

TRANSFER PRICING IN INDIAN INTERNATIONAL TAXATION

JABIULLA¹ & BASAVARAJ C.S²

¹Research Scholar, Department of Post-Graduate Studies & Research in Commerce,
Gulbarga University, Kalaburagi, Karnataka, India

²Professor, Department of Post-Graduate Studies & Research in Commerce,
Gulbarga University, Kalaburagi, Karnataka, India

ABSTRACT

Transfer Pricing plays an important role in international trade and commerce, the growth in number and size of MNCs has brought a number of opportunities, a part from faster economic development. At the same time, the MNCs have also brought a number of problems to face. The scope of MNCs has widened in recent years so much that now more than 60% of the international transactions of the globe belong to MNCs. This has constrained the governments to keep in place proper mechanism to plug the leakage of tax revenue as a result of manipulative pricing policies adopted by these related parties (MNCs).

The study shows that the business and industry in India is comfortable about the specific and general issues studied in the paper. However, as regards to audit procedure, time period of 8 years to maintain documents and cooperation of Transfer Pricing authorities while dealing with assesseees there is negative response and hence, these issues need thorough investigation and necessary modification in the structural aspects of the provisions under study. If this suggestion is implemented the Indian Transfer Pricing provisions positively contribute to the growth of the international trade.

KEYWORDS: Business, Industry, Audit Procedure, Transfer Pricing, International Trade, Multinational Enterprises

INTRODUCTION

Transfer Pricing plays a pivotal role in international trade and commerce when a transaction belongs to two or more associated enterprises based in different tax jurisdictions. Transfer Pricing is a mechanism through which the tax jurisdictions try to levy tax on the relevant amount of income to which they are rightfully entitled. Though Transfer Pricing is of recent origin it has greatly influenced the international tax aspects of almost every country. Though India is a late starter in framing the Transfer Pricing policy it has seriously worked in recent years to follow the foot prints of developed countries.

Transfer prices serve to determine the income of both the parties involved in the cross-border transaction. The Transfer Pricing therefore, influences the tax base of the countries involved in cross-border transactions. In any cross-border tax scenario, the parties involved are the relevant entities of the MNE group along with the tax authorities. When the tax authority of one country adjusts the profit of a member of the MNE group, this may have an effect on the tax base of another country. The outcome of this dichotomy is that Transfer Pricing has become a major tax issue for the companies. In other words, cross-border tax situations involve issues related to jurisdiction, allocation of income and valuation¹.

REVIEW OF LITERATURE

Before embarking upon the research study the researchers made an attempt to review the literature related to research topic. Since, the research area chosen for the study being 'International Taxation', the researchers reviewed the recent research works in the area of Transfer Pricing; the following important works have been reviewed:

Researchers	Country	Year	Outcome of the Study
Kimberly A. Clausing ²	USA	2003	There is a strong and statistically significant relationship between countries' tax rates and the prices of intra-firm transactions.
K. Hung Chan & Agnes W. Y. Lo ³	China	2004	It provides an empirical study of the association between the management's perception of the importance of environmental variables and their choice of international Transfer-Pricing methods in the context of a developing economy.
Nick Houseman & Aaron Leslie ⁴	Australia	2006	With the level of Transfer Pricing scrutiny increasing in the insurance industry, insurers should be incorporating Transfer Pricing into their tax risk management strategies.
Pawan K Chugan ⁵	India	2007	To throw some light on Transfer Pricing and describe advance pricing arrangement system as is being practiced by some of the developed and developing countries to attract more foreign investments and technology transfers.
Ajit Kumar Jain ⁶	India	2015	The author analyses the priority given to various transfer pricing methods from Indian perspective, as well as from the perspective of the OECD and various countries around the world.

OBJECTIVES OF THE STUDY

The main objectives of the present study are:

- To review the Transfer Pricing mechanism in Indian Context.
- To analyse and interpret corporates' view about Transfer Pricing in India.
- To suggest measures for improvement of Transfer Pricing regime in India.

