Communiqué – Your TP Tabloid

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Foreword

As the winters start to set and the festive season begins, we in India, head into another compliance cycle. This year the compliance cycle would be lengthier and extensive as there are two additions to the bucket list – Master File (MF) compliance by November 30 and GST Audit by December 31. Last month witnessed some interesting developments with Central Board of Direct Taxes (CBDT) issuing Scrutiny Guidelines Financial Year (FY) 2018-19 and also releasing Second Annual Report on Advance Pricing Agreement (APA). Even ICAI on its part issued Guidance on the Amended Tax Audit Report, for the benefits of all the stakeholders. On Indian litigation front, we witnessed continued and determined efforts of Indian Courts to clear past litigations. Globally Organisation for Economic Co-operation and Development (OECD) released guidance on four more issues relevant for Country-by-Country Reports (CbCR) implementation and also published transfer pricing country profiles (TPCP) for many new entrants. In the country round up section, we see that alignment of all countries with the evolving global transfer pricing (TP) standards continues. Towards our objective of being your value added partners, we discuss the below in this issue:

We hope that our publications are benefit you in understanding potential impact (if any) of the changes with respect to your business in India. We look forward to your contributions/ suggestions as through a mutually inclusive process we wish to make this series your sounding board for decision on TP going forward. If there are any suggestions/ feedback that you would like to share with us, please write to me at query@nangia.com. Separately, if you would like to discuss any item in this issue in greater detail or general TP matters, please do let us know. Kindly note that information contained within this issue is of general nature and reliance on the same should not be placed without seeking professional advice.

Wishing everyone a prosperous Diwali in advance!

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Scrutiny Guidelines Released by CBDT for FY 2018-19

On August 20, 2018, CBDT issued guidelines for manual selection of returns for complete scrutiny for FY 2018-19 to the tax officers. The CBDT Instruction issued for the financial year 2018-19 supersedes its earlier Instruction on this matter. As compared to the guidelines for FY 2017-18, the present guidelines do not bring about any change. However, these instructions prove helpful for the taxpayers while planning to file tax returns as they are aware of the criteria for selection of cases for scrutiny beforehand and thus, in a better position to prepare for imminent scenario. On the other hand, the instructions are imperative to ensure that the scrutinizing procedure for assessments is conducted in a professional manner by the concerned department and not in some arbitrary and discretionary way.

ICAI Guidance on the Amended Tax Audit Report Released

ICAI has released 'Implementation Guide' for amended Tax Audit Report (in Form 3CD) applicable from August 20, 2018. This guide supplements ICAI's 'Guidance Note on Tax Audit (2014) and provides clause-wise analysis[1] of amendments in reporting requirements of Form 3CD notified by CBDT, for guidance of Members/ Taxpayers. Key guidance on amended clauses pertaining to TP is as follows:

- **Secondary Transfer Pricing Adjustments [Clause 30A]:** The Guidance further clarifies that it is necessary that the disclosure under Clause 30A may need to be done is respect of each and every type of primary adjustment made in the relevant financial year, irrespective of the previous year to which this adjustment pertains to. Over and above the management representation, the Guidance requires the auditor to check tax records to verify reasons for occurrence of primary adjustment such as suo-motto adjustment, etc. Thus, primary onus is on the management. In case of secondary adjustments, the auditor is required to assess the computation of imputed interest calculation basis evidential data in the form of certificates of the relevant SBI/LIBOR interest rates that the taxpayer obtains. It clarifies that interest income imputed has to be till the end of the previous year is to be reported. However, in case interest up to the date of filing of the tax audit report is given, it is advised to provide a proper break-up. ICAI Guidance further explains that it is possible that amount of imputed interest income on the excess money not repatriated to India may relate to more than one year. In such a case, it is advisable for the taxpayer to furnish and tax auditor to verify and report the information pertaining to such primary adjustments in respect of interest income which is chargeable u/s. 92CE(2) so that details in return and tax audit reconcile**.**

