India

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The Organisation for Economic Co-operation and Development ('OECD') recently released a White Paper on Transfer Pricing Documentation ('OECD White Paper') for public consultation as part of its ongoing transfer pricing simplification project.

The OECD White Paper essentially:

- provides an overview of existing guidance and initiatives on transfer pricing documentation;
- defines the objectives of transfer pricing documentation; and
- recommends a two-tiered approach to transfer pricing documentation to make compliance simpler and more straightforward, while at the same time providing tax authorities with more focused and useful information in connection with transfer pricing risk assessment and transfer pricing audits.

The two-tiered documentation structure advocated comprises a "Master File" and a "Local File" approach. The Master File is expected to provide a "Big Picture" of the group-level activities of an Multinational Enterprise ('MNE') group while the Local File would contain the relevant aspects of the specific inter-company transactions entered into by the taxpayer with its associated enterprises ('AE').[1]

It is envisaged that the Master file related information would be relevant for risk assessment purposes and detailed information on the related party transactions can be called for when the arm's length character of specific transactions needs to be assessed.[2]

As with most other countries that have codified documentation requirements, the Indian Transfer Pricing Regulations require maintenance of contemporaneous documentation. The Indian regulations relating to documentation are analysed against the backdrop of the OECD White Paper below.

I. Information to be documented

India introduced comprehensive transfer pricing legislation in 2001[3] (hereinafter known as 'Indian Regulations'), which also included the specific particulars of documentation to be maintained to support the arm's length nature of intercompany transactions. While the Indian Regulations have undergone certain modifications from time to time to provide further clarity or increase their scope, the substantive portions around documentation have remained unchanged.

It would be pertinent here to note that an exact comparison of the Indian Regulations with the recommendations made in the OECD White Paper would be an anachronistic exercise as the Indian Regulations were drafted about 12 years ago when tax authorities and taxpayers had lesser experience in creating and using transfer pricing documentation. Considering that the two sets of guidelines have been envisaged at different points in time, it should be recognised that while Indian Regulations may not have specific guidance in law on various aspects as covered by the OECD White Paper, the Indian Regulations have been fairly comprehensive in their coverage for the purposes of arriving at the arm's length value in relation to intercompany transactions.

The Indian Regulations prescribe the following information and documents to be maintained:[4]

- Description of ownership structure i.e. shareholding pattern of the taxpayer;
- Profile of the multinational group the taxpayer is part of;
- Broad description of business of the taxpayer and its AE(s), including profile of the industry it operates in;
- Inter-company transactions entered into by the taxpayer including value as well as nature and terms of such transactions;
- Analysis of functions performed, risks assumed, assets utilised;
- Record of comparability analysis including method applied from the six methods prescribed in the Indian Regulations, selection of tested party, benchmarking analysis carried out, actual workings carried out as well as comparability economic adjustments made, to support the international transactions with AEs; and
- Any other information relevant for determination of arm's length price.

Apart from the above primary documentation, secondary documentation in terms of industry reports, budgets, forecasts, business plans, inter-company agreements, etc. to the extent available, also need to be maintained.

When considered in the light of the OECD White Paper, the information sought to be included under the Indian Regulations incorporates certain elements of the Master File data and most elements of the Local File data.

A detailed comparative analysis of the Indian Regulations against those of the White Paper reveals that the primary focus of the Indian documentation leans more towards transaction-specific information and analysis of the Indian affiliate's transactions rather than an emphasis on the overview and approach of

the MNE group as a whole, thereby presenting a macro-level "Big Picture" view to the tax administration as advocated in the Master File requirements in the OECD White Paper. At the same time, however, the documentation requirements in the Indian Regulations are wide enough to include provision of all other information to the tax authorities that may be relevant for determination of the arm's length price relative to the transfer price of the international transaction.

A. Master file

The OECD White Paper mandates an MNE to maintain detailed documentation in its Master File covering various aspects of its group-level activities as explained above.

