



LANDSCAPE OF TRANSFER PRICING IN INDIA – IN THE INTERNATIONAL CONTEXT

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Abstract

We are in an era of commercial globalization, it is common to see that multinational companies (MNCs) have branches/subsidiaries/divisions operating in more than one country. In such a situation, it is a practice of MNCs to transfer goods produced by a branch in one country to an associate branch operating in another country. While doing so, the MNC concerned has in mind the goal of minimizing tax burden and maximizing profits, but at the same time two tax jurisdictions or countries have also the consideration of maximizing their revenue. For this purpose countries make laws that govern such transactions. It is an internationally accepted practice that such transfer pricing should be governed by the Arm's Length Principle (ALP) and the transfer price should be the price applicable in case of transaction of arm's length. In other words, the transaction between associates should be priced in the same way as a transaction between independent entities.

The principles governing the taxation of MNCs are embodied in the OECD Model Tax convention of income and capital (OECD Model convention), which serves as the basis for the bilateral income tax treaties between OECD member countries and between OECD member and non-OECD member countries. According to these guidelines, "Transfer Prices "are the prices at which an enterprise transfers physical and intangible property or provides services to associated enterprises. The paper examines the Transfer Pricing provisions in India, in the international context.

Key words : *Transfer pricing, Arm's Length Principle(ALP), OECD, Advance Pricing agreement (APA), General Anti – Avoidance rules (GAAR)*

Introduction

There has been a spectacular growth in the Multinational corporations since World War II. This has reshaped both the global economy and the world politics. With the intensifying force of globalization, the influence of the MNCs in the world economy has further deepened so much that 80% of the world's industrial production is said to be generated by 1,000 largest MNCs and as much as one third of the total US international trade is conducted by and within US owned MNCS by means of intercompany transactions (Truitt, 2006: p.161). According to some recent estimates, MNCs' production worldwide generated value-addition of approximately \$16 trillion in 2010, it is about a quarter of global GDP, while the foreign affiliates of MNCs accounted for more than 10 per cent of global GDP and one-third of world exports (UNCTAD, 2011). If we add to this figure the trade that takes place between MNCs and other unaffiliated firms (which are, more often than not, non-equity modes of international production by the MNCs), which accounted for \$2 trillion in international sales in 2010, then MNCs are involved in about two-thirds of world trade (UNCTAD, 2011; Wittendorff, 2010). No doubt that these MNCs are the keystone of the global economic edifice and they will surely maintain that position in the global village that the world is now.

Literature Review

Researcher Borkowski (1996) observes that the price of tangible and intangible assets transferred between parent multinational corporations and subsidiaries in other countries presents serious challenges to management, operating in complex legal systems. To cite an instance in the Indian context Brand promotional expenditure had become a contentious issue and had generated a great interest in the Indian Transfer Pricing circle after the decision of Delhi High Court in the case of *Maruti Suzuki Vs ACIT, TPO*. The expenditure was spent to create an intangible asset even though it had no book value in the company's Balance Sheet. The decision of the Delhi

High Court has triggered a lot of debates as it has proposed an altogether new methodology to determine whether the brand promotional expenditure incurred by the Indian entity benefitted the foreign holding company or not.

Chugan, 1999 has documented the instances of abuse of transfer pricing for tax avoidance. Continuum to the same the author illustrates the nuances of Advanced pricing arrangement (APA) Chugan(2007a). Gandhi, (2009a) contends that Introduction of safe harbour rules will be a stepping stone to move towards the introduction of APA in the future. Singh et al., (2009), opine that APA is an alternative approach currently gaining greater acceptability. However, Sahu (2008), observes that transfer price litigation has emerged as the biggest source of courtroom battle between Indian tax authorities and multinational corporations operating in India.

Objectives

1. The first & the foremost objective the paper is to understand the Pricing Conundrum in Transfer Pricing confronted by the Multinational corporations (MNCs) and the Tax authorities.
2. Also, to understand the international scenario in respect of Transfer Pricing and OECD guidelines and Arm's Length Principle (ALP) required to be adopted by MNCs while pricing their goods and services.
3. To understand the concept of Transfer Pricing and Arm's length Principles in the context of Income Tax Act 1961 and the Finance act 2012 and other relevant Finance Acts and their implication on the MNCs operating in India.