SCOPE OF THE STUDY

Geographically, the study covers the whole of India. Sample companies spreading across India and belonging to manufacturing and service sector have been covered. The study deals with Transfer Pricing issues only.

METHODOLOGY

Sources of Data

The data for the present study has been gathered from both the primary and the secondary sources. The study is mainly based on primary data. However, the secondary data have also been used. The reports of various committees, publications of the Government, professional and academic journals, prominent websites dealing with tax matters, and

other literature relating to the subject have been used as secondary sources. The primary data in the form of respondents' opinion has been collected from the corporate bodies. Questionnaire using Likert Scale (using Highly Satisfied, Satisfied, Neither Satisfied nor Dissatisfied, Dissatisfied, and Highly Dissatisfied as parameters) and alternative choice responses (with 'Yes/No' parameters) has been used.

Sample Size for the Study

The sample size adopted for the study was 150 companies (86 manufacturing and 64 service sector). The profile of the respondents includes Directors, Executive Directors, Managers and Senior Managers (Taxation) of the respondent companies.

Table 1: Sector-Wise Distribution of Sample Corporate Undertakings

Sl. No.	Sector	Frequency	In Percent
1.	Manufacturing Sector	86	57.34
2.	Service Sector	64	42.66
Total		150	100.00

Source: Field Study

TOOLS AND TECHNIQUES OF DATA ANALYSIS OF THE STUDY

The data gathered through the primary and secondary sources have been edited, tabulated and analysed using simple statistical tools like percentage method is used to analyse the data which is qualitative in nature.

THE STUDY

TRANSFER PRICING MECHANISM IN INDIA

Transfer Pricing - Concept and Meaning:

- In the words of Robert Feinschreiber⁷, *Transfer Pricing*, for tax purposes, is the pricing of inter-company transactions that take place between affiliated businesses.
- Transfer Pricing refers to the price or value attached to transfer of goods and services in related party transactions of an organisation. (Basavaraj CS & Jabiulla)⁸.

Transfer Pricing – Indian Provisions and Rules

The Transfer Pricing provisions under the Indian Income Tax Act, 1961, were introduced in the year 2001 by way of Section 92 and 92A to 92F. Then onwards the relevant provisions have been under constant amendment and modification. As a consequence, the width and breadth of the concept has been restructured in recent years. Transfer Pricing mechanism has been tightened so much so that the escape of revenue is avoided to the maximum extent. Table 2 states the Transfer Pricing aspects covered under different Sections and Rules under the Income Tax Act 1961 and Income Tax Rules 1962.

Table 2: Transfer Pricing Provisions and Rules under Indian Income Tax Act and Rules

Sections	Issues Covered
92	Computation of Income from International transaction having regard to arm's length price
92A	Meaning of Associated Enterprise
92B	Meaning of International transaction
92C	Computation of arm's length price
92CA	Reference to Transfer Pricing Officer (TPO)
92CB	Power of Board to make Safe Harbour Rules
92CC	Advance Pricing Agreement
92CD	Effect of Advance Pricing Agreement
92D	Maintenance, keeping of information and documents by persons entering into an international transaction or specified domestic transaction
92E	Report from an accountant to be furnished by persons entering into international transaction or specified domestic transaction
92F	Definitions of certain terms relevant to computation of arm's length price. etc.
94A	Special measures in respect of transactions with persons located in notified jurisdictional area
144C	Reference to Dispute Resolution Panel
271AA	Penalty for failure to keep and maintain information and documentation in respect of certain transactions
271BA	Penalty for failure to furnish report under Section 92E
271G	Penalty for failure to furnish information or document under Section 92D.
10A	Computation of income from international transactions involving Transfer Pricing having regard to arm's length price and meaning of Act
10B	Arm's length price - Determination
10C	Most appropriate method of Transfer Pricing
10D	Maintenance of documents and information
10E	Report from an accountant to be furnished under section 92E.

