulars have been furnished.

[1] Omitted vide Finance Act 2016

8.3 The explanation creates a rebuttable presumption of concealment or furnishing of inaccurate particulars. The burden of rebuttal is on the assessee and it does not shift to the Department. The assessee is required to prove that he has acted in good faith and with due diligence. If it is so proved, the addition/disallowance shall not be deemed to represent concealed income/inaccurate furnishing of particulars of income.

8.4 While Section 273B states that no penalty shall be imposed if the assessee proves that there was a reasonable cause for the said failure, however given that the provisions of section 273B do not apply to a penalty under section 271(1)(c), the assessee must discharge the burden laid down in Explanation 7 only to contest the non-imposition of penalty under the said section.

8.5 For non-imposition of the penalty under this section, the explanation requires the assessee to prove that the price charged or paid was computed in good faith and with due diligence.

8.6 The aforesaid section was further amended with effect from FY 2012-13 to include therein the reference of specified domestic transactions.

Penalty for under reporting and misreporting of income

8.7 Section 271(1)(c) was deleted by the Finance Act 2016 and in its place section 270A was inserted which is applicable from 1 April 2017. It seeks to levy penalty for under-reporting and misreporting of income.

8.8 Section 270A (7) of the Act prescribes a penalty of 50% of the amount of tax payable on the under-reported income. Further, Section 270A(6)(d) provides that the under-reported income for the purpose of Section 270A shall not include the amount of under-reported income represented by any addition made in conformity with the arm's length price determined by the Transfer Pricing Officer, where the assessee had:

a) maintained information and documents as prescribed under section 92D,

b) declared the international transaction under Chapter X, and,

c) disclosed all the material facts relating to the transaction.

8.9 Section 270A(8) of the Act provides that where under-reported income is in consequence of any misreporting thereof by any person, the penalty shall be equal to two hundred per cent of the amount of tax payable

on under-reported income. Section 270A(9)(f) of the Act provides that the case of misreporting of income shall include failure to report any international transaction or any transaction deemed to be an international transaction or any specified domestic transaction, to which the provisions of Chapter X apply.

Immunity from imposition of penalty

8.10 Section 270AA was inserted by the Finance Act 2016 which is applicable from 1 April 2017. It seeks to grant immunity from imposition of penalty.

8.11 Section 270AA provides that an assessee may make an application to the Assessing Officer to grant immunity from imposition of penalty under section 270A, where the assessee had (a) paid the tax and interest payable as per the order of assessment or reassessment under sub-section (3) of section 143 or section 147 within the period specified in notice of demand, and, (b) no appeal against the order referred to in clause (a) has been filed.

Section 270AA(2) of the Act provides that application shall be made within one month from the end of the month in which the order referred to in clause (a) of sub-section (1) has been received and shall be made in such form as prescribed.

8.12 The immunity is granted only after fulfilment of the conditions specified in Section 270AA(1) of the Act and after the expiry of the period of filing the appeal as specified in clause (b) of sub-section (2) of section 249. No immunity is granted in case of any proceedings for penalty initiated under the circumstances referred to in sub-section (9) of the said section 270A i.e., for under-reporting as a consequence of misreporting.

Penalty for failure to keep and maintain information and documents in respect of international transaction or specified domestic transaction

8.13 Section 271AA relates to penalty for failure to keep and maintain information and document in respect of international transactions or specified domestic transactions.

Section 271AA was substituted by a new section with effect from 1-7-2012. It provides that without prejudice to the provisions of section 270A or section

271 or Section 271BA, if any person in respect of an international transaction or specified domestic transaction:

(a) fails to keep and maintain prescribed documents and information *as required by sub-section (1)or sub-section (2)* of section 92D;

(b) ***fails to report any such transaction*** which is required to be reported; or

(c) maintains or furnishes any incorrect information or documents

the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two percent of the value of each international transaction/Specified domestic transaction entered into by such person.

Further, Section 271AA(2) inserted vide Finance Act 2016 prescribes penalty for failure to furnish master file by the prescribed due date as INR 5,00,000.

8.14 The above provision is without prejudice to section 270A or section 271 and Section 271BA and is invoked when 'any person' fails to keep and maintain any such information and document as required by section 92D (1) and (2) or fails to report any international transaction/ specified domestic transaction or maintains or furnishes any incorrect information or documents.

8.15 Thus, whether or not an international transaction or specified domestic transaction is determined at arm's length price, any person who has entered into such transaction, shall keep and maintain the information/document in respect of such transaction.

8.16 The penalty is invoked for failure to keep and maintain such information/documents or report the same. In other words, the person who has entered into international transaction or specified domestic transaction should both keep as well as maintain such information/documents as well as report the same. Any failure in respect of the same attracts a penalty of 2% of the value of each international transaction or specified domestic transaction entered into by him. Also, this penalty would be in addition to the penalties in section 271BA (i.e., Penalty for failure to furnish report under section 92E) and 271G (Penalty for failure to furnish information or document under section 92D).

Penalty for failure to furnish report under section 92E

8.17 Section 271BA provides that if any person fails to furnish a report from an accountant as required by section 92E, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of one hundred thousand rupees.

8.18 This penalty is invoked if any person fails to furnish a report from an accountant and the same may be levied by the Assessing Officer. The penalty shall be a sum of INR 1 lakh.

Penalty for failure to furnish information or document under section 92D

8.19 Section 271G provides that if any person who has entered into an international transaction or specified domestic transaction fails to furnish any such information or document as required by sub-section (3) of section 92D, the Assessing Officer or the Transfer Pricing Officer as referred to in section 92CA or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two percent, of the value of the international transaction or specified domestic transaction for each such failure.

8.20 The aforesaid section has been further amended with effect from FY 2012-13 to include therein the reference of specified domestic transactions.

Penalty for failure to furnish information or documents under Section 286

8.21 Finance Act 2016 introduced Section 286 which requires parent entity or the alternative reporting entity, resident in India, to furnish a prescribed report within a period of twelve months from the end of the reporting accounting year.

Section 271GB of the Act provides for penalty for failure to furnish the report as prescribed under Section 286 (i.e. Country-by-country report). The penalty prescribed under Section 271GB are as follows:

Nature of penalty	Penalty (INR)
Failure to furnish the prescribed report required to be maintained by the India parent entity or alternate reporting entity in India of the international group:	
a. Where period of failure is equal to or less than 1 month	5,000 per day
b. Where period of failure is greater than 1 month	15,000 per day
c. Continuing default after service of penalty order	50,000 per day
Furnishing of inaccurate particulars (subject to certain conditions)	5,00,000
Failure to produce the information and documents within 30 days (extendable by maximum 30 days)	5,000 per day upto service of penalty order 50,000 per day for default beyond date of service of penalty order

Penalty for furnishing incorrect information in reports and certificates

8.22 The Finance Act, 2017 has introduced penalty on accountants, merchant bankers and registered valuers for furnishing incorrect information in reports and certificates issued under any provisions of the Act, by inserting section 271J to the Act.

In order to ensure that the person furnishing report or certificate undertakes due diligence before making such certification, section 271J provides that if an accountant or a merchant banker or a registered valuer, furnishes incorrect information in a report or certificate under any provisions of the Act or the rules made thereunder, the Assessing Officer or the Commissioner (Appeals) may direct him to pay a sum of ten thousand rupees for each such report or certificate by way of penalty.

For the purpose of this section,

(*a*) "accountant" means an accountant referred to in the *Explanation* below sub-section (2) of section 288;

(*b*) "merchant banker" means Category I merchant banker registered with the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);

(*c*) "registered valuer" means a person defined in clause (*oaa*) of section 2 of the Wealth-tax Act, 1957 (27 of 1957).

Chapter 9
Scope of Examination under Section 92E

Report under section 92E

9.1 According to section 92E 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. The report is to be given by an Accountant in Form No.3CEB as prescribed under Rule 10E.The Income Tax rules have been amended to require the filing of the said report to be done electronically. The scope, as envisaged by section 92E, is restricted to examination of accounts and records of the Assessee relating to the international transaction or specified domestic transaction entered into by the Assessee during the previous year under examination.

9.2 Further, the Accountant has to give his opinion whether "proper information and documents as are prescribed" have been kept by the Assessee in respect of the international transactions or specified domestic transaction entered into by him. The examination under section 92E is not an audit requiring opinion of the Accountant on the true and fair view of the financial statements of the enterprise.

9.3 The report consists of three paragraphs dealing with distinct aspects as summarised hereunder:

The first paragraph contains declaration about examination of the accounts and records of the Assessee in order to review the international transaction(s) and the specified domestic transaction(s).

The second paragraph involves rendering of an opinion whether proper information and documents as are prescribed under Rule 10D are maintained by the Assessee in respect of the identified international transactions and the specified domestic transaction(s), on the basis of the details furnished in Annexure to Form No.3CEB.

The third and the last paragraph requires expression of the opinion whether the particulars given in the Annexure to Form No.3CEB are ***true and correct***.

9.4 Examination of accounts and records

Form No.3CEB

****I/we have examined the accounts and records of ……. (name and address of the Assessee with PAN) relating to the international transaction(s) and the specified domestic transactions entered into by the Assessee during the previous year ending on 31st March, ……***

[Paragraph 1]

9.5 The expression "accounts and records" appearing in the report should normally refer to those accounts and records which are to be examined solely in relation to the international transactions and the specified domestic transactions entered into by the Assessee during the relevant previous year. As the expression "accounts and records" are limited to those pertaining to international transactions and the specified domestic transactions only, the said report does not require the Accountant to certify the true and fair view of the financial statements of the enterprise. Therefore, he should restrict his examination to such details and matters that in his opinion are sufficient to determine whether proper documents have been maintained with respect to international transactions and the specified domestic transactions and whether the particulars disclosed in the annexure are true and correct.

The extent of examination of the said accounts and records is a matter of professional judgment of the Accountant. However, while the Accountant is expected to make specific inquiries as regards various matters that are the subject of the Form No 3CEB, his work often comprises checking, by the application of materiality principles and on a test basis, the evidence supporting the information presented in the Form No 3CEB. Particularly in cases where the Accountant is relying on financial statements of the Assessee audited by another auditor, it is reasonable to rely on the correctness of information contained in such audited financial statements, including as regards its completeness, unless there are any obvious or significant discrepancies. In the event of such discrepancies, the Accountant would need to obtain necessary information, explanations and reconciliations as may be required from the Assessee, and report on that basis.

The Accountant can rely upon the values of the international transactions and the specified transactions reported in the financial statements / tax audit

report of the Company. However, the auditor should undertake due diligence to assess the reasonableness of the value reported therein (by undertaking test checks) and also obtain a representation from the management of the company in this regard.

9.6 The Accountant should obtain from the Assessee a complete list of "accounts and records" maintained by him (both financial and non-financial records) and identify those that need to be produced before him for examination. He should further obtain suitable representation as regards the completeness of the "accounts and records" from the Assessee.

9.7 Where the certifying Accountant is not the statutory auditor of the Assessee he should take the precaution of clearly stating in his report that the figures from the audited general purpose financial statements have been used and relied upon. The Accountant may obtain a written representation from the Assessee on the reconciliation between the figures appearing in his report and the figures appearing in the general-purpose financial statements (as provided in the "Guidance Note on Reports and Certificates for Special Purposes" (Revised 2016)). Further, the Accountant can clearly state that he has relied upon the work performed by the other auditors.

9.8 In conducting the review and examination the Accountant will have to use his professional skill and expertise and apply such audit tests as the circumstances of the case may require. He may apply such tests/sampling techniques as may be deemed proper depending on the internal control procedures followed by the Assessee. The Accountant will also have to keep in mind the concept of materiality depending on the circumstances of each case. He would be well advised to refer to Standards on Auditing as well as the guidance notes issued by the Institute.

9.9 Ensuring completeness of the listing of international transactions and specified domestic transactions is the responsibility of the Assessee. The Assessee should maintain a comprehensive detail of every international transaction and specified domestic transaction. The Accountant should use his professional skill and expertise and apply such tests as the circumstances of the case may require to examine whether the same meets the requirement of law. Further, in relation to the deemed international transactions, the primary responsibility of identification / analyzing such transaction rests with the assesse. It is worthwhile to note that w.e.f. FY 2014-15, transactions of the assesse with an Indian company are also covered within the ambit of 'deemed international transaction'. The Accountant should obtain a representation from the management of the

Assessee as to completeness of the listing of such transactions. However, the Accountant should exercise his professional judgment in this regard.

9.10 The Accountant should obtain a written representation from the Assessee providing him with the name, address, legal status and country of tax residence of each of the enterprises with whom international transactions and the specified domestic transactions have been entered into by the Assessee, and association linkages among them.

9.11 **Maintenance of proper information and documents**

"2.In *my/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 *my/our examination of the records of the Assessee".

9.12 In paragraph 2 of the report the Accountant is required to give his opinion on the Assessee's compliance with the documentation requirements prescribed under Rule 10D.The Accountant should review the documents and records pertaining to international transactions and the specified domestic transactions of the Assessee and compare the same with those prescribed under Rule 10D to form an opinion.

9.13 If the Accountant is satisfied that specified records have been properly maintained by the Assessee then the certification may be done without any qualification. If any document is not maintained or if any qualification or a note as part of emphasis on matter is given in the financial statement by the statutory auditor of the Assessee, then the Accountant should suitably qualify his report or disclose the same in his report depending upon the facts and circumstances of each case. The Accountant should state the qualification in the report making it comprehensive and self-explanatory. In this regard the Accountant should follow principles enshrined in the SA 700(Revised) "Forming an Opinion and Reporting on Financial Statements", SA 705 (Revised) Modifications to the Opinion in the Independent Auditor's Report and SA 706 (Revised) Emphasis of Matters Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report.

9.14 An Assessee in whose case the aggregate value of international transaction as recorded in the books of account does not exceed INR1 crore in aggregate, there is a relief provided under sub-rule (2) of Rule 10D from maintaining the specified information and documents. However, the proviso thereunder necessitates such an Assessee to substantiate that income or

expense as the case may be arising from international transactions has been computed in accordance with section 92 on the basis of material in his possession. Therefore, the Accountant should verify in such cases whether there is any material available with the Assessee in this regard and if available the details thereof needs to be examined. The Accountant shall, in such cases, express his opinion with or without qualification by exercising his professional judgement after verification of the material produced for such examination.

The said rule does not provide any such relief by way of monetary threshold for the purposes of maintaining the information and documents in respect of the specified domestic transactions. Accordingly, where the aggregate of the specified domestic transactions during a previous year exceeds Rs. 20 crores, there would be an obligation to maintain specified information and documents as per sub rule (1) of Rule 10D.

9.15 **Certification regarding particulars in Annexure**

"3.The particulars required to be furnished under section 92E are given in the Annexure to this Form. In *my/our opinion and to the best of my/our information and according to the explanations given to *me/us, the particulars given in the Annexure are true and correct".

9.16 Paragraph 3 of Form No.3CEB provides that the particulars required to be furnished under section 92E are given in the Annexure to this Form and whether in the Accountant's opinion and to the best of his information and according to the explanations given to him, they are true and correct. As mentioned above, the particulars should be obtained from the Assessee, duly authenticated, which should be reviewed by the Accountant. In case of any negative remark or qualification about this matter, the same should be properly reported.

9.17 The Accountant must limit his scope of work and the review procedures to the extent certified in Form No.3CEB.For e.g. in the Annexure the method which has been used to determine the arm's length price needs to be stated. In this context the Accountant is only required to ensure that the method stated as being used to determine the arm's length price by the Assessee has actually been used and it is not the Accountant's responsibility to ensure that the method so used is the most appropriate method as prescribed by the Board.

9.18 The Accountant may mention in the report, wherever necessary, that the correctness has been ensured only to the extent that the Accountant has carried out an examination and further that the certificate is subject to the notes stated against the relevant clauses or Annexure to Form No.3CEB.

9.19 The statutory auditor of the Assessee has to report that the financial statements audited by him give a 'true and fair' view. The requirement in paragraph 3 of Form No.3CEB relating to particulars in Annexure to Form No.3CEB is that the Accountant should report that these particulars are "true and correct". The terminology "true and fair" is widely understood though not defined even by the Companies Act, 2013.On the other hand, the words "true and correct" lay emphasis on factual accuracy of the information. In this context reference is invited to AS-1 and AS(IT)-I relating to disclosure of accounting policies. These standards recognise that the major considerations governing the selection and application of accounting policies are (i) prudence, (ii) substance over form and (iii) materiality. Therefore, while examining the particulars in the Annexure to Form No.3CEB these aspects should be kept in view. In particular, considering the nature of particulars to be examined in the Annexure to Form No.3CEB, the aspect of materiality should be considered. In other words qualifications may be given only in respect of material items as envisaged by the Accountant.

Other aspects

Online filing of Form 3CEB

9.20 From AY 2012-13, CBDT has made it mandatory for enterprises to file their Form 3CEB online, with a view to make the process faster and less error prone. However, the online filing mode does not provide for a facility for documenting notes by the Accountant in each of the relevant clauses or Annexure to Form No.3CEB.

9.21 In order to document the position adopted while certifying the Form 3CEB, the Accountant may issue a memo / written document to the enterprise presenting his/ her notes against the relevant clauses or Annexure to Form No.3CEB.

The Assessee thereafter at his discretion may consider filing the Form 3CEB along with the notes applicable to the relevant clauses or Annexure to Form No. 3CEB, with the Indian tax department to support the position adopted while filing Form No. 3CEB online by an Accountant.

Form 3CEB in case of a permanent establishment of an overseas enterprise

9.22 In the case of an permanent establishment of an overseas enterprise, the clauses of Rule 10D(1) would apply to the extent relevant. Data which is not relevant may not be required to be maintained. The Accountant should rely on his professional judgement to verify the relevance and the extent of details available with the permanent establishment as per Rule 10D(1) in order to establish the arm's length price.

Annexure to Form No.3CEB

9.23 The statement of particulars given in the Annexure to Form No.3CEB contains twenty five clauses. The Accountant has to report whether the particulars furnished in Form No.3CEB are true and correct.

9.24 As stated earlier, the Accountant should obtain a duly authenticated statement of particulars in Annexure to Form No.3CEB from the Assessee. It would be advisable for the Assessee to take into consideration the following general principles while preparing the Annexure:

(a) He can rely upon the judicial pronouncements while taking any particular view about inclusion or exclusion of any items in the particulars to be furnished under any of the clauses specified in the Annexure.

(b) If there is a conflict of judicial opinion on any particular issue, he may refer to the view, which has been followed while giving the particulars under any specified clause.

(c) The Accounting Standards (AS), Guidance Notes, Standards on Auditing (SA) issued by the Institute from time to time should be followed, to the extent applicable.

9.25 While verifying the truth and correctness of the particulars in Annexure to Form No.3CEB it would be advisable for the Accountant to consider the following:

(a) If a particular item is covered in more than one of the specified clauses in the Annexure, care should be taken to make a suitable cross reference to such items at the appropriate places.

(b) If there is any difference in the opinion of the Accountant and that of the Assessee in respect of any information furnished in the Annexure, the Accountant should state both the view points and also the

relevant information in order to enable the tax authority to take a decision in the matter.

(c) If any particular clause in the Annexure is not applicable, the Accountant should state that the same is not applicable.

(d) In examining the particulars furnished in the Annexure, the Accountant should keep in view the law applicable in the relevant year, even though the form of report may not have been amended to bring it in conformity with the amended law.

(e) The information in the Annexure should be based on the books of account, records, documents, information and explanations made available to the Accountant for his examination.

(f) The Annexure should be signed by the Accountant after he has completed his procedures on the particulars given/to be given in the Annexure.

9.26 Particulars to be furnished in the Annexure

PART A

1. Name of the Assessee :

2. Address :

3. Permanent account number :

4. Nature of business or activities of the Assessee*

5. 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 accounts

**Code for nature of business to be filled in as per instructions for filing Form ITR 6*

9.27 Under clause (1) the name of the Assessee whose accounts and records are being examined under section 92E should be given. However, if the examination is in respect of a branch, name of such branch should be

mentioned along with the name of the Assessee (in case a separate branch certificate is done).

9.28 The address to be mentioned under clause (2) should be the same as has been communicated by the Assessee to the Income-tax Department for assessment purposes as on the date of signing of the Form. If the examination is in respect of a permanent establishment of an overseas enterprise including branch or a unit, the address of the branch or the unit should be given. In the case of a company, the address of the registered office should also be stated. In the case of a new Assessee, the address should be that of the principal place of business.

9.29 Under clause (3) the permanent account number (PAN) allotted to the Assessee should be indicated. If the Assessee has not been allotted the permanent account number as on the date of signing of the Form, that fact should be indicated. Where PAN is not known/allotted but the general index register number (GIR) is available, the same may be given.

9.30 Under clause (4) the code for nature of business is to be provided as per the instructions for filling form ITR 6.

9.31 Under clause (5) the status of the Assessee is to be mentioned. This refers to the different classes of Assessees included in the definition of "person" in section 2(31) of the Act, namely, individual, Hindu undivided family, company, firm, an association of persons or a body of individuals whether incorporated or not, a local authority or artificial juridical person. Furthermore, a person has been defined as 'including a permanent establishment of such person', i.e. even a branch or a project office. In case of any violations by a liaison office it may come under the purview of this clause and hence, the same should be disclosed. Further, in case of disputes regarding status of the Assessee, the full facts should be mentioned.

9.32 Under clause (6), since the previous year under the Act uniformly ends on 31st March, the relevant previous year should be mentioned.

9.33 Under clause (7) the assessment year relevant to the previous year for which the accounts and records are being examined should be mentioned.

9.34 Under clause (8) & (9), the aggregate value of international transactions and specified domestic transactions as per books of accounts should be mentioned.

PART B

9.35 ***10. List of associated enterprises with whom the Assessee has entered into international transactions, with the following details:***

(a) Name of the associated enterprise.

(b) Nature of the relationship with the associated enterprise as referred to in section 92A(2).

(c) Brief description of the business carried on by the associated enterprise.

9.36 The Assessee is required to furnish by way of an attachment, a complete list of associated enterprises, duly certified by the authorised person (partner, trustee, managing director etc. depending on the definition of Assessee) with whom the Assessee has entered into international transactions during the previous year. The terms 'associated enterprises' and 'international transactions' have been defined in detail in sections 92A and 92B of the Act, respectively. If an enterprise was 'associated' with the Assessee for a part of the previous year, details should be furnished with respect to that period of the previous year.

In this connection, the Assessee has to maintain a register with the list of the transactions and the relevant details. The Accountant can rely on the information provided in the register of associated enterprise for completing his work.

9.37 The particulars in this clause should be examined on test check basis from an instrument or agreement or any other document evidencing the association of enterprises including any supplementary documents related thereto. In this connection the Accountant has to, based on his best judgement, determine the sampling approach and design the nature and timing of the audit tests.

9.38 In preparing the list of the associated enterprises, it is possible that the extent of association may not be precisely ascertainable during the previous year, i.e. it may be indeterminate or unknown, resulting in a situation whereby the Assessee is not in a position to conclude as to whether any particular entity is covered under the definition of 'associated enterprise', as detailed in section 92A of the Act. In such circumstances, it is advisable both from the viewpoint of the Assessee and the Accountant's perspective that the relevant fact be stated in the Annexure or in the notes, as the case may be, and reference to same be made, if considered significant, in the

Accountant's report. The Assesse could source required data from the master file or CbC report, wherever applicable.

9.39 In certain cases the enterprises may be associated in more than one manner. Since there is no different treatment for any particular form of association, it may be sufficient if the Assessee details any particular relationship with the associated enterprise under clause 10(b).Although the Assessee may be advised to detail all the relationships, disclosure of any one relationship is considered sufficient from a compliance perspective.

9.40 The Accountant should obtain a written representation from the Assessee detailing the business of the associated enterprises with whom the Assessee has transacted. Further, since the completeness of the list of the associated enterprises and transactions with them is the primary responsibility of the Assessee, the Accountant should obtain suitable written representation from the management (Board of directors or its equivalent).

9.41 The Accountant may be advised to use his professional skill and expertise, in determining the scope of work to be performed with respect of getting reasonable comfort on the Assessee's list of international transactions with associated enterprises. The Accountant should, however, be aware of the possibility that transactions with associated enterprises may have been influenced in large measure by conditions similar to the following:-

(a) Lack of sufficient working capital or credit to continue the business;

(b) An urgent desire for a continued favorable earnings record in the hope of supporting the price of the Assessee's share price, if any;

(c) An overly optimistic earnings forecast;

(d) Dependence on a single or relatively few products, customers, or transactions for the continuing success of the venture;

(e) A declining industry characterised by a large number of business failures;

(f) Excess capacity;

(g) Significant litigation, especially litigation between stockholders and management; or

(h) Significant obsolescence dangers because the Assessee is in a high-technology industry.

9.42 The Accountant should place emphasis on test checking material transactions with enterprises associated to the Assessee. Certain

relationships, such as parent-subsidiary or investor-investee, may be clearly evident. Determining the existence of others requires the application of certain procedures, which may include the following:

(a) Evaluate the Assessee's procedures for identifying and properly accounting for international transactions;

(b) Request from appropriate management personnel the names of all associated enterprises and inquire whether there were any transactions with these enterprises during the period;

(c) Review filings by the reporting entity with regulatory agencies for the names of associated enterprises and for other businesses in which officers and directors occupy directorship or management positions; (example director's representations on transactions under sections 297, 299 etc.);

(d) Review stockholder listings of closely held companies to identify principal stockholders;

(e) Enquire, where possible and considered essential of predecessor, principal, or other Accountants/Accountants of associated enterprises concerning their knowledge of existing relationships and the extent of management involvement in material transactions;

(f) Review material investment transactions during the period under review to determine whether the nature and extent of investments during the period create associated enterprises; and

(g) Review the mandatory related party disclosure in the audited financial (AS 18) [The definition of Associated Enterprise u/s. 92A in relation to the International Transactions is different than the definition of related party under AS 18 and therefore the Accountant should review the Associated Enterprises for the purpose of section 92A independently].

9.43 Although it is the responsibility of the Assessee to furnish a complete list of associated enterprises and international transactions, the Accountant must exercise reasonable care to ensure that prima facie and, based on the information that is made available to him, the list of associated enterprises and list of international transactions furnished by the Assessee is reasonably complete based on financial statements and books of accounts. Further, in order to ascertain whether the Assessee has entered into any transactions coming within the scope of sub-section (2) of section 92B, the Accountant should obtain appropriate management representation. For the purpose of

furnishing the list of associated enterprises and international transactions, as envisaged in para 9.42 above, the Assessee may place reliance on the Master file / CbCR report as applicable.

9.44 ***11. Particulars in respect of transactions in tangible property :***

A. Has the Assessee entered into any international transaction(s) in respect of purchase / sale of raw material, consumables or any other supplies for assembling / processing / manufacturing of goods/articles from/to associated enterprises?

Yes/No

If 'yes', provide the following details in respect of each associated enterprise and each transaction or class of transaction:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of transaction and quantity purchased/sold.

(c) Total amount paid/received or payable/ receivable in the transaction-

(i) as per books of account.

(ii) as computed by the Assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price. [See section 92C(1)].

9.45 Under this clause, the Assessee has to furnish details of international transactions in respect of inputs used in the course of assembling, processing and manufacturing. The items referred to in this clause are essentially materials worked upon or used in the course of the Assessee's business, namely, raw materials, components, assemblies and sub-assemblies, consumables, etc. When any of the aforesaid materials are sold before their consumption during the normal course of business, the details of these sales are also to be reported under clause 11A.

At times owing to practical difficulties quantitative details of the purchases and sales of raw materials/ consumables/ other supplies may not be available. In such a case, the Accountant should provide suitable clarificatory note.

B. Has the Assessee entered into any international transaction(s) in respect of purchase / sale of traded / finished goods?

Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each transaction or class of transaction:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of transaction and quantity purchased/sold.

(c) Total amount paid / received or payable / receivable in the transaction-

(i) as per books of account.

(ii) as computed by the Assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price[See section 92C(1)]

9.46 Under this clause, the Assessee has to furnish details of international transactions in respect of purchase/sales of traded goods and purchase/sales of finished goods.

C. Has the Assessee entered into any international transaction(s) in respect of purchase, sale, transfer, lease or use of any other tangible property including transactions specified in Explanation (i)(a) below section 92B(2)? Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each transaction or class of transaction :

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of the property and nature of transaction.

(c) Number of units of each category of tangible property involved in the transaction.

(d) Amount paid/received or payable/ receivable in each transaction of purchase/sale/transfer/use, or lease rent

paid/ received or payable/receivable in respect of each lease provided/entered into:

(i) as per books of account.

(ii) as computed by the Assessee having regard to the arm's length price.

(e) Method used for determining the arm's length price. [see section 92C(1)].

9.47 Under this clause, the Assessee has to furnish details of purchase, sale, lease or use of any other tangible property.

12. Particulars in respect of transactions in intangible property:

Has the Assessee entered into any international transaction(s) in respect of purchase, sale, transfer, lease or use of intangible property including transactions specified in Explanation (i)(b) below section 92B(2)? Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each category of intangible property:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of intangible property and nature of transaction.

(c) Amount paid/received or payable/ receivable for purchase/sale/transfer/lease/use of each category of intangible property:

(i) as per books of account.

(ii) as computed by the Assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price. [see section 92C(1)].

9.48 Under this clause, the Assessee has to furnish details about transaction involving not only commercial/business intangibles such know-how, patent, copyrights, marketing related, technology related, contract related, customer related intangibles but, where applicable even personal intangibles such as literary and artistic copyrights. Intangibles would also include human capital related, location related and goodwill related

intangibles. Any other similar item that derives its value from its intellectual content rather than its physical attributes would also be included as an intangible. As all the intangibles referred to Explanation (ii) to Section 92B may not be separately accounted in the books of accounts the Accountant may need to rely on the transfer pricing documentation maintained by the Assessee under Rule 10D as well as obtain adequate representations from the management stating that all the international transactions relating to intangibles have been disclosed to the Accountant.

13. Particulars in respect of providing of services:

Has the Assessee entered into any international transaction(s) in respect of Services including transactions as specified in Explanation (i)(d) below section 92B(2)? Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each category of service:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of services provided/availed of/ from the associated enterprise.

(c) Amount paid/received or payable/ receivable for the services provided/ taken.

(i) as per books of account.

(ii) as computed by the Assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price. [See section 92C(1)].

9.49 Under this clause, the Assessee has to furnish details about transactions that are in the nature of providing services to associated enterprises. The services contemplated under this clause include provision of market research, market development, marketing management, administration, technical, commercial, repairs, design, scientific research, legal or accounting service, etc. For example, if A Inc., USA (associated enterprise) out-sources its entire accounting function to B Ltd. (Indian subsidiary), such transaction needs to be reported under this clause.

14. Particulars in respect of lending or borrowing of money:

Has the Assessee entered into any international transaction(s) in respect of lending or borrowing of money including any type of advance, payments, deferred payments, receivable, non-convertible preference shares / debentures or any other debt arising during the course of business as specified in Explanation (i)(c) below section 92B(2)? Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each loan/advance :

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Nature of financing agreement.

(c) Currency in which transaction has taken place

(d) Interest rate charged/paid in respect of each lending/borrowing.

(e) Amount paid/received or payable/ receivable in the transaction-

(i) as per books of account.

(ii) as computed by the Assessee having regard to the arm's length price.

(f) Method used for determining the arm's length price. [See section 92C(1)].

9.50 Under this clause, the nature of the financing arrangements i.e. term loan, medium term loan, short term loan, project finance, working capital arrangement, fixed asset financing facility, trade advances, non-convertible preference shares, etc. should be clearly mentioned. The currency denomination of the loan account should be clearly indicated in the form along with any conversion options and any forward cover contracts taken. The Assessee should disclose the interest rate applicable.

15. Particulars in respect of transactions in the nature of guarantee:

Has the Assessee entered into any international transaction(s) in the nature of guarantee? Yes/No

If Yes, please provide the following details :

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Nature of guarantee agreement.

(c) Currency in which guarantee transaction was undertaken

(d) Compensation / fees charged / paid in respect of the transaction

(e) Method used for determining the arm's length price. [See section 92C(1)].

9.51 Under this clause, the nature of the guarantee i.e. whether corporate guarantee, etc. should be clearly mentioned. The compensation charged / paid should also be stated.

16. Particulars in respect of international transactions of purchase or sale of marketable securities, issue and buy back of equity shares, optionally convertible/ partially convertible/ compulsorily convertible debentures/ preference shares:

Has the Assessee entered into any international transaction(s) in respect of purchase or sale of marketable securities or issue of equity shares including transactions specified in Explanation (i)(c) below section 92B(2)? Yes/No

If yes, provide the following details:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into

(b) Nature of transaction

(c) Currency in which the transaction was undertaken

(d) Consideration charged/ paid in respect of the transaction

(e) Method used for determining the arm's length price [See section 92C(1]

9.52 Under this clause, the Assessee has to furnish details about transactions that are in nature of purchase or sale or marketable securities (for example commercial paper, banker's acceptances, treasury bills and other money market instruments) issue and buy back of equity shares, convertible debentures/ preference shares. Further, the Assessee is required to furnish details such as nature of transaction, currency, consideration charged/ paid as per books and method used for determination of arm's

length price. The Government of India vide Instruction No. 2/2015 dated 29.01.2015 has accepted the decision of the Bombay High Court in the case of Vodafone India Service Private Limited [TS-308-HC2014(BOM)-TP-Vodafone India Services]. According to the said Instruction, the premium arising on issue of shares is a capital account transaction and does not give rise to income and, hence not liable to transfer pricing adjustment. However, it is noteworthy that explanation to section 92B and clause 16 of Form No 3CEB continue to require the assessee's to disclose the transaction relating to issue of shares.

Since as per the said Instruction, issue/ allotment of equity shares including at premium to non-resident does not give rise to income under section 92 of the Act, this transaction may not be required to be reported under section 92E read with Rules.

17. Particulars in respect of mutual agreement/ arrangement:

Has the Assessee entered into any international transaction with an associated enterprise or enterprises by way of a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises? Yes/No

If 'yes' provide the following details in respect of each agreement/arrangement:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of such mutual agreement or arrangement.

(c) Amount paid/received or payable/ receivable in each such transaction:

(i) as per books of account.

(ii) as computed by the Assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price. [See section 92C(1)]

9.53 Under this clause, the Assessee has to furnish the details of international transactions pertaining to cost contribution/sharing agreements and mutual arrangements for cost allocation or apportionment thereof.

18. Particulars in respect of international transactions arising out/ being part of business restructuring or reorganizations:

Has the Assessee entered into any international transaction(s) arising out/being part of any business restructuring or reorganization entered into by it with the associated enterprise or enterprises as specified in Explanation (i) (e) below section 92B (2) and which has not been specifically referred to above?

Yes/No

If 'yes' provide the following details:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Nature of transaction

(c) Agreement in relation to such business restructuring/ reorganization

(d) Terms of business restructuring/ reorganization

(e) Method used for determining the arm's length price [See section 92C(1)

9.54 Under this clause, the Assessee has to furnish the details of international transaction with respect business restructuring or reorganization. The Assessee is required to furnish details such as details of AE with whom such transaction has been entered into, nature of transaction and method used for determination of arm's length price.

19. Particulars in respect of any other transaction including the transaction having a bearing on the profits, incomes, losses, or assets of the Assessee:

Has the Assessee entered into any other international transaction(s) including a transaction having a bearing on the profits, income, losses or assets, but not specifically referred to above, with associated enterprise? Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each transaction:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of the transaction.

(c) Amount paid/received or payable/ receivable in each such transaction:

(i) as per books of account.

(ii) as computed by the Assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price. [see section 92C(1)].

9.55 Under this clause, the Assessee is required to furnish details of any other transaction having a bearing on profits, losses, income or assets i.e. it is a residual clause to cover any transaction which has not been covered in the preceding categories. Examples of these transactions could be reimbursement transactions or transactions which do not involve any charge (i.e. free of cost services or goods). These transactions should be identified and further notes could be provided to explain their nature.

20. Particulars of deemed international transaction:

Has the Assessee entered into any transaction with a person other than an AE in pursuance of a prior agreement in relation to the relevant transaction between such other person and the associated enterprise? Yes/No

If 'yes' provide the following details in respect of each of such agreement:

(a) Name and address of the person other than the associated enterprise with whom the deemed international transaction has been entered into.

(b) Description of the transaction.

(c) Amount paid/received or payable/ receivable in the transaction:

(i) as per books of account.

(ii) as computed by the Assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price. [see section 92C(1)].

9.56 Under this clause, the Assessee is required to furnish details with respect to the deemed international transactions. A discussion on what

constitutes a deemed international transaction has already been provided in Para 4.5 and Para 4.6 above. The Assessee is required to furnish details such as description of the transaction, amount paid/ payable or received/ receivable, and the method used for determination of arm's length price.

9.57 The Accountant should examine the information provided by the Assessee, with the documents as he considers essential in connection with the details of nature and terms (including prices) of international transactions entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction.

9.58 The Accountant should examine the information provided in the annexure by the Assessee, by using standard examining practices from the books of account maintained by the Assessee and from information and explanations obtained. He should also verify the information provided by the Assessee in the context of the understanding that he has of the Assessees business. Further, in conducting the examination the Accountant will have to use his professional skill and expertise and apply such tests, based on materiality and sampling, as the circumstances of the case may require.

9.59 For verifying the correctness of the:

(i) 'name and address of the associated enterprise with whom the international transaction has been entered into', and

(ii) 'description of transaction and quantity purchased/sold'

the Accountant may examine any instrument or agreement or any other document (invoices, correspondence etc.) evidencing the transaction and may also verify the books of account of the Assessee.

9.60 For determining the correctness of the, **'**total amount paid/ received or payable/receivable in the transaction as per books of account' the Accountant may, in addition to examining the information/documents detailed above, obtain a confirmation for material international transactions from each associated enterprise, if considered essential. Such confirmation may be undertaken to obtain evidence from third parties about assertions made by the Assessee in the annexure. In general, it is presumed that when evidential matter can be obtained from independent sources outside an entity, it provides greater assurance of reliability for the purposes of an independent examination than that secured solely within the entity.

9.61 Confirmation requests can be designed to elicit evidence that addresses the completeness assertion: that is, if properly designed, confirmations may provide evidence to aid in assessing whether all transactions, accounts and amounts that should be included in the annexure are included. The Accountant may require the identified associated enterprise to seek confirmation from associated parties, the following with respect to the transactions entered into with the Assessee:

(a) description of transaction and quantity purchased/sold;

(b) total amount paid/received or payable/receivable in the transaction; and

(c) listing of all transactions without consideration, if any.

Additionally, obtaining of a confirmation from the associated enterprise would be more advisable in the event that the financial statements / books of account of the Assessee are yet to be audited.

9.62 With regard to the, **'**total amount paid/received or payable/ receivable in the transaction as computed by the Assessee having regard to the arm's length price', the Accountant should get an authenticated declaration from the Assessee along with a computation statement regarding the total amount paid/received or payable/receivable in the transaction as well as the arm's length price as computed by the Assessee.

9.63 With regard to the, 'method used for determining the arm's length price', the Accountant is at no point of time required to suggest the most appropriate method to determine the arm's length price nor is he required to assign any value to any transaction. As stated earlier, the computation of the arm's length prices and the selection of the most appropriate method is the responsibility of the Assessee and the Accountant only needs to verify the same to ensure that they are in accordance with the accounts and records maintained by the Assessee and that the same are true and correct.

9.64 Clauses 11 to 18 and clause 20 of Annexure to Form No.3CEB list typical transactions that generally take place. However, these are not exhaustive and if there are any international transactions that are not specifically covered by these clauses, the particulars as required under clause 19 (in case of any other international transactions) should be furnished in respect of such international transactions.

Further, in case the Assessee has entered into transactions involving cost re-imbursements or transfer of assets, free of cost receipts of services, free of

charge, it is recommended that the Accountant may identify these transactions in the Form No.3CEB and provide notes to explain their nature.

9.65 It may be noted here that though the Accountant is required to make specific inquiries he is not responsible to ensure completeness of the list of international transactions / specified domestic transactions entered into by the Assessee. Further, it is advisable to take a representation from the management stating that all international transaction / specified domestic transactions, whether specifically stated in the Form No.3CEB or not, have been disclosed to the Accountant.

9.66 Form No. 3CEB requires the Accountant, who signs the report, to indicate his membership number. As such, the Accountant should give his membership number and firm's registration number with ICAI and indicate the status, such as proprietor or partner of a firm, in which he has signed the report.

PART C

9.67 21. List of associated enterprises with whom the Assessee has entered into specified domestic transactions, with the following details:

(a) Name, address and PAN of the associated enterprise.

(b) Nature of the relationship with the associated enterprise.

(c) Brief description of the business carried on by the said associated enterprise.

9.68 The Assessee is required to furnish a complete list of associated enterprises, with whom the Assessee has entered into specified domestic transactions during the previous year. The list of associated enterprises must be duly certified by the authorised person (partner, trustee, managing director etc. depending on the definition of Assessee). The term 'associated enterprises' has been defined in detail in Rule 10A of the Rules. If an enterprise was 'associated' with the Assessee for a part of the previous year, details should be furnished with respect to that period of the previous year.

In this connection, the Assessee has to maintain a register with the list of the transactions and the relevant details. The Accountant can rely on the information provided in the register of associated enterprise for completing his work.

9. 69 The particulars in this clause should be examined on test check basis from an instrument or agreement or any other document evidencing the association of enterprises including any supplementary documents related

thereto. In this connection the Accountant has to, based on his best judgement, determine the sampling approach and design the nature and timing of the audit tests.

9.70 In preparing the list of the associated enterprises, it is possible that the extent of association may not be precisely ascertainable during the previous year, i.e. it may be indeterminate or unknown, resulting in a situation whereby the Assessee is not in a position to conclude as to whether any particular entity is covered under the definition of 'associated enterprise', as detailed in Rule 10A. In such circumstances, it is advisable both from the viewpoint of the Assessee and the Accountant's perspective that the relevant fact be stated in the Annexure or in the notes, as the case may be, and reference to same be made, if considered significant, in the Accountant's report.

9.71 In certain cases the enterprises may be associated in more than one manner. Since there is no different treatment for any particular form of association, it may be sufficient if the Assessee details any particular relationship with the associated enterprise under clause 21(b). Although the Assessee may be advised to detail all the relationships, disclosure of any one relationship is considered sufficient from a compliance perspective.

9.72 The Accountant should obtain a written representation from the Assessee detailing the business of the associated enterprises with whom the Assessee has transacted. Further, since the completeness of the list of the associated enterprises is the primary responsibility of the Assessee, the Accountant should obtain suitable representation from the management (Board of directors or its equivalent).

9.73 The Accountant should use his professional skill and expertise, in determining the scope of work to be performed with respect of getting reasonable comfort on the Assessee's list of specified domestic transactions with associated enterprises.

9.74 The Accountant should place emphasis on test checking material transactions with enterprises associated to the Assessee. Certain relationships, such as parent-subsidiary or investor-investee, may be clearly evident. Determining the existence of others requires the application of certain procedures, which may include the following:

(a) Evaluate the Assessee procedures for identifying and properly accounting for specified domestic transactions;

(b) Request from appropriate management personnel the names of all associated enterprises and inquire whether there were any transactions with these enterprises during the period;

(c) Review filings by the reporting entity with regulatory agencies for the names of associated enterprises and for other businesses in which officers and directors occupy directorship or management positions; (example director's representations on transactions under sections 184,188,189 etc.);

(d) Review stockholder listings of closely held companies to identify principal stockholders;

(e) Enquire, where possible and considered essential of predecessor, principal, or other Accountants/Accountants of associated enterprises concerning their knowledge of existing relationships and the extent of management involvement in material transactions;

(f) Review material investment transactions during the period under review to determine whether the nature and extent of investments during the period create associated enterprises; and

(g) Review the mandatory related party disclosure in the audited financial (AS 18).[The definition of Associated Enterprise in Rule 10A is different than the definition of related party under AS 18 and therefore the Accountant should review the Associated Enterprises for the purpose of section 92BA independently]

(h) Review the income tax return of Assessee to determine any tax holiday status claimed by Assessee.

9.75 Although it is the responsibility of the Assessee to furnish a complete list of associated enterprises and specified domestic transactions, the Accountant must exercise reasonable care to ensure that prima facie and, based on the information that is made available to him, the list of associated enterprises and list of specified domestic transactions furnished by the Assessee is reasonably complete.

9.76 ***Particulars in respect of transactions in the nature of any expenditure:***

Has the Assessee entered into any specified domestic transaction(s) being in respect of which payment has been made or is to be made to any person referred to in section 40A(2)(b)?

Yes/No

If 'yes', provide the following details in respect of each of such person and each transaction or class of transaction:

(a) Name of person with whom the specified domestic transaction has been entered into.

(b) Description of transaction along with quantitative details, if any

(c) Total amount paid or payable in the transaction-

(i) as per books of account.

(ii) as computed by the Assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price. [See section 92C(1)].

9.77 Under this clause, the Assessee has to furnish details of specified domestic transactions in respect of expenditure for which payment has been made or to be made to any person referred in section 40A(2)(b). However, in light of amendment in section 92BA of the Act vide Finance Act 2017 (effective from assessment year 2017-18), transactions with persons referred to section 40A(2)(b) are not within the ambit of specified domestic transactions.

22. Particulars in respect of transactions in the nature of transfer or acquisition of any goods or services:

A. Has any undertaking or unit or enterprise or eligible business of

the Assessee [as referred to in section 80A(6), 80IA(8) or section10AA)]transferred any goods or services to any other business carried on by the Assessee?

Yes/No

If 'yes' provide the following details in respect of each unit or enterprise or eligible business:

(a) Name and details of business to which goods or services have been transferred.

(b) Description of goods or services transferred.

(c) Amount received / receivable for transferring of such goods or services -

(i) as per books of account.

(ii) as computed by the Assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price[See section 92C(1)]

9.78 Under this clause, the Assessee has to furnish details of specified domestic transactions respect of sale of goods/services from the Assessee's eligible business to Assessee's other business.

B. Has any undertaking or unit or enterprise or eligible business of

the Assessee [as referred to in section 80A(6), 80IA(8) or section10AA)]acquired any goods or services from another business of the Assessee? Yes/No

If 'yes' provide the following details in respect of each unit or enterprise or eligible business:

(a) Name and details of business from which goods or services have been acquired.

(b) Description of goods or services acquired.

(c) Amount paid / payable for acquiring of such goods or services -

(i) as per books of account.

(ii) as computed by the Assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)]

9.79 Under this clause, the Assessee has to furnish details of specified domestic transactions respect of purchase of goods/services by the Assessee's eligible business from Assessee's other business.

23. Particulars in respect of specified domestic transactions in the nature of any business transacted:

Has the Assessee entered into any specified domestic transaction(s) with any associated enterprise which has resulted in more than ordinary profits to an eligible business to which section 80IA(10) or section 10AA applies? Yes/No

If 'yes' provide the following details:

(a) Name of the person with whom the specified domestic transaction has been entered into

(b) Description of the transaction including quantitative details, if any

(c) Total amount received/receivable or paid/payable in the transaction-

(i) as per books of account.

(ii) as computed by the Assessee having regard to the arm's length price.

(a) Method used for determining the arm's length price [See section 92C(1)]

9.80 Under this clause, the Assessee has to furnish details of specified domestic transactions which has enabled Assessee to earn more than ordinary profits for a business to which section 80IA(10) or section 10AA is applicable. In case the Assessee is of the opinion that a transaction under Section 80IA(10) or Section 10AA does not result in more than ordinary profits to the Assessee, the Assessee does not have to disclose such transaction as specified domestic transaction under clause 24. However, the Assessee has to maintain robust documentation as prescribed under Rule 10D of the rules to substantiate that such transaction has not resulted in more than ordinary profits to the Assessee.

24. Particulars in respect of specified domestic transaction in the nature of any business transacted between the persons referred to in sub-section (6) of section 115BAB:

Has the assessee entered into any specified domestic transaction(s) with any persons referred to in sub-section (6) of section 115BAB which has resulted in more than ordinary profits expected to arise in such business?

If "yes", provide the following details:

(a) Name of the person with whom the specified domestic transaction has been entered into

(b) Description of the transaction including quantitative details, if any.

(c) Total amount received/receivable or paid/payable in the transaction-

(i) Price as per books of account;

(ii) Price as computed by the assessee having regard to the arm's length

(d) Method used for determining the arm's length price [See section 92C(1)

9.81 Under this clause, the Assessee has to furnish details of specified domestic transactions, the Assessee entered into any specified domestic transaction(s) with any persons referred to in sub-section (6) of section 115BAB. With respect to the reporting requirements in above mentioned clauses such as details of the person, description of the transaction, amount paid/payable or received/receivable, method for computing the arm's length nature of the transaction, the Accountant can refer to the guidance elaborated in the previous paragraphs which are relevant for international transactions.

25. Particulars in respect of any other transactions:

Has the Assessee entered into any other specified domestic transactions(s) not specifically referred to above, with an associated enterprise? Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each transaction:

(a) Name of the associated enterprise with whom the specified domestic transaction has been entered into:

(b) Description of the transaction.

(c) Amount paid/received or payable/receivable in the transaction -

(i) as per books of account.

(ii) as computed by the Assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)

9.82 Under this clause, the Assessee has to furnish details of other specified domestic transactions, which are not superficially covered in the above discussed clauses. With respect to other reporting requirements in above mentioned clauses such as details of the person, description of the transaction, amount paid/payable or received/receivable, method for computing the arm's length nature of the transaction, the Accountant can refer to the guidance elaborated in the previous paragraphs which are relevant for international transactions.

Annexure I
Statutory Provisions

1. The Finance Act, 2001 has introduced with effect from A.Y. 2002-03 sections 92 to 92F in the Act. These provisions are commonly known as transfer pricing regulations.

2. The object behind introduction of the provisions as stated by the Finance Minister in his Budget Speech and as explained in the Memorandum explaining the provisions of the Finance Act, 2001 are reproduced below:

"The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions has made the issue of transfer pricing a matter of serious concern, I had set up an Expert Group in November, 1999 to examine the issues relating to transfer pricing. Their report has been received proposing a detailed structure for transfer pricing legislation. Necessary legislative changes are being made in the Finance Bill based on these recommendations".

Vide the Finance Act 2012; specified domestic transactions have also been brought under the purview of transfer pricing provisions.

3. The relevant provisions of the Act dealing with the computation of income from international transactions/specified domestic transactions, certification by a chartered accountant and penalty for non-compliance thereof are given below:

CHAPTER X

SPECIAL PROVISIONS RELATING TO AVOIDANCE OF TAX

3.1 Section 92 - Computation of income from international transaction having regard to arm's length price.

(1) Any income arising from an international transaction shall be computed having regard to the arm's length price.

Explanation. For the removal of doubts, it is hereby clarified that the allowance for any expense or interest arising from an international transaction shall also be determined having regard to the arm's length price.

(2) Where in an international transaction or specified domestic transaction, two or more associated enterprises enter into a mutual agreement or

arrangement for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises, the cost or expense allocated or apportioned to, or, as the case may be, contributed by, any such enterprise shall be determined having regard to the arm's length price of such benefit, service or facility, as the case may be.

(2A) Any allowance for an expenditure or interest or allocation of any cost or expense or any income in relation to the specified domestic transaction shall be computed having regard to the arm's length price.

