India

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Comment on the likelihood of, and scope for local challenges, and possible legal defences, in respect of:

- prolonged losses
- low margins
- "wrongly characterised" arrangements
- uncommercial arrangements that should be disregarded.

I. Introduction

It has been more than a decade since comprehensive transfer pricing ('TP') regulations were introduced in India. The Indian TP regulations[1] are general in nature and do not address specific treatments of all types of transactions. With the completion of eight cycles of TP audit, both the taxpayers and the Indian Revenue have matured significantly in their approach towards reviewing transfer prices paid/ received in light of the functional profile of the parties and the taxpayers' TP policy.

Although there are no clear guidelines provided in the Indian TP regulations regarding Base erosion and Profit shifting, the Indian Income Tax Act ('Act') coupled with the existing jurisprudence on the matter provide some guidance on these issues. With the recent changes to the Act (including those in relation to TP), it appears that the Indian Revenue is considering adoption of tough measures against taxpayers which, being a part of multinational groups, seek to misuse the various nuances of the laws and tax treaties to reduce the overall tax incidence in India. Towards this end, in the recently concluded TP audits, the Indian Revenue has asserted non-arm's length behaviour of taxpayers in relation to certain transactions by, inter alia, questioning the commercial necessity of undertaking the said transactions.

The debate over tax avoidance and tax evasion has been a matter of significant discussion in India for a long time. The thin line between legitimate tax avoidance measures and tax evasion has never been more tested than now. In general, the Indian Revenue has been seen also to target tax avoidance measures even if they are legally valid, where the main purpose appears to be to achieve a tax advantage without any supporting justification in terms of business rationale.

Prior to 1985, based on the ratio laid down in *Duke of Westminster,*[2] it was a well settled position that the avoidance of tax liability by so arranging commercial affairs that the charge of tax is diverted, thus reducing the overall tax liability, should not be prohibited. A taxpayer could resort to a device to divert the income before it accrues or arises to reduce the overall tax incidence. However, this view was diluted to a large extent in *McDowell,*[3] wherein the Supreme Court[4] held that adopting colourful devices cannot be considered as tax planning. This decision blurred the difference between tax avoidance and tax evasion.

However, more recently, the Supreme Court in the cases of *Azadi Bachao Andolan*[5] and *Vodafone International BV*[6] affirmed the principle that where a transaction is not a sham, the Indian Revenue would not be authorised to question the commercial necessity of such a transaction, even though such transaction may lead to a tax advantage for the taxpayer.

The Finance Act 2012 introduced the General Anti Avoidance Rule ('GAAR'), which sought to empower the Revenue to disregard or re-characterise any transaction, if it was satisfied that the transaction lacks commercial justification if viewed from the perspective of arm's length dealings between third parties, and was entered into with the exclusive motive of reducing tax liability. GAAR empowered the Revenue to challenge the economic and commercial justification of a transaction, by nullifying the Supreme Court's ruling in the case of Azadi Bachao Andolan. The proposed Rules however evoked sharp reactions from foreign as well as domestic taxpayers, who feared that unbridled powers to the Revenue would result in harassment. The Government then appointed a committee headed by Mr. Parthasarthi Shome to look into the concerns. Following the Committee's recommendations, the Finance Act 2013 deleted the GAAR provisions from the Act and provided for their enactment with effect from April 1, 2016 (i.e., applicable to tax years beginning April 1, 2015).

II. Likelihood of challenge

The issues addressed below are not specifically dealt with in the Indian TP regulations or Indian judicial precedents in their entirety. Indian Courts have relied upon the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ('OECD TP Guidelines'), existing jurisprudence and position papers of overseas jurisdictions to render their decisions on a few of these issues.

Prolonged losses and low margins

There are no specific provisions in the Indian TP regulations dealing with a situation of prolonged losses or low margins earned by taxpayers. A taxpayer can incur losses or earn marginal profits due to various reasons: e.g., start up operations, unfavourable business conditions, incurring of significant marketing/advertisement expenses, unutilised capacity leading to under-absorption of fixed overheads, higher depreciation in the initial years of plant set-up which could not be absorbed due to lower sales volume etc. The Indian TP regulations, being generic, do not specifically discuss these situations, thereby necessitating their consideration only as general factors of comparability.