Under the Indian Regulations, an overview of the MNE group, including legal and ownership structure of taxpayer and geographical location of AE should be maintained. However, the White Paper envisages information of *all* principal operating entities of the Group, while the Indian Regulations are largely oriented towards providing information in respect of the entity with which the taxpayer has intercompany transactions.

The OECD White Paper also envisages providing management structures and geographical location of key management personnel which is not mandated in the Indian Regulations.

The Indian Regulations are limited to description of the business activities of the taxpayer where the Indian entity is the tested party, and the industry that it operates in. The focus is on the business of the Indian taxpayer and the industry analysis in respect of the Industry that it is part of. Accordingly, the requirements in the White Paper regarding:

- supply chain for the material products and services of the Group;
- important related party service arrangements of the Group;
- list of main markets for the group's products and services and key competitors;
- written FAR showing principal contributions to value creation;
- business restructuring within last five years; and
- links to industry analyses prepared by rating agencies, stock analysts or others familiar with the business

have not been specifically provided for under the Indian Regulations.

Under the OECD White Paper, information required in relation to intangibles includes:

- description of MNE strategy for development, ownership and exploitation of intangible(s);
- material intangibles including important related party arrangements and transfer pricing policies related to R&D and intangible(s); and
- transfers of interests in intangibles during the relevant year, if any, including entities and compensation involved.

There are no specific requirements under the Indian Regulations in respect of information to be maintained with respect to intangibles. That said, intangibles have been brought into the definition of 'International Transaction'[5] in India (with retrospective effect). However, there has been no subsequent amendment made to the documentation requirements in the light of such amendment.

Further, Indian Regulations also do not prescribe any specific information to be provided in relation to financial activities. Should there occur a particular transaction during the year between the Indian taxpayer and an AE, the focus would be on the resultant profitability/ price/ terms of such transaction alone. On the other hand, the OECD White paper envisages the following level of details to be provided under the Master File:

- description of material intercompany financial transactions including principal amounts involved and related parties involved including their geographical location; and
- intercompany transfer pricing policy for the financial activities.

It is pertinent to note here that the approach to maintenance of the 'transfer pricing policy' document is an area of divergence between the OECD White Paper and the Indian Regulations. That said, the OECD White Paper envisages maintenance of a policy document only in respect of intercompany financial transactions.

Indian Regulations do not prescribe provision of any information in respect of the group's financial and tax positions as part of the transfer pricing documentation requirements. The OECD White Paper, on the other hand, envisages:

- presentation of consolidated accounts;
- descriptions of unilateral/ bilateral APAs, if applicable;
- relevant rulings relating to allocation of income;
- pending or resolved proceedings under Mutual Agreement Procedure(s);
- total number of employees in various jurisdictions; and
- consolidated income statement for the most recent year.

The OECD White Paper does not recommend whether the Master File should be maintained for the entire company as a whole or only for the relevant line of business, in case of a diversified MNE. It only states that the comments of business regarding the usefulness of the Master File where more than one line of business is pursued, should be kept in mind. A coordinated documentation system would have sufficient flexibility to allow the taxpayer to supply Master File information either on a company-wide basis or by line of business, depending on which would provide the most relevant transfer pricing information to Tax Authorities.[6] It should however be noted that the above-mentioned elements of the Master File are not specifically provided for, in the information requirements under the Indian Regulations. That said, the Tax Authorities are not precluded from asking for this additional data, in so much as it is relevant to the transaction at issue.

The Indian Regulations provide adequate powers[7] to the tax authorities to call for additional information, including the above documents/ information (from a Master file perspective), during the course of an audit, as it may deem necessary, in as much as the information is relevant to the determination of the arm's length nature of the transaction under scrutiny.

The tax authorities are not prevented from issuing notices to ask for information relating to specific operational or strategic transfer pricing arrangements/ policies of the overseas AE or the MNE Group. In practice, information on intangibles, financial activities, tax positions of the overseas entities can and is called for by the first level of tax authorities, the Transfer Pricing Officers if they consider it relevant to the transactions entered into with the Indian affiliate.