(3) The provisions of this section shall not apply in a case where the computation of income under sub-section (1) or sub section (2A) or the determination of the allowance for any expense or interest under that sub-section, or the determination of any cost or expense allocated or apportioned, or, as the case may be, contributed under sub-section (2) or sub section (2A) has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be, computed on the basis of entries made in the books of account in respect of the previous year in which the international transaction or specified domestic transaction was entered into.

3.2 Section 92A - Meaning of associated enterprise.

(1) For the purposes of this section and sections 92, 92B, 92C, 92D, 92E and 92F, "associated enterprise", in relation to another enterprise, means an enterprise -

(a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

(b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

(2) For the purposes of sub-section (1), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year,

(a) one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise; or

(b) any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises; or

(c) a loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one per cent of the book value of the total assets of the other enterprise; or

(d) one enterprise guarantees not less than ten per cent of the total borrowings of the other enterprise; or

(e) more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or

(f) more than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons; or

(g) the manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights; or

(h) ninety per cent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise; or

(i) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; or

(j) where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; or

(k) where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family or by a relative of a member of such Hindu undivided family or jointly by such member and his relative; or

(l) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than ten per cent interest in such firm, association of persons or body of individuals; or

(m) there exists between the two enterprises, any relationship of mutual interest, as may be prescribed.

3.3 Section 92B - Meaning of international transaction.

(1) For the purposes of this section and sections 92, 92C, 92D and 92E, "international transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

(2) A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be an international transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise where the enterprise or the associated enterprise or both of them are non-residents irrespective of whether such other person is a non-resident or not.

Explanation—For the removal of doubts, it is hereby clarified that—

(i) the expression "international transaction" shall include—

(a) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment,

tools, plant, furniture, commodity or any other article, product or thing;

(b) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;

(c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;

(d) provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;

(e) a transaction of business restructuring or reorganisation, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date;

(ii) the expression "intangible property" shall include—

(a) marketing related intangible assets, such as, trademarks, trade names, brand names, logos;

(b) technology related intangible assets, such as, process patents, patent applications, technical documentation such as laboratory notebooks, technical know-how;

(c) artistic related intangible assets, such as, literary works and copyrights, musical compositions, copyrights, maps, engravings;

(d) data processing related intangible assets, such as, proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters;

(e) engineering related intangible assets, such as, industrial design, product patents, trade secrets, engineering drawing and schema-tics, blueprints, proprietary documentation;

(f) customer related intangible assets, such as, customer lists, customer contracts, customer relationship, open purchase orders;

(g) contract related intangible assets, such as, favourable supplier, contracts, licence agreements, franchise agreements, non-compete agreements;

(h) human capital related intangible assets, such as, trained and organised work force, employment agreements, union contracts;

(i) location related intangible assets, such as, leasehold interest, mineral exploitation rights, easements, air rights, water rights;

(j) goodwill related intangible assets, such as, institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value;

(k) methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data;

(l) any other similar item that derives its value from its intellectual content rather than its physical attributes.

3.4 Section 92BA - Meaning of specified domestic transaction

For the purposes of this section and sections 92, 92C, 92D and 92E, "specified domestic transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely:—

(i) Omitted w.e.f 1.4.2017

(ii) any transaction referred to in section 80A;

(iii) any transfer of goods or services referred to in sub-section (8) of section 80-IA;

(iv) any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;

(v) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or

(va) any business transacted between the persons referred to in sub-section (6) of section 115BAB or

(vi) *any other transaction as may be prescribed,*

and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of twenty crore rupees.

3.5 Section 92C - Computation of arm's length price.

(1) The arm's length price in relation to an international transaction or specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely:

(*a*) comparable uncontrolled price method;

(*b*) resale price method;

(*c*) cost plus method;

(*d*) profit split method;

(*e*) transactional net margin method;

(*f*) such other method as may be prescribed by the Board.

(2) The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed:

Provided that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices:

Provided further that if the variation between the arm's length price so determined and price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed such percentage not exceeding three per cent of the latter, as may be notified by the Central Government in the Official Gazette in this behalf, the price at which the international transaction [or specified domestic transaction] has actually been undertaken shall be deemed to be the arm's length price.

"Provided also that where more than one price is determined by the most appropirate method, the arm's length price in relation to an international transaction or specified domestic transaction undertaken on or after the 1st

day of April, 2014, shall be computed in such manner as may be prescribed and accordingly the first and second proviso shall not apply.

Explanation.—For the removal of doubts, it is hereby clarified that the provisions of the second proviso shall also be applicable to all assessment or reassessment proceedings pending before an Assessing Officer as on the 1st day of October, 2009.

(2A) Where the first proviso to sub-section (2) as it stood before its amendment by the Finance (No. 2) Act, 2009 (33 of 2009), is applicable in respect of an international transaction for an assessment year and the variation between the arithmetical mean referred to in the said proviso and the price at which such transaction has actually been undertaken exceeds five per cent of the arithmetical mean, then, the assessee shall not be entitled to exercise the option as referred to in the said proviso.

(2B) Nothing contained in sub-section (2A) shall empower the Assessing Officer either to assess or reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154 for any assessment year the proceedings of which have been completed before the 1st day of October, 2009.

(3) Where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that -

(*a*) the price charged or paid in an international transaction or specified domestic transaction has not been determined in accordance with sub-sections (1) and (2); or

(*b*) any information and document relating to an international transaction or specified domestic transaction have not been kept and maintained by the assessee in accordance with the provisions contained in sub-section (1) of section 92D and the rules made in this behalf; or

(*c*) the information or data used in computation of the arm's length price is not reliable or correct; or

(*d*) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of section 92D,

the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction or specified domestic transaction

in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him.

Provided that an opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer.

(4) Where an arm's length price is determined by the Assessing Officer under sub-section (3), the Assessing Officer may compute the total income of the assessee having regard to the arm's length price so determined:

Provided that no deduction under section 10A *or* section 10AA or section 10B or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this sub-section:

Provided further that where the total income of an associated enterprise is computed under this sub-section on determination of the arm's length price paid to another associated enterprise from which tax has been deducted or was deductible under the provisions of Chapter XVIIB, the income of the other associated enterprise shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise.

3.6 Section 92CA - Reference to Transfer Pricing Officer

(1) Where any person, being the assessee, has entered into an international transaction or specified domestic transaction in any previous year, and the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval of the Principal Commissioner or Commissioner, refer the computation of the arm's length price in relation to the said international transaction or specified domestic transaction under section 92C to the Transfer Pricing Officer.

(2) Where a reference is made under sub-section (1), the Transfer Pricing Officer shall serve a notice on the assessee requiring him to produce or cause to be produced on a date to be specified therein, any evidence on which the assessee may rely in support of the computation made by him of the arm's length price in relation to the international transaction or specified domestic transaction referred to in sub-section (1).

(2A) Where any other international transaction [other than an international transaction referred under sub-section (1)], comes to the notice of the

Transfer Pricing Officer during the course of the proceedings before him, the provisions of this Chapter shall apply as if such other international transaction is an international transaction referred to him under sub-section (1).

(2B) Where in respect of an international transaction, the assessee has not furnished the report under section 92E and such transaction comes to the notice of the Transfer Pricing Officer during the course of the proceeding before him, the provisions of this Chapter shall apply as if such transaction is an international transaction referred to him under sub-section (1).

(2C) Nothing contained in sub-section (2B) shall empower the Assessing Officer either to assess or reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year, proceedings for which have been completed before the 1st day of July, 2012.

(3) On the date specified in the notice under sub-section (2), or as soon thereafter as may be, after hearing such evidence as the assessee may produce, including any information or documents referred to in sub-section (3) of section 92D and after considering such evidence as the Transfer Pricing Officer may require on any specified points and after taking into account all relevant materials which he has gathered, the Transfer Pricing Officer shall, by order in writing, determine the arm's length price in relation to the international transaction or specified domestic transaction in accordance with sub-section (3) of section 92C and send a copy of his order to the Assessing Officer and to the assessee.

(3A) Where a reference was made under sub-section (1) before the 1st day of June, 2007 but the order under sub-section (3) has not been made by the Transfer Pricing Officer before the said date, or a reference under sub-section (1) is made on or after the 1st day of June, 2007, an order under sub-section (3) may be made at any time before sixty days prior to the date on which the period of limitation referred to in section 153, or as the case may be, in section 153B for making the order of assessment or reassessment or recomputation or fresh assessment, as the case may be, expires.

Provided that in the circumstances referred to in clause (ii) or clause (x) of Explanation 1 to section 153, if the period of limitation available to the Transfer Pricing Officer for making an order is less than sixty days, such remaining period shall be extended to sixty days and the aforesaid period of limitation shall be deemed to have been extended accordingly.

(4) On receipt of the order under sub-section (3), the Assessing Officer shall proceed to compute the total income of the assessee under sub-section (4) of section 92C in conformity with the arm's length price as so determined by the Transfer Pricing Officer.

(5) With a view to rectifying any mistake apparent from the record, the Transfer Pricing Officer may amend any order passed by him under sub-section (3), and the provisions of section 154 shall, so far as may be, apply accordingly.

(6) Where any amendment is made by the Transfer Pricing Officer under sub-section (5), he shall send a copy of his order to the Assessing Officer who shall thereafter proceed to amend the order of assessment in conformity with such order of the Transfer Pricing Officer.

(7) The Transfer Pricing Officer may, for the purposes of determining the arm's length price under this section, exercise all or any of the powers specified in clauses (*a*) to (*d*) of sub-section (1) of section 131 or sub-section (6) of section 133 or section 133A.

Explanation—For the purposes of this section, Transfer Pricing Officer means a Joint Commissioner or Deputy Commissioner or Assistant Commissioner authorised by the Board to perform all or any of the functions of an Assessing Officer specified in sections 92C and 92D in respect of any person or class of persons.

3.7 92CB-Power of Board to make safe harbour rules

(1) The determination of

(a) income referred to in clause (i) of sub-section (1) of section 9; or

(b) arm's length price under section 92C or section 92CA,

shall be subject to safe harbour rules;

(2) The Board may, for the purposes of sub-section (1), make rules for safe harbour.

Explanation.—For the purposes of this section, "safe harbour" means circumstances in which the income-tax authorities shall accept the the transfer price or income, deemed to accrue or arise under clause (i) of sub-section (1) of section 9, as the case may be, declared by the assessee.

3.8 92CC- Advance Pricing Agreement

(1) The Board, with the approval of the Central Government, may enter into an advance pricing agreement with any person, determining the

(a) arm's length price or specifying the manner in which arm's length price is to be determined, in relation to an international transaction to be entered into by that person.

(b) income referred to in clause (i) of sub-section (1) of section 9, or specifying the manner in which said income is to be determined, as is reasonably attributable to the operations carried out in India by or on behalf of that person, being a non-resident

(2) The manner of determination of the arm's length price referred to in clause (a) or the income referred to in clause (b) of sub-section (1), may include the methods referred to in sub-section (1) of section 92C or the methods provided by rules made under this Act, respectively, with such adjustments or variations, as may be necessary or expedient so to do.

(3) Notwithstanding anything contained in section 92C or section 92CA or the methods provided by rules made under this Act, the arm's length price of any international transaction or the income referred to in clause (b) of sub-section (1), in respect of which the advance pricing agreement has been entered into, shall be determined in accordance with the advance pricing agreement so entered.

(4) The agreement referred to in sub-section (1) shall be valid for such period not exceeding five consecutive previous years as may be specified in the agreement.

(5) The advance pricing agreement entered into shall be binding—

(a) on the person in whose case, and in respect of the transaction in relation to which, the agreement has been entered into; and

(b) on the Principal Commissioner or Commissioner, and the income-tax authorities subordinate to him, in respect of the said person and the said transaction.

(6) The agreement referred to in sub-section (1) shall not be binding if there is a change in law or facts having bearing on the agreement so entered.

(7) The Board may, with the approval of the Central Government, by an order, declare an agreement to be void ab initio, if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts.

(8) Upon declaring the agreement void ab initio,—

(a) all the provisions of the Act shall apply to the person as if such agreement had never been entered into; and

(b) notwithstanding anything contained in the Act, for the purpose of computing any period of limitation under this Act, the period beginning with the date of such agreement and ending on the date of order under sub-section (7) shall be excluded:

Provided that where immediately after the exclusion of the aforesaid period, the period of limitation, referred to in any provision of this Act, is less than sixty days, such remaining period shall be extended to sixty days and the aforesaid period of limitation shall be deemed to be extended accordingly.

(9) The Board may, for the purposes of this section, prescribe a scheme specifying therein the manner, form, procedure and any other matter generally in respect of the advance pricing agreement.

"(9A) The agreement referred to in sub-section (1), may, subject to such conditions, procedure and manner as may be prescribed, provide for determining the

(a) arm's length price or specify the manner in which the arm's length price shall be determined in relation to the international transaction entered into by the person;

(b) income referred to in clause (i) of sub-section (1) of section 9, or specifying the manner in which the said income is to be determined, as is reasonably attributable to the operations carried out in India by or on behalf of that person, being a non-resident,

during any period not exceeding four previous years preceding the first of the previous years referred to in sub-section (4), and the arm's length price of such international transaction shall be determined in accordance with the said agreement.

(10) Where an application is made by a person for entering into an agreement referred to in sub-section (1), the proceeding shall be deemed to be pending in the case of the person for the purposes of the Act.

3.9 92CD - Effect to advance pricing agreement

(1) Notwithstanding anything to the contrary contained in section 139, where any person has entered into an agreement and prior to the date of entering into the agreement, any return of income has been furnished under the provisions of section 139 for any assessment year relevant to a previous year to which such agreement applies, such person shall furnish, within a period of three months from the end of the month in which the said agreement

was entered into, a modified return in accordance with and limited to the agreement.

(2) Save as otherwise provided in this section, all other provisions of this Act shall apply accordingly as if the modified return is a return furnished under section 139.

(3) If the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the agreement applies have been completed before the expiry of period allowed for furnishing of modified return under sub-section (1), the Assessing Officer shall, in a case where modified return is filed in accordance with the provisions of sub-section (1), pass an order modifying the total income of the relevant assessment year determined in such assessment or reassessment, *as the case may be,* having regard to and in accordance with the agreement.

(4) Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the agreement applies are pending on the date of filing of modified return in accordance with the provisions of sub-section (1), the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the agreement taking into consideration the modified return so furnished.

(5) Notwithstanding anything contained in section 153 or section 153B or section 144C,—

(a) the order under sub-section (3) shall be passed within a period of one year from the end of the financial year in which the modified return under sub-section (1) is furnished;

(b) the period of limitation as provided in section 153 or section 153B or section 144C for completion of pending assessment or reassessment proceedings referred to in sub-section (4) shall be extended by a period of twelve months.

(6) For the purposes of this section,—

(i) "agreement" means an agreement referred to in sub-section (1) of section 92CC;

(ii) the assessment or reassessment proceedings for an assessment year shall be deemed to have been completed where—

(a) an assessment or reassessment order has been passed; or

(b) no notice has been issued under sub-section (2) of section 143

till the expiry of the limitation period provided under the said section.

3.10. Section 92CE- Secondary adjustment in certain cases (wef 1-04-2018)

(1) Where a primary adjustment to transfer price,—

(i) has been made suo motu by the assessee in his return of income;

(ii) made by the Assessing Officer has been accepted by the assessee;

(iii) is determined by an advance pricing agreement entered into by the assessee under section 92CC on or after the 1st day of April, 2017;

(iv) is made as per the safe harbour rules framed under section 92CB; or

(v) is arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into under section 90 or section 90A for avoidance of double taxation,

the assessee shall make a secondary adjustment:

Provided that nothing contained in this section shall apply, if,—

(i) the amount of primary adjustment made in any previous year does not exceed one crore rupees; or

(ii) the primary adjustment is made in respect of an assessment year commencing on or before the 1st day of April, 2016.

Provided further that no refund of taxes paid, if any, by virtue of provisions of this sub-section as they stood immediately before their amendment by the Finance (No. 2) Act, 2019 shall be claimed and allowed.

(2) Where, as a result of primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss, as the case may be, of the assessee, the excess money or part thereof, as the case may be, which is available with its associated enterprise, if not repatriated to India within the time as may be prescribed, shall be deemed to be an advance made by the assessee to such associated enterprise and the interest on such advance, shall be computed in such manner as may be prescribed.

Explanation.—For the removal of doubts, it is hereby clarified that the excess money or part thereof may be repatriated from any of the associated enterprises of the assessee which is not a resident in India.

(2A) Without prejudice to the provisions of sub-section (2), where the excess money or part thereof has not been repatriated within the prescribed

time, the assessee may, at his option, pay additional income-tax at the rate of eighteen per cent on such excess money or part thereof, as the case may be.

(2B) The tax on the excess money or part thereof so paid by the assessee under sub-section (2A) shall be treated as the final payment of tax in respect of the excess money or part thereof not repatriated and no further credit therefore shall be claimed by the assessee or by any other person in respect of the amount of tax so paid.

(2C) No deduction under any other provision of this Act shall be allowed to the assessee in respect of the amount on which tax has been paid in accordance with the provisions of sub-section (2A).

(2D) Where the additional income-tax referred to in sub-section (2A) is paid by the assessee, he shall not be required to make secondary adjustment under sub-section (1) and compute interest under sub-section (2) from the date of payment of such tax.

(3) For the purposes of this section,—

(i) "associated enterprise" shall have the meaning assigned to it in sub-section (1) and sub-section (2) of section 92A;

(ii) "arm's length price" shall have the meaning assigned to it in clause (ii) of section 92F;

(iii) "excess money" means the difference between the arm's length price determined in primary adjustment and the price at which the international transaction has actually been undertaken;

(iv) "primary adjustment" to a transfer price, means the determination of transfer price in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the assessee;

(v) "secondary adjustment" means an adjustment in the books of account of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.

3.11 Section 92D - Maintenance and keeping of information and document by persons entering into an international transaction or specified domestic transaction

(1) Every person who has entered into an international transaction or specified domestic transaction shall keep and maintain such information and document in respect thereof, as may be prescribed.

Provided that the person, being a constituent entity of an international group, shall also keep and maintain such information and document in respect of an international group as may be prescribed.

Explanation.—For the purposes of this section,—

(A) "constituent entity" shall have the meaning assigned to it in clause (d) of sub-section (9) of section 286;

(B) "international group" shall have the meaning assigned to it in clause (g) of sub-section (9) of section 286.

(2) Without prejudice to the provisions contained in sub-section (1), the Board may prescribe the period for which the information and document shall be kept and maintained under that sub-section.

(3) The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceeding under this Act, require any person who has entered into an international transaction or specified domestic transaction to furnish any information or document in respect thereof, as may be prescribed under sub-section (1), within a period of thirty days from the date of receipt of a notice issued in this regard :

Provided that the Assessing Officer or the Commissioner (Appeals) may, on an application made by such person, extend the period of thirty days by a further period not exceeding thirty days.

(4) Without prejudice to the provisions of sub-section (3), the person referred to in the proviso to sub-section (1) shall furnish the information and document referred to in the said proviso to the authority prescribed under sub-section (1) of section 286, in such manner, on or before the date, as may be prescribed.

Following section 92D shall be substituted for the existing section 92D by the Act No. 23 of 2019, w.e.f. 1-4-2020 :

Maintenance, keeping and furnishing of information and document by certain persons.

92D. *(1) Every person,—*

(i) who has entered into an international transaction or specified domestic transaction shall keep and maintain such information and document in

respect thereof as may be prescribed;

*(*ii*) being a constituent entity of an international group, shall keep and maintain such information and document in respect of an international group as may be prescribed.*

Explanation.—*For the purposes of this clause,—*

*(*A*) "constituent entity" shall have the meaning assigned to it in clause (*d*) of sub-section (9) of section 286;*

*(*B*) "international group" shall have the meaning assigned to it in clause (*g*) of sub-section (9) of section 286.*

(2) Without prejudice to the provisions contained in sub-section (1), the Board may prescribe the period for which the information and document shall be kept and maintained under the said sub-section.

*(3) The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceeding under this Act, require any person referred to in clause (*i*) of sub-section (1) to furnish any information or document referred therein, within a period of thirty days from the date of receipt of a notice issued in this regard:*

Provided *that the Assessing Officer or the Commissioner (Appeals) may, on an application made by such person, extend the period of thirty days by a further period not exceeding thirty days.*

*(4) The person referred to in clause (*ii*) of sub-section (1) shall furnish the information and document referred therein to the authority prescribed under sub-section (1) of section 286, in such manner, on or before such date, as may be prescribed.*

3.12 Section 92E - Report from an accountant to be furnished by persons entering into international transaction

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.

3.13 Section 92F - Definitions of certain terms relevant to computation of arm's length price, etc.

In sections 92, 92A, 92B, 92C, 92D and 92E, unless the context otherwise requires,-

(*i*) "accountant" shall have the same meaning as in the *Explanation* below sub-section (2) of section 288;

(*ii*) "arm's length price" means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions;

(*iii*) "enterprise" means a person (including a permanent establishment of such person) who is, or has been, or is proposed to be, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights, or the provision of services of any kind, or in carrying out any work in pursuance of a contract, or in investment, or providing loan or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, whether such activity or business is carried on, directly or through one or more of its units or divisions or subsidiaries, or whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or places;

(*iiia*) "permanent establishment", referred to in clause (*iii*), includes a fixed place of business through which the business of the enterprise is wholly or partly carried on;

(*iv*) "specified date" means the date one month prior to the due date for furnishing the return of income under sub-section (1) of section 139 for the relevant assessment year;'

(*v*) "transaction" includes an arrangement, understanding or action in concert,

(*A*) whether or not such arrangement, understanding or action is formal or in writing; or

(*B*) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceeding.

3.14 Section 270A - Penalty for under reporting and misreporting of income.

(1) The Assessing Officer or the Commissioner (Appeals) or the Principal Commissioner or Commissioner may, during the course of any proceedings under this Act, direct that any person who has under-reported his income shall be liable to pay a penalty in addition to tax, if any, on the under-reported income.

(2) A person shall be considered to have under-reported his income, if—

(a) the income assessed is greater than the income determined in the return processed under clause (a) of sub-section (1) of section 143;

(b) the income assessed is greater than the maximum amount not chargeable to tax, where no return of income has been furnished *or* where return has been furnished for the first time under section 148;

(c) the income reassessed is greater than the income assessed or reassessed immediately before such reassessment;

(d) the amount of deemed total income assessed or reassessed as per the provisions of section 115JB or section 115JC, as the case may be, is greater than the deemed total income determined in the return processed under clause (a) of sub-section (1) of section 143;

(e) the amount of deemed total income assessed as per the provisions of section 115JB or section 115JC is greater than the maximum amount not chargeable to tax, where no return of income has been furnished or where return has been furnished for the first time under section 148;

(f) the amount of deemed total income reassessed as per the provisions of section 115JB or section 115JC, as the case may be, is greater than the deemed total income assessed or reassessed immediately before such reassessment;

(g) the income assessed or reassessed has the effect of reducing the loss or converting such loss into income.

(3) The amount of under-reported income shall be,—

(i) in a case where income has been assessed for the first time,—

(a) if return has been furnished, the difference between the amount of income assessed and the amount of income determined under clause (a) of sub-section (1) of section 143;

(b) in a case where no return of income has been furnished or where return has been furnished for the first time under section 148,—

(A) the amount of income assessed, in the case of a company, firm or local authority; and

(B) the difference between the amount of income assessed and the maximum amount not chargeable to tax, in a case not covered in item (A);

(ii) in any other case, the difference between the amount of income reassessed or recomputed and the amount of income assessed, reassessed or recomputed in a preceding order:

Provided that where under-reported income arises out of determination of deemed total income in accordance with the provisions of section 115JB or section 115JC, the amount of total under-reported income shall be determined in accordance with the following formula—

(A — B) + (C — D)

where,

A = the total income assessed as per the provisions other than the provisions contained in section 115JB or section 115JC (herein called general provisions);

B = the total income that would have been chargeable had the total income assessed as per the general provisions been reduced by the amount of under-reported income;

C = the total income assessed as per the provisions contained in section 115JB or section 115JC;

D = the total income that would have been chargeable had the total income assessed as per the provisions contained in section 115JB or section 115JC been reduced by the amount of under-reported income:

Provided further that where the amount of under-reported income on any issue is considered both under the provisions contained in section 115JB or section 115JC and under general provisions, such amount shall not be reduced from total income assessed while determining the amount under item D.

Explanation.—*For the purposes of this section,*—

(a) "preceding order" means an order immediately preceding the order during the course of which the penalty under sub-section (1) has been initiated;

(b) in a case where an assessment or reassessment has the effect of reducing the loss declared in the return or converting that loss into income, the amount of under-reported income shall be the difference between the loss claimed and the income or loss, as the case may be, assessed or reassessed.

(4) Subject to the provisions of sub-section (6), where the source of any receipt, deposit or investment in any assessment year is claimed to be an amount added to income or deducted while computing loss, as the case may be, in the assessment of such person in any year prior to the assessment year in which such receipt, deposit or investment appears (hereinafter referred to as "preceding year") and no penalty was levied for such preceding year, then, the under-reported income shall include such amount as is sufficient to cover such receipt, deposit or investment.

(5) The amount referred to in sub-section (4) shall be deemed to be amount of income under-reported for the preceding year in the following order—

(a) the preceding year immediately before the year in which the receipt, deposit or investment appears, being the first preceding year; and

(b) where the amount added or deducted in the first preceding year is not sufficient to cover the receipt, deposit or investment, the year immediately preceding the first preceding year and so on.

(6) The under-reported income, for the purposes of this section, shall not include the following, namely:—

(a) the amount of income in respect of which the assessee offers an explanation and the Assessing Officer or the Commissioner (Appeals) or the Commissioner or the Principal Commissioner, as the case may

be, is satisfied that the explanation is bona fide and the assessee has disclosed all the material facts to substantiate the explanation offered;

(b) the amount of under-reported income determined on the basis of an estimate, if the accounts are correct and complete to the satisfaction of the Assessing Officer or the Commissioner (Appeals) or the Commissioner or the Principal Commissioner, as the case may be, but the method employed is such that the income cannot properly be deduced therefrom;

(c) the amount of under-reported income determined on the basis of an estimate, if the assessee has, on his own, estimated a lower amount of addition or disallowance on the same issue, has included such amount in the computation of his income and has disclosed all the facts material to the addition or disallowance;

(d) the amount of under-reported income represented by any addition made in conformity with the arm's length price determined by the Transfer Pricing Officer, where the assessee had maintained information and documents as prescribed under section 92D, declared the international transaction under Chapter X, and, disclosed all the material facts relating to the transaction; and

(e) the amount of undisclosed income referred to in section 271AAB.

(7) The penalty referred to in sub-section (1) shall be a sum equal to fifty per cent of the amount of tax payable on under-reported income.

(8) Notwithstanding anything contained in sub-section (6) or sub-section (7), where under-reported income is in consequence of any misreporting thereof by any person, the penalty referred to in sub-section (1) shall be equal to two hundred per cent of the amount of tax payable on under-reported income.

(9) The cases of misreporting of income referred to in sub-section (8) shall be the following, namely:—

(a) misrepresentation or suppression of facts;

(b) failure to record investments in the books of account;

(c) claim of expenditure not substantiated by any evidence;

(d) recording of any false entry in the books of account;

(e) failure to record any receipt in books of account having a bearing on total income; and

(f) failure to report any international transaction or any transaction deemed to be an international transaction or any specified domestic transaction, to which the provisions of Chapter X apply.

(10) The tax payable in respect of the under-reported income shall be—

(a) where no return of income has been furnished or where return has been furnished for the first time under section 148 and the income has been assessed for the first time, the amount of tax calculated on the under-reported income as increased by the maximum amount not chargeable to tax as if it were the total income;

(b) where the total income determined under clause (a) of sub-section (1) of section 143 or assessed, reassessed or recomputed in a preceding order is a loss, the amount of tax calculated on the under-reported income as if it were the total income;

(c) in any other case determined in accordance with the formula—

(X-Y)

where,

X = the amount of tax calculated on the under-reported income as increased by the total income determined under clause (a) of sub-section (1) of section 143 or total income assessed, reassessed or recomputed in a preceding order as if it were the total income; and

Y = the amount of tax calculated on the total income determined under clause (a) of sub-section (1) of section 143 or total income assessed, reassessed or recomputed in a preceding order.

(11) No addition or disallowance of an amount shall form the basis for imposition of penalty, if such addition or disallowance has formed the basis of imposition of penalty in the case of the person for the same or any other assessment year.

(12) The penalty referred to in sub-section (1) shall be imposed, by an order in writing, by the Assessing Officer, the Commissioner (Appeals), the Commissioner or the Principal Commissioner, as the case may be.

3.15 Section 271(1)(c)(iii) – Concealment of Income

If the Assessing Officer or the Commissioner (Appeals) or the Commissioner in the course of any proceedings under this Act, is satisfied that any person has concealed the particulars of his income or furnished inaccurate particulars of such income, he may direct that such person shall pay by way

of penalty, in addition to tax, if any payable by him, a sum which shall not be less than, but which shall not exceed three times the amount of tax sought to be evaded by reason of the concealment of particulars of his income or fringe benefits or the furnishing of inaccurate particulars of such income or fringe benefits.

Explanation 7 – Where in the case of an assessee who has entered into an international transaction or specified domestic transaction defined in section 92B, any amount is added or disallowed in computing the total income under sub-section (4) of section 92C, then, the amount so added or disallowed shall, for the purposes of clause (c) of this sub-section, be deemed to represent the income in respect of which particulars have been concealed or inaccurate particulars have been furnished, unless the assessee proves to the satisfaction of the Assessing Officer or Commissioner (Appeals) or the Principal Commissioner or Commissioner that the price charged or paid in such transaction was computed in accordance with the provisions contained in section 92C and in the manner prescribed under that section, in good faith and with due diligence.

Following sub-section (7) has been inserted after sub-section (6) of section 271 by the Finance Act, 2016, w.e.f. 1-4-2017:

(7) The provision of this section shall not apply to and in relation to any assessment for the assessment year commencing on or after the 1st day of April, 2017.

3.16 Section 271AA – Penalty for failure to keep and maintain information and document, etc., in respect of certain transactions.

(1) Without prejudice to the provisions of section 271 or section 271BA, if any person in respect of an international transaction or specified domestic transaction—

(i) fails to keep and maintain any such information and document as required by sub-section (1) or sub-section (2) of section 92D;

(ii) fails to report such transaction which he is required to do so; or

(iii) maintains or furnishes an incorrect information or document,

the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two per cent of the value of each international transaction or specified domestic transaction entered into by such person.

(2) If any person fails to furnish the information and the document as

required under sub-section (4) of section 92D, the prescribed income-tax authority referred to in the said sub-section may direct that such person shall pay, by way of penalty, a sum of five hundred thousand rupees.

3.17 Section 271BA – Penalty for failure to furnish report under section 92E.

If any person fails to furnish a report from an accountant as required by section 92E, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of one hundred thousand rupees.

3.18 Section 271G – Penalty for failure to furnish information or document under section 92D.

If any person who has entered into an international transaction or specified domestic transaction fails to furnish any such information or document as required by sub-section (3) of section 92D, the Assessing Officer or or the Transfer Pricing Officer as referred to in section 92CA, or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two per cent of the value of the international transaction or specified domestic transaction for each such failure.

3.19 Section 271J - Penalty for furnishing incorrect information in reports or certificates.

Without prejudice to the provisions of this Act, where the Assessing Officer or the Commissioner (Appeals), in the course of any proceedings under this Act, finds that an accountant or a merchant banker or a registered valuer has furnished incorrect information in any report or certificate furnished under any provision of this Act or the rules made thereunder, the Assessing Officer or the Commissioner (Appeals) may direct that such accountant or merchant banker or registered valuer, as the case may be, shall pay, by way of penalty, a sum of ten thousand rupees for each such report or certificate.

Explanation.—For the purposes of this section,—

(a) "accountant" means an accountant referred to in the Explanation below sub-section (2) of section 288;

(b) "merchant banker" means Category I merchant banker registered with the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);

(c) "registered valuer" means a person defined in clause (oaa) of section 2 of the Wealth-tax Act, 1957 (27 of 1957)].

Annexure II
Relevant Rules and Forms

Rules relevant to section 92 to 92F are reproduced below:

1. Rule 10A - Meaning of expressions used in computation of arm's length price.

For the purposes of this rule and rules 10AB to 10E,-

(a) "associated enterprise" shall,-

(i) have the same meaning as assigned to it in section 92A; and

(ii) in relation to a specified domestic transaction entered into by an assessee, include -

(A) the persons referred to in clause (b) of sub-section (2) of section 40A in respect of a transaction referred to in clause (a) of sub-section (2) of the said section;

(B) other units or undertakings or businesses of such assessee in respect of a transaction referred to in section 80A or, as the case may be, subsection (8) of section 80-IA;

(C) any other person referred to in sub-section (10) of section 80-IA in respect of a transaction referred to therein;

(D) other units, undertakings, enterprises or business of such assessee, or other person referred to in sub-section (10) of section 80-IA, as the case may be, in respect of a transaction referred to in section 10AA or the transactions referred to in Chapter VI-A to which the provisions of sub-section (8) or, as the case may be, the provisions of sub-section (10) of section 80-IA are applicable;

(aa) "enterprise" shall have the same meaning as assigned to it in clause (iii) of section 92F and shall, for the purposes of a specified domestic transaction, include a unit, or an enterprise, or an undertaking or a business of a person who undertakes such transaction;'.

(ab) "uncontrolled transaction" means a transaction between enterprises other than associated enterprises, whether resident or non-resident;

(b) "property" includes goods, articles or things, and intangible property;

(c) "services" include financial services;

(d) "transaction" includes a number of closely linked transactions.

2. Rule 10AB- Other method of determination of arm's length price.

For the purposes of clause (f) of sub-section (1) of section 92C, the other method for determination of the arms' length price in relation to an international transaction or a specified domestic transaction shall be any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non associated enterprises, under similar circumstances, considering all the relevant facts.

3. Rule 10B - Determination of arm's length price under section 92C.

(1) For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction or a specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely:-

(a) comparable uncontrolled price method, by which,-

(i) the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;

(ii) such price is adjusted to account for differences, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the price in the open market;

(iii) the adjusted price arrived at under sub-clause (ii) is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction or the specified domestic transaction;

(b) resale price method, by which,-

(i) the price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise, is identified;

(ii) such resale price is reduced by the amount of a normal gross

profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;

(iii) the price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;

(iv) the price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;

(v) the adjusted price arrived at under sub-clause (iv) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise;

(c) cost plus method, by which,-

(i) the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;

(ii) the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;

(iii) the normal gross profit mark-up referred to in sub-clause (ii) is adjusted to take into account the functional and other differences, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;

(iv) the costs referred to in sub-clause (i) are increased by the adjusted profit mark-up arrived at under sub-clause (iii);

(v) the sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise;

(d) profit split method, which may be applicable mainly in international transaction or specified domestic transaction involving transfer of unique intangibles or in multiple international transaction or specified domestic transaction which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which -

(i) the combined net profit of the associated enterprises arising from the international transaction or the specified domestic transaction in which they are engaged, is determined;

(ii) the relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;

(iii) the combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under sub-clause (ii);

(iv) the profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction or a specified domestic transaction:

Provided that the combined net profit referred to in sub-clause (i) may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction or specified domestic transaction in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution in the manner specified under sub-clauses (ii) and (iii), and in such a case the

aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction or the specified domestic transaction;

(e) transactional net margin method, by which,-

(i) the net profit margin realised by the enterprise from an international transaction or a specified domestic transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;

(ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;

(iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii);

(v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction or the specified domestic transaction.

(f) Any other method as provided in rule 10AB.

(2) For the purposes of sub-rule (1), the comparability of an international transaction or a specified domestic transaction with an uncontrolled transaction shall be judged with reference to the following, namely:-

(a) the specific characteristics of the property transferred or services provided in either transaction;

(b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;

(c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

(d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

(3) An uncontrolled transaction shall be comparable to an international transaction or a specified domestic transaction if -

(i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or

(ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

(4) The data to be used in analysing the comparability of an uncontrolled transaction with an international transaction or a specified domestic transaction shall be the data relating to the financial year (hereafter in this rule and in rule 10 CA referred to as the 'current year') in which the international transaction or the specified domestic transaction has been entered into :

Provided that data relating to a period not being more than two years prior to the current year may also be considered if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared.

Provided further that the first proviso shall not apply while analysing the comparability of an uncontrolled transaction with an international transaction or a specified domestic transaction, entered into on or after the 1st day of April, 2014.

(5) In a case where the most appropriate method for determination of the arm's length price of an international transaction or a specified domestic

transaction, entered into on or after the 1st day of April, 2014, is the method specified in clause (b), clause (c) or clause (e) of sub-section (1) of section 92 C, then, notwithstanding anything contained in sub-rule (4), the data to be used for analysing the comparability of an uncontrolled transaction with an international transaction or a specified domestic transaction shall be,-

(i) the data relating to the current year; or

(ii) the data relating to the financial year immediately preceding the current year, if the data relating to the current year is not available at the time of furnishing the return of income by the assessee, for the assessment year relevant to the current year:

Provided that where the data relating to the current year is subsequently available at the time of determination of arm's length price of an international transaction or a specified domestic transaction during the course of any assessment proceeding for the assessment year relevant to the current year, then, such data shall be used for such determination irrespective of the fact that the data was not available at the time of furnishing the return of income of the relevant assessment year.

4. Rule 10C - Most appropriate method

(1) For the purposes of sub-section (1) of section 92C, the most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction or specified domestic transaction, and which provides the most reliable measure of an arm's length price in relation to the international transaction or the specified domestic transaction, as the case may be.

(2) In selecting the most appropriate method as specified in sub-rule (1), the following factors shall be taken into account, namely:

(a) the nature and class of the international transaction or the specified domestic transaction;

(b) the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;

(c) the availability, coverage and reliability of data necessary for application of the method;

(d) the degree of comparability existing between the international transaction or the specified domestic transaction and the uncontrolled

transaction and between the enterprises entering into such transactions;

(e) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;

(f) the nature, extent and reliability of assumptions required to be made in application of a method.

5. Rule 10CA- Computation of arm's length price in certain cases

(1) Where in respect of an international transaction or a specified domestic transaction, the application of the most appropriate method referred to in sub-section (1) of section 92 C results in determination of more than one price, then the arm's length price in respect of such international transaction or specified domestic transaction shall be computed in accordance with the provisions of this rule.

(2) A dataset shall be constructed by placing the prices referred to in sub-rule (1) in an ascending order and the arm's length price shall be determined on the basis of the dataset so constructed:

Provided that in a case referred to in clause (i) of sub-rule (5) of rule 10B, where the comparable uncontrolled transaction has been identified on the basis of data relating to the current year and the enterprise undertaking the said uncontrolled transaction, [not being the enterprise undertaking the international transaction or the specified domestic transaction referred to in sub-rule (1)], has in either or both of the two financial years immediately preceding the current year undertaken the same or similar comparable uncontrolled transaction then,-

(i) the most appropriate method used to determine the price of the comparable uncontrolled transaction undertaken in the current year shall be applied in similar manner to the comparable uncontrolled transaction or transactions undertaken in the aforesaid period and the price in respect of such uncontrolled transactions shall be determined; and

(ii) the weighted average of the prices, computed in accordance with the manner provided in sub-rule (3), of the comparable uncontrolled transactions undertaken in the current year and in

the aforesaid period preceding it shall be included in the dataset instead of the price referred to in sub-rule (1) :

Provided further that in a case referred to in clause (ii) of sub-rule (5) of rule 10B, where the comparable uncontrolled transaction has been identified on the basis of the data relating to the financial year immediately preceding the current year and the enterprise undertaking the said uncontrolled transaction, [not being the enterprise undertaking the international transaction or the specified domestic transaction referred to in sub-rule (1)], has in the financial year immediately preceding the said financial year undertaken the same or similar comparable uncontrolled transaction then, -

(i) the price in respect of such uncontrolled transaction shall be determined by applying the most appropriate method in a similar manner as it was applied to determine the price of the comparable uncontrolled transaction undertaken in the financial year immediately preceding the current year; and

(ii) the weighted average of the prices, computed in accordance with the manner provided in sub-rule (3), of the comparable uncontrolled transactions undertaken in the aforesaid period of two years shall be included in the dataset instead of the price referred to in sub-rule (1):

Provided also that where the use of data relating to the current year in terms of the proviso to sub-rule (5) of rule 10 B establishes that,-

(i) the enterprise has not undertaken same or similar uncontrolled transaction during the current year ; or

(ii) the uncontrolled transaction undertaken by an enterprise in the current year is not a comparable uncontrolled transaction,

then, irrespective of the fact that such an enterprise had undertaken comparable uncontrolled transaction in the financial year immediately preceding the current year or the financial year immediately preceding such financial year, the price of comparable uncontrolled transaction or the weighted average of the prices of the uncontrolled transactions, as the case may be, undertaken by such enterprise shall not be included in the dataset.

(3) Where an enterprise has undertaken comparable uncontrolled transactions in more than one financial year, then for the purposes of sub-rule (2) the weighted average of the prices of such transactions shall be computed in the following manner, namely:-

(i) where the prices have been determined using the method referred to in clause (b) of sub-rule (1) of rule 10 B, the weighted average of the prices shall be computed with weights being assigned to the quantum of sales which has been considered for arriving at the respective prices;

(ii) where the prices have been determined using the method referred to in clause (c) of sub-rule (1) of rule 10 B, the weighted average of the prices shall be computed with weights being assigned to the quantum of costs which has been considered for arriving at the respective prices;

(iii) where the prices have been determined using the method referred to in clause (e) of sub-rule (1) of rule 10 B, the weighted average of the prices shall be computed with weights being assigned to the quantum of costs incurred or sales effected or assets employed or to be employed, or as the case may be, any other base which has been considered for arriving at the respective prices.

(4) Where the most appropriate method applied is a method other than the method referred to in clause (d) or clause (f) of sub-section (1) of section 92 C and the dataset constructed in accordance with sub-rule (2) consists of six or more entries, an arm's length range beginning from the thirty-fifth percentile of the dataset and ending on the sixty-fifth percentile of the dataset shall be constructed and the arm's length price shall be computed in accordance with sub-rule(5) and sub-rule (6).

(5) If the price at which the international transaction or the specified domestic transaction has actually been undertaken is within the range referred to in sub-rule (4), then, the price at which such international transaction or the specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price.

(6) If the price at which the international transaction or the specified domestic transaction has actually been undertaken is outside the arm's length range referred to in sub-rule (4), the arm's length price shall be taken to be the median of the dataset.

(7) In a case where the provisions of sub-rule (4) are not applicable, the arm's length price shall be the arithmetical mean of all the values included in the dataset:

***Provided** that, if the variation between the arm's length price so determined and price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed such percentage not exceeding three percent. of the latter, as may be notified by the Central Government in the Official Gazette in this behalf, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price.*

(8) For the purposes of this rule,-

(a) "the thirty-fifth percentile" of a dataset, having values arranged in an ascending order, shall be the lowest value in the dataset such that at least thirty five percent. of the values included in the dataset are equal to or less than such value :

Provided that, if the number of values that are equal to or less than the aforesaid value is a whole number, then the thirty-fifth percentile shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset ;

(b) "the sixth-fifth percentile" of a dataset, having values arranged in an ascending order, shall be the lowest value in the dataset such that at least sixty five percent. of the values included in the dataset are equal to or less than such value:

Provided that, if the number of values that are equal to or less than the aforesaid value is a whole number, then the sixty-fifth percentile shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset;

(c) "the median" of the dataset, having values arranged in an ascending order, shall be the lowest value in the dataset such that at least fifty percent. of the values included in the dataset are equal to or less than such value :

Provided that, if the number of values that are equal to or less than the aforesaid value is a whole number, then the median shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.

Illustration 1. *The data for the current year of the comparable uncontrolled transactions or the entities undertaking such transactions is available at the time of furnishing return of income by the assessee and based on the same, seven enterprises have been identified to have undertaken the comparable uncontrolled transaction in the current year. All the identified comparable enterprises have also undertaken comparable uncontrolled transactions in a period of two years preceding the current year. The Profit level Indicator (PLI) used in applying the most appropriate method is operating profit as compared to operating cost (OP/OC). The weighted average shall be based upon the weight of OC as computed below:*

Sl. No.	***Name***	***Year 1***	***Year 2***	***Year3 [Current Year]***	***Aggregation of OC and OP***	***Weighted Average***
1	***2***	***3***	***4***	***5***	***6***	***7***
1	*A*	*OC = 100 OP = 12*	*OC = 150 OP = 10*	*OC = 225 OP = 35*	*Total OC = 475 Total OP = 57*	*OP/OC = 12%*
2	*B*	*OC = 80 OP = 10*	*OC = 125 OP = 5*	*OC = 100 OP = 10*	*Total OC = 305 Total OP = 25*	*OP/OC =* ***8.2%***
3	*C*	*OC = 250 OP = 22*	*OC = 230 OP = 26*	*OC = 250 OP = 18*	*Total OC = 730 Total OP = 66*	*OP/OC = 9%*
4	*D*	*OC = 180 OP = (-) 9*	*OC = 220 OP = 22*	*OC = 150 OP = 20*	*Total OC = 550 Total OP = 33*	*OP/OC =* ***6%***
5	*E*	*OC = 140 OP = 21*	*OC = 100 OP = (-) 8*	*OC = 125 OP = (-) 5*	*Total OC = 365 Total OP = 8*	*OP/OC =* ***2.2%***
6	*F*	*OC = 160 OP = 21*	*OC = 120 OP = 14*	*OC = 140 OP = 15*	*Total OC = 420 Total OP = 50*	*OP/OC =* ***11.9 %***
7	*G*	*OC = 150 OP = 21*	*OC = 130 OP = 12*	*OC = 155 OP = 13*	*Total OC = 435 Total OP = 46*	*OP/OC =* ***10.57%***

From the above, the dataset will be constructed as follows:

S.I. No.	***1***	***2***	***3***	***4***	***5***	***6***	***7***
Values	*2.2%*	*6%*	*8.2%*	*9%*	*10.57%*	*11.9%*	*12%*

For construction of the arm's length range the data place of thirty-fifth and sixty-fifth percentile shall be computed in the following manner, namely:

*Total no. of data points in dataset * (35/100)*

*Total no. of data points in dataset * (65/100) Thus, the data place of the thirty-fifth percentile = 7*0.35 = 2.45.*

Since this is not a whole number, the next higher data place, i.e; the value at the third place would have at least thirty five percent. of the values below it. The thirty-fifth percentile is therefore value at the third place, i.e, 8.2%.

*The data place of the sixth-fifth percentile is = 7*0.65 = 4.55.*

Since this is not a whole number, the next higher data place, i.e; the value at the fifth place would have at least sixty five percent. of the values below it. The sixty-fifth percentile is therefore value at fifth place, i.e, 10.57%.

The arm's length range will be beginning at 8.2% and ending at 10.57%.

Therefore, if the transaction price of the international transaction or the specified domestic transaction has OP/OC percentage which is equal to or more than 8.2% and less than or equal to 10.57%, it is within the range. The transaction price in such cases will be deemed to be the arm's length price and no adjustment shall be required. However, if the transaction price is outside the arm's length range, say 6.2%, then for the purpose of determining the arm's length price the median of the dataset shall be first determined in the following manner:

*The data place of median is calculated by first computing the total number of data point in the data set * (50/100). In this case it is 7 * 0.5 = 3.5.*

Since this is not a whole number, the next higher data place, i.e; the value at the fourth place would have at least fifty percent. of the values below it (median).

The median is the value at fourth place, i.e., 9%. Therefore, the arm's length price shall be considered as 9% and adjustment shall accordingly be made.

Illustration 2. *The data of the current year is available in respect of enterprises A, C, E, F and G at the time of furnishing the return of income by the assessee and the data of the financial year preceding the current year*

has been used to identify comparable uncontrolled transactions undertaken by enterprises B and D . Further, if the enterprises have also undertaken comparable uncontrolled transactions in earlier years as detailed in the table, the weighted average and dataset shall be computed as below:

Sl. No.	***Name***	***Year 1***	***Year 2***	***Year 3 [Current Year]***	***Aggregation of OC and OP***	***Weighted Average***
1	***2***	***3***	***4***	***5***	***6***	***7***
1	*A*	*OC = 100 OP = 12*	*OC = 150 OP = 10*	*OC = 225 OP = 35*	*Total OC = 475 Total OP = 57*	*OP/OC = 12%*
2	*B*	*OC = 80 OP = 10*	*OC = 125 OP = 5*		*Total OC = 205 OP/OC = **7.31%** Total OP = 15*	
3	*C*	*OC = 250 OP = 22*	*OC = 230 OP = 26*	*OC = 250 OP = 18*	*Total OC = 730 Total OP = 66*	
4	*D*		*OC = 220 OP = 22*		***Total OC = 220 OP = 22***	
5	*E*				*OC = 100 OP/OC = (-)5% OP = (-) 5 Total OC = 100 Total OP = (-)5*	
6	*F*	*OC = 160 OP = 21*	*OC = 120 OP = 14*	*OC = 140 OP = 15*	*Total OC = 420 Total OP = 50*	*OP/OC = **11.9 %***
7	*G*	*OC = 150 OP = 21*	*OC = 130 OP = 12*	*OC = 155 OP = 13*	*Total OC = 435 Total OP = 46*	*OP/OC = **10.57%***

From the above, the dataset will be constructed as follows:

S.I. No.	***1***	***2***	***3***	***4***	***5***	***6***	***7***
Values	*(-)5%*	*7.31%*	*9%*	*10%*	*10.57*	*11.9%*	*12%*

If during the course of assessment proceedings, the data of the current year is available and the use of such data indicates that B has failed to pass any qualitative or quantitative filter or for any other reason the transaction undertaken is not a comparable uncontrolled transaction, then, B shall not be considered for inclusion in the dataset. Further, if the data available at this stage indicates a new comparable uncontrolled transaction undertaken by enterprise H, then, it shall be included. The weighted average and dataset shall be recomputed as under:

Sl. No.	***Name***	***Year 1***	***Year 2***	***Year 3 [Current Year]***	***Aggre-gation of OC and OP***	***Weighted Average***
1	***2***	***3***	***4***	***5***	***6***	***7***
1	*A*	*OC =100 OP = 12*	*OC = 150 OP = 10*	*OC = 225 OP = 35*	*Total OC = 475 Total OP = 57*	*OP/OC = 12%*
2	*C*	*OC =250 OP = 22*	*OC= 230 OP = 26*	*OC = 250 OP = 18*	*Total OC = 730 Total OP = 66*	*OP/OC = 9%*
3	*D*		*OC = 220 OP = 20*	*OC = 150 Total OC = 370 OP = 20 Total OP = 42*		*OP/OC = **11.35%***
4	*E*			*OC = 100 Total OC = 100 OP = (-)5% Total OP = (-)5 OP/OC = (-)5%*		
5	*F*	*OC = 160 OP = 21*	*OC = 120 OP = 14*	*OC = 140 OP = 15*	*Total OC = 420 Total OP = 50*	*OP/OC = **11.9 %***
6	*G*	*OC = 150*	*OC = 130*	*OC = 155 OP = 13*	*Total OC = 435*	*OP/OC = **10.57%***

Sl. No.	Name	Year 1	Year 2	Year 3 [Current Year]	Aggre-gation of OC and OP	Weighted Average
		OP = 21	OP = 12		Total OP = 46	
7	H	OC = 150 OP = 12		OC = 80 Total OC = 230 OP = 10 Total OP = 22		OP/OC = 9.56 %

From the above, the dataset will be constructed as follows:

S.I. No.	1	2	3	4	5	6	7
Values	(-)5%	9%	9.56%	10.57%	11.35%	11.9%	12%

Illustration 3. *In a given case the dataset of 20 prices arranged in ascending order is as under:*

Sl. No.	Profits (in ₹ Thousand)
1	**2**
1	42.00
2	43.00
3	44.00
4	44.50
5	45.00
6	45.25
7	47.00
8	48.00
9	48.15
10	48.35
11	48.45
12	48.48
13	48.50
14	49.00
15	49.10

16	*49.35*
17	*49.50*
18	*49.75*
19	*50.00*
20	*50.15*

Applying the formula given in the Illustration 1, the data place of the thirty-fifth and sixty-fifth percentile is determined as follows:

Thirty-fifth percentile place = 20 (35/100) = 7.*

Sixty-fifth percentile place =20 (65 /100) = 13.*

Since the thirty-fifth percentile place is a whole number, it shall be the average of the prices at the seventh and next higher, i.e; eighth place. This is (47+48) /2 = ₹47,500

Similarly, the sixty-fifth percentile will be average of thirteenth and fourteenth place prices. This is (48.5+49) / 2 = 48,750

The median of the range (the fiftieth percentile place) = 20 (50/100)= 10*

Since the fiftieth percentile place is a whole number, it shall be the average of the prices at the tenth and next higher, i.e; eleventh place. This is (48.35+48.45) / 2 = ₹ 48,400

Thus, the arm's length range in this case shall be from ₹47,500 to ₹48,750.