The Indian Revenue has been scrutinising loss situations or taxpayers with lower margins very closely. Generally, the Indian Revenue would seek to compare the overall loss/low profitability of the taxpayer with the margin of comparable companies that are well established and profit making, where the taxpayer has not been able to explain the economic/commercial factors that caused the losses/low margins. Therefore, a taxpayer would find it difficult to support the arm's length nature of loss-making transactions or lower margins, without adequate and robust documentation demonstrating that:

- losses have been incurred due to various economic/commercial factors; and
- not on account of inter-company TP policy.

In addition, defending expenditures in the nature of royalty, management fees, technical services or any cost sharing to overseas affiliates has been seen to be challenging, when they are incurred in years of business loss or low margins. The Indian Revenue, in general, questions the economic benefits attached to such payments in such situations.

In *Ekl Appliances*,[7] the Revenue challenged the payment of royalty to overseas affiliates as the taxpayer was incurring losses on account of numerous internal/external factors. The Delhi High Court[8] ruled that royalty payments cannot be prohibited on instances of continuous losses where the spending was proven to be incurred "wholly and exclusively" for the purpose of the business of the taxpayer. It is not for the Revenue to inquire into the commercial feasibility of a transaction. Relying on the OECD TP Guidelines, the High Court stated that re-characterisation of lawful business transactions by the Indian Revenue is not allowed.

Wrongly characterised arrangements

The Indian TP regulations do not specifically discuss the circumstances under which it may be appropriate for the Revenue to recharacterise a transaction based on a purported allocation of risk, which does not accord with the economic reality.

The Indian TP regulations envisage that the characterisation of an entity should be based on the functions performed, assets employed and risks assumed by the enterprise. Several Indian rulings[9] have generically endorsed the principal of aligning the economic substance of a transaction with its contractual terms, as laid down in the OECD TP Guidelines. The discussions in these cases have affirmed the view that the higher the risks assumed by a party, the higher the expectation of returns should be.

For the Indian Revenue to disregard a transaction undertaken by a taxpayer, it would have to demonstrate that the transaction is a sham (lacks substance) or is not permissible under law. In the absence of such a determination, while the Indian Revenue could re-price the transaction in accordance with the Indian TP regulations, at present (pending GAAR coming into force) it may not be permissible to disregard the transaction altogether.

For instance, in *Abhishek Auto Industries Ltd*,[10] the Tax Tribunal held that agreements which are approved by regulatory agencies, cannot be disregarded without cogent reasons and the Revenue cannot question the commercial needs and expediencies involved in these arrangements.

If a transaction lacks commercial substance (e.g., the purported risk allocation is not consistent with the functions performed by the parties, or where risks are allocated to parties that do not have adequate control over the creation of risks), the Revenue would generally re-price the transaction in accordance with their commercial reality.

In *GE India Technology Centre Private Limited*,[11] the Tax Tribunal agreed with the Indian Revenue's attempt to re-characterise the taxpayer based on the actual functional and risk profile as opposed to the characterisation concluded in the taxpayers' documentation. The Tax Tribunal agreed that the taxpayer has wrongly characterised itself as a contract software developer whereas it was rendering value added research and development services to its overseas affiliates. Factually, the core function of R&D services was located in India which necessitated decisions on important strategic functions to be taken by the taxpayer. Therefore, the overseas affiliate's control over risk on such decisions was limited. Accordingly, the Tax Tribunal rejected the claim of the taxpayer of being as a low risk service provider.

While coming to the aforesaid conclusion, the Tax Tribunal observed that the identification of risk and the party who bears such risks are important steps in comparability analysis. The conduct of the parties is key to determine whether the actual allocation of risk conforms to contractual risk allocation. Allocation of risk depends upon ability of the parties to the transaction to exercise control over risk. Core functions, key responsibilities, key decision making and level of individual responsibility for the key decisions are important factors to identify the party which has control over the risks. The observations of the Tax Tribunal are broadly in line with the OECD TP Guidelines as well as the comments of the Indian tax administration on "allocation of risks" as put forth in the India chapter of the UN's Transfer Pricing Practical Manual for Developing Countries.