- **Limitation on Interest Deduction [Clause 30B]:** ICAI Guidance clarifies that expenditure of similar nature should be read in the context of "debt" as defined in Section 94B(5)(ii). ICAI Guidance also clarifies that in computing the limit of Rs. 1 crore, only interest and expenditure of similar nature which is deductible while computing income under the head "Profits and Gains of Business or Profession" should be considered, and not interest deductible under any other head of income or interest which is otherwise not deductible. The Guidance states that "The computation of "excess interest" as per section 94B(2) should be within the boundaries of interest referred to in s.94B(1), which is non-resident AE interest. While computing EBITDA, the ICAI Guidance states that the figures as per the final audited stand-alone accounts of the company should be considered accounts of the company should be considered, and not the figures as adjusted for the income tax computation after various allowances and disallowances. Regarding the details of brought forward

[1] Does not cover Clauses 30C (GAAR) and 44 (GST) of the revised Form 3CD as their applicability has been deferred upto 31 March 2019, based on representations received from stakeholders, like ICAI, etc.

excess interest disallowed in earlier years, which has not been allowed as a deduction, and which is available for deduction during the year under audit (without considering the limitation during the year under audit) to be given, the ICAI Guidance clarifies that "Since section 94B was introduced only with effect from assessment year 2018-19, for the report for assessment year 2018-19, this figure would be nil." and going forward the auditor is required to verify the numbers.

- **Country by Country Reporting [Clause 43]:** Clause 43(a) requires the auditor to state whether the assessee or its parent entity or alternate reporting entity is liable to furnish the report referred to in section 286(2). The ICAI Guidance states that the tax auditor should verify in the case of the assessee if any of the abovementioned situations exist and verify if the assessee whose parent is a non-resident has filed Form No. 3CEAC. As per Section 286(4), in cases where a constituent entity resident in India of an international group, although not designated as the alternate reporting entity u/s 286(2), has to furnish the report referred to in Section 286(2), the ICAI Guidance acknowledges that no time limit has been prescribed for filing of this report. Accordingly, this clause does not cover Section 286(4) as of now.

Second Annual Report on APA released

On August 31, 2018, the CBDT carried forward it's unique initiative of last year to bring into the public domain various statistical and qualitative aspects on the performance of India's APA Program for six years of its existence in an Annual Report with a view to encourage discussion and debate amongst various stakeholders on the strengths and weaknesses of the Program to ensure its continued success in the future as well.

Key Findings in the Annual Report

Some of the interesting findings of the Annual Report are as below:

- The wide adoption of this Program by the Indian taxpayers can be estimated from the number of applications - close to 1,000 applications filed thus far since the launch. At the end of last fiscal year, there were 684 APA applications under process compared with 985 filed by end of FY 2017-18. Of the 168 applications filed during FY 2017-18, 53 applications were bi-lateral.

- The report boosts of 67 APAs (58 Unilateral and 9 Bilateral) signed during FY 2017-18, taking the total APA tally to 219 (199 Unilateral and 20 Bilateral) and with that the CBDT has succeeded in providing certainty for 415 years to taxpayers on a cumulative basis. Compared to its 219 APAs since FY14, China managed to sign only 139 APAs in the 12 years between 2005 and 2016. However, it does reveal a dip of 27.5% in number of APAs signed in FY 2017-18 (as compared to FY 2016-17) attributable largely to increase in complexity of cases handled and shortage of manpower in the APA teams.

- The report further indicates that average time to conclude 58 Unilateral APAs in FY 2017-18 was 38.62 months (which is more than the combined average time taken in previous 4 years), however it highlights a highly credible achievement that "more than 70% of the unilateral APAs entered into have been concluded within 3 years of the filing of applications and more than 25% have been entered into within 2 years". But, the time duration to close unilateral APA in India is still better than 40.4 month of average time taken by the US authorities for unilateral APAs. Even the average time to conclude Bilateral APAs has gone up to 45.78 months in FY 2017-18. These timelines are understandable considering the efforts involved in complex transactions and finding a solution amidst the litigations on many issues.

- With the US Competent Authority (CA) opening up the Bilateral APA Program (BAPA) between the two countries from February, 2016, and India now willing to accept BAPAs in respect of all treaty partners (even in the absence of Article 9(2) in the relevant treaty), the report indicates that one significant trend seen is that filing of BAPA applications has

more than doubled in 2017-18 (as compared to 2016-/17). This is an encouraging trend as a bilateral resolution not only fosters an appropriate environment for the businesses to grow by weeding out uncertainty but, also help businesses avoid double taxation. The increased intention to go for bilateral route for the afore-said reasons can also be determined from 33 unilateral APA applications getting converted to BAPA applications during FY 2017-18 with almost 75% of total BAPA applications with United States (U.S.), United Kingdom (UK) and Japan.