B. Local file

The OECD White Paper mandates maintenance of local entity information and transactional level data in respect of all controlled transactions, as well as summary financial data of the taxpayer (including segmented financial data) and comparables.

The Indian documentation requirements largely cover the Local File data listed in the White Paper, being quite comprehensive at the transactional level. The OECD White Paper sets out the Local File data for all material controlled transactions whereas the Indian Regulations do not have such a *de minimis* rule at a transactional level. Hence, information should be maintained for all controlled transactions.[8]

The documentation requirements as set out in the OECD White Paper would especially be of significant value in the case of an Indian outbound enterprise where the Indian company has operations in countries across the world. While helping the Indian company comply with requirements under the Indian regulations, the Master File would provide an excellent source of reference for the tax authorities of the overseas jurisdictions where the subsidiaries or associated enterprises of the Indian companies are located, in relation to macro level information of the Group as sought by them. This would also constitute a repository of the group-wide functional profile of the entities as well as the nature of the intercompany transactions. The Master File can also be used by taxpayers to demonstrate the existence of a consistent intercompany pricing arrangement for transactions. On the other hand, in the case of an MNE group, with primary functions located in an overseas jurisdiction, having an Indian affiliate, may find limited usage of the Master File in the Indian context. However, given the increasing level of scrutiny by the Indian tax authorities, the Master File may yet be relevant to document the 'Big picture' view of the MNE group to the Revenue authorities.

II. Recent developments

While the Indian Regulations have remained largely consistent since their introduction a little more than a decade ago, there are some important recent developments on the approach to maintenance of transfer pricing documentation that require attention from taxpayers. These developments and their impact are discussed below.

A. Characterisation of Offshore Development Centres ('ODCs)

India has seen extensive litigation relating to Information Technology ('IT') (also referred to as Software development services) and Information Technology enabled Services ('ITeS') rendered by captive service providers established by MNEs in India. Transfer pricing disputes have largely revolved around the characterisation of such captives in relation to the services rendered by them.

In order to address this aspect, the Indian tax authorities recently issued a Circular[9] which characterised ODCs into the following categories:

- entrepreneurial
- cost sharing, and
- contract R&D.

The Circular prescribes certain criteria to qualifying as a contract R&D ODC, including location of economically significant functions and risks, the funding methodology, location of the intangibles, etc. between the Indian ODC and the overseas AE(s). Hence, to qualify for the correct characterisation, the functional analysis of the controlled transactions assumes great significance.

In support of this functional analysis, Indian companies and the Indian tax authorities may therefore make reference to the information referred to in the Master File, in order to look at the role played by the Indian entity relative to the 'Big Picture' of the MNE Group and thereby ascertain the correct characterisation of the ODC entity(s). In view of this Circular, the documentation requirements from an Indian standpoint should be bolstered, to demonstrate the fulfilment or otherwise of the stipulated conditions.

B. APAs

India introduced the Advance Pricing Agreement ('APA') Programme with effect from July 1, 2012. Under the prescribed procedure for an APA,[10] the tax authorities, apart from the information prescribed in the Indian Regulations – discussed in Section 1, above – also lay emphasis on the submission of additional documents/ information, for example:

- information in respect of the MNE Group's global strategy;
- detailed FAR analysis of the foreign AE;
- details of any APAs that the MNE Group may have in various countries and the nature of transactions covered under such APAs.

Under the APA regime, there is a pragmatic approach to analyse relevant information and documents pertaining to the taxpayer and its AE in relation to the controlled transaction. The APA rules indicate the intention of the Indian tax authorities to understand the operation of the MNE Group from a macro perspective to enhance their understanding of a taxpayer's business. Again, the maintenance of a Master File can aid the provision of such information.

C. Safe harbour provisions (for certain categories)

The Indian tax administration has recently issued guidelines in relation to the definition and applicability of safe harbour provisions.

Although the Safe Harbour provisions do not provide for any relaxation for maintenance of the prescribed documentation, the eligibility for opting to be covered under Safe Harbour Provisions would itself be influenced by the documentation maintained by the taxpayer, especially in relation to functionally satisfying the qualification criteria.