Source: Compiled from Income Tax Act 1961 and Income Tax Rules 1962.

RESULTS AND DISCUSSIONS

The data gathered from researchers' survey of 150 companies, belonging to manufacturing (86 companies) and service (64 companies) sectors were studied, tabulated and interpreted by classifying information as specific issues of Transfer Pricing and general issues of Transfer Pricing.

Specific Issues

The researchers studied five specific issues concerning the Transfer Pricing practices in India. The response of corporate sector has been summarised in table 3.

Table 3: Respondents' Opinion about Specific Issues Pertaining to Transfer Pricing in India

Sl. No	TP Aspects	Sector	Opinion					Total
			HS	S	NSNDS	DS	HDS	
1	Documentation procedure	M	35	41	05	02	03	86
		S	13	43	03	05	00	64
		Total	48	84	08	07	03	150
		In %	(32)	(56)	(5.34)	(4.66)	(02)	(100)
2.	Stages of clearances	M	06	68	08	04	00	86
		S	05	50	07	01	01	64
		Total	11	118	15	05	01	150
		In %	(7.34)	(78.66)	(10)	(3.34)	(0.66)	(100)
3	Methods applied in deciding Arm's Length Price	M	01	55	14	12	04	86
		S	01	37	13	11	02	64
		Total	02	92	27	23	06	150
		In %	(1.33)	(61.33)	(18)	(15.34)	(04)	(100)
4	Audit procedure	M	00	20	24	35	07	86
		S	01	21	09	27	06	64
		Total	01	41	33	62	13	150
		In %	(0.66)	(27.33)	(22)	(41.35)	(8.66)	(100)
5	Cooperation of Transfer Pricing authorities in Transfer Pricing decision process	M	02	06	20	41	17	86
		S	02	18	09	23	12	64
		Total	04	24	29	64	29	150
		In %	(2.66)	(16)	(19.33)	(42.67)	(19.34)	(100)

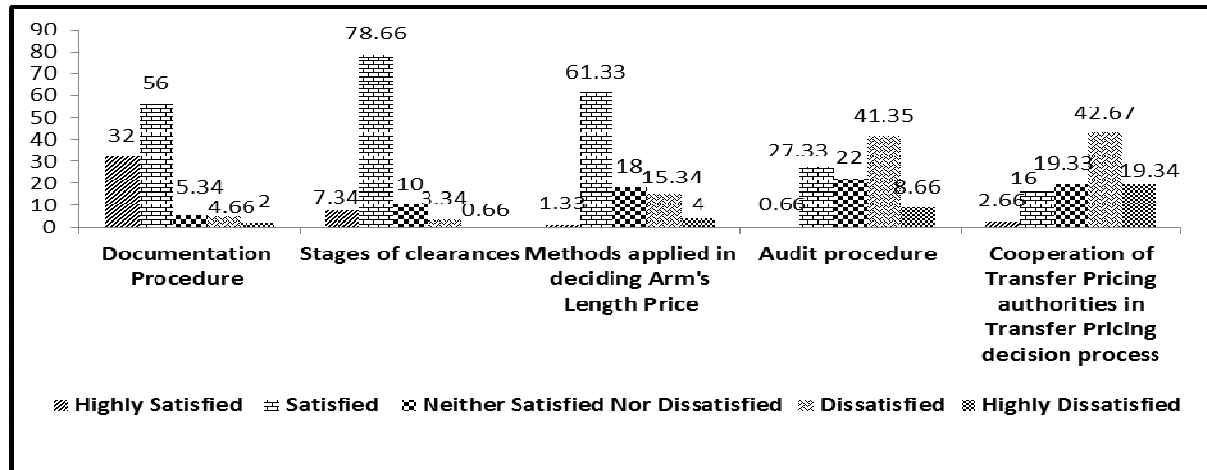
Source: Field Survey.