Consequently, any transaction price which is equal to or more than ₹47,500 but less than or equal to ₹48,750 shall be considered to be within the arm's length range.

6. Rule 10CB - Computation of interest income pursuant to secondary adjustments.

(1) For the purposes of sub-section (2) of section 92CE of the Act, the time limit for repatriation of excess money or part thereof shall be on or before ninety days,—

(i) from the due date of filing of return under sub-section (1) of section 139 of the Act where primary adjustments to transfer price has been made suo-moto by the assessee in his return of income;

(ii) from the date of the order of Assessing Officer or the appellate authority, as the case may be, if the primary adjustments to transfer

price as determined in the aforesaid order has been accepted by the assessee;

(iii) in a case where primary adjustment to transfer price is determined by an advance pricing agreement entered into by the assessee under section 92CC of the Act in respect of a previous year,-

(a) from the date of filing of return under sub-section (1) of section 139 of the Act if the advance pricing agreement has been entered into on or before the due date of filing of return for the relevant previous year;

(b) from the end of the month in which the advance pricing agreement has been entered into if the said agreement has been entered into after the due date of filing of return for the relevant previous year]

(iv) from the due date of filing of return under sub-section (1) section 139 of the Act in the case of option exercised by the assessee as per the safe harbour rules under section 92CB;or

(v) from the date of giving effect by the Assessing Officer under rule 44H to the resolution arrived at under mutual agreement procedure, where the primary adjustment to transfer price is determined by such resolution under a Double Taxation Avoidance Agreement entered into under section 90 or section 90A of the Act

(2) The imputed per annum interest income on excess money or part thereof which is not repatriated within the time limit as per sub-section (1) of section 92CE of the Act shall be computed,—

(i) at the one year marginal cost of fund lending rate of State Bank of India as on 1st of April of the relevant previous year plus three hundred twenty five basis points in the cases where the international transaction is denominated in Indian rupee; or

(ii) at six month London Interbank Offered Rate as on 30th September of the relevant previous year plus three hundred basis points in the cases where the international transaction is denominated in foreign currency.

(3) The interest referred to in sub-rule (2) shall be chargeable on excess money or part thereof which is not repatriated—

(a) *in cases referred to in clause (i), in sub-clause(a) of clause (iii) and clause (iv) of sub rule(1), from the due date of filing of return under sub-section (1) of section 139 of the Act;*

(b) *in cases referred to in clause(ii) of sub-rule(1), from the date of the order of Assessing Officer or the appellate authority, as the case may be;*

(c) *in cases referred to in sub-clause(b) of clause (iii) of sub-rule(1), from the end of the month in which the advance pricing agreement has been entered into by the assessee under section 92CC of the Act;*

(d) *in cases referred to in clause (v) of sub-rule (1), from the date of giving effect by the Assessing Officer under rule 44H to the resolution arrived at under mutual agreement procedure*.

Explanation- For the purposes of this rule, —

(A) "International transaction" shall have the same meaning as assigned to it in section 92B of the Act;

(B) The rate of exchange for the calculation of the value in rupees of the international transaction denominated in foreign currency shall be the telegraphic transfer buying rate of such currency on the last day of the previous year in which such international transaction was undertaken and the "telegraphic transfer buying rate" shall have the same meaning as assigned in the Explanation to rule 26.

7. Rule 10D - Information and documents to be kept and maintained under section 92D.

(1) Every person who has entered into an international transaction or a specified domestic transaction shall keep and maintain the following information and documents, namely:

(a) a description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises;

(b) a profile of the multinational group of which the assessee enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions or specified domestic transactions, as the

case may be, have been entered into by the assessee, and ownership linkages among them;

(c) a broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the associated enterprises with whom the assessee has transacted;

(d) the nature and terms (including prices) of international transactions or specified domestic transactions entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;

(e) a description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involved in the international transaction or the specified domestic transaction;

(f) a record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately, which may have a bearing on the international transactions or the specified domestic transactions entered into by the assessee;

(g) a record of uncontrolled transactions taken into account for analysing their comparability with the international transactions or the specified domestic transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions or the specified domestic transactions as the case may be;

(h) a record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction or specified domestic transaction;

(i) a description of the methods considered for determining the arm's length price in relation to each international transaction or specified domestic transaction or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case;

(j) a record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial

information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions;

(k) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price;

(l) details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under these rules and consequent adjustment made to the total income for tax purposes;

(m) any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

(2) Nothing contained in sub-rule (1), in so far as it relates to an international transaction, shall apply in a case where the aggregate value, as recorded in the books of account, of international transactions entered into by the assessee does not exceed one crore rupees :

Provided that the assessee shall be required to substantiate, on the basis of material available with him, that income arising from international transactions entered into by him has been computed in accordance with section 92.

(*2A) Nothing contained in sub-rule (1), in so far as it relates to an eligible specified domestic transaction referred to in rule 10THB, shall apply in a case of an eligible assessee mentioned in rule 10THA and—*

*(a) the eligible assessee, referred to in clause (*i*) of rule 10THA, shall keep and maintain the following information and documents, namely:—*

(i) a description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises;

(ii) a broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the associated enterprises with whom the assessee has transacted;

(iii) the nature and terms (including prices) of specified domestic transactions entered into with each associated enterprise and

the quantum and value of each such transaction or class of such transaction;

(iv) a record of proceedings, if any, before the regulatory commission and orders of such commission relating to the specified domestic transaction;

(v) a record of the actual working carried out for determining the transfer price of the specified domestic transaction;

(vi) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the transfer price; and

(vii) any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the transfer price;

(b) the eligible assessee, referred to in clause (ii) of rule 10THA, shall keep and maintain the following information and documents, namely:—

(i) a description of the ownership structure of the assessee co-operative society with details of shares or other ownership interest held therein by the members;

(ii) description of members including their addresses and period of membership;

(iii) the nature and terms (including prices) of specified domestic transactions entered into with each member and the quantum and value of each such transaction or class of such transaction;

(iv) a record of the actual working carried out for determining the transfer price of the specified domestic transaction;

(v) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the transfer price;

(vi) the documentation regarding price being routinely declared in transparent manner and being available in public domain; and

(vii) any other information, data or document which may be relevant for determination of the transfer price.]

(3) The information specified in sub-rule (1) and (2A) shall be supported by authentic documents, which may include the following :

(a) official publications, reports, studies and data bases from the

Government of the country of residence of the associated enterprise, or of any other country;

(b) reports of market research studies carried out and technical publications brought out by institutions of national or international repute;

(c) price publications including stock exchange and commodity market quotations;

(d) published accounts and financial statements relating to the business affairs of the associated enterprises;

(e) agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transaction or the specified domestic transaction;

(f) letters and other correspondence documenting any terms negotiated between the assessee and the associated enterprise;

(g) documents normally issued in connection with various transactions under the accounting practices followed.

(4) The information and documents specified under sub-rules (1), (2) and (2A), should, as far as possible, be contemporaneous and should exist latest by the specified date referred to in clause (iv) of section 92F:

Provided that where an international transaction or the specified domestic transaction continues to have effect over more than one previous year, fresh documentation need not be maintained separately in respect of each previous year, unless there is any significant change in the nature or terms of the international transaction or the specified domestic transaction as the case may be, in the assumptions made, or in any other factor which could influence the transfer price, and in the case of such significant change, fresh documentation as may be necessary under sub-rules (1), (2) and (2A) shall be maintained bringing out the impact of the change on the pricing of the international transaction or the specified domestic transaction.

(5) The information and documents specified in sub-rules (1), (2) and (2A) shall be kept and maintained for a period of eight years from the end of the relevant assessment year.

8. Rule 10DA - Maintenance and furnishing of information and document by certain person under section 92D.

10DA. (1) Every person, being a constituent entity of an international group shall,-

(i) if the consolidated group revenue of the international group, of which such person is a constituent entity, as reflected in the consolidated financial statement of the international group for the accounting year, exceeds five hundred crore rupees; and

(ii) the aggregate value of international transactions,-

(A) during the accounting year, as per the books of accounts, exceeds fifty crore rupees, or

(B) in respect of purchase, sale, transfer, lease or use of intangible property during the accounting year, as per the books of accounts, exceeds ten crore rupees, keep and maintain the following information and documents of the international group, namely:-

(a) a list of all entities of the international group along with their addresses;

(b) a chart depicting the legal status of the constituent entity and ownership structure of the entire international group;

(c) a description of the business of international group during the accounting year including,-

(I) the nature of the business or businesses;

(II) the important drivers of profits of such business or businesses;

(III) a description of the supply chain for the five largest products or services of the international group in terms of revenue and any other products including services amounting to more than five per cent. of consolidated group revenue;

(IV) a list and brief description of important service arrangements made among members of the international group, other than those for research and development services;

(V) a description of the capabilities of the main service providers within the international group;

(VI) details about the transfer pricing policies for allocating service costs and determining prices to be paid for intra-group services;

(VII) a list and description of the major geographical markets for the products and services offered by the international group;

(VIII) a description of the functions performed, assets employed and risks assumed by the constituent entities of the international group that contribute at least ten per cent of the revenues or assets or profits of such group; and

(IX) a description of the important business restructuring transactions, acquisitions and divestments;

(d) a description of the overall strategy of the international group for the development, ownership and exploitation of intangible property, including location of principal research and development facilities and their management;

(e) a list of all entities of the international group engaged in development and management of intangible property along with their addresses;

(f) a list of all the important intangible property or groups of intangible property owned by the international group along with the names and addresses of the group entities that legally own such intangible property;

(g) a list and brief description of important agreements among members of the international group related to intangible property, including cost contribution arrangements, principal research service agreements and license agreements;

(h) a detailed description of the transfer pricing policies of the international group related to research and development and intangible property;

(i) a description of important transfers of interest in intangible property, if any, among entities of the international group,

including the name and address of the selling and buying entities and the compensation paid for such transfers;

(j) a detailed description of the financing arrangements of the international group, including the names and addresses of the top ten unrelated lenders;

(k) a list of group entities that provide central financing functions, including their place of operation and of effective management;

(l) a detailed description of the transfer pricing policies of the international group related to financing arrangements among group entities;

(m) a copy of the annual consolidated financial statement of the international group; and

(n) a list and brief description of the existing unilateral advance pricing agreements and other tax rulings in respect of the international group for allocation of income among countries.

(2) The information and document specified under sub-rule (1) shall be furnished to the Joint Commissioner referred to in sub-rule (1) of rule 10DB, in Form No. 3CEAA on or before the due date for furnishing the return of income as specified under sub-section (1) of section 139.

(3) The constituent entity shall furnish Part A of Form No. 3CEAA even if the conditions specified under sub-rule (1) are not satisfied

(4) Where there are more than one constituent entities resident in India of an international group, the Form No. 3CEAA may be furnished by any one constituent entity, if,

(a) the international group has designated such entity for this purpose; and

(b) the information has been conveyed in Form No. 3CEAB to the Joint Commissioner referred to in sub-rule (1) of rule 10DB, in this behalf thirty days before the due date of furnishing the Form No. 3CEAA

(5) The Principal Director General of Income-tax (Systems) or Director General of Income-tax (Systems), as the case may be, shall specify the procedure for electronic filing of Form No. 3CEAA and Form No. 3CEAB and shall also be responsible for evolving and implementing appropriate security,

archival and retrieval policies in relation to the information furnished under this rule.

(6) *The information and documents specified in sub-rule (1) shall be kept and maintained for a period of eight years from the end of the relevant assessment year.*

(7) The rate of exchange for the calculation of the value in rupees of the consolidated group revenue in foreign currency shall be the telegraphic transfer buying rate of such currency on the last day of the accounting year.

Explanation.— *For the purposes of this rule,—*

(A) "telegraphic transfer buying rate" shall have the same meaning as assigned in the Explanation *to rule 26;*

(B) the terms 'accounting year', 'consolidated financial statement' and 'international group' shall have the same meaning as assigned in sub-section (9) of section 286.

9. Rule 10DB - Furnishing of Report in respect of an International Group

(1) The income-tax authority for the purposes of section 286 shall be the Joint Commissioner as may be designated by the Director General of Income-tax (Risk Assessment).

(2) The notification under sub-section (1) of section 286 shall be made in Form No. 3CEAC two months prior to the due date for furnishing of report as specified under sub-section (2) of said section.

(3) Every parent entity or the alternate reporting entity, as the case may be, resident in India, shall, for every reporting accounting year, furnish the report referred to in sub-section (2) of section 286 in Form No. 3CEAD.

(4) The period for furnishing of the report under sub-section (4) of section 286 by the constituent entity referred to in that sub-section shall be twelve months from the end of the reporting accounting year:

Provided *that in case the parent entity of the constituent entity is resident of a country or territory, where, there has been a systemic failure of the country or territory and the said failure has been intimated to such constituent entity, the period for submission of the report shall be six months from the end of the month in which said systemic failure has been intimated.*

(5) The information required to be conveyed under proviso to sub-section (4) of section 286 regarding the designated constituent entity shall be furnished in Form No. 3CEAE.

(6) For the purposes of sub-section (7) of section 286, the total consolidated group revenue of the international group shall be five thousand five hundred crore rupees.

(7) Where the total consolidated group revenue of the international group, as reflected in the consolidated financial statement, is in foreign currency, the rate of exchange for the calculation of the value in rupees of such total consolidated group revenue shall be the telegraphic transfer buying rate of such currency on the last day of the accounting year preceding the accounting year.

(8) The Principal Director General of Income-tax (Systems) or Director General of Income-tax (Systems), as the case may be, shall specify the procedure for electronic filing of Form No. 3CEAC, Form No. 3CEAD and Form No. 3CEAE and shall also be responsible for evolving and implementing appropriate security, archival and retrieval policies in relation to the information furnished under this rule.

Explanation.— *For the purposes of this rule,—*

(A) "telegraphic transfer buying rate" shall have the same meaning as assigned in the Explanation to rule 26;

(B) the terms 'accounting year', 'alternate reporting entity', 'consolidated financial statement', 'international group' and 'reporting accounting year' shall have the same meaning as assigned in sub-section (9) of section 286.]

10. Rule 10E - Report from an accountant to be furnished under section 92E.

The report from an accountant required to be furnished under section 92E by every person who has entered into an international transaction or the specified domestic transaction during a previous year shall be in Form No.3CEB and be verified in the manner indicated therein.

11. Rule 10F - Meaning of expressions used in matters in respect of advance pricing agreement .

For the purposes of this rule and rules 10G to 10T,—

(a) "agreement" means an advance pricing agreement entered into between the Board and the applicant, with the approval of the Central

Government, as referred to in sub-section (1) of section 92CC of the Act;

(b) *"application" means an application for advance pricing agreement made under rule 10-I;*

(ba) *"applicant" means a person who has made an application;*

(c) *"bilateral agreement" means an agreement between the Board and the applicant, subsequent to, and based on, any agreement referred to in rule 44GA between the competent authority in India with the competent authority in the other country regarding the most appropriate transfer pricing method or the arms' length price;*

(d) *"competent authority in India" means an officer authorised by the Central Government for the purpose of discharging the functions as such for matters in respect of any agreement entered into under section 90 or 90A of the Act;*

(e) *"covered transaction" means the international transaction or transactions for which agreement has been entered into;*

(f) *"critical assumptions" means the factors and assumptions that are so critical and significant that neither party entering into an agreement will continue to be bound by the agreement, if any of the factors or assumptions is changed;*

(g) *"most appropriate transfer pricing method" means any of the transfer pricing method, referred to in sub-section (1) of section 92C of the Act, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or function performed by such persons or such other relevant factors prescribed by the Board under rules 10B and 10C;*

(h) *"multilateral agreement" means an agreement between the Board and the applicant, subsequent to, and based on, any agreement referred to in rule 44GA between the competent authority in India with the competent authorities in the other countries regarding the most appropriate transfer pricing method or the arms' length price;*

(ha) *"rollback year" means any previous year, falling within the period not exceeding four previous years, preceding the first of the previous years referred to in sub-section (4) of section 92CC;*

(i) *"tax treaty" means an agreement under section 90, or section 90A of the Act for the avoidance of double taxation;*

(j) "team" means advance pricing agreement team consisting of income-tax authorities as constituted by the Board and including such number of experts in economics, statistics, law or any other field as may be nominated by the Director General of Income-tax (International Taxation);

(k) "unilateral agreement" means an agreement between the Board and the applicant which is neither a bilateral nor multilateral agreement.

12. Rule 10G- Persons eligible to apply

Any person who—

(i) has undertaken an international transaction; or

(ii) is contemplating to undertake an international transaction,

shall be eligible to enter into an agreement under these rules.

13. Rule 10H - Pre-filing consultation

(1) Any person proposing to enter into an agreement under these rules may, by an application in writing, make a request for a pre-filing consultation.

(2) The request for pre-filing consultation shall be made in Form No. 3CEC to the Director General of Income-tax (International Taxation).

(3) On receipt of the request in Form No. 3CEC, the team shall hold pre-filing consultation with the person referred to in rule 10G.

(4) The competent authority in India or his representative shall be associated in pre-filing consultation involving bilateral or multilateral agreement.

(5) The pre-filing consultation shall, among other things,—

(i) determine the scope of the agreement;

(ii) identify transfer pricing issues;

(iii) determine the suitability of international transaction for the agreement;

(iv) discuss broad terms of the agreement.

(6) The pre-filing consultation shall—

(i) not bind the Board or the person to enter into an agreement or initiate the agreement process;

(ii) not be deemed to mean that the person has applied for entering into an agreement.

14. Rule 10-I - Application for advance pricing agreement.

(1) Any person, referred to in rule 10G may, if desires to enter into an agreement furnish an application in Form No. 3CED along with the requisite fee.

(2) The application shall be furnished to Director General of Income-tax (International Taxation) in case of unilateral agreement and to the competent authority in India in case of bilateral or multilateral agreement.

(3) Application in Form No. 3CED may be filed by the person referred to in rule 10G at any time—

(i) before the first day of the previous year relevant to the first assessment year for which the application is made, in respect of transactions which are of a continuing nature from dealings that are already occurring; or

(ii) before undertaking the transaction in respect of remaining transactions.

(4) Every application in Form No. 3CED shall be accompanied by the proof of payment of fees as specified in sub-rule (5).

(5) The fees payable shall be in accordance with following table based on the amount of international transaction entered into or proposed to be undertaken in respect of which the agreement is proposed:

Amount of international transaction entered into or proposed to be undertaken in respect of which agreement is proposed during the proposed period of agreement.	**Fee**
Amount not exceeding ₹ 100 crores	10 lacs
Amount not exceeding ₹ 200 crores	15 lacs
Amount exceeding ₹ 200 crores	20 lacs

15. Rule 10J - Withdrawal of application for agreement.

(1) The applicant may withdraw the application for agreement at any time before the finalisation of the terms of the agreement.

(2) The application for withdrawal shall be in Form No. 3CEE.

(3) The fee paid shall not be refunded on withdrawal of application by the applicant.

16. Rule 10K - Preliminary processing of application.

(1) Every application filed in Form No. 3CED shall be complete in all respects and accompanied by requisite documents.

(2) If any defect is noticed in the application in Form No. 3CED or if any relevant document is not attached thereto or the application is not in accordance with understanding reached in any pre-filing consultation referred to in rule 10H, the Director General of Income-tax (International Taxation) (for unilateral agreement) and competent authority in India (for bilateral or multilateral agreement) shall serve a deficiency letter on the applicant before the expiry of one month from the date of receipt of the application.

(3) The applicant shall remove the deficiency or modify the application within a period of fifteen days from the date of service of the deficiency letter or within such further period which, on an application made in this behalf, may be extended, so however, that the total period of removal of deficiency or modification does not exceed thirty days.

(4) The Director General of Income-tax (International Taxation) or the competent authority in India, as the case may be, on being satisfied, may pass an order providing that application shall not be allowed to be proceeded with if the application is defective and defect is not removed by applicant in accordance with sub-rule (3).

(5) No order under sub-rule (4) shall be passed without providing an opportunity of being heard to the applicant and if an application is not allowed to be proceeded with, the fee paid by the applicant shall be refunded.

17. Rule 10L - Procedure.

(1) If the application referred to in rule 10K has been allowed to be proceeded with, the team or the competent authority in India or his representative shall process the same in consultation and discussion with the applicant in accordance with provisions of this rule.

(2) For the purpose of sub-rule (1), it shall be competent for the team or the competent authority in India or its representative to—

(i) hold meetings with the applicant on such time and date as it deem fit;

(ii) call for additional document or information or material from the applicant;

(iii) visit the applicant's business premises; or

(iv) make such inquiries as it deems fit in the circumstances of the case.

(3) For the purpose of sub-rule (1), the applicant may, if he considers it necessary, provide further document and information for consideration of the team or the competent authority in India or his representative.

(4) For bilateral or multilateral agreement, the competent authority shall forward the application to Director General of Income-tax (International Taxation) who shall assign it to one of the teams.

(5) The team, to whom the application has been assigned under sub-rule (4), shall carry out the enquiry and prepare a draft report which shall be forwarded by the Director General of Income-tax (International Taxation) to the competent authority in India.

(6) If the applicant makes a request for bilateral or multilateral agreement in its application, the competent authority in India shall in addition to the procedure provided in this rule invoke the procedure provided in rule 44GA.

(7) The Director General of Income-tax (International Taxation) (for unilateral agreement) or the competent authority in India (for bilateral or multilateral agreement) and the applicant shall prepare a proposed mutually agreed draft agreement enumerating the result of the process referred to in sub-rule (1) including the effect of the arrangement referred to in sub-rule (5) of rule 44GA which has been accepted by the applicant in accordance with sub-rule (8) of the said rule.

(8) The agreement shall be entered into by the Board with the applicant after its approval by the Central Government.

(9) Once an agreement has been entered into the Director General of Income-tax (International Taxation) or the competent authority in India, as the case may be, shall cause a copy of the agreement to be sent to the Commissioner of Income-tax having jurisdiction over the assessee.

18. Rule 10M - Terms of the agreement.

(1) An agreement may among other things, include—

(i) the international transactions covered by the agreement;

(ii) the agreed transfer pricing methodology, if any;

(iii) determination of arm's length price, if any;

(iv) definition of any relevant term to be used in item (ii) or (iii);

(v) critical assumptions;

(va) rollback provision referred to in rule 10MA;

(vi) the conditions if any other than provided in the Act or these rules.

(2) The agreement shall not be binding on the Board or the assessee if there is a change in any of critical assumptions or failure to meet conditions subject to which the agreement has been entered into.

(3) The binding effect of agreement shall cease only if any party has given due notice of the concerned other party or parties.

(4) In case there is a change in any of the critical assumptions or failure to meet the conditions subject to which the agreement has been entered into, the agreement can be revised or cancelled, as the case may be.

(5) The assessee which has entered into an agreement shall give a notice in writing of such change in any of the critical assumptions or failure to meet conditions to the Director General of Income-tax (International Taxation) as soon as it is practicable to do so.

(6) The Board shall give a notice in writing of such change in critical assumptions or failure to meet conditions to the assessee, as soon as it comes to the knowledge of the Board.

(7) The revision or the cancellation of the agreement shall be in accordance with rules 10Q and 10R respectively.

19. Rule 10MA - Roll Back of the Agreement.

(1) Subject to the provisions of this rule, the agreement may provide for determining the arm's length price or specify the manner in which arm's length price shall be determined in relation to the international transaction entered into by the person during the rollback year (hereinafter referred to as "rollback provision").

(2) The agreement shall contain rollback provision in respect of an international transaction subject to the following, namely:—

(i) the international transaction is same as the international transaction to which the agreement (other than the rollback provision) applies;

(ii) the return of income for the relevant rollback year has been or is furnished by the applicant before the due date specified in Explanation 2 to sub-section (1) of section 139;

(iii) the report in respect of the international transaction had been furnished in accordance with section 92E;

(iv) the applicability of rollback provision, in respect of an international transaction, has been requested by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant; and

(v) the applicant has made an application seeking rollback in Form 3CEDA in accordance with sub-rule (5);

(3) Notwithstanding anything contained in sub-rule (2), rollback provision shall not be provided in respect of an international transaction for a rollback year, if,—

(i) the determination of arm's length price of the said international transaction for the said year has been subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement; or

(ii) the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year.

(4) Where the rollback provision specifies the manner in which arm's length price shall be determined in relation to an international transaction undertaken in any rollback year then such manner shall be the same as the manner which has been agreed to be provided for determination of arm's length price of the same international transaction to be undertaken in any previous year to which the agreement applies, not being a rollback year.

(5) The applicant may, if he desires to enter into an agreement with rollback provision, furnish along with the application, the request for the same in Form No. 3 CEDA with proof of payment of an additional fee of five lakh rupees:

Provided that in a case where an application has been filed on or before the 31st day of March, 2015, Form No.3CEDA along with proof of payment of additional fee may be filed at any time on or before the 30th day of June, 2015 or the date of entering into the agreement whichever is earlier:

Provided further that in a case where an agreement has been entered into on or before the 31st day of March, 2015, Form No.3CEDA along with proof of payment of additional fee may be filed at any time on or before the 30th

day of June, 2015 and, notwithstanding anything contained in rule 10Q, the agreement may be revised to provide for rollback provision in the said agreement in accordance with this rule.

20. Rule 10N - Amendments to Application.

(1) An applicant may request in writing for an amendment to an application at any stage, before the finalisation of the terms of the agreement.

(2) The Director General of Income-tax (International Taxation) (for unilateral agreement) or the competent authority in India (for bilateral or multilateral agreement) may, allow the amendment to the application, if such an amendment does not have effect of altering the nature of the application as originally filed.

(3) The amendment shall be given effect only if it is accompanied by the additional fee, if any, necessitated by such amendment in accordance with fee as provided in rule 10-I.

21. Rule 10-O - Furnishing of Annual Compliance Report.

(1) The assessee shall furnish an annual compliance report to Director General of Income-tax (International Taxation) for each year covered in the agreement.

(2) The annual compliance report shall be in Form 3CEF.

(3) The annual compliance report shall be furnished in quadruplicate, for each of the years covered in the agreement, within thirty days of the due date of filing the income-tax return for that year, or within ninety days of entering into an agreement, whichever is later.

(4) The Director General of Income-tax (International Taxation) shall send one copy of annual compliance report to the competent authority in India, one copy to the Commissioner of Income-tax who has the jurisdiction over the income-tax assessment of the assessee and one copy to the Transfer Pricing Officer having the jurisdiction over the assessee.

22. Rule 10P - Compliance Audit of the agreement.

(1) The Transfer Pricing Officer having the jurisdiction over the assessee shall carry out the compliance audit of the agreement for each of the year covered in the agreement.

(2) For the purposes of sub-rule (1), the Transfer Pricing Officer may require—

(i) the assessee to substantiate compliance with the terms of the agreement, including satisfaction of the critical assumptions, correctness of the supporting data or information and consistency of the application of the transfer pricing method;

(ii) the assessee to submit any information, or document, to establish that the terms of the agreement has been complied with.

(3) The Transfer Pricing Officer shall submit the compliance audit report, for each year covered in the agreement, to the Director General of Income-tax (International Taxation) in case of unilateral agreement and to the competent authority in India, in case of bilateral or multilateral agreement, mentioning therein his findings as regards compliance by the assessee with terms of the agreement.

(4) The Director General of Income-tax (International Taxation) shall forward the report to the Board in a case where there is finding of failure on part of assessee to comply with terms of agreement and cancellation of the agreement is required.

(5) The compliance audit report shall be furnished by the Transfer Pricing Officer within six months from the end of the month in which the Annual Compliance Report referred to in rule 10-O is received by the Transfer Pricing Officer.

(6) The regular audit of the covered transactions shall not be undertaken by the Transfer Pricing Officer if an agreement has been entered into under rule 10L except where the agreement has been cancelled under rule 10R.

23. Rule 10Q - Revision of an agreement.

(1) An agreement, subsequent to it having been entered into, may be revised by the Board, if,—

(a) there is a change in critical assumptions or failure to meet a condition subject to which the agreement has been entered into;

(b) there is a change in law that modifies any matter covered by the agreement but is not of the nature which renders the agreement to be non-binding ; or

(c) there is a request from competent authority in the other country requesting revision of agreement, in case of bilateral or multilateral agreement.

(2) An agreement may be revised by the Board either suo motu *or on request of the assessee or the competent authority in India or the Director General of Income-tax (International Taxation).*

(3) Except when the agreement is proposed to be revised on the request of the assessee, the agreement shall not be revised unless an opportunity of being heard has been provided to the assessee and the assessee is in agreement with the proposed revision.

(4) In case the assessee is not in agreement with the proposed revision the agreement may be cancelled in accordance with rule 10R.

(5) In case the Board is not in agreement with the request of the assessee for revision of the agreement, the Board shall reject the request in writing giving reason for such rejection.

(6) For the purpose of arriving at the agreement for the proposed revision, the procedure provided in rule 10L may be followed so far as they apply.

(7) The revised agreement shall include the date till which the original agreement is to apply and the date from which the revised agreement is to apply.

24. Rule 10R - Cancellation of an agreement.

(1) An agreement shall be cancelled by the Board for any of the following reasons:

*(*i*) the compliance audit referred to in rule 10P has resulted in the finding of failure on the part of the assessee to comply with the terms of the agreement;*

*(*ii*) the assessee has failed to file the annual compliance report in time;*

*(*iii*) the annual compliance report furnished by the assessee contains material errors; or*

*(*iv*) the agreement is to be cancelled under sub-rule (4) of rule 10Q or sub-rule (7) of rule 10RA.*

(2) The Board shall give an opportunity of being heard to the assessee, before proceeding to cancel an application.

(3) The competent authority in India shall communicate with the competent authority in the other country or countries and provide reason for the proposed cancellation of the agreement in case of bilateral or multilateral agreement.

(4) The order of cancellation of the agreement shall be in writing and shall provide reasons for cancellation and for non-acceptance of assessee's submission, if any.

(5) The order of cancellation shall also specify the effective date of cancellation of the agreement, where applicable.

(6) The order under the Act, declaring the agreement as void ab initio*, on account of fraud or misrepresentation of facts, shall be in writing and shall provide reason for such declaration and for non-acceptance of assessee's submission, if any.*

(7) The order of cancellation shall be intimated to the Assessing Officer and the Transfer Pricing Officer, having jurisdiction over the assessee.

25. Rule 10RA - Procedure for giving effect to rollback provision of an Agreement.

(1) The effect to the rollback provisions of an agreement shall be given in accordance with this rule.

(2) The applicant shall furnish modified return of income referred to in section 92CD in respect of a rollback year to which the agreement applies along with the proof of payment of any additional tax arising as a consequence of and computed in accordance with the rollback provision.

(3) The modified return referred to in sub-rule(2) shall be furnished along with the modified return to be furnished in respect of first of the previous years for which the agreement has been requested for in the application.

(4) If any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is the subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant before furnishing the modified return for the said year.

(5) If any appeal filed by the Assessing Officer or the Principal Commissioner or Commissioner is pending before the Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the Assessing Officer or the Principal Commissioner or the Commissioner, as the case may be, within three months of filing of modified return by the applicant.

(6) The applicant, the Assessing Officer or the Principal Commissioner or the Commissioner, shall inform the Dispute Resolution Panel or the Commissioner (Appeals) or the Appellate Tribunal or the High Court, as the case may be, the fact of an agreement containing rollback provision having been entered into along with a copy of the same as soon as it is practicable to do so.

(7) In case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled.

26. Rule 10S - Renewing an agreement.

Request for renewal of an agreement may be made as a new application for agreement, using the same procedure as outlined in these rules except pre-filing consultation as referred to in rule 10H.

27. Rule 10T - Miscellaneous

(1) Mere filing of an application for an agreement under these rules shall not prevent the operation of Chapter X of the Act for determination of arms' length price under that Chapter till the agreement is entered into.

(2) The negotiation between the competent authority in India and the competent authority in the other country or countries, in case of bilateral or multilateral agreement, shall be carried out in accordance with the provisions of the tax treaty between India and the other country or countries.

28. Rule 44GA - Procedure to deal with requests for bilateral or multilateral advance pricing agreements

(1) Where a person has made request for a bilateral or multilateral advance pricing agreement in an application filed in Form No. 3CED in accordance with rule 10-I, the request shall be dealt with subject to provisions of this rule.

(2) The process for bilateral or multilateral advance pricing agreement shall not be initiated unless the associated enterprise situated outside India has initiated process of advance pricing agreement with the competent authority in the other country.

(3) The competent authority in India shall, on intimation of request of the applicant for a bilateral or multilateral agreement, consult and ascertain willingness of the competent authority in other country or countries, as the case may be, for initiation of negotiation for this purpose.

(4) In case of willingness of the competent authority in other country or countries, as the case may be, the competent authority in India shall enter into negotiation in this behalf and endeavour to reach a set of terms which are acceptable to the competent authority in India and the competent authority in the other country or countries, as the case may be.

(5) In case of an agreement after consultation, the competent authority in India shall formalise a mutual agreement procedure arrangement with the competent authority in other country or countries, as the case may be, and intimate the same to the applicant.

(6) In case of failure to reach agreement on such terms as are mutually acceptable to parties mentioned in sub-rule (4), the applicant shall be informed of the failure to reach an agreement with the competent authority in other country or countries.

(7) The applicant shall not be entitled to be part of discussion between competent authority in India and the competent authority in the other country or countries, as the case may be; however the applicant can communicate or meet the competent authority in India for the purpose of entering into an advance pricing agreement.

(8) The applicant shall convey acceptance or otherwise of the agreement within thirty days of it being communicated.

(9) The applicant, in case the agreement is not acceptable may at its option continue with process of entering into an advance pricing agreement without benefit of mutual agreement process or withdraw application in accordance with rule 10J.

Safe Harbour Rules for International Transactions

29. Rule 10TA - Definitions

For the purposes of this rule and rule 10TB to rule 10TG,—

(a) "accountant" means an accountant referred to in the Explanation below sub-section (2) of section 288 of the Act and includes any person recognised for undertaking cost certification by the Government of the country where the associated enterprise is registered or incorporated or any of its agencies, who fulfills the following conditions, namely:—

(I) if he is a member or partner in any entity engaged in rendering accountancy or valuation services then,—

(i) the entity or its affiliates have presence in more than two countries; and

(ii) the annual receipt of the entity in the year preceding the year in which cost certification is undertaken exceeds ten crore rupees;

(II) if he is pursuing the profession of accountancy individually or is a valuer then,—

(i) his annual receipt in the year preceding the year in which cost certification is undertaken, from the exercise of profession, exceeds one crore rupees; and

(ii) he has professional experience of not less than ten years.

(aa) "contract research and development services wholly or partly relating to software development" means the following, namely:—

(i) research and development producing new theorems and algorithms in the field of theoretical computer science;

(ii) development of information technology at the level of operating systems, programming languages, data management, communications software and software development tools;

(iii) development of Internet technology;

(iv) research into methods of designing, developing, deploying or maintaining software;

(v) software development that produces advances in generic approaches for capturing, transmitting, storing, retrieving, manipulating or displaying information;

(vi) experimental development aimed at filling technology knowledge gaps as necessary to develop a software programme or system;

(vii) research and development on software tools or technologies in specialised areas of computing (image processing, geographic data presentation, character recognition, artificial intelligence and such other areas);or

(viii) upgradation of existing products where source code has been made available by the principal, except where the source code has been made available to carry out routine functions like debugging of the software ;

(b) "core auto components" means,—

(i) engine and engine parts, including piston and piston rings, engine valves and parts cooling systems and parts and power train components;

(ii) transmission and steering parts, including gears, wheels, steering systems, axles and clutches;

(iii) suspension and braking parts, including brake and brake assemblies, brake linings, shock absorbers and leaf springs;

(c) "corporate guarantee" means explicit corporate guarantee extended by a company to its wholly owned subsidiary being a non-resident in respect of any short-term or long-term borrowing.

Explanation.—For the purposes of this clause, explicit corporate guarantee does not include letter of comfort, implicit corporate guarantee, performance guarantee or any other guarantee of similar nature;

'(ca) "employee cost" includes,___

(i) salaries and wages;

(ii) gratuities;

(iii) contribution to P rovident Fund and other funds;

(iv) the value of perquisites as specified in clause (2) of section 17 of the Act;

(v) employment related allowances, like medical allowance, dearness allowance, travel allowance and any other allowance;

(vi) bonus or commission by whatever name called;

(vii) lumpsum payments received at the time of termination of service or superannuation or voluntary retirement, such as gratuity, severance pay, leave encashment, voluntary retrenchment benefits, commutation of pension and similar payments;

(viii) expenses incurred on contractual employment of persons performing tasks similar to those performed by the regular employees;

(ix) outsourcing expenses, to the extent of employee cost,

wherever ascertainable, embedded in the total outsourcing expenses:

Provided that where the extent of employee cost embedded in the total outsourcing expenses is not ascertainable, eighty per cent. of the total outsourcing expenses shall be deemed to be the employee cost embedded in the total outsourcing expenses;

(x) recruitment expenses;

(xi) relocation expenses;

(xii) training expenses;

(xiii) staff welfare expenses; and

(xiv) any other expenses related to employees or the employment;

(d) "generic pharmaceutical drug" means a drug that is comparable to a drug already approved by the regulatory authority in dosage form, strength, route of administration, quality and performance characteristics, and intended use;

(e) "information technology enabled services" means the following business process outsourcing services provided mainly with the assistance or use of information technology, namely:—

(i) back office operations;

(ii) call centres or contact centre services;

(iii) data processing and data mining;

(iv) insurance claim processing;

(v) legal databases;

(vi) creation and maintenance of medical transcription excluding medical advice;

(vii) translation services;

(viii) payroll;

(ix) remote maintenance;

(x) revenue accounting;

(xi) support centres;

(xii) website services;

(xiii) data search integration and analysis;

(xiv) remote education excluding education content development; or

(xv) clinical database management services excluding clinical trials,

but does not include any research and development services whether or not in the nature of contract research and development services;

(f) *"intra-group loan" means loan advanced to wholly owned subsidiary being a non-resident, where the loan—*

(i) is sourced in Indian rupees;

(ii) is not advanced by an enterprise, being a financial company including a bank or a financial institution or an enterprise engaged in lending or borrowing in the normal course of business; and

(iii) does not include credit line or any other loan facility which has no fixed term for repayment;

(g) *"knowledge process outsourcing services" means the following business process outsourcing services provided mainly with the assistance or use of information technology requiring application of knowledge and advanced analytical and technical skills, namely:—*

(i) geographic information system;

(ii) human resources services;

(iii) engineering and design services;

(iv) animation or content development and management;

(v) business analytics;

(vi) financial analytics; or

(vii) market research,

but does not include any research and development services whether or not in the nature of contract research and development services;

(ga) "low value-adding intra-group services" means services that are performed by one or more members of a multinational enterprise group on behalf of one or more other members of the same multinational enterprise group and which,___

(i) are in the nature of support services;

(ii) are not part of the core business of the multinational enterprise group, i.e., such services neither constitute the profit-earning activities nor contribute to the economically significant activities of the multinational enterprise group;

(iii) are not in the nature of shareholder services or duplicate services;

(iv) neither require the use of unique and valuable intangibles nor lead to the creation of unique and valuable intangibles;

(v) neither involve the assumption or control of significant risk by the service provider nor give rise to the creation of significant risk for the service provider; and

(vi) do not have reliable external comparable services that can be used for determining their arm's length price, but does not include the following services, namely:___

(i) research and development services;

(ii) manufacturing and production services;

(iii) information technology (software development) services;

(iv) knowledge process outsourcing services;

(v) business process outsourcing services;

(vi) purchasing activities of raw materials or other materials that are used in the manufacturing or production process;

(vii) sales, marketing and distribution activities;

(viii) financial transactions;

(ix) extraction, exploration, or processing of natural resources; and

(x) insurance and reinsurance;

(h) "non-core auto components" mean auto components other than core auto components;

(i) "no tax or low tax country or territory" means a country or territory in which the maximum rate of income-tax is less than fifteen per cent;

(j) "operating expense" means the costs incurred in the previous year by the assessee in relation to the international transaction during the course of its normal operations including costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the assessee to the employees of the assessee, reimbursement to associated enterprises of expenses incurred by the associated enterprises on behalf of the assessee, amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of those associated enterprises and which relate to normal operations of the assessee and depreciation and amortisation expenses relating to the assets used by the assessee, but not including the following, namely:—

(i) interest expense;

(ii) provision for unascertained liabilities;

(iii) pre-operating expenses;

(iv) loss arising on account of foreign currency fluctuations;

(v) extraordinary expenses;

(vi) loss on transfer of assets or investments;

(vii) expense on account of income-tax; and

(viii) other expenses not relating to normal operations of the assessee;

Provided that reimbursement to associated enterprises of expenses incurred by the associated enterprises on behalf of the assessee shall be at cost:

Provided further that amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of the associated enterprises and which relate to normal operations of the assesse shall be at cost;

(k) "operating revenue" means the revenue earned by the assessee in the previous year in relation to the international transaction during the course of its normal operations including costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the assessee to the employees of the assessee but not including the following, namely:—

(i) interest income;

(ii) income arising on account of foreign currency fluctuations;

(iii) income on transfer of assets or investments;

(iv) refunds relating to income-tax;

(v) provisions written back;

(vi) extraordinary incomes; and

(vii) other incomes not relating to normal operations of the assessee

(l) "operating profit margin" in relation to operating expense means the ratio of operating profit, being the operating revenue in excess of operating expense, to the operating expense expressed in terms of percentage;

(la) "relevant previous year" means the previous year relevant to the assessment year in which the option for safe harbour is validly exercised;".

(m) "software development services" means,—

(i) business application software and information system development using known methods and existing software tools;

(ii) support for existing systems;

(iii) converting or translating computer languages;

(iv) adding user functionality to application programmes;

(v) debugging of systems;

(vi) adaptation of existing software; or

(vii) preparation of user documentation,

but does not include any research and development services whether or not in the nature of contract research and development services.

30. Rule 10TB - Eligible assessee

(1) Subject to the provisions of sub-rules (2) and (3), the 'eligible assessee' means a person who has exercised a valid option for application of safe harbour rules in accordance with rule 10TE, and—

(i) is engaged in providing software development services or information technology enabled services or knowledge process outsourcing

services, with insignificant risk, to a non-resident associated enterprise (hereinafter referred as foreign principal);

(ii) has made any intra-group loan;

(iii) has provided a corporate guarantee;

(iv) is engaged in providing contract research and development services wholly or partly relating to software development, with insignificant risk, to a foreign principal;

(v) is engaged in providing contract research and development services wholly or partly relating to generic pharmaceutical drugs, with insignificant risk, to a foreign principal;

(vi) is engaged in the manufacture and export of core or non-core auto components and where ninety per cent or more of total turnover during the relevant previous year is in the nature of original equipment manufacturer sales; or

(vii) is in receipt of low value-adding intra-group services from one or more members of its group.

*(2) For the purposes of identifying an eligible assessee, with insignificant risk, referred to in item (*i*) of sub-rule (1), the Assessing Officer or the Transfer Pricing Officer, as the case may be, shall have regard to the following factors, namely:—*

*(*a*) the foreign principal performs most of the economically significant functions involved, including the critical functions such as conceptualisation and design of the product and providing the strategic direction and framework, either through its own employees or through its other associated enterprises, while the eligible assessee carries out the work assigned to it by the foreign principal;*

*(*b*) the capital and funds and other economically significant assets including the intangibles required, are provided by the foreign principal or its other associated enterprises, and the eligible assessee is only provided a remuneration for the work carried out by it;*

*(*c*) the eligible assessee works under the direct supervision of the foreign principal or its associated enterprise which not only has the capability to control or supervise but also actually controls or supervises the activities carried out through its strategic decisions to perform core functions as well as by monitoring activities on a regular basis;*

(d) the eligible assessee does not assume or has no economically significant realised risks, and if a contract shows that the foreign principal is obligated to control the risk but the conduct shows that the eligible assessee is doing so, the contractual terms shall not be the final determinant;

(e) the eligible assessee has no ownership right, legal or economic, on any intangible generated or on the outcome of any intangible generated or arising during the course of rendering of services, which vests with the foreign principal as evident from the contract and the conduct of the parties.

(3) For the purposes of identifying an eligible assessee, with insignificant risk, referred to in items (iv) and (v) of sub-rule (1), the Assessing Officer or the Transfer Pricing Officer, as the case may be, shall have regard to the following factors, namely:—

(a) the foreign principal performs most of the economically significant functions involved in research or product development cycle, including the critical functions such as conceptualisation and design of the product and providing the strategic direction and framework, either through its own employees or through its other associated enterprises while the eligible assessee carries out the work assigned to it by the foreign principal;

(b) the foreign principal or its other associated enterprises provides the funds or capital and other economically significant assets including intangibles required for research or product development and also provides a remuneration to the eligible assessee for the work carried out by it;

(c) the eligible assessee works under the direct supervision of the foreign principal or its other associated enterprise which has not only the capability to control or supervise but also actually controls or supervises research or product development, through its strategic decisions to perform core functions as well as by monitoring activities on a regular basis;

(d) the eligible assessee does not assume or has no economically significant realised risks, and if a contract shows that the foreign principal is obligated to control the risk but the conduct shows that the eligible assessee is doing so, the contractual terms shall not be the final determinant;

(e) the eligible assessee has no ownership right, legal or economic, on the outcome of the research which vests with the foreign principal and is evident from the contract as well as the conduct of the parties.

31. Rule 10TC - Eligible international transaction.

'Eligible international transaction' means an international transaction between the eligible assessee and its associated enterprise, either or both of whom are non-resident, and which comprises of:

(i) provision of software development services;

(ii) provision of information technology enabled services;

(iii) provision of knowledge process outsourcing services;

(iv) advance of intra-group loan;

(v) provision of corporate guarantee, where the amount guaranteed,—

(a) does not exceed one hundred crore rupees; or

(b) exceeds one hundred crore rupees, and the credit rating of the associated enterprise, done by an agency registered with the Securities and Exchange Board of India, is of the adequate to highest safety;

(vi) provision of contract research and development services wholly or partly relating to software development;

(vii) provision of contract research and development services wholly or partly relating to generic pharmaceutical drugs;

(viii) manufacture and export of core auto components;

(ix) manufacture and export of non-core auto components; or

(x) receipt of low value-adding intra-group services from one or more members of its group,

by the eligible assessee.

32. Rule 10TD - Safe Harbour

(1) Where an eligible assessee has entered into an eligible international transaction and the option exercised by the said assessee is not held to be invalid under rule 10TE, the transfer price declared by the assessee in respect of such transaction shall be accepted by the income-tax authorities, if it is in accordance with the circumstances as specified in sub-rule (2) or, as the case may be, sub-rule (2A).