The Safe Harbour Rules, released by the Central Board of Direct Taxes in September 2013, specifically characterise services rendered by a taxpayer to its AEs in various categories such as software development, IT-enabled services, knowledge processing outsourcing ('KPO') and contract research and development ('R&D') in the software and pharmaceutical industries, where the taxpayer bears insignificant risks in relation to services rendered to its AEs. Conditions have been prescribed to qualify as an insignificant risk bearing entity and such conditions relate to the location of economically significant functions and risks, ownership of intangibles and restrictions on location of the AE in a low tax jurisdiction etc.

In light of the above, the functional analysis of the transactions would normally require considering the Master File data for an overall perspective of the MNE Group to make a definitive claim to be covered under Safe Harbour provisions. The Indian documentation requirements are self-contained and lean towards the Local File data as set out in the OECD White Paper. However, the Master File data prescribed in the White Paper can yet be relevant and possibly useful as:

- the Indian Regulations are broad enough to allow for inclusion of any other 'relevant' information that may be required to compute the transfer price;
- the tax authorities are vested with wide powers to call for various information that may be relevant to compute the arm's length price of a controlled transaction;
- the "Big Picture" may be required for correct characterisation of contract R&D for ODCs located in India;
- the APA information requirements look more specifically at enterprise level data; and
- Master File data may also assist in facilitating correct classification under the Safe Harbour provisions.

III. Documentation structure required

As discussed above, the Indian Regulations prescribe the list of information to be maintained by a taxpayer to support the arm's length nature of controlled transaction. In practice, taxpayers tend to compile all the information required in a transfer pricing report or study containing the economic analysis of the controlled transactions. Secondary information such as inter-company agreements, invoices, industry reports, etc. are maintained separately and submitted at the time of audit, when asked for. Further, the documentation should be maintained separately by each of the legal entities of the MNE Group in India as each such entity is a separately assessable unit under the Indian tax law. Thus, an MNE having various subsidiaries in India will be required to maintain documentation for each subsidiary as each would be audited separately and by separate tax jurisdictions, if located in different cities.

Even though the Indian Regulations mandate the taxpayer to have the prescribed documentation by the due date of filing the tax return, the transfer pricing report containing the documentation itself is not required to be submitted at the time of filing but is required to be furnished at the time of audit.

Broadly, the compliance requirements under the Indian Regulations envisage the filing of an Accountants Report (format prescribed as Form 3CEB)[11] which is required to be filed by the due date of the taxpayer's tax return. The Form requires an accountant[12] to certify the taxpayer's maintenance of the prescribed documentation as well as the value of controlled transactions in the statutorily prescribed format along with the related arm's length price as determined by the taxpayer.

For controlled transactions below INR 10 million with non-resident AEs, the prescribed detailed information is not required to be maintained; instead the taxpayer has the flexibility of maintaining such information which would help support the transfer pricing arrangement.

There are documentation-related penalties in the event of non-maintenance or non-furnishing of the documentation. Such penalties would not apply if the taxpayer demonstrated that the documentation has been reasonably maintained in good faith and with due diligence.

IV. Documentation process

With a view to having a co-ordinated approach to the maintenance of transfer pricing documentation, the OECD White Paper has touched upon some mechanical issues that may differ from country to country and potentially create practical challenges for taxpayers. These are discussed below in relation to the Indian Regulations.

A. Certification of documentation by an outside auditor

Under Indian Regulations, as explained above, compliance includes certification of the Accountant's Report by a practicing chartered accountant (or firm) and maintenance of transfer pricing documentation, as prescribed.

It is also to be noted that the documentation requirements apply to the non-resident AE as well, if it files a tax return in India in respect of the controlled transactions with the Indian affiliate. In most such cases, the AE will rely on the transfer pricing report prepared by the Indian affiliate but will need to separately obtain and file the Accountants' Report.