In another ruling, *Gap International*,[12] the Tax Tribunal accepted the characterisation of the taxpayer as a procurement service provider (for apparel to be sent to the overseas affiliates) and rejected the Indian Revenue's attempt to re-characterise the taxpayer as a reseller of apparel.

The Tax Tribunal ruled that where all significant directions relating to procurement from third party vendors such as designs and trends of apparel, quality parameters of materials, terms and conditions for dealing with vendors, etc, were provided by the overseas affiliates, the Indian taxpayer could not be considered undertaking services akin to an independent reseller. On the contrary, the taxpayer being a routine procurer was acting on the guidelines and procedures prescribed by the overseas affiliates and therefore it should be ideally expected to earn a return on the administrative and other operating costs (similar to a service provider) rather than earning commission on sales like a reseller.

Uncommercial arrangement

There are no specific provisions in the Indian TP regulations that prescribe the situations under which it may be appropriate for the Indian Revenue to disregard the structure adopted by a taxpayer in entering into a controlled transaction.

There is a fundamental difference between Article 9 of the OECD Model Tax Treaties, which has been incorporated in a majority of the tax treaties signed by India; and the Indian TP regulations. Article 9 provides that if conditions are made or imposed between two related parties 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 those enterprises, but by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly. On the other hand, the Indian TP rules merely require that any income arising from an international transaction between two related parties should be computed having regard to the arm's length price. Further, as discussed earlier, based on the Supreme Court's ruling in the case of Azadi Bachao Andolan, so long as a transaction is not a sham or prohibited by law, the Revenue may not be permitted to question the commercial rationale for the taxpayer in transacting in any particular manner. It is a settled principle that commercial expediency has to be judged from the perspective of the businessman, and that the Revenue ought not to step into the shoes of the taxpayer and evaluate the rationale of his business decisions.

Thus a distinction may be made between the commercial substance and the commercial rationale of a transaction. To satisfy the commercial substance, the transaction has to be real, not a sham (conduct should support the form of the transaction) and also otherwise permissible in law. On the other hand, to satisfy the commercial rationale, the transaction ought to be driven by commercial objectives (not mainly for the purpose of achieving a tax advantage). While the Revenue can certainly examine the former question (commercial substance), the latter (commercial rationale) may not be currently within its purview, as per the better view based on the Supreme Court's ruling in Azadi Bachao Andolan.

Therefore, Article 9 of Tax Treaties appears to be wider in ambit than the Indian TP Regulations, so far as conferring powers to the Indian Revenue to re-characterise any transaction is concerned. While the Indian TP regulations, read with the Supreme Court ruling, as above appear to mandate arm's length pricing for a real (not a sham) related party transaction; Article 9 of Tax Treaties, in addition, requires justification of the transaction itself under the yardstick of the arm's-length principle. Under the Indian tax laws,[13] a taxpayer can choose to be governed by either a tax treaty or the Indian domestic tax law, whichever is more beneficial to him.

Since the authorities ought not to judge the commercial rationale of a transaction, it may not be open to them to price the transactions based on a hypothetical transaction which could be deemed to exist, had the transaction been executed between independent parties.

However, if a transaction is a sham (lacks substance), the Revenue authorities have been known to price the transactions in accordance with the commercial reality (economic substance). The Indian TP regulations empower the Revenue to re-compute the arm's-length price where the taxpayer has inter-alia, not computed the arm's-length price as prescribed by the law. In such a case, the authorities would proceed to re-price the transactions reported by the taxpayer, or price a notional transaction as if the taxpayer had failed to report the same.

III. Local options to reduce risk of such challenge

Real time working – contemporaneous documentation

The Indian TP regulations require taxpayers to maintain prescribed documentation[14] contemporaneously on an annual basis in relation to the international transactions undertaken with associated enterprises, which needs to be in place latest by the statutory date (tax return filing date).

The Indian TP regulations do not prescribe any specific documentation in the context of extraordinary situations. Therefore, in the case of exceptional business circumstances such as market penetration strategies, start-up operations, restructurings, prolonged loss, low margins etc., it is prudent to record all possible relevant information relating to such international transactions that is available at the time of entering into the transactions and that which have influenced the determination of the transfer prices.