Methodology

The present study is based on the information collected from various secondary sources such as research journals, OECD guidelines, newspaper articles, various website, bare acts & personal interaction with professionals like Chartered Accountants, Company Secretaries & others.

Pricing Conundrum

One of the most difficult and controversial areas in the relationship between the MNCs and their overseas subsidiaries has been the pricing issue of the goods, services and technologies used in the production and distribution of cross-border transaction of goods and services.

Transfer pricing is a contentious issue for the companies operating in countries where there are disparities in taxation norms and weak legal structures. This is further aggravated in the case of assessment of intangibles. Symbolically, as per UN(1965,p.63) transfer price may be expressed as $(P_a - P_w) / P_w * 100$ Where P_a is the actual import price or export price as indicated in the invoice and P_w is the reference world price used for comparison.

The objectives influencing MNC pricing policy, more specifically referred to as 'transfer pricing issues', are well discussed in O Connor(1997) For example, O' Connor explains that, if a MNC wants to move fund out of a country, it can charge higher price to its foreign affiliate, or can do the opposite when the objective is to supply fund to the affiliate. Similarly, affiliates wishing to pay lower import duty may follow low mark-up policy. If the MNC under-prices the shipment of goods to the foreign affiliate, it can effectively offset the volume effects of exchange quotas. Exchange rate fluctuation is a zero-sum game in the sense that loss of one party results in gain to the other party by equal measure; but depending on the accounting treatments and tax laws of the respective party it can have different effect on different party. The profits from a joint venture similarly can be made to vary depending on the transfer price charged to the affiliates. When firms are organised as decentralized profit centers, transfer pricing between centers can be a major determining factor in arriving at profitability.

Since MNCs and their affiliates are located in different tax jurisdictions having different tax rates, transfer pricing is also influenced by tax considerations. Income tax payments are significant costs for most MNCs and transactions between affiliated entities are an important part of these income tax exposures.

In a typical situation, where tax rates are same in two countries, no special advantage accrues to the MNCs from tax minimization perspective from one markup policy than the other. But when the tax rates are different, the MNCs are likely to pursue a high markup policy in order to shift profits from a higher to a lower tax jurisdiction. Quite logically, in an increasingly globalized economy, the decisions of governments regarding corporate taxation affect the decisions of multinational firms regarding where to locate economic activity and where to book profits. The problem of lost revenues from taxation is further aggravated by the incidences of “Tax havens”, which, in combination with low rates of taxes (sometimes no tax at all) help the unscrupulous enterprises to avoid taxes by means of various subterfuges. These tax havens have in the recent past risen to the fore of the fiscal policy debate and have been identified as one of the root causes of many of the shortfalls plaguing the governments of the world. These tax havens had become the major plank of President Clinton’s 1992 presidential campaign as he wanted to ensure that foreign investors pay their fair share of US taxes. A recent study (Clausing, 2009), which sought to show the implications of tax avoidance on the US economy, revealed that between 1982 and 2004, income shifting incentives in the tax havens cost the U.S. government approximately 35 percent of corporate income tax revenues, involving an amount in excess of \$ 60 billion in 2004. According to Wikipedia article on Tax Haven, 50 largest companies in the FTSE 100 were depriving the UK Treasury of approximately £11.8 billion and global tax revenue lost to tax havens exceeded US\$255 billion per year.