B. Documentation prepared by third parties/ consultants

Indian Regulations do not mandate that documentation should necessarily be prepared by external consultants only. The taxpayer could prepare and compile the documentation internally – there is no variation in the depth of documentation, whether prepared internally or externally.

It should be noted however that whilst there is no compulsion for the transfer pricing report to be compiled by an external consultant, it is mandatory that an independent chartered accountant certifies the fact of maintenance of such documentation and the international transactions with AEs for every taxpayer. Such certification cannot be done internally. In view of the external certification requirement, the market practice is for the appointment of an accounting firm

for both preparation of the transfer pricing documentation and for certification in relation to the Accountants' Report.

C. Use of local comparables

Under the Indian Regulations, transfer pricing documentation is required to be based on contemporaneous data available in the public domain, at the time of preparation of documentation.

The fundamentals of transfer pricing deal with the selection of the 'tested party' as that party to the transaction, which has the lesser complex functions and risks.

The selection of the tested party is a result of the functional analysis. The Comparability analysis is carried out having regard to the determination of the tested party. While the concept of 'tested party', i.e., adoption of the less complex entity as the tested party, is not formally recognised in the Indian Regulations, Indian jurisprudence has recognised and upheld the same.

Specifically, the Tax Tribunal[13] in its ruling in the case of *General Motors*[14] concurred with the principles enunciated on the selection of tested party in the UN Transfer Pricing Manual[15] as well referring to earlier rulings[16] of Indian Tax Tribunals to uphold the selection of the overseas AE as 'tested party' where the facts and circumstances reveal that it is indeed the least complex entity, and requisite information is available about the tested party and comparables.

However, in most cases, the experience is that of the Indian entity being adopted as the 'tested party' (sometimes in part due to availability of reliable data) leading to a preference for Indian/local comparables in most comparability analyses. There is also an apparent reluctance on the part of the first level tax authorities – Transfer Pricing Officers – towards the adoption of overseas tested parties and, in consequence, adoption of regional or other overseas comparables for comparability purposes. Accordingly, the tax authorities ordinarily prefer using only Indian electronic databases given the availability of local comparables' data.

An MNE having a set of comparables for a particular controlled transaction with its various subsidiaries including India, could certainly use its global or regional transfer pricing study for Indian purposes if it can be demonstrated that the AE is the less complex entity. This is an evolving subject and with the passage of time, there is greater appreciation on the part of both taxpayers and tax authorities around the possibility of testing the overseas AE where applicable, using overseas comparables.

D. Translation

English is the prevalent official language in India and is considered to be the reference standard language in which documentation is to be maintained. Communication for audit proceedings and litigation is also carried out in English and there is no insistence by the tax authorities on local language translation.

E. Materiality threshold

Under the Indian Regulations, no materiality threshold is prescribed in terms of the value of transactions or of the nature of transactions that are exempt from transfer pricing requirements. However, where the aggregate value of international transactions with non-resident AEs does not exceed INR 10 million, or the value of specified domestic transactions does not exceed INR 50 million, there is flexibility available to the Taxpayer to maintain/ compile information to support the arm's length nature of its controlled transaction.

All intercompany transactions when entered into with a non-resident AE and specified transactions when entered into with an Indian associated enterprise[17] are required to adhere to the arm's length principle and information requirements are applicable to them.

V. High risk factors

While the tax authorities tend to prefer a higher level of scrutiny on high-value international transactions in the course of audit, there is no specific guidance in the Indian context for the specific nature of transaction(s) at a particular value not to be covered under transfer pricing requirements. In practice, as per an internal administrative circular, it is mandatory for the tax authorities to audit all taxpayers whose total value of controlled transactions exceeds INR 150 million in the tax year, by way of a reference made to designated Transfer Pricing Officers. Taxpayers below this threshold are not necessarily exempt but may get audited on a random basis by the Assessing Officer.

That apart, under the Indian Regulations, there is no process for undertaking and assessing a pre-audit transfer pricing risk. There are no directions issued in respect of any specific transfer pricing risk factors which will result in an audit.