(2) The circumstances referred to in sub-rule (1) in respect of the eligible international transaction specified in column (2) of the Table below shall be as specified in the corresponding entry in column (3) of the said Table:—

Sl. No.	Eligible International Transaction	Circumstances
(1)	(2)	(3)
1.	*Provision of software development services referred to in item (*i*) of rule 10TC.*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is -* *(*i*) not less than 20 per cent, where the aggregate value of such transactions entered into during the previous year does not exceed a sum of five hundred crore rupees; or* *(*ii*) not less than 22 per cent, where the aggregate value of such transactions entered into during the previous year exceeds a sum of five hundred crore rupees.*
2.	*Provision of information technology enabled services referred to in item (ii) of rule 10TC.*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is -* *(*i*) not less than 20 per cent, where the aggregate value of such transactions entered into during the previous year does not exceed a sum of five hundred crore rupees; or* *(*ii*) not less than 22 per cent, where the aggregate value of such transactions entered into during the previous year*

Sl. No.	Eligible International Transaction	Circumstances
		exceeds a sum of five hundred crore rupees.
3.	*Provision of knowledge process outsourcing services referred to in item (iii) of rule 10TC.*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 25 per cent.*
4.	*Advancing of intra-group loans referred to in item (iv) of rule 10TC where the amount of loan does not exceed fifty crore rupees.*	*The Interest rate declared in relation to the eligible international transaction is not less than the base rate of State Bank of India as on 30th June of the relevant previous year plus 150 basis points.*
5.	*Advancing of intra-group loans referred to in item (iv) of rule 10TC where the amount of loan exceeds fifty crore rupees.*	*The Interest rate declared in relation to the eligible international transaction is not less than the base rate of State Bank of India as on 30th June of the relevant previous year plus 300 basis points.*
6.	*Providing corporate guarantee referred to in sub-item (a) of item (v) of rule 10TC.*	*The commission or fee declared in relation to the eligible international transaction is at the rate not less than 2 per cent per annum on the amount guaranteed.*
7.	*Providing corporate guarantee referred to in sub-item (b) of item (v) of rule 10TC.*	*The commission or fee declared in relation to the eligible international transaction is at the rate not less than 1.75 per cent. per annum on the amount guaranteed.*
8.	*Provision of contract research and development services wholly or partly relating to software development referred to in*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 30 per cent.*

Sl. No.	Eligible International Transaction	Circumstances
	*item (*vi*) of rule 10TC.*	
9.	*Provision of contract research and development services wholly or partly relating to generic pharmaceutical drugs referred to in item (*vii*) of rule 10TC.*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 29 per cent.*
10.	*Manufacture and export of core auto components referred to in item (*viii*) of rule 10TC.*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 12 per cent.*
11.	*Manufacture and export of non-core auto components referred to in item (*ix*) of rule 10TC.*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 8.5 per cent.*

(2A) The circumstances referred to in sub-rule (1) in respect of the eligible international transaction specified in column (2) of the Table below shall be as specified in the corresponding entry in column (3) of the said Table:—

Sl. No.	Eligible International Transaction	Circumstances
(1)	(2)	(3)
1.	*Provision of software development services referred to in item (i) of rule 10TC.*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is -* *(i) not less than 17 per cent, where the value of international transaction does not exceed a sum of one hundred crore rupees; or*

Sl. No.	Eligible International Transaction	Circumstances
(1)	(2)	(3)
		(ii) not less than 18 per cent, where the value of international transaction exceeds a sum of one hundred crore rupees but does not exceed a sum of two hundred crore rupees.
2.	*Provision of information technology enabled services referred to in item (ii) of rule 10TC.*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is -* *(i) not less than 17 per cent, where the aggregate value of such transactions entered into during the previous year does not exceed a sum of one hundred crore rupees; or* *(ii) not less than 18 per cent, where the aggregate value of such transactions entered into during the previous year exceeds a sum of one hundred crore rupees but does not exceed a sum of two hundred crore rupees.*
3.	*Provision of knowledge process outsourcing services referred to in item (iii) of rule 10TC.*	*The value of international transaction does not exceed a sum of two hundred crore rupees and the operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is -* *(i) not less than 24 per cent. and the Employee Cost in relation to the Operating Expense is at least sixty per cent.* *(ii) not less than 21 per cent. and the Employee Cost in relation to the*

Sl. No.	Eligible International Transaction	Circumstances
(1)	(2)	(3)
		Operating Expense is forty per cent. or more but less than sixty per cent. or *(iii) not less than 18 per cent and the Employee Cost in relation to the Operating Expense does not exceed forty per cent.*
4.	*Advancing of intra-group loans referred to in item (iv) of rule 10TC where the amount of loan is denominated in Indian Rupees (INR).*	*The interest rate declared in relation to the eligible international transaction is not less than the one-year marginal cost of funds lending rate of State Bank of India as on 1st April of the relevant previous year plus,-* *(i) 175 basis points, where the associated enterprise has CRISIL credit rating between AAA to A or its equivalent;* *(ii) 325 basis points, where the associated enterprise has CRISIL credit rating of BBB-, BBB or BBB+ or its equivalent;* *(iii) 475 basis points, where the associated enterprise has CRISIL credit rating between BB to B or its equivalent;* *(iv) 625 basis points, where the associated enterprise has CRISIL credit rating between C to D or its equivalent; or* *(v) 425 basis points, where credit rating of the associated enterprise is not available and the amount of loan advanced to the associated enterprise including loans to all associated*

Sl. No.	Eligible International Transaction	Circumstances
(1)	(2)	(3)
		enterprises in Indian Rupees does not exceed a sum of one hundred crore rupees in the aggregate as on 31st March of the relevant previous year.
5.	*Advancing of intra-group loans referred to in item (iv) of rule 10TC where the amount of loan is denominated in foreign currency.*	*The interest rate declared in relation to the eligible international transaction is not less than the six-month London Inter-Bank Offer Rate of the relevant foreign currency as on 30th September of the relevant previous year plus, -* *(i) 150 basis points, where the associated enterprise has CRISIL credit rating between AAA to A or its equivalent;* *(ii) 300 basis points, where the associated enterprise has CRISIL credit rating of BBB-, BBB or BBB+ or its equivalent;* *(iii) 450 basis points, where the associated enterprise has CRISIL credit rating between BB to B or its equivalent;* *(iv) 600 basis points, where the associated enterprise has CRISIL credit rating between C to D or its equivalent; or* *(v) 400 basis points, where credit rating of the associated enterprise is not available and the amount of loan advanced to the associated enterprise including loans to all associated enterprises does not exceed a sum equivalent to one hundred crore*

Sl. No.	Eligible International Transaction	Circumstances
(1)	(2)	(3)
		Indian rupees in the aggregate as on 31st March of the relevant previous year.
6.	*Providing corporate guarantee referred to in sub-item (a) or sub-item (b) of item (v) of rule 10TC.*	*The commission or fee declared in relation to the eligible international transaction is at the rate not less than one per cent per annum on the amount guaranteed.*
7.	*Provision of contract research and development services wholly or partly relating to software development referred to in item (vi) of rule 10TC.*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 24 per cent, where the value of the international transaction does not exceed a sum of two hundred crore rupees.*
8.	*Provision of contract research and development services wholly or partly relating to generic pharmaceutical drugs referred to in item (vii) of rule 10TC.*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 24 per cent, where the value of the international transaction does not exceed a sum of two hundred crore rupees.*
9.	*Manufacture and export of core auto components referred to in item (viii) of rule 10TC.*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 12 per cent.*
10.	*Manufacture and export of non-core auto components referred to in item (ix) of rule 10TC.*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 8.5 per*

Sl. No.	Eligible International Transaction	Circumstances
(1)	(2)	(3)
		cent.
11.	*Receipt of low value-adding intra-group services in item (x) of rule 10TC.*	*The entire value of the international transaction, including a mark-up not exceeding 5 per cent., does not exceed a sum of ten crore rupees:* **Provided** *that the method of cost pooling, the exclusion of shareholder costs and duplicate costs from the cost pool and the reasonableness of the allocation keys used for allocation of costs to the assessee by the overseas associated enterprise, is certified by an accountant*.

(3) The provisions of sub-rules (1) and (2) shall apply for the assessment year 2013-14 and four assessment years immediately following that assessment year.

(3A) The provisions of sub-rules (1) and (2A) shall apply for the assessment year 2017-18 and two assessment years immediately following that assessment year:

Provided *that where an eligible assessee is eligible to exercise option under sub-rule (2) or, as the case may be, sub-rule (2A) above, the assessee shall have the right to choose the option which is most beneficial to him*.

(3B) The provisions of sub-rules (1) and (2A) shall apply for the assessment year 2020-21

(4) No comparability adjustment and allowance under the second proviso to sub-section (2) of section 92C shall be made to the transfer price declared by the eligible assessee and accepted under sub-rules (1) and (2) or, as the case may be, (2A) above.

(5) The provisions of sections 92D and 92E in respect of an international transaction shall apply irrespective of the fact that the assessee exercises his option for safe harbour in respect of such transaction.

33. Rule 10TE - Procedure

(1) For the purposes of exercise of the option for safe harbour, the assessee shall furnish a Form 3CEFA, complete in all respects, to the Assessing Officer on or before the due date specified in Explanation 2 *below sub-section (1) of section 139 for furnishing the return of income for—*

*(*i*) the relevant assessment year, in case the option is exercised only for that assessment year; or*

*(*ii*) the first of the assessment years, in case the option is exercised for more than one assessment year:*

***Provided** that the return of income for the relevant assessment year or the first of the relevant assessment years, as the case may be, is furnished by the assessee on or before the date of furnishing of Form 3CEFA.*

(2) The option for safe harbour validly exercised shall continue to remain in force for the period specified in Form 3CEFA or a period of five years whichever is less:

***Provided** that the assessee shall, in respect of the assessment year or years following the initial assessment year, furnish a statement to the Assessing Officer before furnishing return of income of that year, providing details of eligible transactions, their quantum and the profit margins or the rate of interest or commission shown:*

***Provided further** that an option for safe harbour shall not remain in force in respect of any assessment year following the initial assessment year, if—*

*(*i*) the option is held to be invalid for the relevant assessment year by the Transfer Pricing Officer under sub-rule (11) or by the Commissioner under sub-rule (8) in respect of an objection filed by the assessee against the order of the Transfer Pricing Officer under sub-rule (11), as the case may be; or*

*(*ii*) the eligible assessee opts out of the safe harbour, for the relevant assessment year, by furnishing a declaration to that effect, to the Assessing Officer.*

Provided also that in case of the option for safe harbour validly exercised under sub-rule (2A) of rule 10TD, the word “three” shall be substituted for “five”.;

Provided also that nothing contained in this sub-rule shall apply to the

option for safe harbour validly exercised under sub-rule (3B) of rule 10TD." and

(3) On receipt of Form 3CEFA, the Assessing Officer shall verify whether—

(i) the assessee exercising the option is an eligible assessee; and

(ii) the transaction in respect of which the option is exercised is an eligible international transaction,

before the option for safe harbour by the assessee is treated to be validly exercised.

(4) Where the Assessing officer doubts the valid exercise of the option for the safe harbour by an assessee, he shall make a reference to the Transfer Pricing Officer for determination of the eligibility of the assessee or the international transaction or both for the purposes of the safe harbour.

(5) For the purposes of sub-rule (4) and sub-rule (10), the Transfer Pricing Officer may require the assessee, by notice in writing, to furnish such information or documents or other evidence as he may consider necessary, and the assessee shall furnish the same within the time specified in such notice.

(6) Where—

(a) the assessee does not furnish the information or documents or other evidence required by the Transfer Pricing Officer; or

(b) the Transfer Pricing Officer finds that the assessee is not an eligible assessee; or

(c) the Transfer Pricing Officer finds that the international transaction in respect of which the option referred to in sub-rule (1) has been exercised is not an eligible international transaction,

the Transfer Pricing Officer shall, by order in writing, declare the option exercised by the assessee under sub-rule (1) to be invalid and cause a copy of the said order to be served on the assessee and the Assessing Officer:

Provided *that no order declaring the option exercised by the assessee to be invalid shall be passed without giving an opportunity of being heard to the assessee.*

(7) If the assessee objects to the order of the Transfer Pricing Officer under sub-rule (6) or sub-rule (11) declaring the option to be invalid, he may file his objections with the Commissioner, to whom the Transfer Pricing

Officer is subordinate, within fifteen days of receipt of the order of the Transfer Pricing Officer.

(8) On receipt of the objection referred to in sub-rule (7), the Commissioner shall after providing an opportunity of being heard to the assessee pass appropriate orders in respect of the validity or otherwise of the option exercised by the assessee and cause a copy of the said order to be served on the assessee and the Assessing Officer.

(9) In a case where option exercised by the assessee has been held to be valid, the Assessing officer shall proceed to verify whether the transfer price declared by the assessee in respect of the relevant eligible international transactions is in accordance with the circumstances specified in sub-rule (2) or, as the case may be, sub-rule (2A) of rule 10TD and, if it is not in accordance with the said circumstances, the Assessing Officer shall adopt the operating profit margin or rate of interest or commission specified in sub-rule (2) or, as the case may be, sub-rule (2A) of rule 10TD.

(10) Where the facts and circumstances on the basis of which the option exercised by the assessee was held to be valid have changed and the Assessing Officer has reason to doubt the eligibility of an assessee or the international transaction for any assessment year other than the initial Assessment Year falling within the period for which the option was exercised by the assessee, he shall make a reference to the Transfer Pricing Officer for determination of eligibility of the assessee or the international transaction or both for the purpose of safe harbour.

Explanation.—*For purposes of this sub-rule the facts and circumstances include:—*

(a) *functional profile of the assessee in respect of the international transaction;*

(b) *the risks being undertaken by the assessee;*

(c) *the substantive contractual conditions governing the role of the assessee in respect of the international transaction;*

(d) *the conduct of the assessee as referred to in sub-rule (2) or sub-rule (3) of rule 10TB; or*

(e) *the substantive nature of the international transaction.*

(11) The Transfer Pricing Officer on receipt of a reference under sub-rule (10) shall, by an order in writing, determine the validity or otherwise of the option exercised by the assessee for the relevant year after providing an

opportunity of being heard to the assessee and cause a copy of the said order to be served on the assessee and the Assessing Officer.

(12) Nothing contained in this rule shall affect the power of the Assessing Officer to make a reference under section 92CA in respect of international transaction other than the eligible international transaction.

(13) Where no option for safe harbour has been exercised under sub-rule (1) by an eligible assessee in respect of an eligible international transaction entered into by the assessee or the option exercised by the assessee is held to be invalid, the arm's length price in relation to such international transaction shall be determined in accordance with the provisions of sections 92C and 92CA without having regard to the profit margin or the rate of interest or commission as specified in sub-rule (2) or, as the case may be, sub-rule (2A) of rule 10TD.

(14) For the purposes of this rule,—

(i) no reference under sub-rule(4) shall be made by an Assessing Officer after expiry of a period of two months from the end of the month in which Form 3CEFA is received by him;

(ii) no order under sub-rule (6) or sub-rule (11) shall be passed by the Transfer Pricing Officer after expiry of a period of two months from the end of the month in which the reference from the Assessing officer under sub-rule(4) or sub-rule (10), as the case may be, is received by him;

(iii) the order under sub-rule (8) shall be passed by the Commissioner within a period of two months from the end of the month in which the objection filed by the assessee under sub-rule (7) is received by him.

(15) If the Assessing Officer or the Transfer Pricing Officer or the Commissioner, as the case may be, does not make a reference or pass an order, as the case may be, within the time specified in sub-rule (14), then the option for safe harbour exercised by the assessee shall be treated as valid.

34. Rule 10TF - Safe harbour rules not to apply in certain cases.

Nothing contained in rules 10TA, 10TB, 10TC, 10TD or rule 10TE shall apply in respect of eligible international transactions entered into with an associated enterprise located in any country or territory notified under section 94A or in a no tax or low tax country or territory.

35. Rule 10TG - Mutual Agreement Procedure not to apply.

10TG. *Where transfer price in relation to an eligible international transaction declared by an eligible assessee is accepted by the income-tax authorities under section 92CB, the assessee shall not be entitled to invoke mutual agreement procedure under an agreement for avoidance of double taxation entered into with a country or specified territory outside India as referred to in section 90 or 90A*.

36. Rule 10TH - Safe Harbour Rules for Specified Domestic Transactions

10TH. Definitions.— *For the purposes of this rule and rules 10THA to 10THD,—*

(a) "Appropriate Commission" shall have the same meaning as assigned to it in sub-section (4) of section 2 of the Electricity Act, 2003 (36 of 2003);

(b) "Government company" shall have the same meaning as assigned to it in sub-section (45) of section 2 of the Companies Act, 2013 (18 of 2013);

37. Rule 10THA - Eligible assessee

The 'eligible assessee' means a person who has exercised a valid option for application of safe harbour rules in accordance with the provisions of rule 10THC, and—

(i) is a Government company engaged in the business of generation, supply, transmission or distribution of electricity; or

(ii) is a co-operative society engaged in the business of procuring and marketing milk and milk products.

38. Rule 10THB - Eligible specified domestic transaction.

The "Eligible specified domestic transaction" means a specified domestic transaction undertaken by an eligible assessee and which comprises of :—

(i) supply of electricity or

(ii) transmission of electricity; or

(iii) wheeling of electricity; or

(iii) purchase of milk or milk products by a co-operative society from its members

.

39. Rule 10THC - Safe Harbour

(1) Where an eligible assessee has entered into an eligible specified domestic transaction in any previous year relevant to an assessment year and the option exercised by the said assessee is treated to be validly exercised under rule 10THD, the transfer price declared by the assessee in respect of such transaction for that assessment year shall be accepted by the income-tax authorities, if it is in accordance with the circumstances as specified in sub-rule (2).

(2) The circumstances referred to in sub-rule (1) in respect of the eligible specified domestic transaction specified in column (2) of the Table below shall be as specified in the corresponding entry in column (3) of the said Table:—

S. No.	Eligible specified domestic transaction	Circumstances
1.	2.	3.
1.	*Supply of electricity, transmission of electricity, wheeling of electricity referred to in clause (i), (ii) or (iii) of rule 10THB, as the case may be*	*The tariff in respect of supply of electricity, transmission of electricity, wheeling of electricity, as the case may be, is determined or the methodology for determination of the tariff is approved by the Appropriate Commission in accordance with the provisions of the Electricity Act, 2003 (36 of 2003).*
2.	*Purchase of milk or milk products referred to in clause (iv) of rule 10THB.*	*The price of milk or milk products is determined at a rate which is fixed on the basis of the quality of milk, namely, fat content and Solid Not FAT (SNF) content of milk ; and—* *(a) the said rate is irrespective of,—* *(i) the quantity of milk procured;* *(ii) the percentage of shares held by the members in the co-operative society;* *(iii) the voting power held by the members in the society; and*

S. No.	Eligible specified domestic transaction	Circumstances
1.	2.	3.
		*(*b*) such prices are routinely declared by the co-operative society in a transparent manner and are available in public domain*.

(3) No comparability adjustment and allowance under the second proviso to sub-section (2) of section 92C shall be made to the transfer price declared by the eligible assessee and accepted under sub-rule (1).

(4) The provisions of sections 92D and 92E in respect of a specified domestic transaction shall apply irrespective of the fact that the assessee exercises his option for safe harbour in respect of such transaction.

40. Rule 10THD - Procedure

(1) For the purposes of exercise of the option for safe harbour, the assessee shall furnish a Form 3CEFB, complete in all respects, to the Assessing Officer on or before the due date specified in Explanation 2 *to sub-section (1) of section 139 for furnishing the return of income for the relevant assessment year:*

Provided *that the return of income for the relevant assessment year is furnished by the assessee on or before the date of furnishing of Form 3CEFB:*

Provided further *that in respect of eligible specified domestic transactions, other than the transaction referred to in clause (*iv*) of rule 10THB, undertaken during the previous year relevant to the assessment year beginning on the 1st day of April, 2013 or beginning on the 1st day of April, 2014 or beginning on the 1st day of April, 2015, Form 3CEFB may be furnished by the assessee on or before the 31st day of March, 2016:*

Provided also *that in respect of eligible specified domestic transactions, referred to in clause (*iv*) of rule 10THB, undertaken during the previous year relevant to the assessment year beginning on the 1st day of April, 2013 or beginning on the 1st day of April, 2014 or beginning on the 1st day of April, 2015, Form 3CEFB may be furnished by the assessee on or before the 31st day of December, 2015*.

(2) On receipt of Form 3CEFB, the Assessing Officer shall verify whether—

(i) the assessee exercising the option is an eligible assessee; and

(ii) the transaction in respect of which the option is exercised is an eligible specified domestic transaction,

before the option for safe harbour by the assessee is treated to be validly exercised.

(3) Where the Assessing Officer doubts the valid exercise of the option for the safe harbour by an assessee, he may require the assessee, by notice in writing, to furnish such information or documents or other evidence as he may consider necessary, and the assessee shall furnish the same within the time specified in such notice.

(4) Where—

(a) the assessee does not furnish the information or documents or other evidence required by the Assessing Officer; or

(b) the Assessing Officer finds that the assessee is not an eligible assessee; or

(c) the Assessing Officer finds that the specified domestic transaction in respect of which the option referred to in sub-rule (1) has been exercised is not an eligible specified domestic transaction; or

(d) the tariff is not in accordance with the circumstances specified in sub-rule (2) of rule 10THC,

the Assessing Officer shall, by order in writing, declare the option exercised by the assessee under sub-rule (1) to be invalid and cause a copy of the said order to be served on the assessee:

Provided *that no order declaring the option exercised by the assessee to be invalid shall be passed without giving an opportunity of being heard to the assessee.*

(5) If the assessee objects to the order of the Assessing Officer under sub-rule (4) declaring the option to be invalid, he may file his objections with the Principal Commissioner or the Commissioner or the Principal Director or the Director, as the case may be, to whom the Assessing Officer is subordinate, within fifteen days of receipt of the order of the Assessing Officer.

(6) On receipt of the objection referred to in sub-rule (5), the Principal Commissioner or the Commissioner or the Principal Director or the Director, as the case may be, shall after providing an opportunity of being heard to the assessee, pass appropriate orders in respect of the validity or otherwise of the option exercised by the assessee and cause a copy of the said order to be served on the assessee and the Assessing Officer.

(7) For the purposes of this rule,—

(i) no order under sub-rule (4) shall be made by an Assessing Officer after expiry of a period of three months from the end of the month in which Form 3CEFB is received by him;

(ii) the order under sub-rule (6) shall be passed by the Principal Commissioner or Commissioner or Principal Director or Director, as the case may be, within a period of two months from the end of the month in which the objection filed by the assessee under sub-rule (5) is received by him.

(8) If the Assessing Officer or the Principal Commissioner or the Commissioner or the Principal Director or the Director, as the case may be, does not pass an order within the time specified in sub-rule (7), then the option for safe harbour exercised by the assessee shall be treated as valid.

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)

*1. *I/We have examined the accounts and records of ……... (name and address of the assessee with PAN) relating to the international transaction (s) and specified domestic transaction (s) entered into by the assessee during the previous year ending on 31st March, ……*

*2. In *my/our opinion proper information and documents as are prescribed have been kept by the assessee in respect of the international transaction (s) and specified domestic transaction (s) entered into so far as appears from *my/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 *my/our opinion and to the best of *my/our information and according to the explanations given to *me/us, the particulars given in the Annexure are true and correct.*

_____

***Signed _____*

Name : _____

Address : _____

_____

Membership No. _____

Place:

Date:

Notes:

*1. *Delete whichever is not applicable*

*2. **This report has to be signed by -*

(i) a chartered accountant within the meaning of the Chartered Accountant Act, 1949 (38 of 1949); or

(ii) any person who, in relation to any State, is, by virtue of the provisions in sub-section (2) of section 226 of the Companies Act, 1956 (1 of 1956), entitled to be appointed to act as an auditor of companies registered in that State.

ANNEXURE TO FORM NO. 3CEB

Particulars relating to international transactions and specified domestic transactions required to be furnished under section 92E of the Income-tax Act, 1961

PART A

1. Name of the assessee

2. Address

3. Permanent account number

*4. Nature of business or activities of the assessee**

5. 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 accounts

** Code for nature of business to be filled in as per instructions for filling Form ITR 6*

PART B (International transactions)

10. List of associated enterprises with whom the assessee has entered into international transactions, with the following details:

(a) Name of the associated enterprise

(b) Nature of the relationship with the associated enterprise as referred to in section 92A(2).

(c) Brief description of the business carried on by the associated enterprise.

11. Particulars in respect of transactions in tangible property

A. Has the assessee entered into any international transaction(s) in respect of purchase/sale of raw material, consumables or any other supplies for assembling/ processing/ manufacturing of goods/articles from/ to associated enterprises? Yes/No

If 'yes', provide the following details in respect of each associated enterprise and each transaction or class of transaction:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of transaction and quantity purchased/ sold.

(c) Total amount paid/received or payable/ receivable in the transaction -

i) as per books of account.

ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)]

B. Has the assessee entered into any international transaction(s) in respect of purchase/sale of traded/finished goods?

If 'yes' provide the following details in respect of each associated enterprise and each transaction or class of transaction: *Yes/No*

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Depreciation of transaction and quantity purchased/sold.

(c) Total amount paid/received or payable/receivable in the transaction –

i) as per books of account.

ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)]

C. Has the assessee entered into any international transaction(s) in respect of purchase/sale, transfer, lease or use of any other tangible property including transactions specified in Explanation (i)(a) below section 92B(2)?

Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each transaction or class of transaction:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of the property and nature of transaction.

(c) Number of units of each category of tangible property involved in the transaction.

(d) amount paid/received or payable/ receivable in each transaction of purchase/sale/transfer/use, or lease rent paid/ received or payable/ receivable in the in respect of each lease provided/entered into–

i) as per books of account.

ii) as computed by the assessee having regard to the arm's length price.

(e) Method used for determining the arm's length price [See section 92C(1)]

12. Particulars in respect of transactions in intangible property:

Has the assessee entered into any international transaction(s) in respect of purchase/sale/transfer/lease/use of intangible property including transactions specified in Explanation (i)(b) below section 92B(2)? Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each category of intangible property:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of intangible property and nature of transaction.

(c) Amount paid/received or payable/ receivable for purchase/sale/ transfer/lease/use of each category of intangible property–

i) as per books of account;

ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)].

13. Particulars in respect of providing of services:

Has the assessee entered into any international transaction(s) in respect of services including transactions as specified in Explanation (i)(d) below section 92B(2)? Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each category of service:

(a) Name and address of the associated enterprise with whom the transaction has been entered into.

(b) Description of services provided/ availed to/from the associated enterprise.

(c) Amount paid/received or payable/ receivable for the services provided/taken –

(i) as per books of account;

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)]

14. Particulars in respect of lending or borrowing of money:

Has the assessee entered into any international transaction(s) in respect of lending or borrowing of money including any type of advance, payments, deferred payments, receivable, non-convertible preference shares / debentures or any other debt arising during the course of business as specified in Explanation (i)(c) below section 92B(2)? Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each loan/advance:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Nature of financing agreement.

(c) Currency in which transaction has taken place.

(d) Interest rate charged/paid in respect of each lending/borrowing

(e) Amount paid/received or payable/ receivable in the transaction -

(i) as per books of account;

(ii) as computed by the assessee having regard to the arm's length price.

(f) Method used for determining the arm's length price [See section 92C(1)].

15. Particulars in respect of transactions in the nature of guarantee:

Has the assessee entered into any international transaction(s) in the nature of guarantee? Yes/No

If Yes, please provide the following details :

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Nature of guarantee agreement.

(c) Currency in which guarantee transaction was undertaken

(d) Compensation / fees charged / paid in respect of the transaction

(e) Method used for determining the arm's length price. [see section 92C(1)].

16. Particulars in respect of international transactions of purchase or sale of marketable securities, issue and buy back of equity shares, optionally convertible/ partially convertible/ compulsorily convertible debentures/ preference shares:

Has the assessee entered into any international transaction(s) in respect of purchase or sale of marketable securities or issue of equity shares including transactions specified in Explanation (i)(c) below section 92B(2)? Yes/No

If yes, provide the following details:

(a). Name and address of the associated enterprise with whom the international transaction has been entered into

(b). Nature of transaction

(c). Currency in which the transaction was undertaken

(d). Consideration charged/ paid in respect of the transaction

(e). Method used for determining the arm's length price [See section 92C(1]

17. Particulars in respect of mutual agreement or arrangement:

Has the assessee entered into any international transaction with an associated enterprise or enterprises by way of a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises? Yes/No

If 'yes' provide the following details in respect of each agreement/ arrangement:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of such mutual agreement or arrangement.

(c) Amount paid/received or payable/ receivable in each such transaction:

(i) as per books of account.

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price. [see section 92C(1)].

18. Particulars in respect of international transactions arising out/ being part of business restructuring or reorganizations:

Has the assessee entered into any international transaction(s) arising out/being part of any business restructuring or reorganization entered into by it with the associated enterprise or enterprises as specified in Explanation (i) (e) below section 92B (2) and which has not been specifically referred to above? Yes/No

If 'yes' provide the following details:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Nature of transaction

(c) Agreement in relation to such business restructuring/ reorganization

(d) Terms of business restructuring/ reorganization

(e) Method used for determining the arm's length price [See section 92C(1)

19. Particulars in respect of any other transaction including the transaction having a bearing on the profits, incomes, losses, or assets of the assessee:

Has the assessee entered into any international transaction(s) including a transaction having a bearing on the profits, income, losses or assets, but not specifically referred to above, with associated enterprise? Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each transaction:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of the transaction.

(c) Amount paid/received or payable/ receivable in each such transaction:

(i) as per books of account.

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price. [see section 92C(1)].

20. Particulars of deemed international transaction:

Has the assessee entered into any transaction with a person other than an AE in pursuance of a prior agreement in relation to the relevant transaction between such other person and the associated enterprise? Yes/No

If 'yes' provide the following details in respect of each of such agreement:

(a) Name and address of the associated enterprise with whom the international transaction has been entered into.

(b) Description of the transaction.

(c) Amount paid/received or payable/ receivable in each such transaction:

(i) as per books of account.

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price. [see section 92C(1)].

PART C (Specified Domestic transactions)

21. List of associated enterprises with whom the assessee has entered into specified domestic transactions, with the following details:

(a) Name, address and PAN of the associated enterprise.

(b) Nature of the relationship with the associated enterprise.

(c) Brief description of the business carried on by the said associated enterprise.

22. Particulars in respect of transactions in the nature of transfer or acquisition of any goods or services:

A. Has any undertaking or unit or enterprise or eligible business of the assessee [as referred to in section 80A(6), 80IA(8) or section

10AA)]transferred any goods or services to any other business carried on by the assessee? Yes/No

If 'yes' provide the following details in respect of each unit or enterprise or eligible business:

(a) Name and details of business to which goods or services have been transferred.

(b) Description of goods or services transferred.

(c) Amount received / receivable for transferring of such goods or services -

(i) as per books of account.

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)]

B. Has any undertaking or unit or enterprise or eligible business of

the assessee [as referred to in section 80A(6), 80IA(8) or section 10AA)]acquired any goods or services to any other business carried on by the assessee? Yes/No

If 'yes' provide the following details in respect of each unit or enterprise or eligible business:

(a) Name and details of business to which goods or services have been acquired.

(b) Description of goods or services acquired.

(c) Amount paid / payable for transferring of such goods or services -

(i) as per books of account.

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)]

23. Particulars in respect of specified domestic transactions in the nature of any business transacted:

Has the assessee entered into any specified domestic transaction(s) with any associated enterprise which has resulted in more than

ordinary profits to an eligible business to which section 80IA(10) or section 10AA applies? Yes/No

If 'yes' provide the following details:

(a) Name of the person with whom the specified domestic transaction has been entered into

(b) Description of the transaction including quantitative details, if any

(c) Amount received/receivable or paid/payable for transferring of such goods or services -

(i) as per books of account.

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)]

24.` Particulars in respect of specified domestic transaction in the nature of any business transacted between the persons referred to in sub-section (6) of section 115BAB:

Has the assessee entered into any specified domestic transaction(s) with any persons referred to in sub-section (6) of section 115BAB which has resulted in more than ordinary profits expected to arise in such business?

Yes/No

If "yes", provide the following details:

(a) Name of the person with whom the specified domestic transaction has been entered into

(b) Description of the transaction including quantitative details, if any. _____]

(c) Total amount received/receivable or paid/payable in the transaction- Yes/No price.

(i) as per books of account;

(ii) as computed by the assessee having regard to the arm's length

(d) Method used for determining the arm's length price [See section 92C(1)]

25. Particulars in respect of any other transactions:

Has the assessee entered into any other specified domestic transactions(s) not specifically referred to above, with an associated enterprise? Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each transaction:

(a) Name of the associated enterprise with whom the specified domestic transaction has been entered into:

(b) Description of the transaction.

(c) Amount paid/received or payable/receivable in the transaction-

(i) as per books of account.

(ii) as computed by the assessee having regard to the arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)]

_____

***Signed* _____

*Name:*_____

*Address:*_____

_____

Place:

Date:

Notes: **This Annexure has to be signed by –

(a) a chartered accountant within the meaning of Chartered Accountants Act,1949 (38 of 1949)

(b) any person who in relation to any State, is,by virtue of the provisions in sub-section(2) of section 226 of the Companies Act,1956 (1 of 1956), entitled to be appointed to act as an auditor of the Companies registered in that State.

FORM NO. 3CEAA
[See rule 10DA] MASTER FILE
Report to be furnished under sub-section (4) of section 92D of the Income-tax Act, 1961

PART A

1. Name of the assessee:
2. Address of the assessee:
3. Permanent Account Number or Aadhaar Number of the assessee:
4. Name of the international group of which the assessee is a constituent entity:
5. Address of the international group of which the assessee is a constituent entity:
6. Accounting Year for which the report is being submitted:
7. Number of constituent entities of the international group operating in India:
8. Name, Permanent Account Number or Aadhaar Number and address of all the constituent entities included in item No. 7:

Sl. No.	*Name of the constituent entities of the international group*	*Permanent Account Number or Aadhaar Number of the constituent entities of the international group*	*Address of the constituent entities of the international group*

PART B

1. List of all entities of the international group along with their addresses

Sl. No.	*Name*	*Address*

2. Chart depicting the legal status of the constituent entity and ownership structure of the entire international group.
3. Written description of the business of the international group during the accounting year in accordance with clause (*c*) of sub-rule (1) of rule 10DA containing the following, namely:—

(i) the nature of the business or businesses;

(ii) the important drivers of profits of such business or businesses;

(iii) a description of the supply chain for the five largest products or services of the international group in terms of revenue and any other products including services amounting to more than five per cent of the consolidated group revenue;

(iv) a list and brief description of important service arrangements made among members of the international group, other than those for research and development services;

(v) a description of the capabilities of the main service providers within the international group;

(vi) the transfer pricing policies for allocating service costs and determining prices to be paid for intra-group services;

(vii) a list and description of the major geographical markets for the products and services offered

(viii) by the international group;

(ix) the functions, assets and risks analysis of the constituent entities of the international group that contribute at least ten per cent of the revenues or assets or profits of such group; and

(x) a description of the important business restructuring transactions, acquisitions and divestments.

4. Description of the overall strategy of the international group for the development, ownership and exploitation of intangible property, including location of principal research and development facilities and their management.

5. List of all entities of the international group engaged in development of intangible property and in management of intangible property along with their addresses

Sl. No.	***Name of the entity of the international group***	***Address of the entity of the international group***

6. List of all the important intangible property or groups of intangible property owned by the international group along with the names and addresses of the group entities that legally own such intangible property -

Sl. No.	*Intangible property/ group of intangible property*	*Name of the entity who legally owns the intangible property/ group of intangible property*	*Address of the entity*

7. List and brief description of important agreements among members of the international group related to intangible property, including cost contribution arrangements, principal research service agreements and license agreements

8. Description of the transfer pricing policies of the international group related to research and development and intangible property

9. Description of important transfers of interest in intangible property, if any, among entities of the international group, including the names and addresses of the selling and buying entities and the compensation paid for such transfers

10. Detailed description of the financing arrangements of the international group, including the names and addresses of the top ten unrelated lenders

11. List of group entities that provide central financing functions, including their addresses of operation and of effective management

12. Detailed description of the transfer pricing policies of the international group related to financing arrangements among group entities

13. A copy of the annual consolidated financial statement of the international group

14. A list and brief description of the existing unilateral advance pricing agreements and other tax rulings in respect of the international group for allocation of income among countries.

I ..... son/daughter/wife* of Shri ..... hereby declare that I am furnishing the information in my capacity as ..... (designation) of ..... (name of the assessee) and I am competent to furnish the said information and verify it.

Place : ....

Signature

Date : ....

Form No. 3CEAB
[See Rule 10DA]

Intimation by a designated constituent entity, resident in India, of an international group, for the purposes of sub-section (4) of section 92D of the Income-tax Act, 1961

1. *Name of the designated constituent entity –*
2. *Address of the designated constituent entity –*
3. *Permanent account number of the designated constituent entity –*
4. *Name of the international group –*
5. *Name of the parent entity of the international group –*
6. *Address of the parent entity of the international group –he country of residence of the parent entity –*
7. *Accounting Year for which the report is being submitted –*

I, ……., son/daughter/wife of Shri ……. hereby declare that I am furnishing the information in my capacity as ……. (designation) of …… (name of the assessee) and I am competent to furnish the said information and verify it.*

Place: …… *Signature***

Date: ……..…..…… *Address of the declarant*

***Note:** *Strike off whichever is not applicable.*

PAN of the declarant

Form No. 3CEAC
[See Rule 10DB]

Intimation by a constituent entity, resident in India, of an international group, the parent entity of which is not resident in India, for the purposes of sub-section (1) of section 286 of the Income-tax Act, 1961

1. Name of the constituent entity –
2. Address of the constituent entity –
3. Permanent account number of the constituent entity –
4. Name of the international group –
5. Name of the parent entity of the international group –
6. Address of the parent entity of the international group –
7. The country of residence of the parent entity –
8. Whether the international group has designated an alternate reporting entity in place of the parent entity to furnish the report referred to in sub-section (2) of section 286 - Yes/No
9. If yes, name and address of the alternate reporting entity of the international group – (i) Name of alternate reporting entity (ii) Address
10. The country of residence of the alternate reporting entity –
11. Reportable Accounting Year –

I, ……, son/daughter/wife* of Shri …… hereby declare that I am furnishing the information in my capacity as …… (designation) of …… (name of the assessee) and I am competent to furnish the said information and verify it.

Place : …… ……

Signature

Date : …… ……

Address of the declarant

……

PAN

FORM NO. 3CEFA
[See sub-rule (1) of [1][rule 10TE]*]
Application for Opting for Safe Harbour

(a) I propose to opt for the safe harbour rules under section 92CB of the Income-tax Act, 1961 read with rule 10TA to rule 10TG of Income-tax Rules, 1962. In this regard the particulars are as under:

1. *General :*

(a) Full name of the assessee:

(b) [*Permanent Account Number or Aadhaar Number*]:

(c) Address of the assessee:

(d) Nature of business or activities of the assessee:#

(e) Status

(f) Whether the option is to be exercised for one assessment year?

(i) if yes, following details be provided,—

(1) previous year ended

(2) assessment year

(3) date of furnishing of return of income for the assessment year

(ii) if no, following details be provided,—

(1) assessment years for which the option is exercised;

(2) date of furnishing of return of income in respect of the first of the assessment years mentioned in (1)

2. *Eligible International Transaction :*

Sl. No.	***Particulars in respect of eligible international transaction***	***Remarks***
1.	Has the eligible assessee entered into any international transaction in respect of the provision of software development services referred in item	Yes/No

[1] Substituted for "rule 10" by the Income-tax (Ninth Amendment) Rules, 2020, w.r.e.f. 1-4-2020.

Sl. No.	*Particulars in respect of eligible international transaction*	*Remarks*
	(*i*) of rule 10TC? If Yes, provide the following details*:— (a) Name and address of the associated enterprises (AE) with whom the eligible international transaction has been entered into.	
	(b) Name of the country or territory in which AE(s) is located. (c) Whether country or territory is a no tax or low tax country or territory as defined in rule 10TA. (d) Description of the eligible international transaction. (e) Amount received or receivable for the services provided. (f) Operating profit margin in relation to operating expense declared. (g) Whether transfer price is in accordance with the circumstances specified under rule 10TD.	Yes/No
2.	Has the eligible assessee entered into any international transaction in respect of the provision of information technology enabled services referred to in item (*ii*) of rule 10TC? If Yes, provide the following details*: (a) Name and address of the associated enterprises with whom the eligible international transaction has been entered into. (b) Name of the country or territory in which AE(s) is located. (c) Whether country or territory is a no tax or low tax country or territory as defined in rule 10TA. (d) Description of the eligible international	Yes/No Yes/No

Sl. No.	*Particulars in respect of eligible international transaction*	*Remarks*
	transaction. (e) Amount received for the services provided. (f) Operating profit margin in relation to operating expense declared. Whether transfer price is in accordance with the circumstances specified under rule 10TD.	
3.	Has the eligible assessee entered into any international transaction in respect of the provision of knowledge processes outsourcing services referred to in item (*iii*) of rule 10TC? If Yes, provide the following details*: (a) Name and address of the associated enterprises with whom the eligible international transaction has been entered into. (b) Name of the country or territory in which AE (s) is located. (c) Whether country or territory is a no tax or low tax country or territory as defined in rule 10TA. (d) Description of the eligible international transaction. (e) [Employee cost in relation to operating expense declared] (f) Amount received for the services provided. (g) Operating profit margin in relation to operating expense declared. (h) Whether transfer price is in accordance with the circumstances specified under rule 10TD.	Yes/No Yes/No
4.	Has the eligible assessee advanced intra-group loans as referred to in item (*iv*) of rule 10TC? If Yes, provide the following details*:	Yes/No

Sl. No.	*Particulars in respect of eligible international transaction*	*Remarks*
	(a) Name and address of the associated enterprises with whom the eligible international transaction has been entered into. (b) Name of the country or territory in which AE(s) is located. (c) Whether country or territory is a no tax or low tax country or territory as defined in rule 10TA. (d) Description of the eligible international transaction. (e) Currency of denomination of the amount of loan for each loan transaction. (f) [Whether credit rating of AE has been done? If yes, the credit rating rank and the name of the credit rating agency.] (g) The rate at which interest has been charged in respect of each lending. (h) Whether transfer price is in accordance with the circumstances specified under rule 10TD.	Yes/No
5.	Has the eligible assessee provided corporate guarantee(s) as referred to in item (*v*) of rule 10TC? If Yes, provide the following details*: (a) Name and address of the associated enterprises with whom the eligible international transaction has been entered into. (b) Name of the country in which AE(s) is located. (c) Whether country or territory is a no tax or low tax country or territory as defined in rule 10TA. (d) Description of the eligible international transaction. (e) The rate at which the commission or fee has	Yes/No Yes/No

Sl. No.	*Particulars in respect of eligible international transaction*	*Remarks*
	been charged in respect of the transaction declared. (f) Whether AE is required to be credit rated, if yes, the credit rating and the name of rating agency. (g) Whether transfer price is in accordance with the circumstance specified under rule 10TD.	
6.	Has the eligible assessee entered into any international transaction in respect of the provision of contract research and development services wholly or partly relating to software development services as referred to in item (*vi*) of rule 10TC? If Yes, provide the following details*: (a) Name and address of the associated enterprises (AE) with whom the eligible international transaction has been entered into. (b) Name of the country or territory in which AE(s) is located. (c) Whether country or territory is a no tax or low tax country or territory as defined in rule 10TA. (d) Description of the eligible international transaction. (e) Amount received for the services provided. (f) Operating profit margin in relation to operating expense declared. (g) Whether transfer price is in accordance with the circumstances specified under rule 10TD.	Yes/No Yes/No
7.	Has the eligible assessee entered into any international transaction in respect of the provision of contract research and development services wholly or partly relating to generic pharmaceutical	Yes/No

Sl. No.	*Particulars in respect of eligible international transaction*	*Remarks*
	drugs as referred to in item (*vii*) of rule 10TC? If Yes, provide the following details*: (a) Name and address of the associated enterprises (AE) with whom the eligible international transaction has been entered into. (b) Name of the country or territory in which AE(s) is located. (c) Whether country or territory is a no tax or low tax country or territory as defined in rule 10TA. (d) Description of the eligible international transaction. (e) Amount received for the services provided. (f) Operating profit margin in relation to operating expense declared. (g) Whether transfer price is in accordance with the circumstance specified under rule 10TD	Yes/No
8.	Has the eligible assessee entered into any international transaction in respect of manufacturing and export of core auto components as referred to in item (*viii*) of rule 10TC? If Yes, provide the following details*: (a) Name and address of the associated enterprises (AE) with whom the eligible international transaction has been entered into. (b) Name of the country or territory in which AE(s) is located. (c) Whether country or territory is a no tax or low tax country or territory as defined in rule 10TA.	Yes/No Yes/No

Sl. No.	*Particulars in respect of eligible international transaction*	*Remarks*
	(d) Description of the eligible international transaction. (e) Amount received or receivable in relation to such transaction. (f) Operating profit margin in relation to operating expense declared. (g) Whether transfer price is in accordance with the circumstance specified under rule 10TD.	
9.	Has the eligible assessee entered into any international transaction in respect of manufacturing and export of non-core auto components as prescribed in item (*ix*) of rule 10TC? If Yes, provide the following details*: (a) Name and address of the associated enterprises (AE) with whom the eligible international transaction has been entered into. (b) Name of the country or territory in which AE(s) is located. (c) Whether country or territory is a no tax or low tax country or territory as defined in rule 10TA. (d) Description of the eligible international transaction. (e) Amount received or receivable in relation to such transaction. (f) Operating profit margin in relation to operating expense declared. (g) Whether transfer price is in accordance with the circumstance	Yes/No
	specified under rule 10TD.	

Sl. No.	*Particulars in respect of eligible international transaction*	*Remarks*
[10.	Has the eligible assessee entered into any international transaction in respect of receipt of low value-adding intra-group services as referred to in item (x) of rule 10TC? If yes, provide the following details: (a) Name and address of the associated enterprises (AE) with whom the eligible international transaction has been entered into. (b) Name of the country or territory in which AE(s) is located. (c) Whether country or territory is a no tax or low tax country or territory as defined in rule 10TA. (d) Description of the eligible international transaction. (e) Amount paid or payable in relation to such transaction. (f) Mark-up charged in per cent. (g) Whether transfer price is in accordance with the circumstances specified under rule 10TD.	Yes/No

I declare that to the best of my knowledge and belief, the information furnished herein is correct and truly stated.

Place : ……

Date : ……

Notes : Details of the assessee as per rule 10TB to be provided.

Yours faithfully,

……..

Signature

……..

Name

……..

Designation/Capacity

……..

Address

* Details for the relevant assessment year or first of the relevant assessment years, as the case may be, to be provided.

- Particulars of each eligible international transaction should be reported separately along with transfer price declared.
- The application should be signed by the person authorised to sign the return of income under section 140.

Annexure III

Extracts from the Memorandum explaining the relevant provisions of the respective Finance Bill(s)

1. Memorandum explaining the provisions of the Finance Bill, 2001.

Measures to curb tax avoidance

New Legislation to curb tax avoidance by abuse of transfer pricing

"The increasing participation of multinational groups in economic activities in the country has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, thereby, leading to erosion of tax revenues.

With a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises, new provisions are proposed to be introduced in the Income-tax Act. These provisions relate to computation of income from international transactions having regard to the arm's length price, meaning of associated enterprise, meaning of international transaction, determination of arm's length price, keeping and maintaining of information and documents by persons entering into international transactions, furnishing of a report from an accountant by persons entering into such transactions and definitions of certain expressions occurring in the said sections."

2. Memorandum explaining the provisions of the Finance Bill, 2002.

Clarification regarding provisions of Transfer Pricing

"Under the existing provisions contained in section 92 of the Income-tax Act, any income arising from an international transaction shall be computed having regard to the arm's length price.

The intention underlying the provision is to prevent avoidance of tax by shifting taxable income to a jurisdiction outside India, through abuse of transfer pricing. With a view to clarify this intention, it is proposed to

substitute the section so as to provide that even where the international transaction comprises of only an outgoing, the allowance for such expenses or interest arising from the international transaction shall also be determined having regard to the arm's length price, and that the provision would not be applicable in a case where the application of arm's length price results in a downward revision in the income chargeable to tax in India.

The existing provision contained in section 92A of the Income-tax Act to provide as to when two enterprises shall be deemed to be associated enterprises.

It is proposed to amend sub-section (2) of the said section to clarify that the mere fact of participation by one enterprise in the management or control or capital of the other enterprise, or the participation of one or more persons in the management or control or capital of both the enterprises shall not make them associated enterprises, unless the criteria specified in sub-section (2) are fulfilled.

Under the existing provisions contained in the proviso to sub-section (2) of section 92C of the Income-tax Act, if the application of the most appropriate method leads to determination of more than one price, the arithmetical mean of such prices shall be taken to be the arm's length price in relation to the international transaction.

With a view to allow a degree of flexibility in adopting an arm's length price, it is proposed to amend the proviso to sub-section (2) of the said section to provide that where the most appropriate method results in more than one price, a price which differs from the arithmetical mean by an amount not exceeding five per cent of such mean may be taken to be the arm's length price, at the option of the assessee.

Under the existing provisions contained in the second proviso to sub-section (4) of section 92C, where the total income of an enterprise is computed by the Assessing Officer on determination of the arm's length price paid to the associated enterprise from which tax has been deducted under the provisions of Chapter XVII-B, the income of the associated enterprise shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise.

It is proposed to amend the said second proviso to clarify that the provisions contained therein apply not only in a case where tax has been deducted under Chapter XVII-B, but also in cases where such tax was deductible, even if not actually deducted.

Section 92F of the Income-tax Act provides definitions of certain terms relevant to computation of arm's length price. It is proposed to amend the definition of 'enterprise' contained therein so as to include the business of construction as one of the activities in which an enterprise may be engaged, and to provide a separate definition of permanent establishment on the lines of the definition found in tax treaties entered into by India, and to amend the definition of "specified date" to provide that it shall have the same meaning as assigned to "due date" for furnishing of return."

These amendments being of clarificatory nature will take effect retrospectively from 1st April, 2002 and will accordingly, apply to the assessment year 2002-03 and subsequent years.

3. Memorandum explaining the provisions of the Finance Bill, 2006.

Rationalisation of provisions relating to Transfer Pricing

The existing provisions contained in section 92C provide for computation of arm's length price. Sub-section (2) of the said section provides that the most appropriate method shall be applied for computation of arm's length price. Sub-section (3) of the said section lays down the conditions under which the Assessing Officer can determine the arm's length price in a case. Under sub-section (4) it has been provided that on the basis of the arm's length price so determined, the Assessing Officer may compute the total income of an assessee. The first proviso to sub-section (4) provides that where the total income of an assessee as compute by the Assessing Officer is higher than the income declared by the assessee, no deduction under section 10A or section 10B or under Chapter VI-A shall be allowed into respect of the amount of income by which the total income of the assessee is enhance after computation of income under this sub-section.

Sections 10A and 10B provide deductions in respect of the profits and gains derived from exports. Section 10AA also provides for deduction of profits and gains derived from exports, in respect of newly established units in Special Economic Zones. With a view to rationalize the provisions of sub-section (4) of section 92C, it is proposed to amend the first proviso to the said sub-section so as to provide that no deduction under section 10AA shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under sub-section (4).

This amendment will take effect from 1st April, 2007and will, accordingly, apply in relation to the assessment year 2007- 08 and subsequent years.

4. Memorandum explaining the provisions of the Finance Bill, 2007.

Extension of Time limitation for making assessment where a reference is made to the Transfer Pricing Officer

Under the existing provisions of the Income-tax Act, there is no extra time available to the Assessing Officer for competing the assessment or reassessment in cases where a reference is made by him under sub-section 92CA to the Transfer Pricing Officer for determination of the Arm's length price of an international transaction. Since the time limit for selection of cases for scrutiny is one year from the end of the month in which the return was filed, references to Transfer Pricing Officers are made mostly after one year of filing of the return. Thus, Transfer Pricing Officers are not getting adequate time to make a meaningful audit of transfer price in cases referred to them.

With a view that the Transfer Pricing Officers as well as the Assessing Officers get sufficient time to make the audit of transfer price and the assessment in cases involving international transactions, it has been proposed to revise the time limits specified in sections 153 and 153B for making the assessment or reassessment in cases where a reference has been made to the Transfer Pricing Officer. The revised time limits in such cases shall be the time limits specified under the aforesaid sections, as increased by twelve months. It is further proposed to provide that the Transfer Pricing Officer shall determine the Arm's length pricing at least two months before the expiry new statutory time limit for making the assessment or reassessment.

Under the existing provisions of sub-section (4) of section 92CA, it has been provided that on receipt of the order under sub-section (3) of said section, the Assessing Officer shall proceed to compute the total income of the assessee under sub-section (4) of section 92C having regard to the Arm's length price determined under sub-section (3) by the Transfer Pricing Officer.

It has been proposed to amend said sub-section (4) of section 92CA so as to provide that, on receipt of the order under sub-section (3) of section 92CA, the Assessing Officer shall proceed to compute the total income of the assessee under sub-section (4) of section 92C in conformity with the Arm's length price determine under sub-section (3) of section 92CA by the Transfer Pricing Officer.

These amendments will take effect from 1st June, 2007and shall also be applicable in cases where a reference to the Transfer Pricing Officer was

made prior to 1.7.2007 but the Transfer Pricing Officer did not pass the order under sub-section (3) section 92CA before the said date.

5. Memorandum explaining the provisions of the Finance Bill (No. 2), 2009.

Determination of arm's length price in cases of international transactions

Section 92C of the Income-tax Act provides for adjustment in the transfer price of an international transaction with an associated enterprise if the transfer price is not equal to the arm's length price. As a result, a large number of such transactions are being subjected to adjustment giving rise to considerable dispute. Therefore, it is proposed to empower the Board to formulate safe harbour rules i.e. to provide the circumstances in which the Income-tax authorities shall accept the transfer price declared by the assessee.

This amendment will take effect from 1st April, 2009.