This will help the taxpayer to present a robust defence if the exceptional circumstances are challenged by the Indian Revenue. The onus of proving the arm's length nature of a transaction lies with the taxpayer. If, during the course of audit proceedings, the Indian Revenue, on the basis of material or information in their possession, is of the opinion that the arm's length principle was not applied, or adequate and correct documents/ information were not maintained or produced, the total income of the taxpayer may be recomputed. The documentation serves two purposes for the taxpayer – firstly, it helps the taxpayer in justifying the arm's length nature of its controlled transactions, and secondly, it saves the taxpayer from potential penal consequences under the Act that can be invoked for non-compliance with the mandatory documentation maintenance / submission requirements.

Appropriate adjustment

In its annual documentation, the taxpayer can make appropriate adjustments backed with necessary economic justification to support the arm's length nature of its controlled transactions. Such adjustments are acceptable to the Indian Revenue, Tax Tribunals and Courts if carried out based on sound economic principles.

In the case of *Skoda Auto India Pvt Ltd*[15] which was a start-up company, the Tax Tribunal held that it is permissible to make adjustments to costs and profits in appropriate cases for the purpose of comparability analysis. The Tax Tribunal observed that in the case of car manufacturers (such as the taxpayer) with substantial imported raw material content, the manufacturing process is virtually an assembly job and is fundamentally different from that of full-fledged car manufacturers with substantial indigenous inputs. Therefore, an appropriate comparison is possible only after suitable adjustments for functional differences are made. Similarly, appropriate adjustments may be essential on account of unusually high costs incurred at the start-up phase of such a business.

A similar observation was made by the Tax Tribunal in the case of *Schefenacker Motherson Ltd*[16], wherein the taxpayer was in the start-up phase and had incurred significant depreciation cost. In this case, the Taxpayer made an adjustment to its profits to account for the differences in capacity utilisation, technology used, age of assets, differing depreciation accounting policies and comparables etc. The Tax Tribunal accepted the approach adopted by the taxpayer and observed that suitable adjustments were needed for the purposes of better comparability.

Advance pricing arrangements

The Advance Pricing Arrangements programme was introduced in the Indian TP Regulations vide the Finance Act of 2012. The programme is a welcome initiative from the Indian Government since it provides an opportunity to the taxpayer and the Revenue to reduce the uncertainty and TP litigation presently going on in India.

The key highlights of the programme are:

a. an APA can be sought by all taxpayers having international transactions with their overseas affiliates or contemplating to undertake such transactions;

b. the APA aims to cover all kinds of transactions between the Indian tax payer and his overseas associated enterprises;

c. the negotiated terms and conditions including the critical assumptions of the APA are to be agreed with the Revenue. Once agreed under an APA, they shall be binding on both the taxpayer and the Indian Revenue;

d. the APA shall be valid for a maximum period of five years; and

e. the APA can be unilateral, bi-lateral and multilateral.

One of the primary purposes of the APA programme is to settle complex issues relating to cross border restructuring or intangibles, where both the taxpayer and the Revenue face challenges to determine a reliable arm's length price for the transactions.

IV. Legal restriction to limit TP planning

While there are no specific legal restrictions in place to limit TP planning, there are certain provisions or judicial precedents that are relevant to consider in this regard.

Business restructuring

Under the present Indian exchange control regulations, there are procedural challenges in implementing a classical principal structure comprising of separate manufacturing and distribution entities in India. Under such a structure, the Indian contract manufacturing entity would invoice an overseas entrepreneur (principal), while physically shipping the finished goods locally to the Indian distribution entity. In such a case, the local distribution entity would not be in a position to pay the overseas entrepreneur, in the absence of a bill of entry for the goods received from the Indian contract manufacturing entity.

Indian TP regulations were amended by the Finance Act 2012 to clarify that the term international transaction also includes a transaction of business restructuring or reorganisation entered into with an overseas associated enterprise irrespective of whether it impacts profit, income, losses or assets of the taxpayer at the time of transaction or at a future date. Therefore, the TP regulations would apply where taxable income arises in the course of any business restructuring exercise encompassing the Indian taxpayer and the overseas associated enterprise.