- The Report also states that "It is conservatively estimated that the 219 signed APAs have resulted in additional income of about Rs. 10,000 Crore. This translates to a tax payment of about Rs. 3,000 Crore without getting into any litigation or there being any dispute". This definitely lends credibility to the Program, which came as a welcome alternative to the protracted litigation for many companies.

- The Report indicates that the spectrum of the APA Program be it in terms of methods agreed for analysis, nature of international transactions, location of associated enterprises, industry or types of players in an industry, has significantly increased over the earlier years. Having said this, some aspects that remained in forefront like Transactional Net Margin Method in terms of Methods, Information Technology (IT) / IT Enabled Services (ITeS) services in terms of transaction and industry, and, United States (U.S.) and United Kingdom (UK) in terms of country (of the 58 unilateral APAs entered into in last fiscal, 40 have AE of the Indian applicant based in the U.S., followed by the UK with 22 applications. Further, out of the 9 BAPAs signed with Indian taxpayers, 4 pertained to UK and 3 to U.S.).

- As a word of caution, the Report suggests that the Program's future success is dependent upon the availability of adequate skilled manpower to handle complex issues, etc. and physical resources.

Analysis

On an overall basis, the APA Program has indeed matured well over the past six years with complex issues also now finding a resolution at this forum. It (an alternate dispute resolution mechanism) is one of the major initiatives undertaken by the Government of India in the recent past to herald a non-adversarial regime and certainly the above findings in the report resolves its intent and commitment towards such a regime. The acceptance of BAPA with countries that lacked clause 9(2) in the treaty by CBDT further underpinned it's intent and commitment to ensure that benefits of this Program are broad-based. This has ensured that there is a tapering of long drawn litigation to the satisfaction of both the taxpayers (who are able to attain certainty of doing business for upto nine years) and the Indian Government (who is able to divert resources to more productive work).

The impressive APA statistics suggests that India has fared better than many other countries on various accounts and Government's resolve of fostering a non-adversarial tax regime. Thus, it would be imperative that a robust infrastructure of teams/ resources is established along with continued support of India CA to successfully manage the APA Program in future. With this Program helping to create a conducive environment for MNEs to do business in India in line with the Government of India's vision, it is heartening to see that the CBDT itself has acknowledged this challenge in the Report and is committed to plug the gap to see that the initiative moves in the desired direction going forward also.

In addition, as the APA Program now enters a phase of renewals, it would be interesting to see how many companies opt for renewals and the approach adopted by the APA teams for the same.

Case Laws – India

Case Law	Summary
High Court (HC) Rules on comparability[2]	Karnataka HC upholds ITAT-order on comparables selection for ITeS-provider: • *Upheld exclusion of Mercury Outsourcing Management by applying 10 times turnover range* based on the fact that the decision of the ITAT in the other cases would not render the findings of the ITAT in the present case nugatory or perverse; • *Rejected assessee's plea for exclusion of Maple E-Solutions on grounds of non-reliability of financial statements due to alleged fraud by its Directors*, by relying on Softbrands it held that Tribunal "has rightly arrived at a finding that the objections of the Assessee as regards the alleged fraud against the Directors of the company would not disqualify the said comparable to be considered"; and • *Dismissed assessee's plea for inclusion of Genesys International Corporation* (which was excluded by ITAT as it failed 25% RPT filter) by upholding after rejecting assessee's contention that if non-trading/ revenue receipts are excluded, the RPT comes to 10.13%, upholds ITAT view that "when the receipt from the Related Party are falling under the definition of international transactions then the same will be treated as part of the RPT as reported by the said company"
HC: Revenue's appeal dismissed; ITAT-order invalidating TP-adjustment absent TPO reference upheld[3]	Bombay HC upheld ITAT-order invalidating TP-adjustment made without reference to TPO (where value of international transaction exceeded Rs.5cr) for AY 2005-06; ITAT had held that AO's action was in contravention to CBDT Instruction 3/2003 but clarified that while the assessment order was good in law, only the TP-adjustments made therein were bad in law; Noted that given the nature of the transaction, CBDT Instruction was applicable to the case, HC opined since there exist no acceptable/ justifiable reason on record for refusing to abide by the CBDT circular, Tribunal action is completely valid.
HC: Quashes final assessment sans draft order post-remand, directs AO to re-do assessment[4]	Pursuant to remand by ITAT for AY 2009-10, AO made a fresh reference to TPO who proposed TP-adjustments and accordingly, AO passed assessment order incorporating such adjustments without issuance of the draft order; HC relies upon co-ordinate bench ruling. However, it took obtuse reference from JCB and BSC C&C Joint Venture case, and directed AO to complete assessment as per Sec 144C, also directs that time consumed by writ proceedings should be excluded for reckoning limitation during making fresh assessment order
ITAT: Section 142(1) notice containing show-cause for ALP-determination constitutes sufficient notice u/s 92C(3)[5]	Mumbai ITAT upholds validity of Sec 142(1) notice issued by AO for ALP-determination of assessee's international transaction, rejects assessee's plea that AO could not have made TP-adjustment without issuing specific notice u/s 92C for AYs 2010-11 & 2011-12; Observes that AO in its notice, though issued u/s 142(1), had clearly made a show-cause as to why ALP should not be computed in assessee's case and upon assessee not responding to the notice (despite imposition of penalty for non-compliance), AO proceeded to make TP-adjustment; ITAT states that AO has in his action confirmed with the proviso of section 92C(3) and assessee failed to respond. Accordingly, distinguishes assessee's reliance on Delhi HC rulings in Moser Baer and Maruti Suzuki on facts.