Further, the proviso to sub-section (2) of section 92C provides that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices, or, at the option of the assessee, a price which may vary from the arithmetical mean by an amount not exceeding five per cent of such arithmetical mean.

The above provision has been subject to conflicting interpretation by the assessee and the Income Tax Department. The assessee's view is that the arithmetical mean should be adjusted by 5 per cent to arrive at the arm's length price. However, the department's contention is that if the variation between the transfer price and the arithmetical mean is more than 5 per cent of the arithmetical mean, no allowance in the arithmetical mean is required to be made.

With a view to resolving this controversy, it is proposed to amend the proviso to section 92C to provide that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such price. However, if the arithmetical mean, so determined, is within five per cent of the transfer price, then the transfer price shall be treated as the arm's length price and no adjustment is required to be made.

This amendment will take effect from 1st October, 2009 and shall accordingly apply in relation to all cases in which proceedings are pending before the Transfer Pricing Officer (TPO) on or after such date.

Provision for constitution of alternate dispute resolution mechanism

The dispute resolution mechanism presently in place is time consuming and finality in high demand cases is attained only after a long drawn litigation till Supreme Court. Flow of foreign investment is extremely sensitive to prolonged uncertainity in tax related matter. Therefore, it is proposed to amend the Income-tax Act to provide for an alternate dispute resolution mechanism which will facilitate expeditious resolution of disputes in a fast track basis.

The salient features of the proposed alternate dispute resolution mechanism are as under:—

(1) The Assessing Officer shall, forward a draft of the proposed order of assessment (hereinafter in this section referred to as the draft order) to the eligible assessee if he proposes to make, on or after the 1st day of October, 2009, any variation in the income or loss returned which is prejudicial to the interest of such assessee.

(2) On receipt of the draft order, the eligible assessee shall, within thirty days of the receipt by him of the draft order,-

  (a) File his acceptance of the variations to the Assessing Officer; or

  (b) File his objections, if any, to such variation with,—

    (i) The Dispute Resolution Panel; and

    (ii) The Assessing Officer.

(3) The Assessing Officer shall complete the assessment on the basis of the draft order, if —

  (a) The assessee intimates to the Assessing Officer the acceptance of the variation; or

  (b) No objections are received within the period specified in sub-section (2).

(4) The Assessing Officer shall, notwithstanding anything contained in section 153, pass the assessment order under sub-section (3) within one month from the end of the month in which,—

  (a) The acceptance is received; or

  (b) The period of filing of objections under sub-section (2) expires.

(5) The Dispute Resolution Panel shall, in a case where any objections are received under sub-section (2), issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.

(6) The Dispute Resolution Panel shall issue the directions referred to in sub-section (5), after considering the following, namely:—

(a) Draft order;

(b) Objections filed by the assessee;

(c) Evidence furnished by the assessee;

(d) Report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority;

(e) Records relating to the draft order;

(f) Evidence collected by, or caused to be collected by, it; and

(g) Result of any enquiry made by, or caused to be made by it.

(7) The Dispute Resolution Panel may, before issuing any directions referred to in sub-section (5), -

(a) Make such further enquiry, as it thinks fit; or

(b) Cause any further enquiry to be made by any income tax authority and report the result of the same to it.

(8) The Dispute Resolution Panel may confirm, reduce or enhance the variations proposed in the draft order so, however, that it shall not set aside any proposed variation or issue any direction under sub-section (5) for further enquiry and passing of the assessment order.

(9) If the members of the Dispute Resolution Panel differ in opinion on any point, the point shall be decided according to the opinion of the majority of the members.

(10) Every direction issued by the Dispute Resolution Panel shall be binding on the Assessing Officer.

(11) No direction under sub-section (5) shall be issued unless an opportunity of being heard is given to the assessee and the Assessing Officer on such directions which are prejudicial to the interest of the assessee or the interest of the revenue, respectively.

(12) No direction under sub-section (5) shall be issued after nine months from the end of the month in which the draft order is forwarded to the eligible assessee.

(13) Upon receipt of the directions issued under sub-section (5), the Assessing Officer shall, in conformity with the directions, complete, notwithstanding anything to the contrary contained in section 153, the assessment without providing any further opportunity of being heard to the assessee, within one month from the end of the month in which the direction is received.

(14) The Board may make rules for the efficient functioning of the Dispute Resolution Panel and expeditious disposal of the objections filed, under sub-section(2), by the eligible assessee.

(15) For the purposes of this section,—

(a) "Dispute Resolution Panel" means a collegium comprising of three commissioners of Income-tax constituted by the Board for this purpose;

(b) "eligible assessee" means,-

(i) any person in whose case the variation referred to in sub-section (1) arises as a consequence of the order of the Transfer Pricing Officer passed under sub-section (3) of section 92CA; and

(ii) any foreign company.

Further, it is proposed to make consequential amendments—

(i) in sub-section (1) of section 131 so as to provide that "Dispute Resolution Panel" shall have the same powers as are vested in a Court under the Code of Civil Procedure, 1908 (5 of 1908);

(ii) in clause (a) of sub-section (1) of section 246 so as to exclude the order of assessment passed under sub-section (3) of section 143 in pursuance of directions of "Dispute Resolution Panel" as an appealable order and in clause (c) of sub-section (1) of section 246 so as to exclude an order passed under section 154 of such order as an appealable order;

(iii) in sub-section (1) of section 253 so as to include an order of assessment passed under sub-section (3) of section 143 in pursuance of directions of "Dispute Resolution Panel" as an appealable order.

These amendments will take effect from 1st October, 2009.

6. Memorandum explaining the provisions of the Finance Bill, 2011.

Rationalisation of provisions relating to Transfer Pricing

A. Section 92C of the Income-tax Act provides the procedure for computation of the Arm's Length Price (ALP). The section provides the methods of computing the ALP and mandates that the most appropriate method should be chosen to compute ALP. It is also provided that if more than one price is determined by the chosen method, the ALP shall be taken to be the arithmetical mean of such prices. The second proviso to section 92C(2) provides that if the variation between the actual price of the transaction and the ALP, as determined above, does not exceed 5% of the actual price, then, no adjustment will be made and the actual price shall be treated as the ALP.

A fixed margin of 5% across all segments of business activity and range of international transactions has out-lived its utility. It is, therefore, proposed to amend section 92C of the Act to provide that instead of a variation of 5%, the allowable variation will be such percentage as may be notified by Central Government in this behalf.

This amendment is proposed to take effect from 1st April, 2012 and it shall accordingly apply in relation to the Assessment Year 2012-13 and subsequent years.

B. Section 92CA of the Act provides that the Transfer Pricing Officer (TPO) can determine the ALP in relation to an international transaction, which has been referred to the TPO by the Assessing Officer.

It is proposed to amend section 92CA so as to specifically provide that the jurisdiction of the Transfer Pricing Officer shall extend to the determination of the ALP in respect of other international transactions, which are noticed by him subsequently, in the course of proceedings before him. These international transactions would be in addition to the international transactions referred to the TPO by the Assessing Officer.

C. Section 92CA(7) provides that for the purpose of determining the ALP, the TPO can exercise powers available to an assessing officer under section 131(1) and section 133(6). These are powers of summoning or calling for details for the purpose of inquiry or investigation into the matter.

In order to enable the TPO to conduct on-the-spot enquiry and verification, it is proposed to amend section 92CA(7) so as to enable the TPO to also exercise the power of survey conferred upon an income-tax authority under section 133A of the Act.

These amendments are proposed to take effect from 1st June 2011.

D. Section 139 of the Income-tax Act stipulates 30th September of the assessment year as the due date for filing of return of income in case of corporate assessees. In addition to filing a return of income, assessees who have undertaken international transactions are also required (under the provisions of section 92E) to prepare and file a transfer pricing report in Form 3CEB before the due date for filing of return of income.

Corporate assessees face practical difficulties in accessing contemporary comparable data before 30th September in order to furnish a report in respect of their international transactions. It is, therefore, proposed to amend section 139 to extend the due date for filing of return of income by such corporate assessees to 30th November of the assessment year.

This amendment is proposed to take effect from 1st April 2011.

7. Memorandum explaining the provisions of the Finance Bill, 2012.

Rationalization of Transfer Pricing Provisions

Advance Pricing Agreement (APA)

Advance Pricing Agreement is an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time in future. The APAs offer better assurance on transfer pricing methods and are conducive in providing certainty and unanimity of approach.

It is proposed to insert new sections 92CC and 92CD in the Act to provide a framework for advance pricing agreement under the Act. The proposed sections provide the following. –

1. It empowers Board, to enter into an advance pricing agreement with any person undertaking an international transaction.
2. Such APAs shall include determination of the arm's length price or specify the manner in which arm's length price shall be determined, in relation to an international transaction which the person undertake.
3. The manner of determination of arm's length price in such cases shall be any method including those provided in subsection (1) of section 92C, with necessary adjustments or variations.
4. The arm's length price of any international transaction, which is covered under such APA, shall be determined in accordance with the APA so entered and the provisions of section 92C or section 92CA

which normally apply for determination of arm's length price would be modified to this extent and arm's length price shall be determined in accordance with APA.

5. The APA shall be valid for such previous years as specified in the agreement which in no case shall exceed five consecutive previous years.

6. The APA shall be binding only on the person and the Commissioner (including income-tax authorities subordinate to him) in respect of the transaction in relation to which the agreement has been entered into. The APA shall not be binding if there is any change in law or facts having bearing on such APA.

7. The Board is empowered to declare, with the approval of Central Government, any such agreement to be void ab initio, if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts. Once an agreement is declared void ab-initio, all the provisions of the Act shall apply to the person as if such APA had never been entered into.

8. For the purpose of computing any period of limitation under the Act, the period beginning with the date of such APA and ending on the date of order declaring the agreement void ab-initio shall be excluded. However, if after the exclusion of the aforesaid period, the period of limitation referred to in any provision of the Act is less than sixty days, such remaining period shall be extended to sixty days.

9. The Board is empowered to prescribe a Scheme providing for the manner, form, procedure and any other matter generally in respect of the advance pricing agreement.

10. Where an application is made by a person for entering into such an APA, proceedings shall be deemed to be pending in the case of the person for the purposes of the Act like for making enquiries under section 133(6) of the Act.

11. The person entering in to such APA shall necessarily have to furnish a modified return within a period of three months from the end of the month in which the said APA was entered in respect of the return of income already filed for a previous year to which the APA applies. The modified return has to reflect modification to the income only in respect of the issues arising from the APA and in accordance with it.

12. Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the agreement applies are pending on the date of filing of modified return, the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the agreement taking into consideration the modified return so filed and normal period of limitation of completion of proceedings shall be extended by one year.

13. If the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the agreement applies has been completed before the expiry of period allowed for furnishing of modified return,the Assessing Officer shall, in a case where modified return is filed, proceed to assess or reassess or recompute the total income of the relevant assessment year having regard to and in accordance with the APA and to such assessment, all the provisions relating to assessment shall apply as if the modified return is a return furnished under section 139 of the Act. The period of limitation for completion of such assessment or reassessment is one year from the end of the financial year in which the modified return is furnished.

14. All the other provisions of this Act shall apply accordingly as if the modified return is a return furnished under section 139.

These amendments will take effect from 1st July, 2012.

Examination by the Transfer Pricing Officer of international transactions not reported by the Assessee

Section 92CA of the Act provides that the Assessing Officer, if he considers it necessary or expedient to do so, may with the previous approval of Commissioner of Income tax, refer the matter of determination of Arm's Length Price in respect of an international transaction to the Transfer Pricing Officer (TPO). Once reference is made to the TPO, TPO is competent to exercise all powers that are available to the Assessing Officer under sub-section (3) of Section 92C for determination of ALP and consequent adjustment. Further under section 92E of the Act, there is reporting requirement on the taxpayer and the taxpayer is under obligation to file an audit report in prescribed form before the Assessing Officer (AO) containing details of all international transactions undertaken by the taxpayer during the year.

This audit report is the primary document with the Assessing Officer, which contains the details of international transactions undertaken by the taxpayer.

If the assessee does not report such a transaction in the report furnished under section 92E then the Assessing Officer would normally not be aware of such an International Transaction so as to make a reference to the Transfer Pricing Officer. The Transfer Pricing Officer may notice such a transaction subsequently during the course of proceeding before him. In absence of specific power, the determination of Arm's Length Price by the Transfer Pricing Officer would be open to challenge even though the basis of such an action is non-reporting of transaction by the taxpayer at first instance.

It is proposed to amend the section 92CA of the Act retrospectively to empower Transfer Pricing Officer (TPO) to determine Arm's Length Price of an international transaction noticed by him in the course of proceedings before him, even if the said transaction was not referred to him by the Assessing Officer, provided that such international transaction was not reported by the taxpayer as per the requirement cast upon him under section 92E of the Act.

This amendment will take effect retrospectively from 1st June, 2002.

It is also proposed to provide an explanation to effect that due to retrospectivity of the amendment no reopening of any proceeding would be undertaken only on account of such an amendment.

This amendment will take effect from 1st July, 2012.

Transfer Pricing Regulations to apply to certain domestic transactions

Section 40A of the Act empowers the Assessing Officer to disallow unreasonable expenditure incurred between related parties. Further, under Chapter VI-A and section 10AA, the Assessing Officer is empowered to re-compute the income (based on fair market value) of the undertaking to which profit linked deduction is provided if there are transactions with the related parties or other undertakings of the same entity. However, no specific method to determine reasonableness of expenditure or fair market value to re-compute the income in such related transactions is provided under these sections.

The Supreme Court in the case of CIT Vs. Glaxo SmithKline Asia (P) Ltd., in its order has, after examining the complications which arise in cases where fair market value is to be assigned to transactions between domestic related parties, suggested that Ministry of Finance should consider appropriate provisions in law to make transfer pricing regulations applicable to such related party domestic transactions.

The application and extension of scope of transfer pricing regulations to domestic transactions would provide objectivity in determination of income from domestic related party transactions and determination of reasonableness of expenditure between related domestic parties. It will create legally enforceable obligation on assessees to maintain proper documentation. However, extending the transfer pricing requirements to all domestic transactions will lead to increase in compliance burden on all assessees which may not be desirable.

Therefore, the transfer pricing regulations need to be extended to the transactions entered into by domestic related parties or by an undertaking with other undertakings of the same entity for the purposes of section 40A, Chapter VI-A and section 10AA. The concerns of administrative and compliance burden are addressed by restricting its applicability to the transactions, which exceed a monetary threshold of ₹5 crores in aggregate during the year. In view of the circumstances which were present in the case before the Supreme Court, there is a need to expand the definition of related parties for purpose of section 40A to cover cases of companies which have the same parent company.

It is, therefore, proposed to amend the Act to provide applicability of transfer pricing regulations (including procedural and penalty provisions) to transactions between related resident parties for the purposes of computation of income, disallowance of expenses etc. as required under provisions of sections 40A, 80-IA, 10AA, 80A, sections where reference is made to section 80-IA, or to transactions as may be prescribed by the Board, if aggregate amount of all such domestic transactions exceeds Rupees 5 crore in a year. It is further proposed to amend the meaning of related persons as provided in section 40A to include companies having the same holding company.

This amendment will take effect from 1st April, 2013 and will, accordingly, apply in relation to the Assessment Year 2013-14 and subsequent assessment years.

Determination of Arm's Length Price (ALP)

I. Section 92C of the Act provides for computation of arms lengths price. Sub-section (1) of this section provides the set of methods for determination of arm's length price and mandates application of the most appropriate method for determination of arm's length price (ALP). Sub-Section (2) of section 92C provides that where more than one price is determined by application of most appropriate method, the arm's length price shall be taken

to be the arithmetic mean of such prices. The proviso to this sub-section was inserted by Finance Act, 2002 with effect from 01.04.2002 to ensure that in case variation of transaction price from the arithmetic mean is within the tolerance range of 5%, no adjustment was required to be made to transaction value.

Subsequently, disputes arose regarding the interpretation of the proviso. Whether the tolerance band is a standard deduction or not, in case variation of ALP and transaction value exceeded the tolerance band. Different courts interpreted it differently.

In order to bring more clarity and resolving the controversy the proviso was substituted by Finance Act (No.2), 2009. The substituted proviso not only made clear the intent that 5% tolerance band is not a standard deduction but also changed the base of determination of the allowable band, linked it to the transaction price instead of the earlier base of Arithmetic mean. The amendment clarified the ambiguity about applicability of 5% tolerance band, not being a standard deduction.

However, the position prior to amendment by Finance (No.2) Act, 2009 still remained ambiguous with varying judicial decisions. Some favouring departmental stand and others the stand of tax payer. There is, therefore, a need to bring certainty to the issue by clarifying the legislative intent in respect of first proviso to sub-section (2) which was inserted by the Finance Act, 2002.

It is, therefore, proposed to amend the Income Tax Act to provide clarity with retrospective effect in respect of first proviso to section 92C(2) as it stood before its substitution by Finance Act (No.2), 2009 so that the tolerance band of 5% is not taken to be a standard deduction while computing Arm's Length Price and to ensure that due to such retrospective amendment already completed assessments or proceedings are not reopened only on this ground.

The amendments proposed above shall be effective retrospectively from 1st April, 2002 and shall accordingly apply in relation to the Assessment Year 2002-03 and subsequent Assessment Years.

II. In respect of amendment, which was brought by the Finance (No. 2) Act, 2009, the explanatory memorandum clearly mentioned the legislative intent of the amended provision to be applicable to all proceedings pending as on 01.10.2009 before the Transfer Pricing Officer. However, subsequent decisions of certain judicial authorities have created doubts about

applicability of this proviso to proceedings pending as on 01.10.2009. There is need to clarify the legislative intent of making the proviso applicable for all assessment proceedings pending as on 01.10.2009 instead of it being attracted only in respect of proceeding for assessment year 2010-11 and subsequent assessment years.

It is, therefore, proposed to amend the Income Tax Act to provide clarity that second proviso to section 92C shall also be applicable to all proceedings which were pending as on 01.10.2009. The date of coming in force of second proviso inserted by Finance (No.2) Act, 2009.

The amendments will take effect retrospectively from 1st October, 2009.

Filing of return of income, definition of international transaction, tolerance band for ALP, penalties and reassessment in transfer pricing cases

 Section 139 of the Act provides for due date of filing return of income in case of various categories of persons. In addition to filing of return of income, the assesses who have undertaken international transactions are also required to prepare and file a Transfer Pricing report in Form 3CEB, as per Section 92E of the Act, before the due date of filing of return of income. Vide the Finance Act, 2011 the due date for filing of return of income in case of corporate assesses who were required to obtain and file Transfer Pricing report (required under section 92E of the Act), was extended to 30th November of the assessment year.

It has been noted that assesses other than companies are also faced with similar constraints of absence of sufficient contemporary data in public domain by 30th September which is currently the due date of filing of return of income and Transfer Pricing report in their cases.

Therefore, there is a need to extend the due date for filing of return of income in case of non-corporate taxpayers, who have undertaken international transactions and are required to obtain and file Transfer Pricing report as per Section 92E of the Act. The due date of filing of return of income in case of non-corporate assesses be extended to 30th November of the assessment year.

It is proposed to amend Section 139 of the Act, to provide that in case of all assesses who are required to obtain and file Transfer Pricing report as per Section 92E of the Act, the due date would be 30th November of the assessment year.

This amendment will take effect retrospectively from 1st April, 2012 and will, accordingly, apply in relation to the assessment year 2012-13 and subsequent assessment years.

 Section 92B of the Act, provides an exclusive definition of International Transaction. Although, the definition is worded broadly, the current definition of International Transaction leaves scope for its misinterpretation.

The definition by its concise nature does not mention all the nature and details of transactions, taking benefit of which large number of International Transactions are not being reported by taxpayers in transfer pricing audit report. In the definition, the term "intangible property" is included. Still, due to lack of clarity in respect of scope of intangible property, the taxpayer have not reported several such transactions.

Certain judicial authorities have taken a view that in cases of transactions of business restructuring etc. where even if there is an international transaction Transfer Pricing provisions would not be applicable if it does not have bearing on profits or loss of current year or impact on profit and loss account is not determinable under normal computation provisions other than transfer pricing regulations. The present scheme of Transfer pricing provisions does not require that international transaction should have bearing on profits or income of current year.

Therefore, there is a need to amend the definition of international transaction in order to clarify the true scope of the meaning of the term. "international transaction" and to clarify the term "intangible property" used in the definition.

It is, therefore, proposed to amend section 92B of the Act, to provide for the explanation to clarify meaning of international transaction and to clarify the term intangible property used in the definition of international transaction and to clarify that the 'international transaction' shall include a transaction of business restructuring or reorganisation, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets or such enterprises at the time of the transaction or at any future date.

This amendment will take effect retrospectively from 1st April, 2002 and will, accordingly, apply in relation to the assessment year 2002-03 and subsequent assessment years.

 Section 92C provides methods for determination of Arm's Length Price (ALP). Sub section (1) of the said section prescribes the methods of computation of Arm's Length Price. Sub section (2) of the said sub section

provides that if the appropriate method results in more than one price then the arithmetic mean of these prices would be the ALP. The proviso to sub section (2) of section 92C which was amended by Finance Act, 2011 provides that the Central Government may notify a percentage and if variation between the ALP so determined and the transaction price is within the notified percentage (of transaction price), no adjustment shall be made to the transaction price.

There is a need to put an upper ceiling on such tolerance range, which is to be notified, in the legislation.

It is, therefore, proposed to amend Section 92C (2) of the Act, so as to provide an upper ceiling of 3% in respect of power of Central Government to notify the tolerance range for determination of arms length price.

This amendment will take effect from 1st April, 2013 and will, accordingly, apply in relation to the assessment year 2013-14 and subsequent assessment years.

 Section 271BA of the Income Tax Act provides a penalty of ` 1 lakh in cases where any person fails to furnish a report from an accountant as required by Section 92E.

Section 271AA provides penalty for failure to keep and maintain information and document in respect of International Transaction.

Section 271G provides penalty for failure to furnish information or document under Section 92D which requires maintenance of certain information and documents in the prescribed proforma by persons entering into an International Transaction.

The above scheme of penalty provisions allows for misuse of provisions due to lack of effective deterrent. In order to suppress information about international transactions, some taxpayers may not furnish the report or get the Transfer Pricing audit done. The meager penalty of ₹ 1 lakh as compared to the quantum of international transactions is not an effective deterrent. There is presently no penalty for non-reporting of an international transaction in report filed under section 92E or maintenance or furnishing of incorrect information or documents. Therefore, there is need to provide effective deterrent based on transaction value to enforce compliance with Transfer Pricing regulations.

It is, therefore, proposed to amend Section 271AA to provide levy of a penalty at the rate of 2% of the value of the international transaction, if the taxpayer.-

i. fails to maintain prescribed documents or information or;

ii. fails to report any international transaction which is required to be reported, or;

iii. maintains or furnishes any incorrect information or documents.

This penalty would be in addition to penalties in section 271BA and 271G.

This amendment will take effect from 1st July, 2012.

 Section 147 of the Act, provides for reopening of the cases of the previous years, if any income chargeable to tax has escaped assessment. Explanation to this section provides certain circumstances where it will be deemed that income has escaped assessments.

Under the Act, income from an international transactions has to be computed in accordance with arm's length principle and transfer pricing provisions apply to such transactions. Therefore, in each and every case of international transaction, the income arising from such transaction has to be tested against the benchmark of arm's length price. In certain transactions, transaction value is at arm's length price and no adjustment takes place whereas in others it may lead to adjustments. If an international transaction is not reported by the assessee, such transaction never gets benchmarked against arm's length principle. It is, therefore, imperative that non-reporting of international transactions should lead to a presumption of escapement of income.

It is, therefore, proposed to amend Section 147 of the Act, to provide that in all cases where it is found that an international transaction has not been reported either by non-filing of report or otherwise by not including such transaction in the report mentioned in section 92E then such non-reporting would be considered as a case of deemed escapement of income and such a case can be reopened under section 147 of the Act.

This amendment will take effect from 1st July, 2012.

Appeal against the directions of the Dispute Resolution Panel (DRP)

The institution of Dispute Resolution Panel (DRP) was created by Finance Act, 2009 with a view to bring about speedy resolution of disputes in the case of international transactions particularly involving Transfer Pricing issues.

Under the provisions of sub-section (8) of section 144C, the DRP has the power to confirm, reduce or enhance the variations proposed in the draft order. The Income Tax Department does not have the right to appeal against

the directions given by the DRP. The taxpayer has been given a right to appeal directly to the Income Tax Appellate Tribunal (ITAT) against the order passed by the Assessing Officer in pursuance of the directions of the DRP.

As the directions given by the DRP are binding on the Assessing Officer, it is accordingly proposed to provide that the Assessing Officer may also file an appeal before the ITAT against an order passed in pursuance of directions of the DRP.

It is therefore proposed to amend the provisions of section 253 and section 254 of the Income-tax Act to provide for filing of appeal by the Assessing Officer against an order passed in pursuance of directions of the DRP in respect of an objection filed on or after 1st July, 2012.

These amendments will take effect from the 1st day of July, 2012.

Power of the DRP to enhance variations

Dispute Resolution Panel (DRP) had been constituted with a view to expeditiously resolve the cases involving transfer pricing issues in the case of any person having international transactions or in case of a foreign company. It has been provided under sub-section (8) of section 144C that DRP may confirm, reduce or enhance the variations proposed in the draft order of the Assessing Officer.

In a recent judgement, it was held that the power of DRP is restricted only to the issues raised in the draft assessment order and therefore it cannot enhance the variation proposed in the order as a result of any new issue which comes to the notice of the panel during the course of proceedings before it.

This is not in accordance with the legislative intent.

It is accordingly proposed to insert an Explanation in the provisions of section 144C to clarify that the power of the DRP to enhance the variation shall include and shall always be deemed to have included the power to consider any matter arising out of the assessment proceedings relating to the draft assessment order. This power to consider any issue would be irrespective of the fact whether such matter was raised by the eligible assessee or not.

This amendment will be effective retrospectively from the 1st day of April, 2009 and will accordingly apply to assessment year 2009-10 and subsequent assessment years.

Completion of assessment in search cases referred to DRP

Under the provisions of section 144C of the Income-tax Act where an eligible assessee files an objection against the draft assessment order before the Dispute Resolution Panel (DRP), then, the time limit for completion of assessments are as provided in section 144C notwithstanding anything in section 153. A similar provision is proposed to be made where assessments are framed as a result of search and seizure to provide that for such assessments, time limit specified in section 144C will apply, notwithstanding anything in section 153B.

It is also proposed to provide for exclusion of such orders passed by the Assessing Officer in pursuance of the directions of the DRP, from the appellate jurisdiction of the Commissioner (Appeals) and to provide for filing of appeals directly to ITAT against such orders. Accordingly, consequential amendments are proposed to be made in the provisions of section 246A and 253 of the Income-tax Act.

These amendments in the provisions of the Income-tax Act will take effect retrospectively from the 1st day of October, 2009.

8. Memorandum explaining the provisions of the Finance (No.2) Act, 2014

Roll back provision in Advance Pricing Agreement Scheme

Section 92CC of the Act provides for Advance Pricing Agreement (APA). It empowers the Central Board of Direct Taxes, with the approval of the Central Government, to enter into an APA with any person for determining the Arm's Length Price (ALP) or specifying the manner in which ALP is to be determined in relation to an international transaction which is to be entered into by the person. The agreement entered into is valid for a period, not exceeding 5 previous years, as may be mentioned in the agreement. Once the agreement is entered into, the ALP of the international transaction, which is subject matter of the APA, would be determined in accordance with such an APA.

In many countries the APA scheme provides for "roll back" mechanism for dealing with ALP issues relating to transactions entered into during the period prior to APA. The "roll back" provisions refers to the applicability of the methodology of determination of ALP, or the ALP, to be applied to the international transactions which had already been entered into in a period prior to the period covered under an APA. However, the "roll back" relief is provided on case to case basis subject to certain conditions. Providing of

such a mechanism in Indian legislation would also lead to reduction in large scale litigation which is currently pending or may arise in future in respect of the transfer pricing matters.

Therefore, it is proposed to amend the Act to provide roll back mechanism in the APA scheme. The APA may, subject to such prescribed conditions, procedure and manner, provide for determining the arm's length price or for specifying the manner in which arm's length price is to be determined in relation to an international transaction entered into by a person during any period not exceeding four previous years preceding the first of the previous years for which the advance pricing agreement applies in respect of the international transaction to be undertaken in future.

This amendment will take effect from 1st October, 2014.

Rationalisation of the Definition of International Transaction

The existing provisions of section 92B of the Act define 'International transaction' as a transaction in the nature of purchase, sale, lease, provision of services, etc. between two or more associated enterprises, either or both of whom are non-residents.

Sub-section (2) of the said section extends the scope of the definition of international transaction by providing that a transaction entered into with an unrelated person shall be deemed to be a transaction with an associated enterprise, if there exists a prior agreement in relation to the transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between the other person and the associated enterprise. The sub-section as presently worded has led to a doubt whether or not, for the transaction to be treated as an international transaction, the unrelated person should also be a non-resident.

Therefore, it is proposed to amend section 92B of the Act to provide that where, in respect of a transaction entered into by an enterprise with a person other than an associated enterprise, there exists a prior agreement in relation to the relevant transaction between the other person and the associated enterprise or, where the terms of the relevant transaction are determined in substance between such other person and the associated enterprise, and either the enterprise or the associated enterprise or both of them are non-resident, then such transaction shall be deemed to be an international transaction entered into between two associated enterprises, whether or not such other person is a non-resident.

This amendment will take effect from 1st April, 2015 and will, accordingly, apply in relation to the assessment year 2015-16 and subsequent assessment years.

Levy of Penalty under section 271G by Transfer Pricing Officers

The existing provisions of section 271G of the Act provide that if any person who has entered into an international transaction or specified domestic transaction fails to furnish any such document or information as required by sub-section (3) of section 92D, then such person shall be liable to a penalty which may be levied by the Assessing Officer or the Commissioner (Appeals).

Section 92CA provides that an Assessing Officer may make reference to a Transfer Pricing Officer (TPO) for determination of arm's length price (ALP). TPO has been defined in the said section to mean a Joint Commissioner or Deputy Commissioner or Assistant Commissioner who is authorised by the Board to perform all or any of the functions of an Assessing Officer specified in sections 92C and 92D. The determination of arm's length price in several cases is done by the TPO. It is, therefore, proposed to amend section 271G of the Act to include TPO, as referred to in Section 92CA, as an authority competent to levy the penalty under section 271G in addition to the Assessing Officer and the Commissioner (Appeals).

This amendment will take effect from 1st October, 2014.

9. Memorandum explaining the provisions of the Finance Act, 2015

Raising the threshold for specified domestic transaction

The existing provisions of section 92BA of the Act define "specified domestic transaction" in case of an assessee to mean any of the specified transactions, not being an international transaction, where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of five crore rupees.

In order to address the issue of compliance cost in case of small businesses on account of low threshold of five crores rupees, it is proposed to amend section 92BA to provide that the aggregate of specified transactions entered into by the assessee in the previous year should exceed a sum of twenty crore rupees for such transaction to be treated as 'specified domestic transaction'.

This amendment will take effect from 1st April, 2016 and will, accordingly, apply in relation to the assessment year 2016-17 and subsequent assessment years.

10. Memorandum explaining the provisions of the Finance Bill, 2016

BEPS action plan - Country-By-Country Report and Master File

Sections 92 to 92F of the Act contain provisions relating to transfer pricing regime. Under provision of section 92D, there is requirement for maintenance of prescribed information and document relating to the international transaction and specified domestic transaction.

The OECD report on Action 13 of BEPS Action plan provides for revised standards for transfer pricing documentation and a template for country-by-country reporting of income, earnings, taxes paid and certain measure of economic activity. India has been one of the active members of BEPS initiative and part of international consensus. It is recommended in the BEPS report that the countries should adopt a standardised approach to transfer pricing documentation. A three-tiered structure has been mandated consisting of:-

(i) a master file containing standardised information relevant for all multinational enterprises (MNE) group members;

(ii) a local file referring specifically to material transactions of the local taxpayer; and

(iii) a country-by-country report containing certain information relating to the global allocation of the MNE's income and taxes paid together with certain indicators of the location of economic activity within the MNE group.

The report mentions that taken together, these three documents (country-by-country report, master file and local file) will require taxpayers to articulate consistent transfer pricing positions and will provide tax administrations with useful information to assess transfer pricing risks. It will facilitate tax administrations to make determinations about where their resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries.

The country-by-country report requires multinational enterprises (MNEs) to report annually and for each tax jurisdiction in which they do business; the amount of revenue, profit before income tax and income tax paid and accrued. It also requires MNEs to report their total employment, capital, accumulated earnings and tangible assets in each tax jurisdiction. Finally, it requires MNEs to identify each entity within the group doing business in a particular tax jurisdiction and to provide an indication of the business activities each entity engages in. The Country-by-Country (CbC) report has

to be submitted by parent entity of an international group to the prescribed authority in its country of residence. This report is to be based on consolidated financial statement of the group.

The Master File is intended to provide an overview of the MNE groups business, including the nature of its global business operations, its overall transfer pricing policies, and its global allocation of income and economic activity in order to assist tax administrations in evaluating the presence of significant transfer pricing risk. In general, the master file is intended to provide a high-level overview in order to place the MNE group's transfer pricing practices in their global economic, legal, financial and tax context. The master file shall contain information which may not be restricted to transaction undertaken by a particular entity situated in particular country. In that aspect, information in master file would be more comprehensive than the existing regular transfer pricing documentation. The master file shall be furnished by each entity to the tax authority of the country in which it operates.

In order to implement the international consensus, it is proposed to provide a specific reporting regime in respect of CbC reporting and also the master file. It is proposed to include essential elements in the Act while remaining aspects can be detailed in rules.

The elements relating to CbC reporting requirement and matters related to it proposed to be included through amendment of the Act are:—

(i) the reporting provision shall apply in respect of an international group having consolidated revenue above a threshold to be prescribed.

(ii) the parent entity of an international group, if it is resident in India shall be required to furnish the report in respect of the group to the prescribed authority on or before the due date of furnishing of return of income for the Assessment Year relevant to the Financial Year (previous year) for which the report is being furnished;

(iii) the parent entity shall be an entity which is required to prepare consolidated financial statement under the applicable laws or would have been required to prepare such a statement, had equity share of any entity of the group been listed on a recognized stock exchange in India;

(iv) every constituent entity in India, of an international group having parent entity that is not resident in India, shall provide information regarding the country or territory of residence of the parent of the

international group to which it belongs. This information shall be furnished to the prescribed authority on or before the prescribed date;

(v) the report shall be furnished in prescribed manner and in the prescribed form and would contain aggregate information in respect of revenue, profit & loss before Income-tax, amount of Income-tax paid and accrued, details of capital, accumulated earnings, number of employees, tangible assets other than cash or cash equivalent in respect of each country or territory along with details of each constituent's residential status, nature and detail of main business activity and any other information as may be prescribed. This shall be based on the template provided in the OECD BEPS report on Action Plan 13;

(vi) an entity in India belonging to an international group shall be required to furnish CbC report to the prescribed authority if the parent entity of the group is resident ;-

  (a) in a country with which India does not have an arrangement for exchange of the CbC report; or

  (b) such country is not exchanging information with India even though there is an agreement; and

  (c) this fact has been intimated to the entity by the prescribed authority;

(vii) If there are more than one entities of the same group in India, then the group can nominate (under intimation in writing to the prescribed authority) the entity that shall furnish the report on behalf of the group. This entity would then furnish the report;

(viii) If an international group, having parent entity which is not resident in India, had designated an alternate entity for filing its report with the tax jurisdiction in which the alternate entity is resident, then the entities of such group operating in India would not be obliged to furnish report if the report can be obtained under the agreement of exchange of such reports by Indian tax authorities;

(ix) The prescribed authority may call for such document and information from the entity furnishing the report for the purpose of verifying the accuracy as it may specify in notice. The entity shall be required to make submission within thirty days of receipt of notice or further period if extended by the prescribed authority, but extension shall not be beyond 30 days;

(x) For non-furnishing of the report by an entity which is obligated to furnish it, a graded penalty structure would apply:-

(a) if default is not more than a month, penalty of ₹5000/- per day applies;

(b) if default is beyond one month, penalty of ₹15000/- per day for the period exceeding one month applies;

(c) for any default that continues even after service of order levying penalty either under (a) or under (b), then the penalty for any continuing default beyond the date of service of order shall be @ ₹50,000/- per day;

(xi) In case of timely non-submission of information before prescribed authority when called for, a penalty of ₹5000/- per day applies. Similar to the above, if default continues even after service of penalty order, then penalty of ₹50,000/- per day applies for default beyond date of service of penalty order;

(xii) If the entity has provided any inaccurate information in the report and,-

(a) the entity knows of the inaccuracy at the time of furnishing the report but does not inform the prescribed authority; or

(b) the entity discovers the inaccuracy after the report is furnished and fails to inform the prescribed authority and furnish correct report within a period of fifteen days of such discovery; or

(c) the entity furnishes inaccurate information or document in response to notice of the prescribed authority, then penalty of ₹ 500,000/- applies;

(xiii) The entity can offer reasonable cause defence for non-levy of penalties mentioned above. The proposed amendment in the Act in respect of maintenance of Master File and furnishing it are: -

(i) the entities being constituent of an international group shall, in addition to the information related to the international transactions, also maintain such information and document as is prescribed in the rules. The rules shall thereafter prescribe the information and document as mandated for master file under OECD BEPS Action 13 report;

(ii) the information and document shall also be furnished to the prescribed authority within such period as may be prescribed

and the manner of furnishing may also be provided for in the rules;

(iii) for non-furnishing of the information and document to the prescribed authority, a penalty of ₹5 lakh shall be leviable. However, reasonable cause defence against levy of penalty shall be available to the entity.

As indicated above, the CbC reporting requirement for a reporting year does not apply unless the consolidated revenues of the preceding year of the group, based on consolidated financial statement, exceeds a threshold to be prescribed. The current international consensus is for a threshold of € 750 million equivalent in local currency. This threshold in Indian currency would be equivalent to ₹5395 crores (at current rates). Therefore, CbC reporting for an international group having Indian parent, for the previous year 2016-17, shall apply only if the consolidated revenue of the international group in previous year 2015-16 exceeds ₹5395 crore (the equivalent would be determinable based on exchange rate as on the last day of previous year 2015-16).

The amendments will be effective from 1st April, 2017 and shall apply for the Assessment year 2017-18 and subsequent assessment years.

Rationalisation of penalty provisions

Under the existing provisions, penalty on account of concealment of particulars of income or furnishing inaccurate particulars of income is leviable under section 271(1)(c) of the Income-tax Act. In order to rationalize and bring objectivity, certainty and clarity in the penalty provisions, it is proposed that section 271 shall not apply to and in relation to any assessment for the assessment year commencing on or after the 1stday of April, 2017 and subsequent assessment years and penalty be levied under the newly inserted section 270A with effect from 1st April, 2017. The new section 270A provides for levy of penalty in cases of under reporting and misreporting of income. Sub-section (1) of the proposed new section 270A seeks to provide that the Assessing Officer, Commissioner (Appeals) or the Principal Commissioner or Commissioner may levy penalty if a person has under reported his income.

It is proposed that a person shall be considered to have under reported his income if,-

(a) the income assessed is greater than the income determined in the return processed under clause (a) of sub-section (1) of section 143;

(b) the income assessed is greater than the maximum amount not chargeable to tax, where no return of income has been furnished;

(c) the income reassessed is greater than the income assessed or reassessed immediately before such re-assessment;

(d) the amount of deemed total income assessed or reassessed as per the provisions of section 115JB or 115JC, as the case may be, is greater than the deemed total income determined in the return processed under clause (a) of sub-section (1) of section 143;

(e) the amount of deemed total income assessed as per the provisions of section 115JB or 115JC is greater than the maximum amount not chargeable to tax, where no return of income has been filed;

(f) the income assessed or reassessed has the effect of reducing the loss or converting such loss into income.

The amount of under-reported income is proposed to be calculated in different scenarios as discussed herein. In a case where return is furnished and assessment is made for the first time the amount of under reported income in case of all persons shall be the difference between the assessed income and the income determined under section 143(1)(a). In a case where no return has been furnished and the return is furnished for the first time, the amount of under-reported income is proposed to be:

(i) for a company, firm or local authority, the assessed income;

(ii) for a person other than company, firm or local authority, the difference between the assessed income and the maximum amount not chargeable to tax.

In case of any person, where income is not assessed for the first time, the amount of under reported income shall be the difference between the income assessed or determined in such order and the income assessed or determined in the order immediately preceding such order.

It is further proposed that in a case where under reported income arises out of determination of deemed total income in accordance with the provisions of section 115JB or section 115JC, the amount of total under reported income shall be determined in accordance with the following formula-

(A - B) + (C - D)

where,

A = the total income assessed as per the provisions other than the

provisions contained in section 115JB or section 115JC (herein called general provisions);

B = the total income that would have been chargeable had the total income assessed as per the general provisions been reduced by the amount of under reported income;

C = the total income assessed as per the provisions contained in section 115JB or section 115JC;

D = the total income that would have been chargeable had the total income assessed as per the provisions contained in section 115JB or section 115JC been reduced by the amount of under reported income.

However, where the amount of under reported income on any issue is considered both under the provisions contained in section 115JB or section 115JC and under general provisions, such amount shall not be reduced from total income assessed while determining the amount under item D.

It is clarified that in a case where an assessment or reassessment has the effect of reducing the loss declared in the return or converting that loss into income, the amount of under reported income shall be the difference between the loss claimed and the income or loss, as the case may be, assessed or reassessed.

Calculation of under-reported income in a case where the source of any receipt, deposit or investment is linked to earlier year is proposed to be provided based on the existing Explanation 2 to sub-section (I) of section 271 (1).

It is also proposed that the under-reported income under this section shall not include the following cases:

(i) where the assessee offers an explanation and the income-tax authority is satisfied that the explanation is bona fide and all the material facts have been disclosed;

(ii) where such under-reported income is determined on the basis of an estimate, if the accounts are correct and complete but the method employed is such that the income cannot properly be deducted therefrom;

(iii) where the assessee has, on his own, estimated a lower amount of addition or disallowance on the issue and has included such amount in the computation of his income and disclosed all the facts material to the addition or disallowance;

(iv) where the assessee had maintained information and documents as prescribed under section 92D, declared the international transaction under Chapter X and disclosed all the material facts relating to the transaction;

(v) where the undisclosed income is on account of a search operation and penalty is leviable under section 271AAB.

It is proposed that the rate of penalty shall be fifty per cent of the tax payable on under-reported income. However in a case where under reporting of income results from misreporting of income by the assessee, the person shall be liable for penalty at the rate of two hundred per cent of the tax payable on such misreported income. The cases of misreporting of income have been specified as under:

(i) misrepresentation or suppression of facts;

(ii) non-recording of investments in books of account;

(iii) claiming of expenditure not substantiated by evidence;

(iv) recording of false entry in books of account;

(v) failure to record any receipt in books of account having a bearing on total income;

(vi) failure to report any international transaction or deemed international transaction under Chapter X.

It is also proposed that in case of company, firm or local authority, the tax payable on under reported income shall be calculated as if the under-reported income is the total income. In any other case the tax payable shall be thirty per cent of the under-reported income.

It is also proposed that no addition or disallowance of an amount shall form the basis for imposition of penalty, if such addition or disallowance has formed the basis of imposition of penalty in the case of the person for the same or any other assessment year.

These amendments will take effect from 1st day of April, 2017 and will, accordingly apply in relation to assessment year 2017-2018 and subsequent years.

Consequential amendments have been proposed in sections 119, 253, 271A, 271AA, 271AAB, 273A and 279 to provide reference to newly inserted section 270A.

The provisions of section 270A are illustrated through examples as below:

Example 1. Case is of a firm liable to tax at the rate of 30 per cent.:

	(Figures in ₹ lakh)
Returned total Income	100
Total Income determined under section 143(1)(a)	110
Total Income assessed under section 143(3)	150
Total Income reassessed under section 147 180	180

Considering that none of the additions or disallowances made in assessment or reassessment as above qualifies under sub-section (6) of section 270A, the penalty would be calculated as under:

Under-reported Income	(150-110) = 40	(180-150) = 30
Tax Payable on under-reported Income	30 % of 40 = 12	30 % of 30 = 9
Penalty Leviable*	50 % of 12 = 6	50 % of 9 = 4.5

* Considering under-reported income is not on account of misreporting

Example 2. Case is of an individual below 60 years of age and no return of income has been furnished:

	(Figures in ₹)
Total Income assessed under section 143(3)	10,00,000
Under-reported Income	10,00,000-2,50,000* =7,50,000
Tax Payable on under-reported Income	30 % of 7,50,000 = 2,25,000
Penalty Leviable**	50 % of 2,25,000 = 1,12,500

* Being maximum amount not chargeable to tax

** Considering under-reported income is not on account of misreporting

Example 3. Case is of a company liable to tax at the rate of 30 per cent.:

	(Figures in ₹ lakh)
Returned total Income (loss)	(-)100
Total Income (loss) determined under section 143(1)(a)	(-)90
Total Income (loss) assessed under section 143(3)	(-)40
Total Income reassessed under section 147	20

Considering that none of the additions or disallowances made in assessment or reassessment as above qualifies under sub-section (6) of section 270A, the penalty would be calculated as under:

	Assessment under section 143 (3)	Re-assessment under section 147
Under-reported Income	(-)40 minus (-)90 = 50	20 minus (-)40 = 60
Tax Payable on under-reported Income	30 % of 50 = 15	30 % of 60 = 18
Penalty Leviable*	50 % of 15 = 7.5	50 % of 18 = 9

** Considering under-reported income is not on account of misreporting*

Extension of time limit to Transfer Pricing Officer in certain cases

As per the existing provisions, the Transfer Pricing Officer (TPO) has to pass his order sixty days prior to the date on which the limitation for making assessment expires. It is noted that at times seeking information from foreign jurisdictions becomes necessary for determination of arm's length price by the TPO and at times proceedings before the TPO may also be stayed by a court order.

It is proposed to amend sub-section (3A) of section 92CA to provide that where assessment proceedings are stayed by any court or where a reference for exchange of information has been made by the competent authority, the time available to the Transfer Pricing Officer for making an order after excluding the time for which assessment proceedings were stayed or the time taken for receipt of information, as the case may be, is less than sixty days, then such remaining period shall be extended to sixty days.

The amendment will take effect from 1st day of June, 2016.

Immunity from penalty and prosecution in certain cases by inserting new section 270AA

It is proposed to provide that an assessee may make an application to the Assessing Officer for grant of immunity from imposition of penalty under section 270A and initiation of proceedings under section 276C, provided he pays the tax and interest payable as per the order of assessment or reassessment within the period specified in such notice of demand and does not prefer an appeal against such assessment order. The assessee can make such application within one month from the end of the month in which the order of assessment or reassessment is received in the form and manner, as may be prescribed.

It is proposed that the Assessing Officer shall, on fulfilment of the above conditions and after the expiry of period of filing appeal as specified in sub-section (2) of section 249, grant immunity from initiation of penalty and proceeding under section 276C if the penalty proceedings under section 270A has not been initiated on account of the following, namely:—

(a) misrepresentation or suppression of facts;

(b) failure to record investments in the books of account;

(c) claim of expenditure not substantiated by any evidence;

(d) recording of any false entry in the books of account;

(e) failure to record any receipt in books of account having a bearing on total income; or

(f) failure to report any international transaction or any transaction deemed to be an international transaction or any specified domestic transaction to which the provisions of Chapter X apply.

It is proposed that the Assessing Officer shall pass an order accepting or rejecting such application within a period of one month from the end of the month in which such application is received. However, in the interest of natural justice, no order rejecting the application shall be passed by the Assessing Officer unless the assessee has been given an opportunity of being heard. It is proposed that order of Assessing Officer under the said section shall be final.

It is proposed that no appeal under section 246A or an application for revision under section 264 shall be admissible against the order of assessment or reassessment referred to in clause (a) of sub-section (1), in a case where an order under section 270AA has been made accepting the application.

Clause (b) of sub-section (2) of section 249 provides that an appeal before the Commissioner (Appeals) is to be made within thirty days of the receipt of the notice of demand relating to an assessment order.

It is proposed to provide that in a case where the assessee makes an application under section 270AA of the Income-tax Act seeking immunity from penalty and prosecution, then, the period beginning from the date on which such application is made to the date on which the order rejecting the application is served on the assessee shall be excluded for calculation of the aforesaid thirty days period. The proposed amendment is consequential to the insertion of section 270AA.

These amendments will take effect from the 1st day of April, 2017 and will, accordingly, apply in relation to the assessment year 2017 -2018 and subsequent years.

11. Memorandum explaining the provisions of the Finance Bill, 2017

Scope of section 92BA of the Income-tax Act relating to Specified Domestic Transactions

The existing provisions of section 92BA of the Act, inter-alia provide that any expenditure in respect of which payment has been made by the assessee to certain "specified persons" under section 40A(2)(b) are covered within the ambit of specified domestic transactions.

As a matter of compliance and reporting, taxpayers need to obtain the chartered accountant's certificate in Form 3CEB providing the details such as list of related parties, nature and value of specified domestic transactions (SDTs), method used to determine the arm's length price for SDTs, positions taken with regard to certain transactions not considered as SDTs, etc. This has considerably increased the compliance burden of the taxpayers.

In order to reduce the compliance burden of taxpayers, it is proposed to provide that expenditure in respect of which payment has been made by the assessee to a person referred to in under section 40A(2)(b) are to be excluded from the scope of section 92BA of the Act. Accordingly, it is also proposed to make a consequential amendment in section 40(A)(2)(b) of the Act.

These amendments will take effect from 1st April, 2017 and will, accordingly, apply in relation to the assessment year 2017- 18 and subsequent years.

Secondary adjustments in certain cases

"Secondary adjustment" means an adjustment in the books of accounts of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee. As per the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD transfer pricing guidelines), secondary adjustment may take the form of constructive dividends, constructive equity contributions, or constructive loans.

The provisions of secondary adjustment are internationally recognised and are already part of the transfer pricing rules of many leading economies in

the world. Whilst the approaches to secondary adjustments by individual countries vary, they represent an internationally recognised method to align the economic benefit of the transaction with the arm's length position.

In order to align the transfer pricing provisions in line with OECD transfer pricing guidelines and international best practices, it is proposed to insert a new section 92CE to provide that the assessee shall be required to carry out secondary adjustment where the primary adjustment to transfer price, has been made suo motu by the assessee in his return of income; or made by the Assessing Officer has been accepted by the assessee; or is determined by an advance pricing agreement entered into by the assessee under section 92CC; or is made as per the safe harbour rules framed under section 92CB; or is arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into under section 90 or 90A.

It is proposed to provide that where as a result of primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss, as the case may be, of the assessee, the excess money which is available with its associated enterprise, if not repatriated to India within the time as may be prescribed, shall be deemed to be an advance made by the assessee to such associated enterprise and the interest on such advance, shall be computed as the income of the assessee, in the manner as may be prescribed.

It is also proposed to provide that such secondary adjustment shall not be carried out if, the amount of primary adjustment made in the case of an assessee in any previous year does not exceed one crore rupees and the primary adjustment is made in respect of an assessment year commencing on or before 1st April, 2016.

This amendment will take effect from 1st April, 2018 and will, accordingly, apply in relation to the assessment year 2018-19 and subsequent years.