Note:

- Figures in parenthesis are percentage to the total.
- HS – Highly Satisfied, S – Satisfied, NSNDS – Neither Satisfied Nor Dissatisfied, DS – Dissatisfied and HDS – Highly Dissatisfied.
- M-Manufacturing and S – Service Sector.

Table 3 shows that the documentation procedure prescribed under the provisions of Income Tax Act (ITA) pertaining to Transfer Pricing has been accepted by more than 88 percent of the respondents, so also the stages of clearance involved in deciding the arm's length price, which is accepted by more than 86 percent of the respondents. However, as regards to audit procedure and the cooperation of Transfer Pricing authorities in Transfer Pricing decision process the corporate participants expressed their reservations.

The outcome of the results is that majority of the respondent-corporate houses are satisfied about three parameters considered for the study. While, two have been rejected since majority of the respondent-corporates are dissatisfied about them.



Source: Field survey.

Figure 1: Respondents' Opinion about Specific Issues of Transfer Pricing

General Issues

In recent years, India has been viewed as an attractive and rapid investment destination, and has witnessed an increased presence of multinational enterprises (MNEs) and a significant increase in international trade. The researchers sought, as a part of their study, the questions pertaining to five general issues in connection with Transfer Pricing. Their views have been summarised in Table 4.

Table 4: Respondents' Opinion about General Issues of Transfer Pricing in India

Sl.No.	General Issues of Transfer Pricing	Multiple Option					
		Yes			No		
		M	S	Total	M	S	Total
1.	Transfer Pricing has become the most discussed tax topic today in corporates	86	64	150	00	00	00
		(100)	(100)	(100)	(00)	(00)	(00)
2.	Transfer Pricing is one of the most complex tax issues faced by the business.	84	61	145	02	03	05
		(97.67)	(95.32)	(96.66)	(2.33)	(4.68)	(3.34)
3.	Coping with frequently changing Transfer Pricing provisions is a difficult task.	73	47	120	13	17	30
		(84.88)	(73.43)	(80)	(15.12)	(26.57)	(20)
4.	Whether the time period of 8 years to keep and maintain the necessary information after the assessment year is acceptable.	28	30	58	58	34	92
		(32.55)	(46.87)	(38.66)	(67.45)	(53.13)	(61.34)
5.	Indian Government has not put enough effort to solve the problem of increasing Transfer Pricing litigations.	69	43	112	17	21	38
		(80.23)	(67.18)	(74.66)	(19.77)	(32.82)	(25.34)

Source: Field survey.

Note:

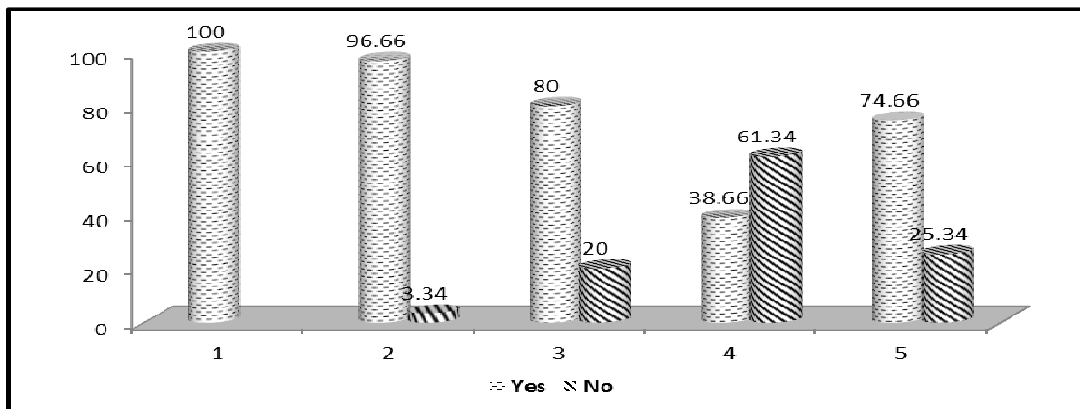
- Figures in parenthesis are percentage to the total.
- HS – Highly Satisfied, S – Satisfied, NSNDS – Neither Satisfied Nor Dissatisfied, DS – Dissatisfied and HDS –

Highly Dissatisfied.