[2] Acusis Software India Pvt Ltd(TS-973-HC-2018(KAR)-TP)
[3] S.G. Asia Holdings (India) P Ltd [TS-922-HC-2018(BOM)-TP]
[4] Stryker India Pvt Ltd [TS-931-HC-2018(DEL)-TP]
[5] Kaybee Private Limited [TS-898-ITAT-2018(Mum)-TP]

OECD releases further guidance on four issues relevant for CbCR implementation

"Three-tiered structure" documentation scheme, which include CbCR, advocated by OECD's Action Plan 13 has been adopted by various jurisdictions across the globe and the stakeholders (i.e. both the Taxpayers and Tax Administrators) continue to stumble upon newer issues pertaining to definitional, interpretational and other areas during the implementation phase. Accordingly, from time-to-time OECD has endeavoured to address these through issuance of common public guidance (in the form of question and answers). On September 13, 2018, the OECD updated its guidance on CbCR for multinationals, approved by the "Inclusive Framework on BEPS," a coalition of over 100 countries, on four issues:

- The new guidance clarifies the treatment of dividends received. Prospectively, the OECD's updated guidance allows jurisdictions the flexibility as to how to treat the dividends received from other Constituent Entities (CEs) for the purposes of "Profit (loss) before Income Tax" in Table 1. However, it encourages taxpayers to indicate in Table 3 whether dividends received from other CEs are included in "Profit (loss) before income tax" in Table 1 and, if so, for which jurisdictions so that a level playing field is created when these numbers are assessed by the tax authorities. Further, it indicates that disclosure on "income tax accrued (current year)" and "income tax paid (on cash basis)" should be consistent with those pertaining to "Profit (loss) before Income Tax" so that no additional issues are created.

- The updated guidance also states that shortened amounts should not be used in completing Table 1.

- The new guidance provides that prospectively in cases where an MNE uses proportional consolidation in preparing its consolidated financial statements for a CE, then disclosure on financial parameter (including details on number of employees, etc.) in CbCR has to be made in similar manner accompanied with appropriate notes as per the suggested language so that the big picture is made clear to the stakeholders as they use the CbCR information for risk assessment purposes.

- A Table that summarizes existing interpretative guidance on the approach to be applied in cases of mergers, demergers, and acquisitions has also been included.

Analysis

The periodic interpretative guidance provided by OECD through a consensus approach is very valuable as it helps to iron out the differences among jurisdictions and stakeholders such that CbCR is implemented consistently across the globe. Consistent implementation will not only ensure a level playing field, but also provide certainty for both Taxpayers and Tax Administrators as it improves their ability to use CbCR in their risk assessment work. Thus, it assists to put to rest issues that can in future lead to unnecessary litigation and in fact carry within them the force to obliterate the larger intent with which the new disclosure requirements.