Transfer of IP/risk/high value functions

Intangible property

There are no specific provisions in India governing the TP aspects of transactions involving intangible property. The Finance Act 2012 amended the Indian TP regulations to clarify the meaning of "Intangibles" under an inclusive definition. The definition, in addition to covering generally accepted marketing and technology related intangible assets, also includes customer lists, customer relationships and trained and organised work force as intangibles.

The term "international transaction" has been correspondingly clarified to include 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.

The Indian TP regulations do not have any specific provisions which recognise the concept of economic ownership as distinct from legal ownership. A landmark ruling was pronounced by the Indian Authority for Advance Rulings[17] (the 'AAR') in *Foster's Group*, whereby as part of a global transfer of certain assets, the trademarks and brands, which were licensed to the Indian entity, were transferred by Foster's Group to SAB Miller Group outside India. In its Ruling, the AAR recognised that marketing and advertising efforts by the Indian entity generated goodwill and therefore created a valuable intangible asset in India. Accordingly, the transfer was considered taxable in India, irrespective of the domicile of its legal owner and also the fact that the brand was registered outside India.

A similar question was raised before the AAR in *Pfizer Corporation*, which sold technical know-how to EAC Denmark outside India. The know-how had been licensed to and used by Pfizer India, almost exclusively, with improvements/ improvisations also being made in India. EAC Denmark entered into a separate agreement with Pfizer India to terminate use of the know-how, for which Pfizer India was also paid early termination compensation. In this case, since the intangible's licence and use was terminated and reverted back to the legal owner against payment of adequate compensation, no asset was said to be located in India either in tangible or intangible form, and thus the offshore sale thereof was held as being non-taxable in India by the AAR. Evidently, the fact of early termination was absent in the case of Foster's Group, and Pfizer Corporation's case was distinguishable from the Foster's Group case. However, the notable similarity in both cases lies in the acknowledgement of economic value, being present in India, despite legal ownership being vested elsewhere.

However, in a more recent case, a Special Bench of the Tax Tribunal in *LG Electronics India Pvt Ltd*[18] observed that economic ownership of a brand is a concept which exists only in a commercial sense. To explain, the Tribunal hypothesised that if the legal owner sold its brand, then the sale consideration would not be shared amongst such economic owners and would vest only with the legal owner. Therefore, the Tribunal held that in the context of the Act, it is only the legal (and not economic) ownership which is recognised.

However, it is worthwhile to highlight that a blanket dismissal of the concept of economic ownership does not seem appropriate for the reason that the worth of a brand essentially arises from its usage and where its value is created or enhanced. If the significant people functions around advertising and marketing are performed by the licensee leading to brand value creation or enhancement, then the licensee becomes the economic owner of the brand. If the rights of the licensee are impaired at the time the legal owner sells the brand, the licensee may seek a compensation for the brand value created or enhanced by it, depending on the terms of the licence agreement, the level of investment made in the brand by the licensee, etc.

The above rulings, though not a legal restriction on IP planning per se, do set out important principles on the issue of legal vs economic ownership which is so critical in the context of IP planning or business restructurings.

High value functions/risk transfer

The Indian TP regulations do not contain any specific rules for determining the allocation of risks or transfer of functions and/ or profit potential. Several rulings by Tax Tribunals and Courts in the past have generically endorsed the principle of aligning the economic substance of a transaction with its contractual terms. Hence, for determining how risks are distributed, the Indian Revenue would regard to the factual reality which essentially implies examining who exercises control over the risks or where are the "significant people functions" located. "Control" in this context means the capacity to take decisions with respect to risk, e.g. decision to put the capital at risk, whether and how to manage the risk.

In case of GE India discussed earlier, the Tribunal held that the conduct of the parties is the key to determine whether the actual allocation of risk confirms to contractual risk allocation. Core functions, key responsibilities, key decision making and level of individual responsibility for the key decisions are important factors to identify the party which has control over the risks. In the said case, the Tribunal observed that the core function of R&D were located in India which necessitated decisions on important strategic functions to be taken by the taxpayer. Therefore, the overseas affiliate's control over risk on such decisions was limited. Accordingly, the Tax Tribunal rejected the claim of the taxpayer of being as a low risk service provider.