At the beginning of the audit, the taxpayer is usually required to submit the transfer pricing report that establishes that all international transactions with AEs (through aggregation or otherwise) are at arm's length. It is at the discretion of the tax authorities to decide the scope and extent of the audit and to determine which transactions merit closer scrutiny.

The OECD White Paper presents the following features that could potentially indicate high transfer pricing risk:

- significant transactions with related parties in low tax jurisdictions;
- transfers of intangibles to related parties;
- business restructurings;
- specific types of transactions that could potentially erode tax base – interest payments, royalties etc.;
- persistent loss making;
- poor or non-existent documentation of related parties; and
- excessive debt.

From the above, practically speaking, the Indian tax authorities tend to look closely at controlled transactions involving transfer of intangibles, base erosion payments, such as interest and commissions to related parties, persistent loss-making entities and have, recently, started examining business restructuring in

greater detail, hence the presence of such transactions could be termed as high risk factors. The tax authorities have specifically targeted transactions with low tax jurisdictions in the context of Circular 6/2013 (discussed earlier) with the onus placed on the taxpayer to demonstrate that the Indian entity does in fact serve as a contract R&D enterprise relative to the overseas entity located in a low-tax jurisdiction. Such transactions with low tax jurisdictions have also been removed from the ambit of Safe Harbour provisions.

In addition to the above, high risk factors that require to be appropriately documented and justified can arise in the following controlled transactions:

- intra group services received/ rendered – cost allocation/ cost contribution arrangements;
- advertising / marketing and promotion expenditure incurred by the taxpayer that may result in creation of marketing intangibles for the MNE group; and
- payment of guarantee commission.

VI. Conclusion

The Indian Regulations around documentation are, in a sense, both static and dynamic. While the Regulations prescribed around maintenance of documentation have not fundamentally changed, the evolving nature of the subject, leading to the inclusion of topics such as intangibles and restructuring, the emergence of new dispute resolution avenues, such as APAs and Safe Harbour provisions, and clarity arising from jurisprudence and circulars under domestic law are changing the contours of the documentation landscape in India.

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NOTES

[1] Section 92A of the Income Tax Act, 1961
[2] See the introduction to White Paper on Transfer Pricing documentation
[3] Section 92 through 92F of the Income Tax Act, 1961 read with Rule 10A to 10T of the Income Tax Rules, 1962
[4] Under Rule 10D of the Income Tax Rules, 1962
[5] Explanation to Section 92B of the Income Tax Act, 1961
[6] Refer Para 76 on Page 21 of the OECD White Paper on transfer pricing documentation
[7] Under Section 133(6) of the Income Tax Act, 1961
[8] Subject to threshold limits of INR 10 million for international intercompany transactions and INR 50 million for specified domestic intercompany transactions
[9] See Circular No 6 of 2013 issued by the Central Board of Direct Taxes ('CBDT')
[10] See Rule 10F to 10T of the Income tax Rules, 1962.
[11] Under Section 92E of the Act read with Rule 10E of the Rules
[12] An Accountant as defined as per Section 288(2) of the Income tax Act, 1961.
[13] Income Tax Appellate Tribunal, which is the second level appellate authority in the India tax Administration and is also the final fact finding authority for all cases of
[14] *General Motors India P Ltd v. DCIT* [ITA nos. 3096/Ahd/2010 and 3308/Ahd/2011]
[15] Para 5.3.3.1.and 10.4.1.3
[16] *Development Consultants P Ltd v. DCIT* [2008] 115 TTJ 577 (Kol), *Mastek Ltd. v.ACIT* [2012] 53 SOT 111 (Ahd), *AIA Engineering Ltd. v. ACIT* [2012] 50 SOT 134 (Ahd), *Ranbaxy Laboratories Ltd v. ACIT* [2008] 110 ITD 428 (Delhi), and *Sony India P Ltd. v. DCIT* [2008] 114 ITD 448 (Delhi): [2009] 315 ITR 150 (Delhi) (AT)].
[17] As per Section 92BA of the Act, subject to a minimum threshold value of INR 50 million

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