OECD's latest update on Country Profile

Recently, the OECD has published new transfer pricing country profiles (TPCP) for for Costa Rica, Greece, Republic of Korea, Panama, Seychelles, South Africa and Turkey and updated that of Singapore. These new profiles reflect the current TP legislation and practices of each country. The country profiles are now available for 52 countries.

The updated TPCPs reflect revisions to TP Guidelines resulting from the 2015 Reports on Actions 8-10 Aligning Transfer Pricing Outcomes with Value Creation and Action 13 Transfer Pricing Documentation and Country-by-Country Reporting of the OECD/G20 Project on BEPS, in addition to changes incorporating the revised guidance on safe harbours approved in 2013 and consistency changes made to the rest of the OECD TP Guidelines.

The TP profiles focus on countries' domestic legislation regarding key TP principles, including

the arm's length principle, TP methods, comparability analysis, intangibles, intra-group services, cost contribution agreements, TP documentation, administrative approaches to avoiding and resolving disputes, safe harbours and other implementation measures. The information contained in the TPCP is intended to clearly reflect the current state of countries' legislation and to indicate to what extent their rules follow the OECD TP Guidelines. The information was provided by countries themselves in response to a questionnaire so as to achieve the highest degree of accuracy.

Analysis

Many jurisdictions have revised their local TP rules/ regulations following the recent changes to the global tax policy landscape being pioneered by OECD. Accordingly, this harmonised information to map progress and clearly bring out the current position of each covered country on key aspects of TP legislation is a welcome step. It would really benefit the multinational enterprises and other tax practitioners across the globe by serving as a great starting point to get a high level clarity on TP requirements in a country and take informed decisions in today's fast changing world scenario.

Other news – around the globe!

Nigeria

- Retroactively effective from March 12, 2018, the Federal Inland Revenue Service (FIRS) issued new transfer pricing regulations that would replace erstwhile regulations from 2012. Some of the changes brought about are stricter penalties due to non-compliance, change in the applicability of safe harbour, documentation requirement, etc.
- FIRS on Monday, 17 September 2018, issued a public notice pertaining to the rules for MNE groups that meet the notification requirement under the CbCR regulations to comply with the requirement else it would result in imposition of penalties. Thus, reinforcing its resolve to enforce compliance.

New Zealand

- Inland Revenue Department has requested comments on five draft "special reports" (pertaining to interest limitation, hybrid and branch mismatch agreement, TP, PE avoidance and BEPS-related administrative measures), which are intended to provide guidance on how the tax agency would consider certain elements of a new tax law addressing BEPS that have become applicable from on or after July 1, 2018.

Ireland

- Comments have been sought by Ireland's Department of Finance on detailed outline of the proposed framework for its controlled foreign company (CFC) regime, scheduled to be effective 1 January 2019. Further, in Corporation Tax Roadmap published by Ireland's government, it is clearly stated that the Government intends to update TP rules to reflect 2017 OECD's TP Guidelines by introducing new provisions in Finance Bill 2019 that would take effect from January 1, 2020.

Poland

- The Ministry of Finance has posted on the e-Deklaracje website (in Polish) interactive and simplified forms to be used as transfer pricing reports. Using a qualified electronic signature, the completed report may be submitted electronically via the e-Deklaracje system. Further, the timeline for submission has been extended.

Saudi Arabia

- Government of Saudi Arabia becomes the 84th jurisdiction to join BEPS multilateral instrument for exchange of information pertaining to CbCR.

Israel

- On September 5th, the Israeli tax authority published two circulars on TP: 1) ITA Circular 11/2018, which determines the appropriate TP method for distribution, marketing, and sales activities of MNE in the domestic market; and 2) ITA Circular 12/2018, which states the rates and profit margins for certain transactions as part of its safe harbour regime.

Cyprus

- On 19th September, the Cyprus Tax Department (CTD) announced that any revised CbC notifications that need to be filed for 2017 and submission of CbC notifications for the 2018 reporting fiscal year must be submitted by 31 December 2018 to avoid the imposition of penalties. The CTD also announced that no CbC exchange information agreement is expected to be signed between Cyprus and the United States before 31 December 2018.

Peru

- On 24 August 2018, Peru enacted Legislative Decree 1381, which amends the definition of tax havens and preferential tax regimes for tax purposes and extends application of TP rules to transactions entered with entities subject to preferential tax regimes.

Australia

- On August 24, 2018, Royal Asset was accorded to Australia's law to adopt OECD's MLI Bill 2018.

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