In order to provide a better clarity and to assist taxpayers in examining whether they are performing high value functions or undertaking significant risks, recently the Central Board of Direct Taxes has issued a Circular that specifies certain conditions to be fulfilled for development centres in India. The Circular provides that a development centre, to be called as a contract R&D service provider with insignificant risk, should cumulatively comply with the following conditions. It should:

i. be largely involved in economically insignificant functions and the foreign principal should be performing most of the economically significant functions in research or product development;

ii. use economically insignificant assets. The foreign principal should provide funds/ capital and other economically significant assets including intangibles assets in the research or product development;

iii. work under the control or supervision of the foreign principal for the R&D activities who has capability to control or supervise the R&D function through its strategic decisions as well as to monitor activities;

iv. not assume or bear any economically significant realised risks, and

v. not have the final ownership right (economic or legal) of the intangible developed. The ownership lies with the foreign principal.

The CBDT has also emphasised on "substance" at the level of the foreign principal, as a pre-condition for the Indian R&D centre being accorded a "contract R&D service provider" status, which again, is per the OECD TP Guidelines. The above guidance tends to provide a better clarity on characterisation and remuneration models for taxpayers in India involved in research and development.

Cross border financing

Transfer pricing arrangements related to cross border financing would include inter-company loans, guarantees, cash pooling arrangements etc. The Indian TP regulations do not specifically address treatment of these specific transactions; however, the definition of "international transactions" includes borrowing and lending of money and any transaction that has an effect on the profits, losses, incomes and assets of a taxpayer. The newly introduced explanation of "international transactions" in 2012 provides a wider definition of capital financing, to include any type of long-term or short-term borrowing, lending or guarantee, any type of advance, deferred payments or receivables. Accordingly, all kinds of financial transactions in the form of debt would be covered within the ambit of Indian TP regulations.

Taxpayers have historically faced challenges from the Revenue on issues such as interest on loans, charging of arm's-length fees for the provision of financial guarantees. In *VVF*[19] and *Perot Systems,*[20] the Tribunal held that even in cases where the taxpayer has given interest free loans to its overseas affiliates out of its own funds and out of commercial expediency, the Indian Revenue was empowered to impute notional interest on such loans under the TP regulations. Similarly, in case of *Asian Paints Ltd*,[21] the Tax Tribunal held that the provision of a financial guarantee constitutes the performance of a service, i.e. to cover risk of default, and hence warrants a charge.

As regards thin capitalisation, as discussed earlier, Article 9 of the tax treaties appears to have wider amplitude than the Indian TP regulations. Under the Indian TP regulations, one would only need to prove that the price of a transaction between two related parties is at arm's length, while under Article 9, one would (in addition) also need to prove that the transaction itself is executed under the arm's length principles.

Under the Indian TP regulations, it would be sufficient compliance if one were to establish that the rate of interest paid on international related party debt is at arm's length. The Revenue may not be permitted to question the arm's length nature of the transaction itself, namely whether, given the credit worthiness of the Indian subsidiary, a third party lender would have at all advanced the loan; and accordingly recharacterise the entire amount between a loan and equity, by applying judicious transfer pricing methodology. On the other hand, Article 9 of Tax Treaties permits thin capitalisation questions also to be asked, in addition to testing the arm's length price of the interest, as borne out by the OECD TP Guidelines and commentaries of the OECD's Model Tax Treaties.

Incidentally, once GAAR becomes effective, it would expressly empower the Revenue to inter alia recharacterise a loan into equity, which the Revenue was hitherto not authorised to do under the existing TP regulations.

V. Indian GAAR

Historically, the Indian tax laws have had provisions to address the issue of tax avoidance under the specific anti-avoidance rules in the form of TP regulations, imposing a reasonableness requirement for payments to specified related parties, dividend and bonus stripping transactions, understatement of consideration for transfer of immovable property etc. However, in general, the existing jurisprudence provided that the Indian Revenue should not question the commercial needs and expediencies involved in an arrangement, the decisions on which should be left to the taxpayer.