- M-Manufacturing and S – Service Sector.

The Table 4 deals with the sector-wise response of the respondents pertaining to certain general issues of Transfer Pricing in India. An overwhelming 100 percent respondents belonging to both manufacturing and service sectors, have said that Transfer Pricing is most discussed tax topic today. Transfer Pricing is the most complex tax issue faced by the business and industry and coping with frequently changing Transfer Pricing provisions is a difficult task. However, the time limit of 8 years to keep and maintain the necessary information after the assessment year is rejected by majority of both the types of respondents. More than 80 percent of respondents of both the sectors have expressed their discomfort towards the Transfer Pricing decisions of IT department in general.

The results for respondents as a whole, is also the same which indicates that the opinion of the respondents based on sector is not different to that of the total respondents with a minor variation which does not affect the direction of findings.



Source: Field survey.

Figure 2: Respondents' Opinion about General Issues of Transfer Pricing

FINDINGS

Findings Relating to Specific Issues of Transfer Pricing in India

- 88% of the total corporate-respondents consider that Transfer Pricing documentation procedure prevailing in India is acceptable. Sector-wise 88.37% of manufacturing sector respondents and 87.5% of service sector respondents have accepted the Transfer Pricing documentation procedure prevailing in India.
- The study reveals that more than 86% of the total corporate-respondents agree to the stages of clearance pertaining to Transfer Pricing. Sector-wise 86.04% of manufacturing sector respondents and 85.93% of service sector respondents have accepted to the stages of clearance pertaining to Transfer Pricing in India.
- The study shows that more than 62% of the total corporate-respondents are happy with the methods adopted in deciding arm's length price. Sector-wise 65.11% of manufacturing sector respondents and 59.37% of service sector respondents agree to the methods adopted in deciding arm's length price.

- The study exhibits that a significant number (41.35%) of the total corporate-respondents did not agree to audit procedure in India. Sector-wise 40.69% of the manufacturing sector respondents and 42.18% of service sector respondents are not happy with the audit procedure in India.
- 62% (aggregate of dissatisfied and highly dissatisfied) of the corporate-respondents belonging to both manufacturing sector and service sector have opined that the cooperation of authorities in Transfer Pricing process is not adequate.

Findings Relating to General Issues of Transfer Pricing in India

- It was found that, all the corporate-respondents of the study (100%) have opined that Transfer Pricing is most discussed tax topic today in corporates.
- More than 95% of service sector respondents and more than 97% of manufacturing sector respondents have opined that Transfer Pricing is a very complex issue faced by the businesses.
- Majority (84.88%) of the manufacturing sector respondents and 73.43% of service sector respondents have agreed that adopting to changing Transfer Pricing provisions is a difficult task.
- Transfer Pricing provisions' condition that the corporates should maintain documentary evidence and information for at least 8 years' time period, after the assessment year is not accepted by 67.45% of the respondents belonging to manufacturing sector and 53.13% of the respondents belonging to service sector.
- 80.23% of manufacturing sector respondents and 67.18% of service sector respondents felt that the effort put by the Indian government in solving the problem of Transfer Pricing litigation is inadequate.

CONCLUSIONS

The study shows that the business and industry in India is comfortable about the specific and general issues studied in the paper. However, as regards to audit procedure, time period of 8 years to maintain documents and cooperation of Transfer Pricing authorities while dealing with assesseees there is negative response and hence, these issues need thorough investigation and necessary modification in the structural aspects of the provisions under study. If this suggestion is implemented the Indian Transfer Pricing provisions positively contribute to the growth of the international trade.

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