12. Memorandum explaining the provisions of the Finance (No. 2) Bill, 2019

Clarification with regard to power of the Assessing Officer in respect of modified return of income filed in pursuance to signing of the Advance Pricing Agreement (APA)

Section 92CC of the Act empowers the Central Board of Direct Taxes (CBDT) to enter into an APA, with the approval of the Central Government, with any person for determining the Arm's Length Price (ALP) or specifying

the manner in which ALP is to be determined in relation to an international transaction which is to be entered into by that person. The APA is valid for a period, not exceeding five previous years, as may be specified therein. This section also provides for rollback of the APA for four years. Thus, once the APA is entered into, the ALP of the international transaction, which is subject matter of the APA, would be determined in accordance with such APA.

In order to give effect to the APA, section 92CD also provides for mechanism, including filing of modified return of income by the taxpayer and manner of completion of assessments by the Assessing Officer having regard to terms of the APA.

Sub-section (3) of this section deals with a situation where assessment or re-assessment has already been completed, before expiry of the time allowed for filing of modified return. Apprehensions have been expressed stating that due to the use of words "assess or reassess or recompute", the Assessing Officer may start fresh assessment or reassessment in respect of completed assessments or reassessments of the assessees who have modified their returns of income in accordance with the APA entered into by them, while the intention of the legislature is for Assessing Officer to merely modify the total income consequent to modification of return of income in pursuance to APA.

It is, therefore, proposed to amend sub-section (3) of section 92CD to clarify that in cases where assessment or reassessment has already been completed and modified return of income has been filed by the tax payer under sub-section (1) of said section, the Assessing Officers shall pass an order modifying the total income of the relevant assessment year determined in such assessment or reassessment, having regard to and in accordance with the APA.

This amendment will take effect from 1st September, 2019.

Clarification with regard to provisions of secondary adjustment and giving an option to assessee to make one-time payment

In order to align the transfer pricing provisions with international best practices, section 92CE of the Act provides for secondary adjustments in certain cases.

It, inter alia, provides that the assessee shall be required to carry out secondary adjustment where the primary adjustment to transfer price, has been made suo motu, or made by the Assessing Officer and accepted by him; or is determined by an advance pricing agreement entered into by him under section 92CC of the Act; or is made as per safe harbour rules

prescribed under section 92CB of the Act; or is arising as a result of resolution of an assessment through mutual agreement procedure under an agreement entered into under section 90 or 90A of the Act.

The proviso to said sub-section provides exemption in cases where the amount of primary adjustment made in any previous year does not exceed one crore rupees; and the primary adjustment is made in respect of an assessment year commencing on or before 1st April, 2016.

Several concerns have been expressed regarding effective implementation of secondary adjustments regime and seeking clarity in law.

In order to address such concerns and to make the secondary adjustment regime more effective and easy to comply with, it is proposed to amend section 92CE of the Act so as to provide that:-

(i) the condition of threshold of one crore rupees and of the primary adjustment made upto assessment year 2016-17 are alternate conditions;

(ii) the assessee shall be required to calculate interest on the excess money or part thereof;

(iii) the provision of this section shall apply to the agreements which have been signed on or after 1st April, 2017; however, no refund of the taxes already paid till date under the pre amended section would be allowed;

(iv) the excess money may be repatriated from any of the associated enterprises of the assessee which is not resident in India;

(v) in a case where the excess money or part thereof has not been repatriated in time, the assessee will have the option to pay additional income-tax at the rate of eighteen per cent on such excess money or part thereof in addition to the existing requirement of calculation of interest till the date of payment of this additional tax. The additional tax is proposed to be increased by a surcharge of twelve per cent;

(vi) the tax so paid shall be the final payment of tax and no credit shall be allowed in respect of the amount of tax so paid;

(vii) the deduction in respect of the amount on which such tax has been paid, shall not be allowed under any other provision of this Act; and

(viii) if the assessee pays the additional income-tax, he will not be required to make secondary adjustment or compute interest from the date of payment of such tax.

The amendments proposed in para (i) to (iv) above will take effect retrospectively from the 1st April, 2018 and will, accordingly, apply in relation to the assessment year 2018-19 and subsequent assessment years.

Further, the amendments proposed in para (v) to (viii) will be effective from 1st September, 2019.

Rationalisations of provisions relating to maintenance, keeping and furnishing of information and documents by certain persons

Section 92D of the Act inter alia, provides for maintenance and keeping of information and document by persons entering into an international transaction or specified domestic transaction in the prescribed manner.

Sub-section (1) of section 92D provides that every person who has entered into an international transaction or specified domestic transaction shall keep and maintain the prescribed information and document in respect thereof.

Proviso to said section inserted through the Finance Act, 2016 provides that the person, being a constituent entity of an international group, shall also keep and maintain such information and document in respect of an international group as may be prescribed. Accordingly, Rule 10DA, prescribed for this purpose, provides the requisite information to be furnished in prescribed form, subject to the thresholds of the consolidated group revenue and the international transaction.

It is proposed to substitute section 92D of the Act, in order to provide that the information and document to be kept and maintained by a constituent entity of an international group, and filing of required form, shall be applicable even when there is no international transaction undertaken by such constituent entity.

It is also proposed to provide that information shall be furnished by the constituent entity of an international group to the prescribed authority.

This amendment will take effect from the 1st April, 2020 and will, accordingly, apply in relation to the assessment year 2020-21 and subsequent assessment years.

13. Memorandum explaining the provisions of the Finance Bill, 2020

Amendment for providing attribution of profit to Permanent Establishment in

Safe Harbour Rules under section 92CB and in Advance Pricing Agreement under section 92CC

Section 92CB of the Act empowers the Central Board of Direct Taxes (Board) for making safe harbour rules (SHR) to which the determination of the arm's length price (ALP) under section 92C or section 92CA of the Act shall be subject to. As per Explanation to said section the term “safe harbour” means circumstances in which the Income-tax Authority shall accept the transfer price declared by the assessee. This section was inserted in the Act to reduce the number of transfer pricing audits and prolonged disputes especially in case of relatively smaller assessees. Besides reduction of disputes, the SHR provides certainty as well.

Further, section 92CC of the Act empowers the Board to enter into an advance pricing agreement (APA) with any person, determining the ALP or specifying the manner in which the ALP is to be determined, in relation to an international transaction to be entered into by that person. APA provides tax certainty in determination of ALP for five future years as well as for four earlier years (Rollback).

SHR provides tax certainty for relatively smaller cases for future years on general terms, while APA provides tax certainty on case to case basis not only for future years but also Rollback years. Both SHR and the APA have been successful in reducing litigation in determination of the ALP.

It has been represented that the attribution of profits to the PE of a non-resident under clause (i) of sub-section (1) of section 9 of the Act in accordance with rule 10 of the Rules also results in avoidable disputes in a number of cases. In order to provide certainty, the attribution of income in case of a non-resident person to the PE is also required to be clearly covered under the provisions of the SHR and the APA.

In view of the above, it is proposed to amend section 92CB and section 92CC of the Act to cover determination of attribution to PE within the scope of SHR and APA.

With respect to section 92CB, the amendment will take effect from 1st April, 2020 and will, accordingly, apply in relation to the assessment year 2020-21 and subsequent assessment years. 17 With respect to section 92CC, the amendment will take effect from 1st April, 2020 and therefore will apply to an APA entered into on or after 1st April, 2020.

Excluding interest paid or payable to Permanent Establishment of a non-resident Bank for the purpose of disallowance of interest under section 94B.

Section 94B of the Act, inter alia, provides that deductible interest or similar expenses exceeding one crore rupees of an Indian company, or a permanent establishment (PE) of a foreign company, paid to the associated enterprises (AE) shall be restricted to 30 per cent. of its earnings before interest, taxes, depreciation and amortisation (EBITDA) or interest paid or payable to AE, whichever is less. Further, a loan is deemed to be from an AE, if an AE provides implicit or explicit guarantee in respect of that loan. AE for the purposes of this section has the meaning assigned to it in section 92A of the Act. This section was inserted in the Act through the Finance Act, 2017 in order to implement the measures recommended in final report on Action Plan 4 of the Base Erosion and Profit Shifting (BEPS) project under the aegis of G-20-Organisation of Economic Co-operation and Development (OECD) countries to address the issue of base erosion and profit shifting by way of excess interest deductions.

Representations have been received to carve out interest paid or payable in respect of debt issued by a PE of a non-resident in India, being a person engaged in the business of banking for the reason that as per the existing provisions a branch of the foreign company in India is a non-resident in India. Further, the definition of the AE in section 92A, inter alia, deems two enterprises to be AE, if during the previous year a loan advanced by one enterprise to the other enterprise is at 50 per cent. or more of the book value of the total assets of the other enterprise. Thus, the interest paid or payable in respect of loan from the branch of a foreign bank may attract provisions of interest limitation provided for under this section.

It is, therefore, proposed to amend section 94B of the Act so as to provide that provisions of interest limitation would not apply to interest paid in respect of a debt issued by a lender which is a PE of a non-resident, being a person engaged in the business of banking, in India.

This amendment will take effect from 1st April, 2021 and will, accordingly, apply in relation to the assessment year 2021-22 and subsequent assessment years.

14. Memorandum explaining the provisions of the Finance Bill, 2022

Faceless Schemes under the Act

1. The Central Government has undertaken a number of measures to

make the processes under the Act, electronic, by eliminating person to person interface between the taxpayer and the Department to the extent technologically feasible, and provide for optimal utilisation of resources and a team-based assessment with dynamic jurisdiction. A series of futuristic reforms have been introduced in the domain of Direct Tax administration for the benefit of taxpayers and economy. This started with faceless assessment in electronic mode involving no human interface between taxpayers and tax officials. The faceless procedures are being introduced in a phased manner in the Act.

2. As part of this process of making the tax administration transparent and efficient, provisions for notifying faceless schemes under sections 92CA, 144C, 253 and 264A were introduced in the Act through Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 with effect from 01.11.2020 and under section 255, was inserted through Finance Act, 2021 with effect from 01.04.2021:

S.No. Section Scheme Date of Limitation 92CA Faceless determination of arm's length price 31st day of March, 2022 2. 144C Faceless Dispute Resolution Panel 31st day of March, 2022 3. 253 Faceless appeal to Appellate Tribunal 31st day of March, 2022 4. 255 Faceless procedure of Appellate Tribunal 31st day of March, 20

S.No.	Section	Scheme	Date of Limitation
1.	92CA	Faceless determination of arm's length price	31st day of March, 2022
2.	144C	Faceless Dispute Resolution Panel	31st day of March, 2022
3.	253	Faceless appeal to Appellate Tribunal	31st day of March, 2022
4.	255	Faceless procedure of Appellate Tribunal	31st day of March, 2023

3. Section 92CA and section 144C are principally related to the transfer pricing functions and international taxation which are presently out of the regime of faceless assessment. New schemes for these two functions are a part of the assessment function and should follow the faceless assessment procedure, wherein certain modifications are proposed which will have an impact on the information technology structure. Therefore, notification at this time shall result in delay in stabilization of the systems.

4. As for notification of scheme under section 255, the Appellate Tribunal is deemed to be a civil court for all the purposes of section 195 of the Act and Chapter XXXV of the Code of Criminal Procedure, 1898. Therefore, a scheme governing the procedures to be followed by such a body needs to be formulated after due consultations with Ministry of Law & Justice. Similarly, the scheme under section 253 have to follow the scheme under section 255.

5. In light of the above limitations it is proposed to extend the date for issuing directions for the purposes of these sections 92CA, 144C, 253 and 255 till 31st March, 2024.

6. These amendments will take effect from 1 st April, 2022.

Amendment in the provisions of section 263 of the Act

1. Section 263 of the Act contains the provision for revision of order which is erroneous in so far as it is prejudicial to the interests of revenue. An order under section 263 of the Act can be passed within two years from the end of the financial year in which the order sought to be revised was passed.

2. As per provisions of section 92CA, if the Assessing Officer considers it necessary or expedient, he may, with the approval of the Principal Commissioner or Commissioner refer the computation of arm's length price (ALP or specified domestic transaction entered into by an assessee, to the Transfer Pricing Officer (TPO). The TPO passes an order determining the ALP in an international transaction or specified domestic transaction under the provisions of section 92CA and send it to the Assessing Officer for final income determination. However, it is not clear as to who has the power under section 263 to revise the order of the TPO passed under section 92CA.

3. Therefore, it is proposed to amend the provisions of section 263 of the Act so as to provide that the Principal Chief Commissioner or the Chief Commissioner or the Principal Commissioner or Commissioner who is assigned the jurisdiction of transfer pricing may call for and examine the record of any proceeding under this Act, and if he considers that any order passed by the TPO, working under his jurisdiction, to be erroneous in so far as it is prejudicial to the interests of revenue, he may pass an order directing revision of the order of TPO. Consequential changes are also be made in the provisions of section 153 of the Act inter alia to provide two months' time to the Assessing Officer to give effect to the order of TPO consequent to the directions in the revision order.

4. Further, in section 153 of the Act, it is proposed to

(i) provide that the provisions of sub-sections (3) and (5) of that section shall also be applicable to order passed by Transfer Pricing Officer under section 92CA,

(ii) to insert sub-section (5A) to provide that where the Transfer Pricing Officer gives effect to an order or direction under section 263 by means of an order under section 92CA and forwards such order to the Assessing Officer, the 106 Assessing Officer shall proceed to modify the order of assessment or reassessment or recomputation, in conformity with such order of the Transfer Pricing Officer, within two months from the end of the month in which such order of the Transfer Pricing Officer is received by him,

(iii) provide that the said provisions of the sub-section (6) shall also be applicable to orders referred to in the sub-section (5A) inserted in the Act.

5. These amendments will take effect from 1 st of April, 2022.

Annexure IV
Circulars

1. Circular No.12 of 2001 dated 23rd August, 2001

To

All the Chief Commissioners/
Director-General of Income-tax

Subject: Provisions governing transfer price in an international transaction - regarding.

The Finance Act, 2001, has substituted the existing section 92 of the Income-tax Act by new sections 92 and 92A to 92F. These new provisions lay down that income arising from an international transaction between associated enterprises shall be computed having regard to the arm's length price. The term "associated enterprise" has been defined in section 92A. Section 92B defines an "international transaction" between two or more associated enterprises. The provisions contained in section 92C provide for methods to determine the arm's length price in relation to an international transaction, and the most appropriate method to be followed out of the specified methods. While the primary responsibility of determining and applying an arm's length price is on the assessee, sub-section (3) of section 92C empowers the Assessing Officer to determine the arm's length price and compute the total income of the assessee accordingly, subject to the conditions provided therein. Section 92D provides for certain information and documents required to be maintained by persons entering into international transactions, and section 92E provides for a report of an accountant to be furnished along with the return of income.

The Board have prescribed rules 10A to 10E in the Income-tax Rules, 1962, giving the manner and the circumstances in which different methods would be applied in determining arm's length price and the factors governing the selection of the most appropriate method. The form of the report of the accountant and the documents and information required to be maintained by the assessees have also been prescribed.

The aforesaid provisions have been enacted with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profit and tax in India so that the profits chargeable to tax in India

do not get diverted elsewhere by altering the prices charged and paid in intra-group transactions leading to erosion of our tax revenues.

However, this is a new legislation. In the initial years of its implementation, there may be room for different interpretations leading to uncertainties with regard to determination of arm's length price of an international transaction. While it would be necessary to protect our tax base, there is a need to ensure that the taxpayers are not put to avoidable hardship in the implementation of these regulations.

In this background the Board have decided the following:

(i) The Assessing Officer shall not make any adjustment to the arm's length price determined by the taxpayer, if such price is up to 5 per cent less or up to 5 per cent more than the price determined by the Assessing Officer. In such cases the price declared by the taxpayer may be accepted.

(ii) The provisions of sections 92 and 92A to 92F come into force with effect from 1st April, 2002, and are accordingly applicable to the assessment year 2002-03 and subsequent years. The law requires the associated enterprises to maintain such documents and information relating to international transactions as may be prescribed. However, the necessary rules could be framed by the Board only after the Finance Bill received the assent of the President and have just been notified. Therefore, where an assessee has failed to maintain the prescribed information or documents in respect of transactions entered into during the period 1.4.2001 to 31.8.2001 the provisions of section 92C(3) should not be invoked for such failure. Penalty proceedings under section 271AA or 271G should also not be initiated for such default.

(iii) It should be made clear to the concerned Assessing Officers that where an international transaction has been put to a scrutiny, the Assessing Officer can have recourse to sub-section (3) of section 92C only under the circumstances enumerated in clauses (a) to (d) of that sub-section and in the vent of material information or documents in his possession on the basis of which an opinion can be formed that any such circumstance exists. In all other cases, the value of the international transaction should be accepted without further scrutiny.

This may be brought to the notice of all the officers working in your region.

Yours faithfully
(Sd.) Batsala Jha Yadav
Under Secretary (TPL-IV)
F.No.142/41/2001-TPL]

2. Extracts from Explanatory Circular No.14 on provisions relating to Finance Act, 2001

"New Legislation to curb tax avoidance by abuse of transfer pricing

55.1 The increasing participation of multi-national groups in economic activities in the country has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multi-national group. The profits derived by such enterprises carrying on business in India can be controlled by the multi-national group, by manipulating the prices charged and paid in such intra-group transactions, thereby, leading to erosion of tax revenues.

55.2 Under the existing section 92 of the Income-tax Act, which was the only section dealing specifically with cross border transactions, an adjustment could be made to the profits of a resident arising from a business carried on between the resident and a non-resident, if it appeared to the Assessing Officer that owing to the close connection between them, the course of business was so arranged so as to produce less than expected profits to the resident. Rule 11 prescribed under the section provided a method of estimation of reasonable profits in such cases. However, this provision was of a general nature and limited in scope. It did not allow adjustment of income in the case of non-residents. It referred to a "close connection" which was undefined and vague. It provided for adjustment of profits rather than adjustment of prices, and the rule prescribed for estimating profits was not scientific. It also did not apply to individual transactions such as payment of royalty, etc., which are not part of a regular business carried on between a resident and a non-resident. There were also no detailed rules prescribing the documentation required to be maintained.

55.3 With a view to provide a detailed statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multi-national enterprises, the Act has substituted section 92 with a new section, and has introduced new section 92A to 92F in the Income-tax Act, relating to computation of income from an international

transaction having regard to the arm's length price, meaning of associated enterprise, meaning of international transaction, computation of arm's length price, maintenance of information and documents by persons entering into international transactions, furnishing of a report from an accountant by persons entering into international transactions and definitions of certain expressions occurring in the said sections.

55.4 The newly substituted section 92 provides that income arising from an international transaction between associated enterprises shall be computed having regard to the arm's length price. Any expense or outgoing in an international transaction is also to be computed having regard to the arm's length price. Thus in the case of a manufacturer, for example, the provisions will apply to exports made to the associated enterprise as also to imports from the same or any other associated enterprise. The provision is also applicable in a case where the international transaction comprises only an outgoing from the Indian assessee.

55.5 The new section further provides that the cost or expenses allocated or apportioned between two or more associated enterprises under a mutual agreement or arrangement shall be at arm's length price. Examples of such transactions could be where one associated enterprise carries out centralized functions which also benefit one or more other associated enterprises, or two or more associated enterprises agree to carry out a joint activity, such as research and development, for their mutual benefit.

55.6 The new provision is intended to ensure that profits taxable in India are not understated (or losses are not overstated) by declaring lower receipts or higher outgoings than those which would have been declared by persons entering into similar transactions with unrelated parties in the same or similar circumstances. The basic intention underlying the new transfer pricing regulations is to prevent shifting out of profits by manipulating prices charges or paid in international transactions, thereby eroding the country's tax base. The new section 92 is, therefore, not intended to be applied in cases where the adoption of the arm's length price determined under the regulations would result in a decrease in the overall tax incidence in India in respect of the parties involved in the international transaction.

55.7 The substituted new sections 92A and 92B provide meanings of the expressions "associated enterprise" and "international transaction" with reference to which the income is to be computed under the new section 92. While sub-section (1) of section 92A gives a general definition of associated enterprises, based on the concept of participation in management, control or

capital, sub-section (2) specifies the circumstances under which the two enterprises shall be deemed to be associated enterprises.

55.8 Section 92B provides a broad definition of an international transaction, which is to be read with the definition of transaction given in section 92F. An international transaction is essentially a cross border transaction between associated enterprises in any sort of property, whether tangible or intangible, or in the provision of services, lending of money etc. At least one of the parties to the transaction must be a non-resident. The definition also covers a transaction between two non-residents, where the example, one of them has a permanent establishment whose income is taxable in India.

55.9 Sub-section (2) of section 92B extends the scope of the definition of international transaction by providing that a transaction entered into with an unrelated person shall be deemed to be a transaction with an associated enterprise, if there exists a prior agreement in relation to the transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined by the associated enterprise. An illustration of such a transaction could be where the assessee, being an enterprise resident in India, exports goods to an unrelated person abroad, and there is a separate arrangement or agreement between the unrelated person and an associated enterprise which influences the price at which the goods are exported. In such a case the transaction with the unrelated enterprise will also be subject to transfer pricing regulations.

55.10 The new section 92C provides that the arm's length price in relation to an international transaction shall be determined by (a) comparable uncontrolled price method; or (b) resale price method; or (c) cost plus method; or (d) profits split method; or (e) transactional net margin method; or (f) any other method which may be prescribed by the Board. For the present, no additional method has been prescribed. One of the five specified methods shall be the most appropriate method in respect of a particular international transaction, and shall be applied for computation of arm's length price in the manner specified by the rules. Rules 10A to 10E, which have been separately notified vide S.O. 808(E), dated 21.8.2001 inter alia, provide for the factors which are to be considered in selecting the most appropriate method. The major considerations in this regard have been specified to be the availability, coverage and reliability of data necessary for application of the method, the extent and reliability of assumptions required to be made and the degree of comparability existing between the international transaction and the uncontrolled transaction. The rules also lay down in

detail the manner in which the methods are to be applied in determining the arm's length price.

55.11 Applying the most appropriate method to different sets of comparable data can possibly result in computation of more than one arm's length price. With a view to avoid unnecessary disputes, the proviso to section 92C(2) provides that in such a case the arithmetic mean of the prices shall be adopted as the arm's length price. In normal course, if the different sets of comparable data are equally reliable there may not be any significant divergence between the various arm's length prices determined.

55.12 Under the new provisions the primary onus is on the tax payer to determine an arm's length price in accordance with the rules, and to substantiate the same with the prescribed documentation. Where such onus is discharged by the assessee and the data used for determining the arm's length price is reliable and correct, there can be no intervention by the Assessing Officer. This is made clear by sub-section (3) of section 92C which provides that the Assessing Officer may intervene only if he is, on the basis of material or information or document in his possession, of the opinion that the price charged in the international transaction has not been determined in accordance with sub-sections (1) and (2), or information and documents relating to the international transaction have not been kept and maintained by the assessee in accordance with the provisions contained in sub-section (1) of section 92D and the rules made thereunder; or the information or data used in computation of the arm's length price is not reliable or correct; or the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of section 92D. If any one of such circumstances exists, the Assessing Officer may reject the price adopted by the assessee and determine the arm's length price in accordance with the same rules. However, an opportunity has to be given to the assessee before determining such price. Thereafter, as provided in sub-section (4) of section 92C, the Assessing Officer may compute the total income on the basis of the arm's length price so determined by him.

55.13 The first proviso to section 92C(4) recognizes the commercial reality that even when a transfer pricing adjustment is made under that sub-section, the amount represented by the adjustment would not actually have been received in India or would have actually gone out of the country. Therefore it has been provided that no deductions under section 10A or 10B or under Chapter VI-A shall be allowed in respect of the amount of adjustment.

55.14 The second proviso to section 92C(4) refers to a case where the amount involved in the international transaction has already been remitted abroad after deducting tax at source and subsequently, in the assessment of the resident payer, an adjustment is made to the transfer price involved and, thereby, the expenditure represented by the amount so remitted is partly disallowed. Under the Income-tax Act, a non-resident in receipt of income from which tax has been deducted at source has the option of filing a return of income in respect of the relevant income. In such cases, a non-resident could claim a refund of a part of the tax deducted at source, on the ground that an arm's length price has been adopted by the Assessing Officer in the case of the resident and the same price should be considered in determining the taxable income of the non-resident. However, the adoption of the arm's length price in such cases would not alter the commercial reality that the entire amount claimed earlier would have actually been received by the entity located abroad. It has therefore been made clear in the second proviso that income of one associated enterprise shall not be recomputed merely by reason of an adjustment made in the case of the other associated enterprise on determination of arm's length price by the Assessing Officer.

55.15 The new section 92D provides that every person who has undertaken an international transaction shall keep and maintain such information and documents as may be specified by rules made by the Board. The Board may also specify by rules the period for which the information and documents are required to be retained. The documentation required to be maintained has been prescribed under rule 10D. Such documentation includes background information on the commercial environment in which the transaction has been entered into, and information regarding the international transaction entered into, the analysis carried out to select the most appropriate method and to identify comparable transactions, and the actual working out of the arm's length price of the transaction. The documentation should be available with the assessee by the specified date defined in section 92F and should be retained for a period of 8 years. During the course of any proceedings under the Act, an Assessing Officer or Commissioner (Appeals) may require any person who has undertaken an international transaction to furnish any of the information and documents specified under the rules with a period of thirty days from the date of receipt of a notice issued in this regard, and such period may be extended by a further period not exceeding thirty days.

55.16 The new section 92E provides that every person who has entered into an international transaction during a previous year shall obtain a report from accountant and furnish such report on or before the specified date in the

prescribed form and manner. Rule 10E and Form No.3CEB have been notified in this regard. The accountants' report only requires furnishing of factual information relating to the international transaction entered into, the arm's length price determined by the assessee and the method applied in such determination. It also requires an opinion as to whether the prescribed documentation has been maintained.

55.17 The new section 92F defines the expression "accountant", "arm's length price", "enterprise", "specified date" and "transaction" used in sections 92, 92A, 92B, 92C, 92D and 92E. The definition of enterprise is broad and includes a permanent establishment, even though a PE is not a separate legal entity. Consequently, transactions between a foreign enterprise and its PE, for example, between the head office abroad and a branch in India, are also subject to these transfer pricing regulations. Also the regulation 33 would apply to transactions between a foreign enterprise and a PE of another foreign enterprise. The term permanent establishment has not been defined in the provisions but its meaning may be understood with reference to the tax treaties entered into by India.

55.18 With a view to ensure that multinational enterprises comply with the requirements of the new regulations, the Act has also amended section 271 and inserted new sections 271AA, 271BA and 271G in the Income-tax Act, so as to provide for penalty to be levied in cases of non-compliance with procedural requirements, and in cases of understatement of profits through fraud or willful negligence.

55.19 The new Explanation 7 to sub-section (1) of section 271 provides that where in the case of an assessee who has entered into an international transaction, any amount is added or disallowed in computing the total income under sub-sections (1) and (2) of section 92, then, the amount so added or disallowed shall be deemed to represent income in respect of which particulars have been concealed or inaccurate particulars have been furnished. However, no penalty under section 271(1)(c) shall be levied where the assessee proves to the satisfaction of the Assessing Officer or the Commissioner (Appeals) that the price charged or paid in such transaction has been determined in accordance with section 92C in good faith and with due diligence.

55.20 The new section 271AA provides that if any person who has entered into an international transaction fails to keep and maintain any such information and documents as specified under section 92D, the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by

way of penalty, a sum equal to two per cent of the value of the international transaction entered into by such person.

55.21 The new section 271BA provides that if any person fails to furnish a report from an accountant as required by section 92E, the Assessing Officer may direct that such person shall pay by way of penalty, a sum of one lakh rupees.

55.22 The new section 271G provides that if any person who has entered into an international transaction fails to furnish any information or documents as required under sub-section (3) of section 92D, the Assessing Officer or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two per cent of the value of the international transaction.

55.23 The Act has also amended section 273B to provide that the above mentioned penalties under sections 271AA, 271BA and 271G shall not be imposable if the assessee proves that there was reasonable cause for such failures.

55.24 These amendments will take effect from 1st April, 2002 and will accordingly apply to the assessment year 2002-2003 and subsequent years."
[Circular No.14/2001]

F.No.142/13/2010-SO (TPL)

Government of India, Ministry of Finance, Department of Revenue
Central Board of Direct Taxes
New Delhi, the 30th September, 2010
CORRIGENDUM

No._____(F.No.142/13/2010-SO(TPL). In partial modification of Circular No.5 / 2010 dated 03.06.2010,

(i) in para 37.5 of the said Circular, for the lines

"the above amendment has been made applicable with effect from 1st April, 2009 and will accordingly apply in respect of assessment year 2009-10 and subsequent years."

the following lines shall be read;

"the above amendment has been made applicable with effect from 1st October 2009 and shall accordingly apply in relation to all cases in which proceedings are pending before the Transfer Pricing Officer (TPO) on or after such date."

(ii) in para 38.3, for the date "1st October, 2009", the following date shall be read : "1st April, 2009".

(Pawan K. Kumar)
Director (TPL-IV)
Corrigendum No.5/2010 (F.No.142/13/2010-SO(TPL)

3. SECTION 92C OF THE INCOME-TAX ACT, 1961, READ WITH RULE 10B OF THE INCOME-TAX RULES, 1962 - TRANSFER PRICING - COMPUTATION OF ARM'S LENGTH PRICE - APPLICATION OF PROFIT SPLIT METHOD

CIRCULAR NO. 2/2013 [F. NO. 500/139/2012], DATED 26-3-2013

[WITHDRAWN BY CIRCULAR NO. 5/2013 [F. NO.500/139/2012-FTD-I], DATED 29-6-2013]

It has been brought to the notice of CBDT that clarification is needed for selection of profit split method (PSM) as most appropriate method. The issue has been examined in CBDT. It is hereby clarified that while selecting PSM as the most appropriate method, the following points may be kept in mind:

1. Since there is no correlation between cost incurred on R&D activities and return on an intangible developed through R&D activities, the use of transfer pricing methods [like Transactional Net Margin Method] that seek to estimate the value of intangible based on cost of intangible development (R&D cost) plus a return, is generally discouraged.

2. Rule 10B(1)(*d*) of Income-tax Rules, 1962 (the Rules) provides that profit split method (PSM) may be applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction. The PSM determines appropriate return on intangibles on the basis of relative contributions made by each associated enterprise.

3. Selection and application of PSM will depend upon following factors as prescribed under rule 10C(2) of the Rules :

   - the nature and class of the international transaction;
   - the class or classes of associated enterprises entering into the

transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprise;

- the availability, coverage and reliability of data necessary for application of the method;
- the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprise entering into such transactions;
- the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprise entering into such transactions;
- the nature, extent and reliability of assumptions required to be made in application of a method.

4. It is evident from the above that rule 10C(2) of the Rules stipulates availability, coverage and reliability of data necessary for the application of the method as one of the several factors in selection of most appropriate method. Accordingly, in a case, where the Transfer Pricing Officer (TPO) is of view that PSM cannot be applied to determine the arm's length price of international transactions involving intangibles due to non-availability of information and reliable data required for application of the method, he must record reasons for non-applicability of PSM before considering TNMM or comparable uncontrolled price method (CUP) as most appropriate method depending upon facts and circumstances of the case.

5. Application of Profit Split Method requires information mainly about the taxpayer and associated enterprises. Section 92D of the Income-tax Act, 1961 provides for maintenance of relevant information and documents by the taxpayer as prescribed under rule 10D of the Rules. Therefore, there should be good and sufficient reason for non-availability of such information with the taxpayer.

6. Depending upon facts and circumstances of the case, TPO may consider TNMM or CUP method as appropriate method by selecting comparables engaged in development of intangibles in same line of business and make upward adjustments taking into account transfer of intangibles without additional remuneration, location savings and location specific advantages

The above may be brought to the notice of all concerned.

4. SECTION 92C OF THE INCOME-TAX ACT, 1961 - TRANSFER PRICING - COMPUTATION OF ARM'S LENGTH PRICE - CLARIFICATIONS ON FUNCTIONAL PROFILE OF DEVELOPMENT CENTRES ENGAGED IN CONTRACT R&D SERVICES WITH INSIGNIFICANT RISK - CONDITIONS RELEVANT TO IDENTIFY SUCH DEVELOPMENT CENTRES

CIRCULAR NO. 3/2013 [F NO. 500/139/2012], DATED 26-3-2013 [SEE ALSO AMENDMENT MADE BY CIRCULAR NO. 6/2013, DATED 29-6-2013]

It has been brought to the notice of CBDT that there is divergence of views amongst the field officers and taxpayers regarding the functional profile of development centres engaged in contract R&D services for the purposes of transfer pricing audit. Moreover, while at times taxpayers have been insisting that they are contract R&D service providers with insignificant risk, the TPOs are treating them as full or significant risk-bearing entities and making transfer pricing adjustments accordingly. The issue has been examined in CBDT. It is hereby clarified that a development centre in India may be treated as a contract R&D service provider with insignificant risk if the following conditions are cumulatively complied with :

1 Foreign principal performs most of the economically significant functions involved in research or product development cycle whereas Indian development centre would largely be involved in economically insignificant functions;

2. The principal provides funds/ capital and other economically significant assets including intangibles for research or product development and Indian development centre would not use any other economically significant assets including intangibles in research or product development;

3. Indian development centre works under direct supervision of foreign principal who not only has capability to control or supervise but also actually controls or supervises research or product development through its strategic decisions to perform core functions as well as monitor activities on regular basis;

4. Indian development centre does not assume or has no economically significant realized risks. If a contract shows the principal to be controlling the risk but conduct shows that Indian development centre is doing so, then the contractual terms are not the final determinant of

actual activities. In the case of foreign principal being located in a country/territory widely perceived as a low or no tax jurisdiction, it will be presumed that the foreign principal is not controlling the risk. However, the Indian development centre may rebut this presumption to the satisfaction of the revenue authorities; and

5. Indian development centre has no ownership right (legal or economic) on outcome of research which vests with foreign principal, and that it shall be evident from conduct of the parties.

The satisfaction of all the above mentioned conditions should be borne out by the conduct of the parties and not merely by the contractual terms.

The above may be brought to the notice of all concerned.

5. SECTION 92C OF THE INCOME-TAX ACT, 1961 - TRANSFER PRICING - COMPUTATION OF ARM'S LENGTH PRICE - CLARIFICATIONS ON FUNCTIONAL PROFILE OF DEVELOPMENT CENTERS ENGAGED IN CONTRACT R&D SERVICES WITH INSIGNIFICANT RISK - CONDITIONS RELEVANT TO IDENTIFY SUCH DEVELOPMENT CENTERS - AMENDMENT OF CIRCULAR NO. 3/2013, DATED 26-3-2013

CIRCULAR NO.06/2013 [F NO. 500/139/2012], DATED 29-6-2013

It has been brought to the notice of CBDT that there is divergence of views amongst the field officers and taxpayers regarding the functional profile of development centres engaged in contract R&D services for the purposes of determining arm's length price/transfer pricing. In some cases, while taxpayers insist that they are contract R&D service providers with insignificant risk, the TPOs treat them as full or significant risk-bearing entities and make transfer pricing adjustments accordingly. The issue has been examined in the CBDT.

The Research and Development Centres set up by foreign companies can be classified into three broad categories based on functions, assets and risk assumed by the centre established in India. These are:

1. Centres which are entrepreneurial in nature;

2. Centres which are based on cost-sharing arrangements; and

3. Centres which undertake contract research and development.

While the three categories are not water-tight compartments, it is possible to distinguish them based on functions, assets and risk. It will be obvious that

in the first case the Development Centre performs significantly important functions and assumes substantial risks. In the third case, it will be obvious that the functions, assets and risk are minimal. The second case falls between the first and the third cases.

More often than not, the assessee claims that the Development Centre in India must be treated as a contract R&D service provider with insignificant risk. Consequently, the assessee claims that in such cases the Transactional Net Margin Method (TNMM) must be adopted as the most appropriate method.

The CBDT has carefully considered the matter and lays down the following guidelines for identifying the Development Centre as a contract R&D service provider with insignificant risk.

1. Foreign principal performs most of the economically significant functions involved in research or product development cycle either through its own employees or through its associated enterprises while the Indian Development Centre carries out the work assigned to it by the foreign principal. Economically significant functions would include critical functions such as conceptualization and design of the product and providing the strategic direction and framework;

2. The foreign principal or its associated enterprise(s) provides funds/capital and other economically significant assets including intangibles for research or product development. The foreign principal or its associated enterprise(s) also provides a remuneration to the Indian Development Centre for the work carried out by the latter;

3. The Indian Development Centre works under the direct supervision of the foreign principal or its associated enterprise which has not only the capability to control or supervise but also actually controls or supervises research or product development through its strategic decisions to perform core functions as well as monitor activities on regular basis;

4. The Indian Development Centre does not assume or has no economically significant realized risks. If a contract shows that the foreign principal is obligated to control the risk but the conduct shows that the Indian Development Centre is doing so, then the contractual terms are not the final determinant of actual activities;

5. In the case of a foreign principal being located in a country/territory widely perceived as a low or no tax jurisdiction, it will be presumed

that the foreign principal is not controlling the risk. However, the Indian Development Centre may rebut this presumption to the satisfaction of the revenue authorities. Low tax jurisdiction shall mean any country or territory notified in this behalf under section 94A of the Act or any other country or territory that may be notified for the purpose of Chapter X of the Act;

6. Indian Development Centre has no ownership right (legal or economic) on the outcome of the research which vests with the foreign principal and that this is evident from the contract as well as from the conduct of the parties.

The Assessing Officer or the Transfer Pricing Officer, as the case may be, shall have regard to the guidelines above and shall take a decision based on the totality of the facts and circumstances of the case. In doing so, the Assessing Officer or the Transfer Pricing Officer, as the case may be, shall be guided by the conduct of the parties and not merely by the terms of the contract.

The Assessing Officer or the Transfer Pricing Officer, as the case may be, shall bear in mind the provisions of section 92C of the Act and Rule 10A to Rule 10C of the Rules. He shall also apply the guidelines enumerated above and select the 'most appropriate method'.

The above may be brought to the notice of all concerned.

6. Clarifications on Rollback Provisions of Advance Pricing Agreement Scheme

Circular No. 10/2015 [F.No. 500/7/2015-APA-II] DATED 10-06-2015

The Advance Pricing Agreement provisions were introduced in 2012 through insertion of sections 92CC and 92CD in the Income-tax Act, 1961 by the Finance Act, 2012. Subsequently, the Advance Pricing Agreement Scheme was notified vide S.O. 2005 (E), dated 30/8/2012, thereby inserting Rules 10F to 10T and Rule 44GA in the Income-tax Rules, 1962.

2. Rollback provisions in the APA Scheme were introduced through subsection (9A) inserted in section 92CC by the Finance (No. 2) Act, 2014 and the relevant rules, namely, Rules 10MA and 10RA, have been notified recently vide S.O. 758(E) dated 14th March, 2015 and S.O. 915(E) dated 1st April, 2015. Subsequent to the notification of the rules, requests for clarification regarding certain issues have been received in the Central Board

of Direct Taxes. In order to clarify such issues, the Board has decided to adopt a Question and Answer format and the clarifications are hereby provided as below:

Q.1 Under rule 10 MA(2)(ii) there is a condition that the return of income for the relevant roll back year has been or is furnished by the applicant before the due date specified in Explanation 2 to sub-section (1) of section 139 of the Income tax

Act (hereinafter referred to as the 'Act'). It is not clear as to whether applicants who have filed returns under section 139(4) or 139(5) of the Act would be eligible for roll back.

Answer:

The return of income under section 139(5) of the Act can be filed only when a return under section 139(1) has already been filed. Therefore, the return of income filed under section 139(5) of the Act, replaces the original return of income filed under section 139(1) of the Act. Hence, if there is a return which is filed under section 139(5) of the Act to revise the original return filed before the due date specified in Explanation 2 to sub-section (1) of section 139, the applicant would be entitled for rollback on this revised return of income. However, rollback provisions will not be available in case of a return of income filed under section 139(4) because it is a return which is not filed before the due date.

Q.2 Rule 10MA (2)(i) mandates that the rollback provision shall apply in respect of an international transaction that is same as the international transaction to which the agreement (other than the rollback provision) applies. It is not clear what is the meaning of the word "same". Further, it is not clear whether this restriction also applies to the Functions, Assets, Risks (FAR) analysis.

Answer:

The international transaction for which a rollback provision is to be allowed should be the same as the one proposed to be undertaken in the future years and in respect of which the agreement has been reached. There cannot be a situation where rollback is finalised for a transaction which is not covered in the agreement for future years. The term same international transaction implies that the transaction in the rollback year has to be of same nature and undertaken with the same associated enterprise(s), as proposed to be undertaken in the future years and in respect of which agreement has been

reached. In the context of FAR analysis, the restriction would operate to ensure that rollback provisions would apply only if the FAR analysis of the rollback year does not differ materially from the FAR validated for the purpose of reaching an agreement in respect of international transactions to be undertaken in the future years for which the agreement applies. The word "materially" is generally being defined in the Advance Pricing Agreements being entered into by CBDT. According to this definition, the word "materially" will be interpreted consistently with its ordinary definition and in a manner that a material change of facts and circumstances would be understood as a change which could reasonably have resulted in an agreement with significantly different terms and conditions.

Q.3 Rule 10MA (2)(iv) requires that the application for rollback provision, in respect of an international transaction, has to be made by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant. Clarification is required as to whether rollback has to be requested for all four years or applicant can choose the years out of the block of four years.

Answer:

The applicant does not have the option to choose the years for which it wants to apply for rollback. The applicant has to either apply for all the four years or not apply at all. However, if the covered international transaction(s) did not exist in a rollback year or there is some disqualification in a rollback year, then the applicant can apply for rollback for less than four years. Accordingly, if the covered international transaction(s) were not in existence during any of the rollback years, the applicant can apply for rollback for the remaining years. Similarly, if in any of the rollback years for the covered international transaction(s), the applicant fails the test of the rollback conditions contained in various provisions, then it would be denied the benefit of rollback for that rollback year. However, for other rollback years, it can still apply for rollback.

Q.4 Rule 10 MA(3) states that the rollback provision shall not be provided in respect of an international transaction for a rollback year if the determination of arm's length price of the said international transaction for the said year has been the subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement. Further, Rule 10 RA(4) provides that if any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback

year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant.

There is a need to clarify the phrase "Tribunal has passed an order disposing of such appeal" and on the mismatch, if any, between Rule 10MA(3) and Rule 10RA(4).

Answer:

The reason for not allowing rollback for the international transaction for which Appellate Tribunal has passed an order disposing of an appeal is that the ITAT is the final fact finding authority and hence, on factual issues, the matter has already reached finality in that year. However, if the ITAT has not decided the matter and has only set aside the order for fresh consideration of the matter by the lower authorities with full discretion at their disposal, the matter shall not be treated as one having reached finality and hence, benefit of rollback can still be given. There is no mismatch between Rule 10MA(3) and Rule 10RA(4).

Q.5 Rule 10MA(3)(ii) provides that rollback provision shall not be provided in respect of an international transaction for a rollback year if the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year. It may be clarified whether the rollback provisions in such situations can be applied in a manner so as to ensure that the returned income or loss is accepted as the final income or loss after applying the rollback provisions.

Answer:

It is clarified that in case the terms of rollback provisions contain specific agreement between the Board and the applicant that the agreed determination of ALP or the agreed manner of determination of ALP is subject to the condition that the ALP would get modified to the extent that it does not result in reducing the total income or increasing the total loss, as the case may be, of the applicant as declared in the return of income of the said year, the rollback provisions could be applied. For example, if the declared income is ₹100, the income as adjusted by the TPO is ₹120, and the application of the rollback provisions results in reducing the income to ₹90, then the rollback for that year would be determined in a manner that the declared income ₹100 would be treated as the final income for that year.

Q.6 Rule 10RA(7) states that in case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled. It is to be clarified as to whether the entire agreement is to be cancelled or only that year for which roll back fails.

Answer:

The procedure for giving effect to a rollback provision is laid down in Rule 10RA. Sub-rules (2), (3), (4) and (6) of the Rule specify the actions to be taken by the applicant in order that effect may be given to the rollback provision. If the applicant does not carry out such actions for any of the rollback years, the entire agreement shall be cancelled. This is because the rollback provision has been introduced for the benefit of the applicant and is applicable at its option. Accordingly, if the rollback provision cannot be given effect to for any of the rollback years on account of the applicant not taking the actions specified in sub-rules (2), (3), (4) or (6), the entire agreement gets vitiated and will have to be cancelled.

Q.7 If there is a Mutual Agreement Procedure (MAP) application already pending for a rollback year, what would be the stand of the APA authorities? Further, what would be the view of the APA Authorities if MAP has already been concluded for a rollback year?

Answer:

If MAP has been already concluded for any of the international transactions in any of the rollback year under APA, rollback provisions would not be allowed for those international transactions for that year but could be allowed for other years or for other international transactions for that year, subject to fulfilment of specified conditions in Rules 10MA and 10RA. However, if MAP request is pending for any of the rollback year under APA, upon the option exercised by the applicant, either MAP or application for roll back shall be proceeded with for such year.

Q.8 Rule 10MA(1) provides that the agreement may provide for determining ALP or manner of determination of ALP. However, Rule 10MA(4) only specifies that the manner of determination of ALP should be the same as in the APA term. Does that mean the ALP could be different?

Answer:

Yes, the ALP could be different for different years. However, the manner of determination of ALP (including choice of Method, comparability analysis and Tested Party) would be same.

Q.9 Will there be compliance audit for roll back? Would critical assumptions have to be validated during compliance audit?

Answer:

Since rollback provisions are for past years, ALP for the rollback years would be agreed after full examination of all the facts, including validation of critical assumptions. Hence, compliance audit for the rollback years would primarily be to check if the agreed price or methodology has been applied in the modified return.

Q.10 Whether applicant has an option to withdraw its rollback application? Can the applicant accept the rollback results without accepting the APA for the future years?

Answer:

The applicant has an option to withdraw its roll back application even while maintaining the APA application for the future years. However, it is not possible to accept the rollback results without accepting the APA for the future years. It may also be noted that the fee specified in Rule 10MA(5) shall not be refunded even where a rollback application is withdrawn.

Q.11 For already concluded APAs, will new APAs be signed for rollback or earlier APAs could be revised?

Answer:

The second proviso to Rule 10MA(5) provides for revision of APAs already concluded to include rollback provisions.

Q.12 For already concluded APAs, where the modified return has already been filed for the first year of the APA term, how will the time-limit for filing modified return for rollback years be determined?

Answer:

The time to file modified return for rollback years will start from the date of signing the revised APA incorporating the rollback provisions.

Q.13 In case of merger of companies, where one or more of those companies are APA applicants, how would the rollback provisions be allowed and to which company or companies would it be allowed?

Answer:

The agreement is between the Board and a person. The principle to be followed in case of merger is that the person (company) who makes the APA

application would only be entitled to enter into the agreement and be entitled for the rollback provisions in respect of international transactions undertaken by it in rollback years. Other persons (companies) who have merged with this person (company) would not be eligible for the rollback provisions. To illustrate, if A, B and C merge to form C and C is the APA applicant, then the agreement can only be entered into with C and only C would be eligible for the rollback provisions. A and B would not be eligible for the rollback provisions. To illustrate further, if A and B merge to form a new company C and C is the APA applicant, then nobody would be eligible for rollback provisions.

Q.14 In case of a demerger of an APA applicant or signatory into two or more companies (persons), who would be eligible for the rollback provisions?

Answer:

The same principle as mentioned in the previous answer, i.e., the person (company) who makes an APA application or enters into an APA would only be entitled for the rollback provisions, would continue to apply. To illustrate, if A has applied for or entered into an APA and, subsequently, demerges into A and B, then only A will be eligible for rollback for international transactions covered under the APA. As B was not in existence in rollback years, availing or grant of rollback to B does not arise.

7. INSTRUCTION NO. 3/2016 DATED 10TH MARCH, 2016 - GUIDELINES FOR IMPLEMENTATION OF TRANSFER PRICING PROVISIONS - REPLACEMENT OF INSTRUCTION NO. 15/2015

The provisions relating to transfer pricing are contained in Sections 92 to 92F in Chapter X of the Income-tax Act, 1961. These provisions came into force w.e.f. Assessment Year 2002-2003 and have seen a number of amendments over the years, including the insertion of Safe Harbour and Advance Pricing Agreement provisions and the extension of the applicability of transfer pricing provisions to Specified Domestic Transactions.

2. In terms of the provisions, any income arising from an international transaction or specified domestic transaction between two or more associated enterprises shall be computed having regard to the Arm's Length Price. Instruction No. 3 was issued on 201h May, 2003 to provide guidance to the Transfer Pricing Officers (TPOs) and the Assessing Officers (AOs) to operationalise the transfer pricing provisions and to have procedural uniformity. Due to a number of legislative, procedural and structural changes carried out over the last few years, Instruction No. 3 of 2003 was replaced

with Instruction No. 15/2015, dated 161h October, 2015. After the issuance of Instruction No. 15/2015, the Board has received some suggestions and queries, which have been examined in detail. Accordingly, this Instruction is being issued to replace Instruction No. 15 of 2015. This Instruction is applicable for both international transactions and specified domestic transactions between associated enterprises. The guidelines on various issues are as follows:

3. Reference to Transfer Pricing Officer {TPO)

3.1 The power to determine the Arm's Length Price (ALP) in an international transaction or specified domestic transaction is contained in sub-section (3) of Section 92C. However, Section 92CA provides that where the Assessing Officer (AO) considers it necessary or expedient so to do, he may refer the computation of ALP in relation to an international transaction or specified domestic transaction to the TPO. For proper administration of the Income-tax Act, the Board has decided that the AO shall henceforth make a reference to the TPO only under the circumstances laid out in this Instruction.

3.2 All cases selected for scrutiny, either under the Computer Assisted Scrutiny Selection [CASS] system or under the compulsory manual selection system (in accordance with the CBDT's annual instructions in this regard - for example, Instruction No. 6/2014 for selection in F.Y 2014-15 and Instruction No. 8/2015 for selection in F.Y 2015-16), on the basis of transfer pricing risk parameters [in respect of international transactions or specified domestic transactions or both] have to be referred to the TPO by the AO, after obtaining the approval of the jurisdictional Principal Commissioner of Income-tax (PCIT) or Commissioner of Income-tax (CIT). The fact that a case has been selected for scrutiny on a TP risk parameter becomes clear from a perusal of the reasons for which a particular case has been selected and the same are invariably available with the jurisdictional AO. Thus, if the reason or one of the reasons for selection of a case for scrutiny is a TP risk parameter, then the case has to be mandatorily referred to the TPO by the AO, after obtaining the approval of the jurisdictional PCIT or CIT.

3.3 Cases selected for scrutiny on non-transfer pricing risk parameters but also having international transactions or specified domestic transactions, shall be referred to TPOs only in the following circumstances:

(a) where the AO comes to know that the taxpayer has entered into international transactions or specified domestic transactions or both but the taxpayer has either not filed the Accountant's report under

Section 92E at all or has not disclosed the said transactions in the Accountant's report filed;

(b) where there has been a transfer pricing adjustment of Rs. 1O Crore or more in an earlier assessment year and such adjustment has been upheld by the judicial authorities or is pending in appeal; and

(c) where search and seizure or survey operations have been carried out under the provisions of the Income-tax Act and findings regarding transfer pricing issues in respect of international transactions or specified domestic transactions or both have been recorded by the Investigation Wing or the AO.