The Finance Act, 2012 introduced General Anti-Avoidance Rules (GAAR) in the Act, which empower the Indian Revenue to disregard or re-characterise certain transaction where it considers the transaction as an 'impermissible avoidance agreement'. An impermissible avoidance arrangement has been defined to mean an arrangement, the main purpose or one of the main purposes of which is to obtain a tax benefit and it:

a. creates rights or obligations, which are not ordinarily created between persons dealing at arm's length;
b. results, directly or indirectly, in the misuse, or abuse, of the provisions of the Act;
c. lacks commercial substance or is deemed to lack commercial substance, in whole or in part; or
d. is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes.

This effectively means that the GAAR would empower the Indian Revenue to question the economic and business rationale of any transaction. While the effective date of GAAR coming into force has been presently deferred to Indian tax years beginning from April 1, 2015, as and when it comes into force it is bound to have a substantial impact on the scrutiny procedures applied by the Indian Revenue.

The only silver lining in this arena can be a robust TP analysis coupled with adequate documentation to justify the functional and risk profile of the parties and the commercial rationale for the transaction, to evidence the fact the transaction between the Indian tax payer and its affiliate is not intended majorly to obtain a tax advantage and hence should not be regarded as an 'impermissible avoidance agreement'.

VI. Internet based businesses

The Indian TP regulations do not provide separate provisions for internet based business. In general, all the provisions of Indian TP regulations are equally applicable to such businesses/ transactions.

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NOTES

[1] Section 92 through 92F of the Income Tax Act, 1961 read with Rule 10A to 10E of the Income Tax Rules, 1962.

[2] *Duke of Westminster vs. IR* [19TC 490, 511, 520(HL)]

[3] *McDowell vs. CTO* [154 ITR 148 (SC)]

[4] The Supreme Court is the apex court in India.

[5] *Union of India vs Azadi Bachao Andolan* [263 ITR 706 (SC)]

[6] *Vodafone International Holdings B.V. vs Union of India and Others* [2012-TII-01-SC-INTL] [341 ITR 1 (SC)]

[7] *CIT v EKL Appliances Ltd.* [TS-206-HC-2012(Del)]

[8] High Courts in India are the third level of appeal and adjudicate only questions of law.

[9] *Mentor Graphics (Noida) Pvt. Ltd. v. Dy Commissioner of Income-tax* (ITA No. 1969/D/2006) and *E-Gain Communication Pvt. Ltd. v. ITO* (ITA No. 1685-PN-07)

[10] *Abhishek Auto Industries Ltd vs DCIT* 1(1) [2010-TII-54-ITAT-DEL-TP]

[11] *GE India Technology Center Private Limited vs DCIT*, Circle 11(3), Bangalore [ITA No.789/Bang/2010 & ITA Nos.487 & 925/Bang/2011]

[12] *GAP International Sourcing (India) Pvt. Ltd. vs ACIT* 12(1); TS-667-ITAT-2012(DEL)-TP

[13] Section 90(2) of the Act.

[14] Rule 10D of the Income Tax Rules, 1962.

[15] *Skoda Auto India Pvt Ltd vs ACIT* [2009-TIOL-214-ITAT-PUNE]

[16] ITA No. 4459/Del/07 & ITA No. 4460/Del/07

[17] In order to provide the facility of ascertaining the income-tax liability of a non-resident, to plan their income-tax affairs well in advance and to avoid drawn-out and expensive litigation, a scheme of Advance Rulings was introduced under the Act by the Finance Act 1993. An applicant desirous of obtaining an advance ruling may make an application to the Authority for Advance Rulings, stating the question on which the advance ruling is sought. While advance rulings are binding only on the applicants seeking them and on the Income tax authorities, they do have some persuasive value in other cases.

[18] *LG Electronics India Pvt. Ltd. v. ACIT* [2013] 29 taxmann.com 300 (Delhi)(SB) [ITA No. 5140/Del/2011]

[19] *VVF Limited vs DCIT* [2010-TIOL-55-ITAT-MUM]

[20] *Perot Systems TSI (India) Ltd.vs DCIT* [2010-TIOL-51-ITAT-DEL]

[21] *Asian Paints Limited vs ACIT* (LTU) – [ITA No. 408/Mum/2010]