3.4 For cases to be referred by the AO to the TPO in accordance with paragraphs 3.2 and 3.3 above, in respect of transactions having the following situations, the AO must, as a jurisdictional requirement, record his satisfaction that there is an income or a potential of an income arising and/or being affected on determination of the ALP of an international transaction or specified domestic transaction before seeking approval of the PCIT or CIT to refer the matter to the TPO for determination of the ALP:

- where the taxpayer has not filed the Accountant's report under Section 92E of the Act but the international transactions or specified domestic transactions undertaken by it come to the notice of the AO;
- where the taxpayer has not declared one or more international transaction or specified domestic transaction in the Accountant's report filed under Section 92E of the Act and the said transaction or transactions come to the notice of the AO; and
- where the taxpayer has declared the international transactions or specified domestic transactions in the Accountant's report filed under Section 92E of the Act but has made certain qualifying remarks to the effect that the said transactions are not international transactions or specified domestic transactions or they do not impact the income of the taxpayer.

In the above three situations, the AO must provide an opportunity of being heard to the taxpayer before recording his satisfaction or otherwise. In case no objection is raised by the taxpayer to the applicability of Chapter X [Sections 92 to 92F] of the Act to these three situations, then AO should refer the international transaction or specified domestic transaction to the TPO for determining the ALP after obtaining the approval of the PCIT or CIT. However, where the applicability of Chapter X [Sections 92 to 92F] to these

three situations is objected to by the taxpayer, the AO must consider the taxpayer's objections and pass a speaking order so as to comply with the principles of natural justice. If the AO decides in the said order that the transaction in question needs to be referred to the TPO, he should make a reference after obtaining the approval of the PCIT or CIT.

3.5 In addition to the cases to be referred as per paragraphs 3.2 and 3.3, a case involving a transfer pricing adjustment in an earlier assessment year that has been fully or partially set-aside by the ITAT, High Court or Supreme Court on the issue of the said adjustment shall invariably be referred to the TPO for determination of the ALP.

3.6 Since the provisions of Section 92CA of the Act, inter-alia, refer to the computation of the ALP of the international transaction or specified domestic transaction, it is imperative for the AO to ensure that all international transactions or relevant specified domestic transactions or both, as the case may be, are explicitly mentioned in the letter through which the reference is made to the TPO. In this regard, guidelines as under may be followed:

(a) If a case has been selected for scrutiny on a TP risk parameter pertaining to international transactions only, then the international transactions shall alone be referred to the TPO;

(b) If a case has been selected for scrutiny on a TP risk parameter pertaining to specified domestic transactions only, then the specified domestic transactions shall alone be referred to the TPO; and

(c) If a case has been selected for scrutiny on the basis of TP risk parameters pertaining to both international transactions and specified domestic transactions, then the international transactions and the specified domestic transactions shall together be referred to the TPO. Since international transactions may be benchmarked together at the entity level due to the inter-linkages amongst them, if a case has been selected for scrutiny on a TP risk parameter pertaining to one or more international transactions, then all the international transactions entered into by the taxpayer - except those about which the AO has decided not to make a reference as per paragraph 3.4 - shall be referred to the TPO.

3.7 For administering the transfer pricing regime in an efficient manner, it is clarified that though AO has the power under Section 92C to determine the ALP of international transactions or specified domestic transactions, determination of ALP should not be carried out at all by the AO in a case

where reference is not made to the TPO. However, in such cases, the AO must record in the body of the assessment order that due to the Board's Instruction on this matter, the transfer pricing issue has not been examined at all.

4. Role of Transfer Pricing Officer (TPO)

4.1 The role of the TPO begins after a reference is received from the AO. In terms of Section 92CA, this role is limited to the determination of the ALP in relation to international transactions or specified domestic transactions referred to him by the AO. However, if any other international transaction comes to the notice of the TPO during the course of the proceedings before him, then he is empowered to determine the ALP of such other international transactions also by virtue of Section 92CA (2A) and (2B). The transfer price has to be determined by the TPO in terms of Section 92C. The price has to be determined by using any one of the methods stipulated in sub-section (1) of Section 92C and by applying the most appropriate method referred to in Sub-section (2) thereof. There may be occasions where application of the most appropriate method provides results which are different but equally reliable. In all such cases, further scrutiny may be necessary to evaluate the appropriateness of the method, the correctness of the data, weight given to various factors and so on. The selection of the most appropriate method will depend upon the facts of the case and the factors mentioned in Rule 1OC. The TPO, after taking into account all relevant facts and data available to him, shall determine the ALP and pass a speaking order.

4.2 The TPO's order should contain details of the data used, reasons for arriving at a certain price and the applicability of methods. It may be emphasised that the application of method including the application of the most appropriate method, the data used, factors governing the applicability of respective methods, computation of price under a given method will all be subjected to judicial scrutiny. It is, therefore, necessary that the order of the TPO contains adequate reasons on all these counts. Copies of the documents or the relevant data used in arriving at the arm's length price should be made available to the AO for his records and the use at subsequent stages of appellate or penal proceedings.

4.3 The TPO, being an Additional/ Joint CIT, shall obtain the approval of the jurisdictional CIT (Transfer Pricing) before passing the order. On the other hand, the TPO, being a Deputy I Assistant CIT, shall obtain the approval of the jurisdictional Additional/ Joint CIT before passing the order. The jurisdictional CIT (TP} should assign a limited number of important and

complex cases, not exceeding 50, to the Additional/ Joint CsIT (TPOs) working in the same jurisdiction. For the selection of such important and complex cases by the CsIT (TP), the concerned CCsIT (International Taxation) shall frame appropriate guidelines.

4.4 In addition to the above, the TPO is required to carry out the Compliance Audit of the Advance Pricing Agreements (APAs) entered into by the Board and the taxpayers in accordance with Rule 1OP of the Income-tax Rules.

4.5 The TPO is also required to play an important role in respect of Safe Harbour provisions. Whenever a reference is made to the TPO under subrule (4) or sub-rule (10) of Rule 1OTE of the Income-tax Rules, the TPO has to carefully examine all the facts and circumstances of the taxpayer's exercise of an option for Safe Harbour and pass an order in writing as mandated in sub-rule (6) or sub-rule (11) of the said Rule, respectively.

5. Role of the AO after Determination of ALP by the TPO

Under sub-section (4) of Section 92C (read with sub-section (4) of Section 92CA), the AO has to compute the total income of the assessee in conformity with the ALP determined by the TPO under sub-section (3) of Section 92CA.

6. Maintenance of Data Base

It is to be ensured by the CIT (TP) that the references received from the AOs by the TPOs in his jurisdiction are dealt with expeditiously and accurate record of all events connected with the whole process of determination of ALP is maintained. This record is to be maintained by each TPO, separately for international transactions and specified domestic transactions, in the formats enclosed as Annexure-1 and Annexure-11 to this Instruction and the same shall be maintained electronically on the Department's ITBA system as and when the same becomes fully functional. These formats will serve as an important database for future action and also help in bringing about uniformity in the determination of the ALP in identical or substantially identical cases. The CsIT (TP) must ensure that a consolidated report for the entire Charge is generated and stored after the completion of each transfer pricing audit cycle.

This issues under Section 119 of the Income-tax Act, 1961 and replaces Instruction No. 15 of 2015 with immediate effect. References made to TPOs u/s 92CA of the Act after the issuance of Instruction No. 15/2015, which are not in conformity with this Instruction, may be withdrawn by the concerned PCIT or CIT.

8. SECTION 92CC OF THE INCOME-TAX ACT, 1961 - TRANSFER PRICING - ADVANCE PRICING AGREEMENT (APA) - CBDT INKS THE THREE HUNDRED ADVANCE PRICING AGREEMENT CBDT PRESS RELEASE, DATED 1-10-2019

The Central Board of Direct Taxes (CBDT) has signed the 300th Advance Pricing Agreement during the month of September, 2019. This is a significant landmark of India's APA Programme, which is currently in its seventh year.

Three APAs were entered into in September, 2019 (2 Unilateral and 1 Bilateral APA), which has taken the total number of APAs signed by CBDT to 300. During the ongoing fiscal, the total number of APAs entered into has gone up to 29 (27 Unilateral and 2 Bilateral APAs). The Bilateral APA signed in September, 2019 pertains to United Kingdom.

The APAs entered into during September, 2019 pertain to various sectors of the economy like retail, garments, and consumer foods. The international transactions covered in these agreements, inter alia, include provision of software development services, contract manufacturing, provision of IT enabled Services and provision of Support Services.

The APA Scheme continues to make good progress in providing tax certainty to MNEs. It reflects the Government's commitment towards fostering a non-adversarial tax regime.

9. INCOME-TAX (SECOND AMENDMENT) RULES, 2020 - AMENDMENT IN RULES 10DA AND 10DB NOTIFICATION G.S.R. 14(E)[NO.03/2020 (F. NO. 370142/19/2019-TPL)], DATED 6-1-2020

In exercise of the powers conferred by sub-section (1) and sub-section (4) of section 92D and sub-section (8) of section 286 read with section 295 of the Income-tax Act, 1961 (43 of 1961), the Central Board of Direct Taxes hereby makes the following rules further to amend the Income-tax Rules, 1962, namely: -

1. *Short title and commencement*—(1) These rules may be called the Income-tax (2nd Amendment) Rules, 2020.

(2) Save as otherwise provided in these rules, they shall come into force on the date of their publication in the Official Gazette.

2. In the Income-tax Rules, 1962 (hereinafter referred to as the said rules), in rule 10 DA, with effect from the 1st day of April, 2020, —

(a) for the marginal heading, the following marginal heading shall be substituted, namely: -"Maintenance and furnishing of information and document by certain person under section 92D";

(b) for sub-rules (2), (3), (4) and (5), the following sub-rules shall be substituted, namely: -

"(2) The information and document specified under sub-rule (1) shall be furnished to the Joint Commissioner referred to in sub-rule (1) of rule 10DB, in Form No. 3CEAA on or before the due date for furnishing the return of income as specified under sub-section (1) of section 139.

(3) The constituent entity shall furnish Part A of Form No. 3CEAA even if the conditions specified under sub-rule (1) are not satisfied.

(4) Where there are more than one constituent entities resident in India of an international group, the Form No. 3CEAA may be furnished by any one constituent entity, if, —

(*a*) the international group has designated such entity for this purpose; and

(*b*) the information has been conveyed in Form No. 3CEAB to the Joint Commissioner referred to in sub-rule (1) of rule 10DB, in this behalf thirty days before the due date of furnishing the Form No. 3CEAA.";

(*c*) sub-rules (6), (7) and (8) shall be re-numbered as sub-rules (5), (6) and (7) respectively.

3. In the said rules, in rule 10DB, —

(*a*) for sub-rules (1) and (2), the following shall be substituted, namely: -

"(1) The income-tax authority for the purposes of section 286 shall be the Joint Commissioner as may be designated by the Director General of Income-tax (Risk Assessment).

(2) The notification under sub-section (1) of section 286 shall be made in Form No. 3CEAC two months prior to the due date for furnishing of report as specified under sub-section (2) of said section.";

10. NOTIFICATION NO. 50/2017/F. NO. 500/1/2014-APA-II DATED 9TH JUNE, 2017

S.O. 1866(E).—In exercise of the powers conferred by the third proviso to sub-section (2) of section 92C of the Income-tax Act, 1961 (43 of 1961)(hereinafter referred to as the 'Act'), read with proviso to sub-rule (7) of rule 10CA of the Income-tax Rules, 1962, the Central Government hereby notifies that where the variation between the arm's length price determined under section 92C of the Act and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed one per cent. of the latter in respect of wholesale trading and three per cent. of the latter in all other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price for assessment year 2017-18 and assessment year 2018-19.

Explanation.- For the purposes of this notification, "wholesale trading" means an international transaction or specified domestic transaction of trading in goods, which fulfils the following conditions, namely:—

(i) purchase cost of finished goods is eighty per cent. or more of the total cost pertaining to such trading activities; and

(ii) average monthly closing inventory of such goods is ten per cent. or less of sales pertaining to such trading activities.

11. NOTIFICATION NO. 64/2019/F. NO. 500/1/2014-APA-11 DATED: 13TH SEPTEMBER, 2019

S.O. 3272(E).—In exercise of the powers conferred by the third proviso to sub-section (2) of section 92C of the Income-tax Act, 1961 (43 of 1961)(hereinafter referred to as the 'said Act'), read with proviso to sub-rule (7) of rule 10CA of the Income-tax Rules, 1962, the Central Government hereby notifies that where the variation between the arm's length price determined under section 92C of the said Act and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed one per cent. of the latter in respect of wholesale trading and three per cent. of the latter in all other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price for assessment year 2019-2020.

Explanation.- For the purposes of this notification, "wholesale trading" means an international transaction or specified domestic transaction of

trading in goods, which fulfils the following conditions, namely:-

(i) purchase cost of finished goods is eighty per cent. or more of the total cost pertaining to such trading activities; and

(ii) average monthly closing inventory of such goods is ten per cent. or less of sales pertaining to such trading activities.

12. Notification No. 25/2020/ F. No. 370142/14/2020-TPL dated 20th May, 2020

G.S.R. 304(E).— In exercise of the powers conferred by section 295 read with sub-section (2) of section 92CB of the Income-tax Act, 1961 (43 of 1961), the Central Board of Direct Taxes hereby makes the following rules further to amend the Income-tax Rules, 1962, namely:___

1. Short title and commencement.—(1) These rules may be called the Income-tax (9th Amendment) Rules, 2020.

(2) They shall come into force and shall be deemed to have come into force from the 1st day of April, 2020.

2. In the Income-tax Rules, 1962,—

(i) in rule 10TD, after sub-rule (3A), the following rule shall be inserted, namely:— "(3B) The provisions of sub-rules (1) and (2A) shall apply for the assessment year 2020-21";

(ii) in rule 10TE, in sub-rule (2), after the third proviso, the following proviso shall be inserted, namely: ___ "Provided also that nothing contained in this sub-rule shall apply to the option for safe harbour validly exercised under sub-rule (3B) of rule 10TD."; and

(iii) in Appendix II, in Form No 3CEFA, in the heading, in the brackets, for the word and figure "rule 10" the word, figure and letters "rule 10TE" shall be substituted.

13. NOTIFICATION S.O. 2928(E)[NO. 70/2022/F. NO. 500/1/2014-APA-II] [28-06-2022]

S.O. 2928(E).—In exercise of the powers conferred by the third proviso to sub-section (2) of section 92C of the Income-tax Act, 1961 (43 of 1961)(hereafter referred to as the „said Act"), read with proviso to sub-rule (7) of rule 10CA of the Income-tax Rules, 1962, the Central Government hereby notifies that where the variation between the arm"s length price determined under section 92C of the said Act and the price at which the international transaction or specified domestic transaction has actually been

undertaken does not exceed one per cent. of the latter in respect of wholesale trading and three per cent. of the latter in all other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm"s length price for assessment year 2022-2023.

Explanation.- For the purposes of this notification, "wholesale trading" means an international transaction or specified domestic transaction of trading in goods, which fulfils the following conditions, namely:-

(i) purchase cost of finished goods is eighty per cent. or more of the total cost pertaining to such trading activities; and

(ii) average monthly closing inventory of such goods is ten per cent. or less of sales pertaining to such trading activities.

Explanatory Memorandum

The notification provides for tolerance range of one per cent. for wholesale trading and three per cent. in all other cases for assessment year 2022-2023. It is certified that none will be adversely affected by the retrospective effect being given to the notification.

14. Notification No. 66 /2022/F. No. 370142/26/2022-TPL

G.S.R. 458(E).—In exercise of the powers conferred by section 295 read with sub-section (2) of section 92CB of the Income-tax Act, 1961 (43 of 1961), the Central Board of Direct Taxes hereby makes the following rules further to amend the Income-tax Rules, 1962, namely:—

1. Short title and commencement. - (1) These rules may be called the Income-tax (18th Amendment) Rules, 2022.

(2) They shall be deemed to have come into force from the 1st day of April, 2022.

2. In the Income-tax Rules, 1962, in rule 10TD, in sub-rule (3B), for the words and figures "assessment years 2020-21 and 2021-22", the words and figures "assessment years 2020-21, 2021-22 and 2022-23" shall be substituted.

Explanatory Memorandum : This amendment is effective from 1st day of April, 2022 and applies to assessment year 2022 -2023 relevant to previous year 2021-2022. Accordingly, it is hereby certified that no person is being adversely affected by giving retrospective effect to these rules.

Note : The principal rules were published in the Gazette of India, Extraordinary, Part-II, section-3, subsection (ii) vide number S.O. 969 (E) dated the 26th March, 1962 and were last amended vide notification number G.S.R. 455 (E), dated the 16th June, 2022.

15. Notification No. 124/2021/F. No. 500/1/2014-APA-II]

S.O. 4586(E).—In exercise of the powers conferred by the third proviso to sub-section (2) of section 92C of the Income-tax Act, 1961 (43 of 1961)(hereafter referred to as the „said Act"), read with proviso to sub-rule (7) of rule 10CA of the Income-tax Rules, 1962, the Central Government hereby notifies that where the variation between the arm"s length price determined under section 92C and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed one per cent. of the latter in respect of wholesale trading and three per cent. of the latter in all other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm"s length price for Assessment Year 2021-2022.

Explanation.- For the purposes of this notification, "wholesale trading" means an international transaction or specified domestic transaction of trading in goods, which fulfils the following conditions, namely:-

(i) purchase cost of finished goods is eighty per cent. or more of the total cost pertaining to such trading activities; and

(ii) average monthly closing inventory of such goods is ten per cent. or less of sales pertaining to such trading activities.

Explanatory Memorandum

The notification provides for tolerance range of one per cent. for wholesale trading and three per cent. in all other cases for assessment year 2021-2022. It is certified that none will be adversely affected by the retrospective effect being given to the notification

16. INCOME-TAX (EIGHTEENTH AMENDMENT) RULES, 2022 - AMENDMENT IN RULE 10TD

NOTIFICATION G.S.R. 458(E) [NO. 66/2022/F. NO. 370142/26/2022-TPL], DATED 17-6-2022

In exercise of the powers conferred by section 295, read with sub-section (2) of section 92CB of the Income-tax Act, 1961 (43 of 1961), the Central Board

of Direct Taxes hereby makes the following rules further to amend the Income-tax Rules, 1962, namely:—

Short title and commencement.

1. (1) These rules may be called the Income-tax (18th Amendment) Rules, 2022.

(2) They shall be deemed to have come into force from the 1st day of April, 2022.

2. In the Income-tax Rules, 1962, in rule 10TD, in sub-rule (3B), for the words and figures "assessment years 2020-21 and 2021-22", the words and figures "assessment years 2020-21, 2021-22 and 2022-23" shall be substituted.

17. SECTION 92C OF THE INCOME-TAX ACT, 1961, READ WITH RULE 10CA OF THE INCOME-TAX RULES, 1962 - COMPUTATION OF ARM'S LENGTH PRICE - DEEMED ARM'S LENGTH PRICE FOR ASSESSMENT YEAR 2021-22

NOTIFICATION S.O. 4586(E) [NO. 124/2021/F. NO. 500/1/2014-APA-II], DATED 29-10-2021

In exercise of the powers conferred by the third proviso to sub-section (2) of section 92C of the Income-tax Act, 1961 (43 of 1961)(hereafter referred to as the 'said Act'), read with proviso to sub-rule (7) of rule 10CA of the Income-tax Rules, 1962, the Central Government hereby notifies that where the variation between the arm's length price determined under section 92C and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed one per cent. of the latter in respect of wholesale trading and three per cent. of the latter in all other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price for Assessment Year 2021-22.

Explanation.—For the purposes of this notification, "wholesale trading" means an international transaction or specified domestic transaction of trading in goods, which fulfils the following conditions, namely:—

(*i*) purchase cost of finished goods is eighty per cent. or more of the total cost pertaining to such trading activities; and

(*ii*) average monthly closing inventory of such goods is ten per cent. or less of sales pertaining to such trading activities.

18. INCOME-TAX (THIRTIETH AMENDMENT) RULES, 2021 - AMENDMENT IN RULE 10TD

NOTIFICATION NO. G.S.R. 661(E) [NO. 117/2021/F. NO. 370142/44/2021-TPL, DATED 24-9-2021

In exercise of the powers conferred by sub-section (2) of section 92CB, read with section 295 of the Income-tax Act, 1961 (43 of 1961), the Central Board of Direct Taxes hereby makes the following rules further to amend the Income-tax Rules, 1962, namely:—

Short title and commencement

1. (1) These rules may be called the Income-tax (30th Amendment) Rules, 2021.

(2) They shall be deemed to have come into force from the 1st day of April, 2021.

2. In the Income-tax Rules, 1962, in rule 10TD, in sub-rule (3B), for the words and figures "assessment year 2020-21", the words and figures "assessment years 2020-21 and 2021-22" shall be substituted.

19. INCOME-TAX (NINTH AMENDMENT) RULES, 2021 - AMENDMENT IN RULES 10DA AND 10DB, AND FORM NO. 3CEAB

NOTIFICATION G.S.R 250(E) [NO. 31/2021/F.NO.370142/19/2019-TPL], DATED 5-4-2021

In exercise of the powers conferred by sub-section (1) and sub-section (4) of section 92D and sub-section (8) of section 286, read with section 295 of the Income-tax Act, 1961 (43 of 1961), the Central Board of Direct Taxes hereby makes the following rules further to amend the Income-tax Rules, 1962, namely:—

Short title and commencement

1. (1) These rules may be called the Income-tax (9th Amendment) Rules, 2021.

(2) They shall come into force on the 1st day of April, 2021.

2. In the Income-tax Rules, 1962 (hereinafter referred to as the principal rules), in rule 10DA,—

(*a*) in sub-rule (2), for the word "Commissioner", the word "Director" shall be substituted;

(*b*) in sub-rule (4), —

(*i*) for the words "constituent entities resident in India of an international group" the words, brackets and figure "constituent entities of an international group required to file the information and document under sub-rule (2)," shall be substituted;

(*ii*) in clause (*b*), for the word "Commissioner", the word "Director" shall be substituted.

3. In the principal rules, in rule 10DB,—

(*a*) for sub-rule (1) the following sub-rule shall be substituted, namely:—

"(1) The income-tax authority for the purposes of section 286 shall be the Joint Director as may be designated by the Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems), as the case may be.";

(*b*) in sub-rule (6), for the words "five thousand five hundred" the words "six thousand four hundred" shall be substituted.

4. In the principal rules, in the Appendix II, in Form No. 3CEAB, in the heading, the words", resident in India," shall be omitted.

20. SECTION 92C OF THE INCOME-TAX ACT, 1961 - TRANSFER PRICING - COMPUTATION OF ARM'S LENGTH PRICE - DEEMED ARM'S LENGTH PRICE IN CASE OF VARIATION IN ARM'S LENGTH PRICE DETERMINED UNDER SAID SECTION AND PRICE AT WHICH INTERNATIONAL TRANSACTION OR SPECIFIED DOMESTIC TRANSACTION HAD ACTUALLY BEEN UNDERTAKEN

NOTIFICATION NO. S.O. 3660 (E) [NO. 83/2020/F. NO. 500/1/2014-APA-II], DATED 19-10-2020

In exercise of the powers conferred by the third proviso to sub-section (2) of section 92C of the Income-tax Act, 1961 (43 of 1961) (hereinafter referred to as the 'said Act'), read with proviso to sub-rule (7) of rule 10CA of the Income-tax Rules, 1962, the Central Government hereby notifies that where the variation between the arm's length price determined under section 92C of the said Act and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed one per cent. of the latter in respect of wholesale trading and three per cent. of the latter in all other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price for assessment year 2020-21.

Explanation.— For the purposes of this notification, "wholesale trading" means an international transaction or specified domestic transaction of trading in goods, which fulfils the following conditions, namely:—

(*i*) purchase cost of finished goods is eighty per cent. or more of the total cost pertaining to such trading activities; and

(*ii*) average monthly closing inventory of such goods is ten per cent. or less of sales pertaining to such trading activities.

21. INCOME-TAX (TWENTY SECOND AMENDMENT) RULES, 2020 - AMENDMENT IN RULE 5, FORM NO. 3CD, FORM NO. 3CEB AND FORM ITR-6; INSERTION OF RULES 21AG, 21AH, FORM NO. 10-IE AND FORM NO. 10-IF

NOTIFICATION G.S.R. 610(E) [NO. 82/2020/F.NO.370142/30/2020-TPL], DATED 1-10-2020

In exercise of the powers conferred by section 44AB, section 92E, clause (*iv*) of sub-section (2) of section 115BAA, sub-clause (*iii*) of clause (*c*) of sub-section (2) of section 115BAB, clause (*iii*) of sub-section (2), proviso to sub-section (3) and sub-section (5) of section 115BAC, clause (*iii*) of sub-section (2), proviso to sub-section (3) and sub-section (5) of section 115BAD read with section 295 the Income-tax Act, 1961 (43 of 1961), the Central Board of Direct Taxes hereby makes the following rules further to amend the Income-tax Rules, 1962, namely: —

Short title and commencement

1. (1) These rules may be called the Income-tax (22nd Amendment) Rules, 2020.

(2) They shall come into force on the date of their publication in the Official Gazette.

2. In the Income-tax Rules, 1962 (hereafter referred to as the principal rules), —

(*a*) in rule 5, in sub-rule (1), for the proviso, the following proviso shall be substituted, namely:—

"Provided that the allowance under clause (*ii*) of sub-section (1) of section 32 in respect of depreciation of any block of assets entitled to more than forty per cent. shall be restricted to forty per cent. on the written down value of such block of assets in case of —

(*i*) a domestic company which has exercised option under sub-section (4) of section 115BA, or under sub-section (5) of section 115BAA, or under sub-section (7) of section 115BAB; or

(*ii*) an individual or Hindu undivided family which has exercised option under sub-section (5) of section 115BAC; or

(*iii*) a co-operative society resident in India which has exercised option under sub-section (5) of section 115BAD:

Provided further that, for the purposes of section 115BAA, if the following conditions are satisfied, namely: —

(*i*) option under sub-section (5) thereof is exercised for a previous year relevant to the assessment year beginning on the 1st day of April, 2020;

(*ii*) there is a depreciation allowance, in respect of a block of asset, from any earlier assessment year or allowance of unabsorbed depreciation deemed so under section 72A, which is attributable to the provisions in clause (*iia*) of sub-section (1) of section 32; and

(*iii*) such depreciation or allowance for unabsorbed depreciation is not allowed to be set off under clause (*ii*) or clause (*iii*) of sub-section (2) thereof, the written down value of the block of asset as on the 1st day of April, 2019 shall be increased by such depreciation or allowance for unabsorbed depreciation not allowed to be set off:

Provided also that, for the purposes of section 115BAC and section 115BAD, if the following conditions are satisfied, namely: —

(*i*) the option under sub-section (5) of the respective section is exercised for a previous year relevant to the assessment year beginning on the 1st day of April, 2021;

(*ii*) there is a depreciation allowance, in respect of a block of asset, from any earlier assessment year which is attributable to the provisions in clause (*iia*) of sub-section (1) of section 32; and

(*iii*) such depreciation is not allowed to be set off under sub-clause (*a*) of clause (*ii*) of sub-section (2) of section 115BAC or clause (*ii*) of sub-section (2) of section 115BAD,

the written down value of the block of asset as on the 1st day of April, 2020 shall be increased by such depreciation not allowed to be set off.";

(*b*) after rule 21AF, the following rules shall be inserted, namely: -

"Exercise of option under sub-section (5) of section 115BAC. - 21AG.––(1) The option to be exercised in accordance with the provisions of sub-section (5) of section 115BAC by a person, being an individual or Hindu undivided family, for any previous year relevant to the assessment year beginning on or after the 1st day of April, 2021, shall be in Form No. 10-IE.

(2) The option in Form No. 10-IE shall be furnished electronically either under digital signature or electronic verification code.

(3) The Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems), as the case may be, shall, -

(*i*) specify the procedure for filing of Form No. 10-IE;

(*ii*) specify the data structure, standards and manner of generation of electronic verification code, referred to in sub-rule (2), for verification of the person furnishing the said Form; and

(*iii*) be responsible for formulating and implementing appropriate security, archival and retrieval policies in relation to the Form so furnished.

Exercise of option under sub-section (5) of section 115BAD. - 21AH.––(1) The option to be exercised in accordance with the provisions of sub-section (5) of section 115BAD by a person, being a cooperative society resident in India, for any previous year relevant to the assessment year beginning on or after the 1st day of April, 2021, shall be in Form No. 10-IF.

(2) The option in Form No. 10-IF shall be furnished electronically either under digital signature or electronic verification code.

(3) The Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems), as the case may be, shall, -

(*i*) specify the procedure for filing of Form No. 10-IE;

(*ii*) specify the data structure, standards and manner of generation of electronic verification code, referred to in sub-rule (2), for verification of the person furnishing the said Form; and

(*iii*) be responsible for formulating and implementing appropriate security, archival and retrieval policies in relation to the Form so furnished.

3. In the principal rules, in Appendix II,-

(*a*) in Form No 3CD,-

(*i*) in Part A, after serial number 8 and the entries relating thereto, the following shall be inserted, namely: -

"8*a.* Whether the assessee has opted for taxation under section 115BA/115BAA/115BAB?";

(*ii*) in Part B, -

(I) in serial number 18, after clause (*c*), the following clauses shall be inserted, namely: -

"(*ca*) Adjustment made to the written down value under section 115BAA (for assessment year 2020-21 only) ……..

(*cb*) Adjusted written down value ……";

(II) in serial number 32, for clause (*a*), the following clause shall be substituted, namely: -

"(*a*) Details of brought forward loss or depreciation allowance, in the following manner, to the extent available:

Sl. No.	*Assessment Year*	*Nature of loss/allowance (in rupees)*	*Amount as returned* (in rupees)*	*All losses/allowances not allowed under section 115BAA*	*Amount as adjusted by withdrawal of additional depreciation on account of opting for taxation under section 115BAA^*	*Amounts as assessed (give reference to relevant order)*	*Remarks*
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)

*If the assessed depreciation is less and no appeal pending than take assessed.

To be filled in for assessment year 2020-21 only.";

(*b*) in Form No 3CEB, in Part C,-

(*i*) serial number 22 and the entries relating thereto shall be omitted;

(*ii*) serial numbers 23 and 24 shall be re-numbered as serial numbers 22 and 23 respectively;

(*iii*) after serial number 23 as so renumbered, the following shall be inserted, namely: -

"24.	Particulars in respect of specified domestic transaction in the nature of any business transacted between the persons referred to in sub-section (6) of section 115BAB: Has the assessee entered into any specified domestic transaction(*s*) with any persons referred to in sub-section (6) of section 115BAB which has resulted in more than ordinary profits expected to arise in such business? If "yes", provide the following details: (*a*) Name of the person with whom the specified domestic transaction has been entered into (*b*) Description of the transaction including quantitative details, if any. (*c*) Total amount received/receivable or paid/payable in the transaction - (*i*) as per books of account; (*ii*) as computed by the assessee having regard to the arm's length price. (*d*) Method used for determining the arm's length price [*See* section 92C(1)].	Yes/No . . . . "

Annexure V

Mandatory Communication - Relevant Extracts from the Code of Ethics

(Twelfth Edition – May 2020)

2.14.1.8 *A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he :-*

Clause (8): ***accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing;***

2.14.1.8 (i) It must be pointed out that professional courtesy alone is not the major reason for requiring a member to communicate with the existing accountant who is a member of the Institute or a certified auditor. The underlying objective is that the member may have an opportunity to know the reasons for the change in order to be able to safeguard his own interest, the legitimate interest of the public and the independence of the existing accountant. It is not intended, in any way, to prevent or obstruct the change. When making the enquiry from the retiring auditor, the one proposed to be appointed or already appointed should primarily find out whether there are any professional or other reasons why he should not accept the appointment.

2.14.1.8 (ii) It is important to remember that every client has an inherent right to choose his accountant; also that he may, subject to compliance with the statutory requirements in the case of limited Companies, make a change whenever he chooses, whether or not the reasons which had impelled him to do so are good and valid. The change normally occurs where there has been a change of venue of business and a local accountant is preferred or where the partner who has been dealing with the clients affairs retires or dies; or where temperaments clash or the client has some good reasons to feel dissatisfied. In such

cases, the retiring auditor should always accept the situation with good grace.

Grounds for Non-acceptance of Audit

2.14.1.8 (iii) The existence of a dispute as regards the fees may be root cause of an auditor being changed. This would not constitute valid professional reasons on account of which an audit should not be accepted by the member to whom it is offered. However, in the case of an undisputed audit fees for carrying out the statutory audit under the Companies Act, 2013 or various other statutes having not been paid, the incoming auditor should not accept the appointment unless such fees are paid. In respect of other dues, the incoming auditor should in appropriate circumstances use his influence in favour of his predecessor to have the dispute as regards the fees settled. The professional reasons for not accepting an audit would be:

(a) Non-compliance of the provisions of Sections 139 and 140 of the Companies Act, 2013 as mentioned in Clause (9) of the Part - I of First Schedule to The Chartered Accountants Act, 1949 ; and

(b) Non-payment of undisputed Audit Fees by auditees other than in case of Sick Units for carrying out the Statutory Audit under the Companies Act, 2013 or various other statutes; and

(c) Issuance of a qualified report.

2.14.1.8 (iv) In the first two cases, an auditor who accepts the audit would be guilty of professional misconduct. In this connection, attention of members is invited to the Council General Guidelines, 2008 appearing in Chapter-4. In the said Guidelines, Council has explained that the *provision for audit fee in accounts signed by both the auditee and the auditor along with other expenses, if any, incurred by the auditor in connection with the audit*, *shall* be considered as *"undisputed audit fee"* and *"sick unit"* shall mean *a unit registered for not less than five years, which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.*

Recourse in case of Qualified Audit Report

2.14.1.8 (v) In the last case, however, he may accept the audit if he is satisfied that the attitude of the retiring auditor was not proper and justified. If, on the other hand, he feels that the retiring auditor had qualified the report for good and valid reasons, he should refuse to accept the audit. There is no rule, written or unwritten, which would prevent an auditor from accepting the appointment offered to him in these circumstances. However, before accepting the audit, he should ascertain the full facts of the case. For nothing will bring the profession to disrepute so much as the knowledge amongst the public that if an auditor is found to be "inconvenient" by the client, he could readily be replaced by another who would not displease the client and this point cannot be too over-emphasised.

Fees pending due to non-availability of Previous Auditor

2.14.1.8 (vi) Where the previous auditor is not available for accepting payment of undisputed audit fees, and it is not otherwise possible to transfer the payment to him electronically, the incoming auditor may advise the client to purchase Demand Draft of the amount equivalent to undisputed Audit Fees of retiring auditor, and may accept the Audit assignment after verifying the same. It will be the duty of the incoming auditor to ensure the payment of undisputed Audit Fees of the retiring auditor at the earliest possibility.

Course of action in case of change of Auditorship

2.14.1.8 (vii) What should be the correct procedure to adopt when a prospective client tells you that he wants to change his auditor and wants you to take up his work? There being two persons involved, the Company and the old auditor, the former should be asked whether the retiring auditor had been informed of the intention to change. If the answer is in the affirmative, then a communication should be addressed to the retiring auditor. If, however, it is learnt that the old auditor has not been informed, and the client is not willing to make the first move, it would be necessary to ask him the reason for the proposed change. If there is no valid reason for a change, it would be healthy practice not to accept the audit. If he decides to accept the audit he should address a communication to the retiring auditor.

As stated earlier, the object of the incoming auditor, in communicating with the retiring auditor is to ascertain from him whether there are any circumstances which warrant him not to accept the appointment. For example, whether the previous auditor has been changed on account of having qualified his report or he had expressed a wish not to continue on account of something inherently wrong with the administration of the business. The retiring auditor may even give out information regarding the condition of the accounts of the client or the reason that impelled him to qualify his report. In all these cases it would be essential for the incoming auditor to carefully consider the facts before deciding whether or not he should accept the audit, and should he do so, he must also take into account the information while discharging his duties and responsibilities.

Duty of Retiring Auditor

2.14.1.8(viii) On the request of the incoming auditor to the retiring auditor for providing known information regarding any facts or other information of which, in the opinion of the retiring auditor, the incoming auditor needs to be aware before deciding whether to accept the engagement, the retiring auditor shall provide the information diligently.

Sometimes, the retiring auditor fails without justifiable cause except a feeling of hurt because of the change, to respond to the communication of the incoming auditor. So that it may not create a deadlock, the incoming auditor appointed can act, after waiting for a reasonable time for a reply.

Certificate of Posting not a conclusive proof of communication

2.14.1.8 (ix) The Council has taken the view that a mere posting of a letter under certificate of posting is not sufficient to establish communication with the retiring auditor unless there is some evidence to show that the letter has in fact reached the person communicated with. A Chartered Accountant who relies solely upon a letter posted under certificate of posting therefore does so at his own risk.

The view taken by the Council has been confirmed in a decision by the Rajasthan High Court in J.S. Bhati vs. The Council of the

Institute of the Chartered Accountants of India and another. (Pages 72-79 of Vol. V of Disciplinary Cases published by the Institute - Judgement delivered on 29th August, 1975). The following observations of the Court are relevant in this context:-

"Mere obtaining a certificate of posting in my opinion does not fulfill the requirements of clause (8) of Schedule I as the presumption under Section 114 of the Evidence Act that the letter in due course reached the addressee cannot replace that positive degree of proof of the delivery of the letter to the addressee which the letters of the law in this case require. The expression 'in communication with' when read in the light of the instructions contained in the booklet 'Code of Conduct' cannot be interpreted in any other manner but to mean that there should be positive evidence of the fact that the communication addressed to the outgoing auditor by the incoming auditor reached his hands. Certificate of posting of a letter cannot, in the circumstances, be taken as positive evidence of its delivery to the addressee."

Positive Evidence of Delivery required

2.14.1.8 (x) Members should therefore communicate with a retiring auditor in such a manner as to retain in their hands positive evidence of the delivery of the communication to the addressee. In the opinion of the Council, the following would in the normal course provide such evidence:-

(a) Communication by a letter sent through "Registered Acknowledgement due", or

(b) By hand against a written acknowledgement, or

(c) Acknowledgement of the communication from retiring auditor's vide email address registered with the Institute or his last known official email address, or

(d) Unique Identification Number (UDIN) generated on UDIN portal (subject to separate guidelines to be issued by the Council in this regard)

Premises found Locked

2.14.1.8 (xi) The communication received back by the incoming auditor with "Office found Locked" written on the Acknowledgement Due shall be deemed as having been delivered to the retiring auditor.

Firm not found at the given Registered Address

2.14.1.8 (xii) If the Communication sent by the incoming auditor is received back with remarks "No such office exists at this address", and the address of communication is the same as registered with the Institute on the date of dispatch, the letter will be deemed to be delivered, unless the retiring auditor proves that it was not really served and that he was not responsible for such non-service.

As a matter of professional courtesy and professional obligation it is necessary for the new auditor appointed to act jointly with the earlier auditor and to communicate with such earlier auditor.

Special Audit under Income Tax Act, 1961

2.14.1.8(xiii) It would be a healthy practice if a Tax Auditor appointed for conducting special audit under the Income Tax Act,1961 communicates with the member who has conducted the Statutory Audit.

The Council has also laid down the detailed guidelines on the subject as under:-

Communication required for all kinds of audit

2.14.1.8(xiv) The requirement for communicating with the previous auditor being a Chartered Accountant in practice would apply to all types of Audit viz., Statutory Audit, Tax Audit, GST Audit, Internal Audit, Concurrent Audit or any other kind of audit.

Communication in case of Assignments done by other professionals

2.14.1.8(xv) A Communication is mandatorily required for all types of Audit/Report where the previous auditor is a Chartered Accountant. In case of assignments done by other professionals not being Chartered Accountants, it would also be a healthy practice to communicate.

Lack of time in acceptance of Government Audits

2.14.1.8(xvi) Although the mandatory requirement of communication with previous auditor being Chartered Accountant applies, in uniform manner, to audits of both government and Non-Government entities, yet in the case of audit of government Companies/ banks or their branches, if the appointment is made well in time to enable the obligation cast under this clause to be fulfilled,

such obligation must be complied with before accepting the audit. However, in case the time schedule given for the assignment is such that there is no time to wait for the reply from the outgoing auditor, the incoming auditor may give a conditional acceptance of the appointment and commence the work which needs to be attended to immediately after he has sent the communication to the previous auditor in accordance with this clause. In his acceptance letter, he should make clear to the client that his acceptance of appointment is subject to professional objections, if any, from the previous auditors and that he will decide about his final acceptance after taking into account the information received from the previous auditor.

Meaning of Terms

2.14.1.8(xvii) Various doubts have been raised by the members about the terms "audit", "previous auditor", "Certificate" and "report", normally while interpreting the aforesaid Clause (8). These terms need to be clarified.

- The definition of "Audit" is given in the Framework for Assurance Engagements (the Framework) issued by the Institute which is as under:

  "For assurance engagements relating to historical financial information in particular, such engagements which provide reasonable assurance are called audits".

  The Framework also describes the objective of reasonable assurance engagements which is as under:

  The objective of a reasonable assurance engagement is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement as the basis for a positive form of expression of the practitioner's conclusion.

- The term "previous auditor" means the immediately preceding auditor who held same or similar assignment comprising same/similar scope of work. For example, a Chartered Accountant in practice appointed for an assignment of physical verification of inventory of raw materials, spares, stores and finished goods, before acceptance of appointment, must communicate with the

previous auditor being a Chartered Accountant in practice who was holding the appointment of physical verification of inventory of raw materials, stores, finished goods and fixed assets. The mandatory communication with the previous auditor being a Chartered Accountant is required even in a case where the previous auditor happens to be an auditor for a year other than the immediately preceding year.

- "Auditor's Report" mentioned in SA 700 states the objective of the Report as forming an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained. As explained in the Institute's publication viz., 'Guidance Note on Reports and Certificates for Special Purposes' (which governs reports other than those which are issued in audits or reviews) states that the word 'certificate' as described in the laws and regulations or even in the contracts that an entity might have entered into can normally be associated with reasonable assurance. A practitioner is expected to provide either a reasonable assurance (about whether the subject matter of examination is materially misstated) or a limited assurance (stating that nothing has come to the practitioner's attention that causes the practitioner to believe that the subject matter is materially misstated). A practitioner is not expected to reduce the engagement risk to zero. Therefore, whenever a practitioner is required to give a "certificate" or a "report" for special purpose, the practitioner needs to undertake a careful evaluation of the scope of the engagement, i.e., whether the practitioner would be able to provide reasonable assurance or limited assurance on the subject matter.

Relevant Extracts from Volume-I of Code of Ethics

SECTION 320

PROFESSIONAL APPOINTMENTS

Introduction

320.1 Professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

320.2 Acceptance of a new client relationship or changes in an existing engagement might create a threat to compliance with one or more of the fundamental principles. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

Client and Engagement Acceptance

General

320.3 A1 Threats to compliance with the principles of integrity or professional behaviour might be created, for example, from questionable issues associated with the client (its owners, management or activities). Issues that, if known, might create such a threat include client involvement in illegal activities, dishonesty, questionable financial reporting practices or other unethical behaviour.

320.3 A2 Factors that are relevant in evaluating the level of such a threat include:

- Knowledge and understanding of the client, its owners, management and those charged with governance and business activities.
- The client's commitment to address the questionable issues, for example, through improving corporate governance practices or internal controls.

320.3 A3 A self-interest threat to compliance with the principle of professional competence and due care is created if the engagement team does not possess, or cannot acquire, the competencies to perform the professional services.

320.3 A4 Factors that are relevant in evaluating the level of such a threat include:

- An appropriate understanding of:
  - The nature of the client's business;
  - The complexity of its operations;
  - The requirements of the engagement; and
  - The purpose, nature and scope of the work to be performed.
- Knowledge of relevant industries or subject matter.
- Experience with relevant regulatory or reporting requirements.
- The existence of quality control policies and procedures designed to provide reasonable assurance that engagements are accepted only when they can be performed competently.

320.3 A5 Examples of actions that might be safeguards to address a self-interest threat include:

- Assigning sufficient engagement personnel with the necessary competencies.
- Agreeing on a realistic time frame for the performance of the engagement.
- Using experts where necessary.

R320. 3 A6 Professional accountants while accepting engagement of attest functions are required to comply with the "Know Your client" (KYC) Norms of the Institute. The Announcement issued in this regard in reproduced below:-

1. *Where Client is an individual /proprietor*

A. General Information

- ✓ *Name of the Individual*
- ✓ *PAN No. or Aadhar Card No. of the Individual*
- ✓ *Business Description*
- ✓ *Copy of last Audited Financial Statement*

B. Engagement Information

- ✓ *Type of Engagement*

2. Where Client is a Corporate Entity

A. General Information

- ✓ *Name and Address of the Entity*
- ✓ *Business Description*
- ✓ *Name of the Parent Company in case of Subsidiary*
- ✓ *Copy of last Audited Financial Statement*

B. Engagement Information

- ✓ *Type of Engagement*

C. Regulatory Information

- ✓ *Company PAN No.*
- ✓ *Company Identification No.*
- ✓ *Directors' Names & Addresses*
- ✓ *Directors' Identification No.*

3. Where Client is a Non- Corporate Entity

A. General Information

- ✓ *Name and Address of the Entity*
- ✓ *Copy of PAN No.*
- ✓ *Business Description*
- ✓ *Partner's Names & Addresses (with their PAN/Aadhar Card/DIN No.)*
- ✓ *Copy of last Audited Financial Statement*

B. Engagement Information

- ✓ *Type of Engagement*

Explanation: "Attest Functions" for this purpose will include services pertaining to Audit, Review, Agreed upon Procedures and Compilation of Financial Statements.

Changes in a Professional Appointment

General

R320.4 Subject to compliance with the provisions of Clause (8) of Part-I of First Schedule to The Chartered Accountants Act, 1949, and Council directions thereunder**, a** professional accountant, shall determine whether there are any reasons for not accepting an engagement when the accountant:

(a) Is asked by a potential client to replace another accountant;

(b) Considers tendering for an engagement held by another accountant subject to compliance with council guidelines dated 7th April, 2016 issued in this regard, as amended from time to time; or

(c) Considers undertaking work that is complementary or additional to that of another accountant.

320.4 A1 There might be reasons for not accepting an engagement. One such reason might be if a threat created by the facts and circumstances cannot be addressed by applying safeguards. For example, there might be a self-interest threat to compliance with the principle of professional competence and due care if a professional accountant accepts the engagement before knowing all the relevant facts.

320.4 A2 If a professional accountant is asked to undertake work that is complementary or additional to the work of an existing or predecessor accountant, a self-interest threat to compliance with the principle of professional competence and due care might be created, for example, as a result of incomplete information.

320.4 A3 A factor that is relevant in evaluating the level of such a threat is whether tenders state that, before accepting the engagement, contact with the existing or predecessor accountant will be requested. This contact gives the proposed accountant the opportunity to inquire whether there are any reasons why the engagement should not be accepted.

320.4 A4 Examples of actions that might be safeguards to address such a self-interest threat include:

- Asking the existing or predecessor accountant to provide any known information of which, in the existing or predecessor accountant's opinion, the proposed accountant needs to be aware before deciding whether to accept the engagement. For example, inquiry might reveal previously undisclosed pertinent facts and might indicate disagreements with the existing or predecessor accountant that might influence the decision to accept the appointment.
- Obtaining information from other sources such as through inquiries of third parties or background investigations regarding senior management or those charged with governance of the client.

Communicating with the Existing or Predecessor Accountant (except in case of Audit, Review, Report or any other assignment, as may be prescribed by ICAI from time to time and governed with the provisions of Clause (8) of Part-I of First Schedule to The Chartered Accountants Act, 1949, and Council directions thereunder)

320.5 A1 A proposed accountant will usually need the client's permission, preferably in writing, to initiate discussions with the existing or predecessor accountant.

R320.6 If unable to communicate with the existing or predecessor accountant, the proposed accountant shall take other reasonable steps to obtain information about any possible threats.

Communicating with the Proposed Accountant

R320.7 When an existing or predecessor accountant is asked to respond to a communication from a proposed accountant, the existing or predecessor accountant shall:

(a) Comply with relevant laws and regulations governing the request; and

(b) Provide any information honestly and unambiguously.

320.7 A1 An existing or predecessor accountant is bound by confidentiality. Whether the existing or predecessor accountant is permitted or required to discuss the affairs of a client with a proposed accountant will depend on the nature of the

engagement and:

(a) Whether the existing or predecessor accountant has permission from the client for the discussion; and

(b) The legal and ethics requirements relating to such communications and disclosure,

320.7 A2 Circumstances where a professional accountant is or might be required to disclose confidential information, or when disclosure might be appropriate, are set out in paragraph 114.1 A1 of the Code.

Changes in Audit or Review Appointments

R320.8 Subject to provisions of Clause (8) of Part I of First Schedule of the Chartered Accountants Act, 1949, and Council directions thereunder, in the case of an audit or review of financial statements, a professional accountant shall request the existing or predecessor accountant to provide known information regarding any facts or other information of which, in the existing or predecessor accountant's opinion, the proposed accountant needs to be aware before deciding whether to accept the engagement.

The existing or predecessor accountant shall provide the information honestly and unambiguously.

Client and Engagement Continuance

R320.9 For a recurring client engagement, a professional accountant shall periodically review whether to continue with the engagement.

320.9 A1 Potential threats to compliance with the fundamental principles might be created after acceptance which, had they been known earlier, would have caused the professional accountant to decline the engagement. For example, a self-interest threat to compliance with the principle of integrity might be created by improper earnings management or balance sheet valuations.

Using the Work of an Expert

R320.10 When a professional accountant intends to use the work of an expert, the accountant shall determine whether the use is warranted.

320.10 A1 Factors to consider when a professional accountant intends to use the work of an expert include the reputation and expertise of the expert, the resources available to the expert, and the professional and ethics standards applicable to the expert. This information might be gained from prior association with the expert or from consulting others.

Annexure VI

Revision of recommended scale of fee chargeable for the professional assignments done by Chartered Accountants

An announcement hosted by Committee for Members in Practice(CMP), ICAI- on 11th February, 2020 :

PARTICULARS			**Rates**		
			For Class A Cities	**For Class B Cities**	**For Class C Cities**
			Revised Minimum Recommended scale of Fees (₹)	**Revised Minimum Recommended scale of Fees (₹)**	**Revised Minimum Recommended scale of Fees (₹)**
I)	**ADVISING ON DRAFTING OF DEEDS/AGREEMENTS**				
	(a)	i) Partnership Deed	15,000/- & Above	10,000/- & Above	8,000/- & Above
		ii) Partnership Deed (With consultation & Tax Advisory)	20,000/- & Above	15,000/- & Above	10,000/- & Above
	(b)	Filing of Forms with Registrar of Firms	7,000/- & Above Per Form	5,000/- & Above Per Form	3,000/- & Above
	(c)	Supplementary / Modification in Partnership Deed	12,000/- & Above	9,000/- & Above	6,000/- & Above
	(d)	Joint Development Agreements/Joint	12,000/- & Above	9,000/- & Above	6,000/- &

PARTICULARS			Rates		
			For Class A Cities	For Class B Cities	For Class C Cities
			Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)
		Venture Agreements	(See Note – 1)	(See Note – 1)	Above (See Note-1)
	(e)	Other Deeds such as Power of Attorney, Will, Gift Deed etc.	5,000/- & Above	4,000/- & Above	3,000/- & Above
II)	**INCOME TAX**				
	A.	**Filing of Return of Income**			
	I)	For Individuals/ HUFs etc.			
	(a)	Filing of Return of Income with Salary/Other Sources/Share of Profit	8,000/- & Above	6,000/- & Above	4,000/- & Above
	(b)	Filing of Return of Income with detailed Capital Gain working			
		(i) Less than 10 Transactions (For Shares & Securities)	11,000/- & Above	8,000/- & Above	5,000/- & Above
		(ii) More than 10 Transactions (For Shares &	17,000/- & Above	12,000/- & Above	8,000/- & Above

PARTICULARS			Rates		
			For Class A Cities	For Class B Cities	For Class C Cities
			Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)
		Securities)			
	(c)	Filing of Return of Income for Capital Gain on Immovable property	32,000/- & Above	22,000/- & Above	15,000/- & Above
	(d)	Filing of Return of Income with Preparation of Bank Summary, Capital A/c & Balance Sheet.	12,000/- & Above	9,000/- & Above	6,000/- & Above
	II)	(a) Partnership Firms/Sole Proprietor with Advisory Services	15,000/- & Above	10,000/- & Above	8,000/- & Above
		(b) Minor's I.T. Statement	8,000/- & Above	6,000/- & Above	4,000/- & Above
		(c) Private Ltd. Company:			
		(i) Active	25,000/- & Above	18,000/- & Above	12,000/- & Above
		(ii) Defunct	12,000/- & Above	9,000/- & Above	6,000/- & Above
		(d) Public Ltd. Company			
		(i) Active	65,000/- &	45,000/- &	30,000/- &

PARTICULARS			Rates		
			For Class A Cities	For Class B Cities	For Class C Cities
			Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)
			Above	Above	Above
		(ii) Defunct	25,000/- & Above	18,000/- & Above	12,000/- & Above
	B.	**Filing of Forms Etc.**	**(Quarterly Fees)**	**(Quarterly Fees)**	
	(a)	Filing of TDS/TCS Return (per Form)			
		(i) With 5 or less Entries	4,000/- & Above	3,000/- & Above	2,000/- & Above
		(ii) With more than 5 Entries	9,000/- & Above	7,000/- & Above	5,000/- & Above
	(b)	Filing of Form No. 15-H/G (per Set)	4,000/- & Above	3,000/- & Above	2,000/- & Above
	(c)	Form No. 49-A/49-B	4,000/- & Above	3,000/- & Above	2,000/- & Above
	(d)	Any other Forms filed under the Income Tax Act	4,000/- & Above	3,000/- & Above	2,000/- & Above
	C.	**Certificate**			
		Obtaining Certificate from Income Tax Department	14,000/- & Above	10,000/- & Above	7,000/- & Above
	D.	**Filing of Appeals Etc.**			

PARTICULARS			Rates		
			For Class A Cities	For Class B Cities	For Class C Cities
			Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)
	(a)	First Appeal Preparation of Statement of Facts, Grounds of Appeal, Etc.	32,000/- & Above	22,000/- & Above	15,000/- & Above
	(b)	Second Appeal (Tribunal)	65,000/- & Above	45,000/- & Above	30,000/- & Above
	E.	**Assessments Etc.**			
	(a)	Attending Scrutiny Assessment/ Appeal			
		(i) Corporate	See Note 1	See Note 1	See Note 1
		(ii) Non Corporate	32,000/- & Above	22,000/- & Above	15,000/- & Above
	(b)	Attending before Authorities	10,000/- & Above Per Visit	7,000/- & Above Per Visit	5,000/- & Above Per Visit
	(c)	Attending for Rectifications/Refunds / Appeal effects Etc.	7,000/- & Above Per Visit	5,000/- & Above Per Visit	3,000/- & Above Per Visit
	(d)	Income Tax Survey	80,000/- & Above	55,000/- & Above	35,000/- & Above
	(e)	T.D.S. Survey	50,000/- & Above	35,000/- & Above	25,000/- & Above

PARTICULARS			Rates		
			For Class A Cities	For Class B Cities	For Class C Cities
			Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)
	(f)	Income Tax Search and Seizure	See Note 1	See Note 1	See Note 1
	(g)	Any other Consultancy	See Note 1	See Note 1	See Note 1
III)	**CHARITABLE TRUST**				
	(a)	(i) Registration Under Local Act	25,000/- & Above	18,000/- & Above	12,000/- & Above
		(ii) Societies Registration Act	32,000/- & Above	22,000/- & Above	15,000/- & Above
	(b)	Registration Under Income Tax Act	25,000/- & Above	18,000/- & Above	12,000/- & Above
	(c)	Exemption Certificate U/s 80G of Income Tax Act	20,000/- & Above	15,000/- & Above	10,000/- & Above
	(d)	Filing Objection Memo/other Replies	10,000/- & Above	7,000/- & Above	5,000/- & Above
	(e)	Filing of Change Report	10,000/- & Above	7,000/- & Above	5,000/- & Above
	(f)	Filing of Annual Budget	10,000/- & Above	7,000/- & Above	5,000/- & Above
	(g)	Attending before Charity Commissioner including for	8,000/- & Above per visit	6,000/- & Above per visit	4,000/- & Above

PARTICULARS			Rates		
			For Class A Cities	For Class B Cities	For Class C Cities
			Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)
		Attending Objections			
	(h)	(i) F.C.R.A. Registration	35,000/- & Above	25,000/- & Above	18,000/- & Above
		(ii) F.C.R.A. Certification	8,000/- & Above	6,000/- & Above	4,000/- & Above
IV)	**COMPANY LAW AND LLP WORK**				
	(a)	Filing Application for Name Approval	8,000/- & Above	6,000/- & Above	4,000/- & Above
	(b)	Incorporation of a Private Limited Company/LLP	35,000/- & Above	25,000/- & Above	18,000/- & Above
	(c)	Incorporation of a Public Limited Company	65,000/- & Above	45,000/- & Above	30,000/- & Above
	(d)	Advisory or consultation in drafting MOA, AOA	15,000/- & Above	11,000/- & Above	8,000/- & Above
	(e)	(i) Company's/LLP ROC Work, Preparation of Minutes, Statutory Register & Other Secretarial Work	See Note 1	See Note 1	See Note 1
		(ii) Certification (Per Certificate)	15,000/- & Above	11,000/- & Above	8,000/- & Above

PARTICULARS			Rates		
			For Class A Cities	For Class B Cities	For Class C Cities
			Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)
	(f)	Filing Annual Return Etc.	10,000/- & Above per Form	7,000/- & Above per Form	5,000/- & Above
	(g)	Filing Other Forms Like : F-32, 18, 2 etc.	5,000/- & Above per Form	4,000/- & Above per Form	3,000/- & Above
	(h)	Increase in Authorised Capital Filing of F-5, F-23, preparation of Revised Memorandum of Association/Article of Association/LLP Agreement	25,000/- & Above	20,000/- & Above	14,000/- & Above
	(i)	DPIN/DIN per Application	4,000/- & Above	3,000/- & Above	2,000/- & Above
	(j)	Company Law Consultancy including Petition drafting	See Note 1	See Note 1	See Note 1
	(k)	Company Law representation including LLP before RD and NCLT	See Note 1	See Note 1	See Note 1
	(l)	ROC Representation	See Note 1	See Note 1	See Note 1

PARTICULARS			Rates		
			For Class A Cities	For Class B Cities	For Class C Cities
			Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)
V)	AUDIT AND OTHER ASSIGNMENTS				
		Rate per day would depend on the complexity of the work and the number of days spent by each person			
		(i) Principal	18,000/- & Above per day	12,000/- & Above per day	8,000/- & Above per day
		(ii) Qualified Assistants	10,000/- & Above per day	7,000/- & Above per day	5,000/- & Above per day
		(iii) Semi Qualified Assistants	5,000/- & Above per day	4,000/- & Above per day	3,000/- & Above per day
		(iv) Other Assistants	3,000/- & Above per day	2,000/- & Above per day	1,000/- & Above per Day
		Subject to minimum indicative Fees as under:			
		(i) Tax Audit	40,000/- & Above	30,000/- & Above	22,000/- & Above
		(ii) Company Audit			
		(a) Small Pvt. Ltd. Co. (Turnover up to ₹2 Crore)	50,000/- & Above	35,000/- & Above	25,000/- & Above
		(b) Medium Size Pvt. Ltd. Co./ Public Ltd. Co.	80,000/- & Above	55,000/- & Above	35,000/- & Above

PARTICULARS			Rates		
			For Class A Cities	For Class B Cities	For Class C Cities
			Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)
		(c) Large Size Pvt. Ltd. Co./Public Ltd. Co.	See Note 1	See Note 1	See Note 1
		(iii) Review of TDS Compliance	25,000/- & Above	18,000/- & Above	12,000/& Above
		(iv) Transfer Pricing Audit	See Note 1	See Note 1	See Note 1
VI)	**INVESTIGATION, MANAGEMENT SERVICES OR SPECIAL ASSIGNMENTS**				
		Rate per day would depend on the complexity of the work and the number of days spent by each person			
		(a) Principal	35,000/- & Above + per day charge	25,000/- & Above + per day charge	18,000/- & Above per day charge
		(b) Qualified Assistant	18,000/- & Above + per day charge	12,000/- & Above + per day charge	8,000/- & Above per day charge
		(c) Semi Qualified Assistant	10,000/- & Above + per day charge	7,000/- & Above + per day charge	5,000/- & Above per day charge
VII)	**CERIFICATION WORK**				
	(a)	Issuing Certificates	See Note	See Note	See Note 1

PARTICULARS			Rates		
			For Class A Cities	For Class B Cities	For Class C Cities
			Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)
		under the Income Tax Act i.e. U/s 80IA/80IB/10A/ 10B & other Certificates	1	1	
	(b)	Other Certificates			
		For LIC/Passport/ Credit Card/Etc.	10,000/- & Above	7,000/- & Above	5,000/- & Above
	(c)	Other Attestation (True Copy)	3,000/- & Above per form	2,000/- & above per Form	1,000/- & Above
	(d)	Net worth Certificate for person going abroad	18,000/- & Above	12,000/- & Above	8,000/- & Above
VIII)	**RERA**				
	(a)	Audit of Accounts	10,000/- & Above	7,000/- & Above	5,000/- & Above
	(b)	Appearance Before Appellate Tribunal or Regulatory Authority or Adjudicating Authority	50,000/- & Above	35,000/- & Above	25,000/- & Above
	(c)	Advisory & Consultation	See Note 1	See Note 1	See Note 1

PARTICULARS			Rates		
			For Class A Cities	For Class B Cities	For Class C Cities
			Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)
	(d)	Certification for withdrawal of amount	See Note 1	See Note 1	See Note 1
IX)	CONSULTATION & ARBITRATION				
		Rate per hour would depend on the complexity of the work and the number of hours spends by each person.			
	(a)	Principal	35,000/- & Above(initial fees) + additional fees @ 8,000/- & Above per hour	25,000/- & Above(initial fees) + additional fees @ 6,000/- & Above per hour	18,000/- & Above (initial fees) + additional fees @ 4,000/- & Above per hour
	(b)	Qualified Assistant	6,000/- & Above per hour	4,000/- & Above per hour	3,000/- & Above per hour
	(c)	Semi Qualified Assistant	3,000/- & Above per hour	2,000/- & Above per hour	1,000/- & Above per hour
X)	NBFC/RBI MATTERS				
	(a)	NBFC Registration with RBI	See Note 1	See Note 1	See Note 1
	(b)	Other Returns	18,000/- & Above	12,000/- & Above	8,000/- & Above

PARTICULARS			Rates		
			For Class A Cities	For Class B Cities	For Class C Cities
			Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)
XI)	GST				
	(a)	Registration	20,000/- & Above	15,000/- & Above	10,000/- & Above
	(b)	Registration with Consultation	See Note 1	See Note 1	See Note 1
	(c)	Tax Advisory & Consultation i.e. about value, taxability, classification etc.	See Note 1	See Note 1	See Note 1
	(d)	Challan/ Returns	15,000/- & Above + (4,000/- Per Month)	10,000/- & Above + (3,000/- Per Month)	8,000/- & Above + (2,000/- Per Month)
	(e)	Adjudication/Show Cause notice reply	30,000/- & Above	20,000/- & Above	15,000/- & Above
	(f)	Filing of Appeal/ Appeals Drafting	30,000/- & Above	20,000/- & Above	15,000/- & Above
	(g)	Furnish details of inward/outward supply	See Note 1	See Note 1	See Note 1
	(h)	Misc services i.e. refund, cancellation/ revocation registration, maintain electronic cash ledger etc.	See Note 1	See Note 1	See Note 1

PARTICULARS			Rates		
			For Class A Cities	For Class B Cities	For Class C Cities
			Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)
	(i)	Audit of accounts and reconciliation Statement	40,000/- & Above	20,000/- & Above	12,000/- & Above
	(j)	Any Certification Work	10,000/- & Above	7,000/- & Above	5,000/- & Above
XII)	**FEMA MATTERS**				
	1	Filing Declaration with RBI in relation to transaction by NRIs/OCBs	35,000/- & Above	25,000/- & Above	18,000/- & Above
	2	Obtaining Prior Permissions from RBI for Transaction with NRIs/OCBs	50,000/- & Above	35,000/- & Above	25,000/- & Above
	3	**Technical Collaboration:**			
		Advising, obtaining RBI permission, drafting and preparing technical collaboration agreement and incidental matters	See Note 1	See Note 1	See Note 1
	4	**Foreign Collaboration:**			
		Advising, obtaining RBI permission, drafting and	See Note 1	See Note 1	See Note 1

PARTICULARS			Rates		
			For Class A Cities	For Class B Cities	For Class C Cities
			Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)	Revised Minimum Recommended scale of Fees (₹)
		preparing technical collaboration agreement and incidental matters (incl. Shareholders Agreement)			
	5	Advising on non Resident Taxation Matters including Double Tax Avoidance Agreements including FEMA	See Note 1	See Note 1	See Note 1
XIII)	**PROJECT FINANCING**				
	(a)	Preparation of CMA Data	See Note 1	See Note 1	See Note 1
	(b)	Services relating to Financial sector	See Note 1	See Note 1	See Note 1
XIV)	**ACCOUNTANCY SERVICES**				
		Book keeping and preparation of financial statements			See Note 1
		Other services			See Note 1
XV)		Other services not listed above			See Note 1

Notes:

1) Fees to be charged depending on the complexity and the time spent on the particular assignment.

2) The above recommended minimum scale of fees is as recommended by the Committee for Members in Practice (CMP) of ICAI.

3) The aforesaid table states recommendatory minimum scale of fees works out by taking into account average time required to complete such assignments. However, members are free to charge varying rates depending upon the nature and complexity of assignment and time involved in completing the same.

4) Office time spent in travelling & out-of-pocket expenses would be chargeable. The Committee issues for general information the above recommended scale of fees which it considers reasonable under present conditions. It will be appreciated that the actual fees charged in individual cases will be matter of agreement between the member and the client.

5) GST should be collected separately wherever applicable.

6) The Committee also recommends that the bill for each service should be raised separately and immediately after the services are rendered.

7) Classification of Class A, Class B and Class C is given below.

8) The amount charged will be based on the location of the service provider.

Please note the above mentioned rates are as per the data available on ICAI website at below link:

https://cmpbenefits.icai.org/wp-content/uploads/2020/02/Details-download.pdf

S. No.	State/Union Territories	Cities classified as A	Cities Classified as B	Cities classified as C
1.	ANDAMAN & NICOBAR ISLANDS			All cities
2.	ANDHRA PRADESH		Vijayawada, Greater Visakhapatnam, Guntur, Nellore	Other Cities
3.	ARUNACHAL PRADESH			All cities

S. No.	State/Union Territories	Cities classified as A	Cities Classified as B	Cities classified as C
4.	ASSAM		Guwahati	Other Cities
5.	BIHAR		Patna	Other Cities
6.	CHANDIGARH		Chandigarh	
7.	CHHATTISGARH		Durg-Bhilai Nagar, Raipur	Other Cities
8.	DADRA & NAGAR HAVELI			All cities
9.	DAMAN & DIU			All cities
10.	DELHI	DELHI		
11.	GOA			All cities
12.	GUJARAT	Ahmedabad	Rajkot, Jamnagar, Bhavnagar, Vadodara Surat	Other cities
13.	HARYANA		Faridabad, Gurgaon	Other cities
14.	HIMACHAL PRADESH			All cities
15.	JAMMU & KASHMIR		Srinagar, Jammu	Other Cities
16.	JHARKHAND		Jamshedpur, Dhanbad, Ranchi, Bokro Steel City	Other cities
17.	KARNATAKA	Bengaluru	Belgaum, Hubli-Dharwad, Mangalore, Mysore, Gulbarga	Other cities
18.	KERALA		Kozhikode, Kochi,	Other cities

S. No.	State/Union Territories	Cities classified as A	Cities Classified as B	Cities classified as C
			Thiruvanathapuram, Thrissur, MalappuramKannur, Kollam	
19.	LAKSHADWEEP			All cities
20.	MADHYA PRADESH		Gwalior, Indore, Bhopal, Jabalpur, Ujjain	Other Cities
21.	MAHARASHTRA	Greater Mumbai, Pune	Amravati, Nagpur, Aurangabad, Nashik, Bhiwandi, Solapur, Kolhapur, Vasai-Virar City, Malegaon, Nansws-Waghala, Sangli	Other Cities
22.	MANIPUR			All cities
23.	MEGHALAYA			All cities
24.	MIZORAM			All cities
25.	NAGALAND			All cities
26.	ODISHA		Cuttack, Bhubaneswar, Rourkela	Other Cities
27.	PUDUCHERRY		Puducherry/ Pondicherry	
28.	PUNJAB		Amritsar,	Other Cities

S. No.	State/Union Territories	Cities classified as A	Cities Classified as B	Cities classified as C
			Jalandhar, Ludhiana,	
29.	RAJASTHAN		Bikaner, Jaipur, Jodhpur, Kota, Ajmer	Other Cities
30.	SIKKIM			All cities
31.	TAMIL NADU	Chennai	Salem, Tiruppur, Coimbatore, Tiruchirappalli, Madurai, Erode	Other Cities
32	TELANGANA	Hyderabad	Warangal	Other cities
33.	TRIPURA			All cities
34.	UTTAR PRADESH		Moradabad, Meerut, Ghaziabad, Aligarh, Agra, Bareilly, Lucknow, Kanpur, Allahabad, Gorakhpur, Varanasi, Saharanpur, Noida, Firozabad, Jhansi	Other Cities
35.	UTTARAKHAND		Dehradun	Other Cities
36.	WEST BENGAL	Kolkata	Asansol, Siliguri, Durgapur	Other Cities

Annexure VII

SA 610(Revised)*
Using the Work of Internal Auditors

(Effective for audits of financial statements for periods beginning on or after April 1, 2016)

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Standard on Auditing (SA) 610(Revised), "Using the Work of Internal Auditors", should be read in the context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services," which sets out the authority of SAs and SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing".

Introduction

Scope of this SA

1. This Standard on Auditing (SA) deals with the external auditor's responsibilities if using the work of internal auditors. This includes (a) using the work of the internal audit function in obtaining audit evidence and (b) using internal auditors to provide direct assistance under the direction, supervision and review of the external auditor.

2. This SA does not apply if the entity does not have an internal audit function. (Ref: Para. A2)

3. If the entity has an internal audit function, the requirements in this SA relating to using the work of that function do not apply if:

(a) The responsibilities and activities of the function are not relevant to the audit; or

(b) Based on the auditor's preliminary understanding of the function obtained as a result of procedures performed under SA 315,[2] the external auditor does not expect to use the work of the function in obtaining audit evidence.

Nothing in this SA requires the external auditor to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor; it remains a decision of the external auditor in establishing the overall audit strategy.

[2] SA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment.

4. Furthermore, the requirements in this SA relating to direct assistance do not apply if the external auditor does not plan to use internal auditors to provide direct assistance.

5. In some cases, the external auditor may be prohibited, or restricted to some extent, by law or regulation from using the work of the internal audit function or using internal auditors to provide direct assistance. The SAs do not override laws or regulations that govern an audit of financial statements.[3] Such prohibitions or restrictions will therefore not prevent the external auditor from complying with the SAs. (Ref: Para. A31)

Relationship between SA 315 and SA 610 (Revised)

6. Many entities establish internal audit functions as part of their internal control and governance structures. The objectives and scope of an internal audit function, the nature of its responsibilities and its organizational status, including the function's authority and accountability, vary widely and depend on the size and structure of the entity and the requirements of management and, where applicable, those charged with governance.

7. SA 315 addresses how the knowledge and experience of the internal audit function can inform the external auditor's understanding of the entity and its environment and identification and assessment of risks of material misstatement. SA 315[4] also explains how effective communication between the internal and external auditors also creates an environment in which the external auditor can be informed of significant matters that may affect the external auditor's work.

8. Depending on whether the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors, the level of competency of the internal audit function, and whether the function applies a systematic and disciplined approach, the external auditor may also be able to use the work of the internal audit function in a constructive and complementary manner. This SA addresses the external auditor's responsibilities when, based on the external auditor's preliminary understanding of the internal audit function obtained as a result of procedures performed under SA 315, the external auditor expects to use the work of the internal audit function as part of the audit evidence

[3] SA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing, paragraph A56.
[4] SA 315, Paragraph A115.

obtained.[5] Such use of that work modifies the nature or timing, or reduces the extent, of audit procedures to be performed directly by the external auditor.

9. In addition, this SA also addresses the external auditor's responsibilities if considering using internal auditors to provide direct assistance under the direction, supervision and review of the external auditor.

10. There may be individuals in an entity that perform procedures similar to those performed by an internal audit function. However, unless performed by an objective and competent function that applies a systematic and disciplined approach, including quality control, such procedures would be considered internal controls and obtaining evidence regarding the effectiveness of such controls would be part of the auditor's responses to assessed risks in accordance with SA 330.[6]

The External Auditor's Responsibility for the Audit

11. The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal audit function or internal auditors to provide direct assistance on the engagement. Although they may perform audit procedures similar to those performed by the external auditor, neither the internal audit function nor the internal auditors are independent of the entity as is required of the external auditor in an audit of financial statements in accordance with SA 200.[7] This SA, therefore, defines the conditions that are necessary for the external auditor to be able to use the work of internal auditors. It also defines the necessary work effort to obtain sufficient appropriate evidence that the work of the internal audit function, or internal auditors providing direct assistance, is adequate for the purposes of the audit. The requirements are designed to provide a framework for the external auditor's judgments regarding the use of the work of internal auditors to prevent over or undue use of such work.

Effective Date

12. This SA is effective for audits of financial statements for periods beginning on or after 1st April, 2016.

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[5] See paragraphs 15–25.

[6] SA 330,The Auditor's Responses to Assessed Risks.

[7] SA 200, paragraph 14.

Objectives

13. The objectives of the external auditor, where the entity has an internal audit function and the external auditor expects to use the work of the function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor, or to use internal auditors to provide direct assistance, are:

(a) To determine whether the work of the internal audit function or direct assistance from internal auditors can be used, and if so, in which areas and to what extent;

and having made that determination:

(b) If using the work of the internal audit function, to determine whether that work is adequate for purposes of the audit; and

(c) If using internal auditors to provide direct assistance, to appropriately direct, supervise and review their work.

Definitions

14. For purposes of the SAs, the following terms have the meanings attributed below:

(a) *Internal audit function* – A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes. (Ref: Para. A1–A4)

(b) *Direct assistance* – The use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.

Requirements

Determining Whether, in Which Areas, and to What Extent the Work of the Internal Audit Function Can Be Used

Evaluating the Internal Audit Function

15. The external auditor shall determine whether the work of the internal audit function can be used for purposes of the audit by evaluating the following:

(a) The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors; (Ref: Para. A5–A9)

(b) The level of competence of the internal audit function; and (Ref: Para. A5–A9)

(c) Whether the internal audit function applies a systematic and disciplined approach, including quality control. (Ref: Para. A10–A11)

16. The external auditor shall not use the work of the internal audit function if the external auditor determines that:

(a) The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors;

(b) The function lacks sufficient competence; or

(c) The function does not apply a systematic and disciplined approach, including quality control. (Ref: Para. A12–A14)

Determining the Nature and Extent of Work of the Internal Audit Function that Can Be Used

17. As a basis for determining the areas and the extent to which the work of the internal audit function can be used, the external auditor shall consider the nature and scope of the work that has been performed, or is planned to be performed, by the internal audit function and its relevance to the external auditor's overall audit strategy and audit plan. (Ref: Para. A15–A17)

18. The external auditor shall make all significant judgments in the audit engagement and, to prevent undue use of the work of the internal audit function, shall plan to use less of the work of the function and perform more of the work directly: (Ref: Para. A15–A17)

(a) The more judgment is involved in:

  (i) Planning and performing relevant audit procedures; and

  (ii) Evaluating the audit evidence gathered; (Ref: Para. A18–A19)

(b) The higher the assessed risk of material misstatement at the assertion level, with special consideration given to risks identified as significant; (Ref: Para. A20–A22)

(c) The less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors; and

(d) The lower the level of competence of the internal audit function.

19. The external auditor shall also evaluate whether, in aggregate, using the work of the internal audit function to the extent planned would still result in the external auditor being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed. (Ref: Para. A15–A22)

20. The external auditor shall, in communicating with those charged with governance an overview of the planned scope and timing of the audit in accordance with SA 260(Revised),[8] communicate how the external auditor has planned to use the work of the internal audit function. (Ref: Para. A23)

Using the Work of the Internal Audit Function

21. If the external auditor plans to use the work of the internal audit function, the external auditor shall discuss the planned use of its work with the function as a basis for coordinating their respective activities. (Ref: Para. A24–A26)

22. The external auditor shall read the reports of the internal audit function relating to the work of the function that the external auditor plans to use to obtain an understanding of the nature and extent of audit procedures it performed and the related findings.

23. The external auditor shall perform sufficient audit procedures on the body of work of the internal audit function as a whole that the external auditor plans to use to determine its adequacy for purposes of the audit, including evaluating whether:

(a) The work of the function had been properly planned, performed, supervised, reviewed and documented;

(b) Sufficient appropriate evidence had been obtained to enable the function to draw reasonable conclusions; and

(c) Conclusions reached are appropriate in the circumstances and the reports prepared by the function are consistent with the results of the work performed. (Ref: Para. A27–A30)

24. The nature and extent of the external auditor's audit procedures shall be responsive to the external auditor's evaluation of:

(a) The amount of judgment involved;

(b) The assessed risk of material misstatement;

[8] SA 260(Revised), Communication with Those Charged with Governance, paragraph 15.

(c) The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors; and

(d) The level of competence of the function;[9] (Ref: Para. A27–A29)

and shall include reperformance of some of the work. (Ref: Para. A30)

25. The external auditor shall also evaluate whether the external auditor's conclusions regarding the internal audit function in paragraph 15 of this SA and the determination of the nature and extent of use of the work of the function for purposes of the audit in paragraphs 18–19 of this SA remain appropriate.

Determining Whether, in Which Areas, and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance

Determining Whether Internal Auditors Can Be Used to Provide Direct Assistance for Purposes of the Audit

26. The external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. If so, paragraphs 27–35 and 37 do not apply. (Ref: Para. A31)

27. If using internal auditors to provide direct assistance is not prohibited by law or regulation, and the external auditor plans to use internal auditors to provide direct assistance on the audit, the external auditor shall evaluate the existence and significance of threats to objectivity and the level of competence of the internal auditors who will be providing such assistance. The external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity shall include inquiry of the internal auditors regarding interests and relationships that may create a threat to their objectivity. (Ref: Para. A32–A34)

28. The external auditor shall not use an internal auditor to provide direct assistance if:

(a) There are significant threats to the objectivity of the internal auditor; or

(b) The internal auditor lacks sufficient competence to perform the proposed work. (Ref: Para. A32–A34)

[9] See paragraph 18.

Determining the Nature and Extent of Work that Can Be Assigned to Internal Auditors Providing Direct Assistance

29. In determining the nature and extent of work that may be assigned to internal auditors and the nature, timing and extent of direction, supervision and review that is appropriate in the circumstances, the external auditor shall consider:

(a) The amount of judgment involved in:

  (i) Planning and performing relevant audit procedures; and

  (ii) Evaluating the audit evidence gathered;

(b) The assessed risk of material misstatement; and

(c) The external auditor's evaluation of the existence and significance of threats to the objectivity and level of competence of the internal auditors who will be providing such assistance. (Ref: Para. A35–A39)

30. The external auditor shall not use internal auditors to provide direct assistance to perform procedures that:

(a) Involve making significant judgments in the audit; (Ref: Para. A19)

(b) Relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited; (Ref: Para. A38)

(c) Relate to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or

(d) Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance. (Ref: Para. A35–A39)

31. Having appropriately evaluated whether and, if so, to what extent internal auditors can be used to provide direct assistance on the audit, the external auditor shall, in communicating with those charged with governance an overview of the planned scope and timing of the audit in accordance with SA 260(Revised),[10] communicate the nature and extent of the planned use of internal auditors to provide direct assistance so as to reach a mutual

[10] SA 260(Revised), paragraph 15.

understanding that such use is not excessive in the circumstances of the engagement. (Ref: Para. A39)

32. The external auditor shall evaluate whether, in aggregate, using internal auditors to provide direct assistance to the extent planned, together with the planned use of the work of the internal audit function, would still result in the external auditor being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed.

Using Internal Auditors to Provide Direct Assistance

33. Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:

(a) Obtain written agreement from an authorized representative of the entity that the internal auditors will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor; and

(b) Obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.

34. The external auditor shall direct, supervise and review the work performed by internal auditors on the engagement in accordance with SA 220.[11] In so doing:

(a) The nature, timing and extent of direction, supervision, and review shall recognize that the internal auditors are not independent of the entity and be responsive to the outcome of the evaluation of the factors in paragraph 29 of this SA; and

(b) The review procedures shall include the external auditor checking back to the underlying audit evidence for some of the work performed by the internal auditors.

The direction, supervision and review by the external auditor of the work performed by the internal auditors shall be sufficient in order for the external auditor to be satisfied that the internal auditors have obtained sufficient appropriate audit evidence to support the conclusions based on that work. (Ref: Para. A40–A41)

[11] SA 220, Quality Control for an Audit of Financial Statements.

35. In directing, supervising and reviewing the work performed by internal auditors, the external auditor shall remain alert for indications that the external auditor's evaluations in paragraph 27 are no longer appropriate.

Documentation

36. If the external auditor uses the work of the internal audit function, the external auditor shall include in the audit documentation:

(a) The evaluation of:

  (i) Whether the function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors;

  (ii) The level of competence of the function; and

  (iii) Whether the function applies a systematic and disciplined approach, including quality control;

(b) The nature and extent of the work used and the basis for that decision; and

(c) The audit procedures performed by the external auditor to evaluate the adequacy of the work used.

37. If the external auditor uses internal auditors to provide direct assistance on the audit, the external auditor shall include in the audit documentation:

(a) The evaluation of the existence and significance of threats to the objectivity of the internal auditors, and the level of competence of the internal auditors used to provide direct assistance;

(b) The basis for the decision regarding the nature and extent of the work performed by the internal auditors;

(c) Who reviewed the work performed and the date and extent of that review in accordance with SA 230;[12]

(d) The written agreements obtained from an authorized representative of the entity and the internal auditors under paragraph 33 of this SA; and

(e) The working papers prepared by the internal auditors who provided direct assistance on the audit engagement.

***

[12] SA 230, Audit Documentation.

Application and Other Explanatory Material

Definition of Internal Audit Function (Ref: Para. 2, 14(a))

A1. The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control such as the following:

Activities Relating to Governance

- The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management.

Activities Relating to Risk Management

- The internal audit function may assist the entity by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and internal control (including effectiveness of the financial reporting process).
- The internal audit function may perform procedures to assist the entity in the detection of fraud.

Activities Relating to Internal Control

- *Evaluation of internal control*. The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control. For example, the internal audit function might plan and perform tests or other procedures to provide assurance to management and those charged with governance regarding the design, implementation and operating effectiveness of internal control, including those controls that are relevant to the audit.
- *Examination of financial and operating information*. The internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.

- *Review of operating activities.* The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non-financial activities of an entity.
- *Review of compliance with laws and regulations.* The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

A2. Activities similar to those performed by an internal audit function may be conducted by functions with other titles within an entity. Some or all of the activities of an internal audit function may also be outsourced to a third-party service provider. Neither the title of the function, nor whether it is performed by the entity or a third-party service provider, are sole determinants of whether or not the external auditor can use the work of the function. Rather, it is the nature of the activities; the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors; competence; and systematic and disciplined approach of the function that are relevant. References in this SA to the work of the internal audit function include relevant activities of other functions or third-party providers that have these characteristics.

A3. In addition, those in the entity with operational and managerial duties and responsibilities outside of the internal audit function would ordinarily face threats to their objectivity that would preclude them from being treated as part of an internal audit function for the purpose of this SA, although they may perform control activities that can be tested in accordance with SA 330.[13] For this reason, monitoring controls performed by an owner-manager would not be considered equivalent to an internal audit function.

A4. While the objectives of an entity's internal audit function and the external auditor differ, the function may perform audit procedures similar to those performed by the external auditor in an audit of financial statements. If so, the external auditor may make use of the function for purposes of the audit in one or more of the following ways:

- To obtain information that is relevant to the external auditor's assessments of the risks of material misstatement due to error or fraud. In this regard, SA 315[14] requires the external auditor to obtain

[13] See paragraph 10.

[14] SA 315, paragraph 6(a).

an understanding of the nature of the internal audit function's responsibilities, its status within the organization, and the activities performed, or to be performed, and make inquiries of appropriate individuals within the internal audit function (if the entity has such a function); or

- Unless prohibited, or restricted to some extent, by law or regulation, the external auditor, after appropriate evaluation, may decide to use work that has been performed by the internal audit function during the period in partial substitution for audit evidence to be obtained directly by the external auditor.[15]

In addition, unless prohibited, or restricted to some extent, by law or regulation, the external auditor may use internal auditors to perform audit procedures under the direction, supervision and review of the external auditor (referred to as "direct assistance" in this SA).[16]

Determining Whether, in Which Areas, and to What Extent the Work of the Internal Audit Function Can Be Used

Evaluating the Internal Audit Function

Objectivity and Competence (Ref: Para. 15(a)–(b))

A5. The external auditor exercises professional judgment in determining whether the work of the internal audit function can be used for purposes of the audit, and the nature and extent to which the work of the internal audit function can be used in the circumstances.

A6. The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors and the level of competence of the function are particularly important in determining whether to use and, if so, the nature and extent of the use of the work of the function that is appropriate in the circumstances.

A7. Objectivity refers to the ability to perform those tasks without allowing bias, conflict of interest or undue influence of others to override professional judgments. Factors that may affect the external auditor's evaluation include the following:

- Whether the organizational status of the internal audit function, including the function's authority and accountability, supports the

[15] See paragraphs 15–25.

[16] See paragraphs 26–35.

ability of the function to be free from bias, conflict of interest or undue influence of others to override professional judgments. For example, whether the internal audit function reports to those charged with governance or an officer with appropriate authority, or if the function reports to management, whether it has direct access to those charged with governance.

- Whether the internal audit function is free of any conflicting responsibilities, for example, having managerial or operational duties or responsibilities that are outside of the internal audit function.
- Whether those charged with governance oversee employment decisions related to the internal audit function, for example, determining the appropriate remuneration policy.
- Whether there are any constraints or restrictions placed on the internal audit function by management or those charged with governance, for example, in communicating the internal audit function's findings to the external auditor.
- Whether the internal auditors are members of relevant professional bodies and their memberships obligate their compliance with relevant professional standards relating to objectivity, or whether their internal policies achieve the same objectives.

A8. Competence of the internal audit function refers to the attainment and maintenance of knowledge and skills of the function as a whole at the level required to enable assigned tasks to be performed diligently and in accordance with applicable professional standards. Factors that may affect the external auditor's determination include the following:

- Whether the internal audit function is adequately and appropriately resourced relative to the size of the entity and the nature of its operations.
- Whether there are established policies for hiring, training and assigning internal auditors to internal audit engagements.
- Whether the internal auditors have adequate technical training and proficiency in auditing. Relevant criteria that may be considered by the external auditor in making the assessment may include, for example, the internal auditors' possession of a relevant professional designation and experience.
- Whether the internal auditors possess the required knowledge relating

to the entity's financial reporting and the applicable financial reporting framework and whether the internal audit function possesses the necessary skills (for example, industry-specific knowledge) to perform work related to the entity's financial statements.

- Whether the internal auditors are members of relevant professional bodies that oblige them to comply with the relevant professional standards including continuing professional development requirements.

A9. Objectivity and competence may be viewed as a continuum. The more the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors and the higher the level of competence of the function, the more likely the external auditor may make use of the work of the function and in more areas. However, an organizational status and relevant policies and procedures that provide strong support for the objectivity of the internal auditors cannot compensate for the lack of sufficient competence of the internal audit function. Equally, a high level of competence of the internal audit function cannot compensate for an organizational status and policies and procedures that do not adequately support the objectivity of the internal auditors.

Application of a Systematic and Disciplined Approach (Ref: Para. 15(c))

A10. The application of a systematic and disciplined approach to planning, performing, supervising, reviewing and documenting its activities distinguishes the activities of the internal audit function from other monitoring control activities that may be performed within the entity.

A11. Factors that may affect the external auditor's determination of whether the internal audit function applies a systematic and disciplined approach include the following:

- The existence, adequacy and use of documented internal audit procedures or guidance covering such areas as risk assessments, work programs, documentation and reporting, the nature and extent of which is commensurate with the size and circumstances of an entity.
- Whether the internal audit function has appropriate quality control policies and procedures, for example, such as those policies and procedures in SQC 1[17] that would be applicable to an internal audit

[17] Standard on Quality Control (SQC) 1, Quality Control for Firms that Perform Audits and

function (such as those relating to leadership, human resources and engagement performance) or quality control requirements in standards set by the relevant professional bodies for internal auditors. Such bodies may also establish other appropriate requirements such as conducting periodic external quality assessments.

Circumstances When Work of the Internal Audit Function Cannot Be Used (Ref: Para. 16)

A12. The external auditor's evaluation of whether the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors, the level of competence of the internal audit function, and whether it applies a systematic and disciplined approach may indicate that the risks to the quality of the work of the function are too significant and therefore it is not appropriate to use any of the work of the function as audit evidence.

A13. Consideration of the factors in paragraphs A7, A8 and A11 of this SA individually and in aggregate is important because an individual factor is often not sufficient to conclude that the work of the internal audit function cannot be used for purposes of the audit. For example, the internal audit function's organizational status is particularly important in evaluating threats to the objectivity of the internal auditors. If the internal audit function reports to management, this would be considered a significant threat to the function's objectivity unless other factors such as those described in paragraph A7 of this SA collectively provide sufficient safeguards to reduce the threat to an acceptable level.

A14. In addition, a self-review threat[18] is created when the external auditor accepts an engagement to provide internal audit services to an audit client, and the results of those services will be used in conducting the audit. This is because of the possibility that the engagement team will use the results of the internal audit service without properly evaluating those results or without exercising the same level of professional skepticism as would be exercised when the internal audit work is performed by individuals who are not members of the firm. Paragraph 290.173 of the Code of Ethics, issued by the Institute of Chartered Accountants of India therefore in the context of

Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements.

[18] Attention of the members is also invited to paragraph 2.1 of the Guidance Note on Independence of Auditors, issued by the Institute of Chartered Accountants of India.

provision of internal audit service to financial statement audit clients, specifically provides that "a statutory auditor of an entity cannot be its internal auditor as it will not be possible for him to give an independent and objective opinion". The said Code of Ethics discusses the threats and the safeguards that can be applied to reduce the threats to an acceptable level in other circumstances.

Determining the Nature and Extent of Work of the Internal Audit Function that Can Be Used

Factors Affecting the Determination of the Nature and Extent of the Work of the Internal Audit Function that Can Be Used (Ref: Para. 17–19)

A15. Once the external auditor has determined that the work of the internal audit function can be used for purposes of the audit, a first consideration is whether the planned nature and scope of the work of the internal audit function that has been performed, or is planned to be performed, is relevant to the overall audit strategy and audit plan that the external auditor has established in accordance with SA 300.[19]

A16. Examples of work of the internal audit function that can be used by the external auditor include the following:

- Testing of the operating effectiveness of controls.
- Substantive procedures involving limited judgment.
- Observations of inventory counts.
- Tracing transactions through the information system relevant to financial reporting.
- Testing of compliance with regulatory requirements.
- In some circumstances, audits or reviews of the financial information of subsidiaries that are not significant components to the group (where this does not conflict with the requirements of SA 600).[20]

A17. The external auditor's determination of the planned nature and extent of use of the work of the internal audit function will be influenced by the external auditor's evaluation of the extent to which the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors and the level of competence of

[19] SA 300, Planning an Audit of Financial Statements.
[20] SA 600, Using the Work of Another Auditor.

the internal audit function in paragraph 18 of this SA. In addition, the amount of judgment needed in planning, performing and evaluating such work and the assessed risk of material misstatement at the assertion level are inputs to the external auditor's determination. Further, there are circumstances in which the external auditor cannot use the work of the internal audit function for purpose of the audit as described in paragraph 16 of this SA.

Judgments in planning and performing audit procedures and evaluating results (Ref: Para. 18(a), 30(a))

A18. The greater the judgment needed to be exercised in planning and performing the audit procedures and evaluating the audit evidence, the external auditor will need to perform more procedures directly in accordance with paragraph 18 of this SA, because using the work of the internal audit function alone will not provide the external auditor with sufficient appropriate audit evidence.

A19. Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement in accordance with paragraph 18. Significant judgments include the following:

- Assessing the risks of material misstatement;
- Evaluating the sufficiency of tests performed;
- Evaluating the appropriateness of management's use of the going concern assumption;
- Evaluating significant accounting estimates; and
- Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor's report.

Assessed risk of material misstatement (Ref: Para. 18(b))

A20. For a particular account balance, class of transaction or disclosure, the higher an assessed risk of material misstatement at the assertion level, the more judgment is often involved in planning and performing the audit procedures and evaluating the results thereof. In such circumstances, the external auditor will need to perform more procedures directly in accordance with paragraph 18 of this SA, and accordingly, make less use of the work of the internal audit function in obtaining sufficient appropriate audit evidence.

Furthermore, as explained in SA 200,[21] the higher the assessed risks of material misstatement, the more persuasive the audit evidence required by the external auditor will need to be, and, therefore, the external auditor will need to perform more of the work directly.

A21. As explained in SA 315,[22] significant risks require special audit consideration and therefore the external auditor's ability to use the work of the internal audit function in relation to significant risks will be restricted to procedures that involve limited judgment. In addition, where the risks of material misstatement is other than low, the use of the work of the internal audit function alone is unlikely to reduce audit risk to an acceptably low level and eliminate the need for the external auditor to perform some tests directly.

A22. Carrying out procedures in accordance with this SA may cause the external auditor to reevaluate the external auditor's assessment of the risks of material misstatement. Consequently, this may affect the external auditor's determination of whether to use the work of the internal audit function and whether further application of this SA is necessary.

Communication with Those Charged with Governance (Ref: Para. 20)

A23. In accordance with SA 260(Revised),[23] the external auditor is required to communicate with those charged with governance an overview of the planned scope and timing of the audit. The planned use of the work of the internal audit function is an integral part of the external auditor's overall audit strategy and is therefore relevant to those charged with governance for their understanding of the proposed audit approach.

Using the Work of the Internal Audit Function

Discussion and Coordination with the Internal Audit Function (Ref: Para. 21)

A24. In discussing the planned use of their work with the internal audit function as a basis for coordinating the respective activities, it may be useful to address the following:

- The timing of such work.
- The nature of the work performed.

[21] SA 200, paragraph A29.
[22] SA 315, paragraph 4(e).
[23] SA 260(Revised), paragraph 15.

- The extent of audit coverage.
- Materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures), and performance materiality.
- Proposed methods of item selection and sample sizes.
- Documentation of the work performed.
- Review and reporting procedures.

A25. Coordination between the external auditor and the internal audit function is effective when, for example:

- Discussions take place at appropriate intervals throughout the period.
- The external auditor informs the internal audit function of significant matters that may affect the function.
- The external auditor is advised of and has access to relevant reports of the internal audit function and is informed of any significant matters that come to the attention of the function when such matters may affect the work of the external auditor so that the external auditor is able to consider the implications of such matters for the audit engagement.

A26. SA 200[24] discusses the importance of the auditor planning and performing the audit with professional skepticism, including being alert to information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence. Accordingly, communication with the internal audit function throughout the engagement may provide opportunities for internal auditors to bring matters that may affect the work of the external auditor to the external auditor's attention.[25] The external auditor is then able to take such information into account in the external auditor's identification and assessment of risks of material misstatement. In addition, if such information may be indicative of a heightened risk of a material misstatement of the financial statements or may be regarding any actual, suspected or alleged fraud, the external auditor can take this into account in the external auditor's identification of risk of material misstatement due to fraud in accordance with SA 240.[26]

[24] SA 200, paragraphs 15 and A18.

[25] SA 315, paragraph A115.

[26] SA 315, paragraph A10 in relation to SA 240, The Auditor's Responsibilities Relating to Fraud in

Procedures to Determine the Adequacy of Work of the Internal Audit Function (Ref: Para. 23–24)

A27. The external auditor's audit procedures on the body of work of the internal audit function as a whole that the external auditor plans to use provide a basis for evaluating the overall quality of the function's work and the objectivity with which it has been performed.

A28. The procedures the external auditor may perform to evaluate the quality of the work performed and the conclusions reached by the internal audit function, in addition to re performance in accordance with paragraph 24, include the following:

- Making inquiries of appropriate individuals within the internal audit function.
- Observing procedures performed by the internal audit function.
- Reviewing the internal audit function's work program and working papers.

A29. The more judgment involved, the higher the assessed risk of material misstatement, the less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors, or the lower the level of competence of the internal audit function, the more audit procedures are needed to be performed by the external auditor on the overall body of work of the function to support the decision to use the work of the function in obtaining sufficient appropriate audit evidence on which to base the audit opinion.

Re-performance (Ref: Para. 24)

A30. For purposes of this SA, reperformance involves the external auditor's independent execution of procedures to validate the conclusions reached by the internal audit function. This objective may be accomplished by examining items already examined by the internal audit function or, where it is not possible to do so, the same objective may also be accomplished by examining sufficient other similar items not actually examined by the internal audit function. Reperformance provides more persuasive evidence regarding the adequacy of the work of the internal audit function compared to other procedures the external auditor may perform in paragraph A28. While it is not necessary for the external auditor to do reperformance in each area of work

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of the internal audit function that is being used, some reperformance is required on the body of work of the internal audit function as a whole that the external auditor plans to use in accordance with paragraph 24. The external auditor is more likely to focus reperformance in those areas where more judgment was exercised by the internal audit function in planning, performing and evaluating the results of the audit procedures and in areas of higher risk of material misstatement.

Determining Whether, in Which Areas and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance

Determining Whether Internal Auditors Can Be Used to Provide Direct Assistance for Purposes of the Audit (Ref: Para. 5, 26–28)

A31. In case where the external auditor is prohibited by law or regulation from using internal auditors to provide direct assistance, it is relevant for the principal auditors to consider whether the prohibition also extends to component auditors and, if so, to address this in the communication to the component auditors.

A32. As stated in paragraph A7 of this SA, objectivity refers to the ability to perform the proposed work without allowing bias, conflict of interest or undue influence of others to override professional judgments. In evaluating the existence and significance of threats to the objectivity of an internal auditor, the following factors may be relevant:

- The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors.[27]
- Family and personal relationships with an individual working in, or responsible for, the aspect of the entity to which the work relates.
- Association with the division or department in the entity to which the work relates.
- Significant financial interests in the entity other than remuneration on terms consistent with those applicable to other employees at a similar level of seniority.

Material issued by relevant professional bodies for internal auditors may provide additional useful guidance.

[27] See paragraph A7.

A33. There may also be some circumstances in which the significance of the threats to the objectivity of an internal auditor is such that there are no safeguards that could reduce them to an acceptable level. For example, because the adequacy of safeguards is influenced by the significance of the work in the context of the audit, paragraph 30(a) and (b) prohibits the use of internal auditors to provide direct assistance in relation to performing procedures that involve making significant judgments in the audit or that relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited. This would also be the case where the work involved creates a self-review threat, which is why internal auditors are prohibited from performing procedures in the circumstances described in paragraph 30(c) and (d).

A34. In evaluating the level of competence of an internal auditor, many of the factors in paragraph A8 of this SA may also be relevant, applied in the context of individual internal auditors and the work to which they may be assigned.

Determining the Nature and Extent of Work that Can Be Assigned to Internal Auditors Providing Direct Assistance (Ref: Para. 29–31)

A35. Paragraphs A15–A22 of this SA provide relevant guidance in determining the nature and extent of work that may be assigned to internal auditors.

A36. In determining the nature of work that may be assigned to internal auditors, the external auditor is careful to limit such work to those areas that would be appropriate to be assigned. Examples of activities and tasks that would not be appropriate to use internal auditors to provide direct assistance include the following:

- Discussion of fraud risks. However, the external auditors may make inquiries of internal auditors about fraud risks in the organization in accordance with SA 315.[28]
- Determination of unannounced audit procedures as addressed in SA 240.

[28] SA 315, paragraph 6(a).

A37. Similarly, since in accordance with SA 505[29] the external auditor is required to maintain control over external confirmation requests and evaluate the results of external confirmation procedures, it would not be appropriate to assign these responsibilities to internal auditors. However, internal auditors may assist in assembling information necessary for the external auditor to resolve exceptions in confirmation responses.

A38. The amount of judgment involved and the risk of material misstatement are also relevant in determining the work that may be assigned to internal auditors providing direct assistance. For example, in circumstances where the valuation of accounts receivable is assessed as an area of higher risk, the external auditor could assign the checking of the accuracy of the aging to an internal auditor providing direct assistance. However, because the evaluation of the adequacy of the provision based on the aging would involve more than limited judgment, it would not be appropriate to assign that latter procedure to an internal auditor providing direct assistance.

A39. Notwithstanding the direction, supervision and review by the external auditor, excessive use of internal auditors to provide direct assistance may affect perceptions regarding the independence of the external audit engagement.

Using Internal Auditors to Provide Direct Assistance (Ref: Para. 34)

A40. As individuals in the internal audit function are not independent of the entity as is required of the external auditor when expressing an opinion on financial statements, the external auditor's direction, supervision and review of the work performed by internal auditors providing direct assistance will generally be of a different nature and more extensive than if members of the engagement team perform the work.

A41. In directing the internal auditors, the external auditor may, for example, remind the internal auditors to bring accounting and auditing issues identified during the audit to the attention of the external auditor. In reviewing the work performed by the internal auditors, the external auditor's considerations include whether the evidence obtained is sufficient and appropriate in the circumstances, and that it supports the conclusions reached.

[29] SA 505, External Confirmations, paragraphs 7 and 16.