There are number of tax havens around the world, but the Cayman Islands—a tiny British dependency of some 54,000 population in the Caribbean Sea—has come to the fore in connection with a tax dispute between the Government of India and Vodafone International Holdings B.V. The tax dispute, which involved intricate chain-holdings of several international and Indian companies, boils down to the right of the Indian Government to tax an overseas transaction between three foreign entities, namely the Vodafone International holdings (resident for tax purposes in the Netherlands), CGP Investments (Holdings) Ltd., (a company resident for tax purposes in the Cayman Islands) and The Hutchison Group (Hong Kong-based). In a merger/acquisition type of deal between Vodafone and Hutchison group in the Cayman Island-based CGP Investments, the underlying assets of one Indian company also got transferred to Vodafone International. The Government of India slapped a Rs. 12,000 crores tax notice on Vodafone, but in a wending course of protracted legal battle the Indian Apex Court gave verdict in favor Vodafone, reversing the earlier judgment of the Bombay High Court favoring the Indian Government. No doubt the judgment of the Supreme Court is in consonance with the strict interpretation of the language used in the Income-tax Act, 1961, but to get at the nub of things (which could not have been done under the existing provisions due to the unforeseen limitations of legal wordings) the Government has made amendments to the Act retrospectively from 1962, inviting scathing attack from the media as well as from the Industry. While the Vodafone issue could be a topic of healthy academic debate, in the context of tax haven, the identity and the “reputation” of the Cayman Islands needs some elaboration.

In the recent past this tax haven was the subject of an investigation by the United States Government Accountability Office (GAO, 2008) entailing the enforcement challenge for the US tax authorities. The report of the GAO, among several other things, provides some interesting facts about one Uglund House—a tiny building owned by Maples and Calder, a law firm and company-services provider that serves as registered office for the 18,857 entities it created as of March 2008 on behalf of a largely international clientele. The Report also mentioned that 96 percent of those entities were exempt companies, exempt limited partnerships, and exempt trusts. They were prohibited from trading in the Cayman Islands with any persons, firm, or other corporation except in furtherance of their business that is carried on outside the Cayman Islands. Needless to mention that Cayman Islands and its ilk are the causes of headaches for the governments throughout the world, inviting stricter enforcement mechanism in the form of transfer price regulations.

Arm’s length principle (ALP) for Transfer Pricing

The “Arm’s Length price” of a transaction between the two associated enterprises is the price that would be paid if the transaction had taken place between two comparable independent and unrelated parties, where the consideration is only commercial.



The Arm's Length Principle (ALP), in the context of taxation, is explained in the OECD Model tax convention as under:

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

The OECD transfer pricing guidelines provide guidance on the application of the arm's length principle in order to arrive at the proper transfer pricing range between associated enterprises. Market forces determine business relations between independent parties. The Arm's length principle seeks to adjust the profits between two associated enterprises by comparing the same as if the transaction is carried out between two independent enterprises. It treats each enterprise as a separate independent entity rather than as inseparable parts of a single unified business.

As globalization continues to make inroad into the global economy, the fiscal authorities all over the world are getting increasingly concerned to get their legitimate share of tax revenue from MNC activities in their territories. The OECD (Organisation for Economic Cooperation and Development) Guidelines for Multinational Enterprises (OECD, 2008), therefore, required the MNCs to provide the relevant authorities the information necessary for the correct determination of taxes to be assessed in connection with their operations and conforming transfer pricing practices to the arm's length principle.

Arm's length pricing (ALP), which is now an international consensus, is a method of stripping the possible camouflage embedded in the transfer pricing. It is set forth in Article 9 of the OECD Model Tax Convention as: Where “conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly”(OECD, 2010).

Simply stated, ALP is the price for the hypothetical transaction, which the associated enterprises would have agreed if they would have made comparable transactions on the open market rather than the controlled transaction that was in fact made. The arm's length principle involves a valuation of controlled transactions where the yardstick is the market transaction. Transfer pricing, therefore, demands a critical economic analysis to show how transfer price has been determined and to substantiate that it complies with the arm's length principle. It is, in fact, an exercise in comparability which is at the heart of transfer pricing. The question usually revolves around the factors that determine the tested transaction and how these can be compared with the independent but equivalent situations observed between arm's-length parties (Zetter et al, 2009).

From the point of view of taxation policy the choice of arm's length principle is justified by the fact that it contributes tax equality and neutrality between the associated enterprises and an independent enterprise. The principles of equality and neutrality are the core values of the tax law and constitute the basis for tax treatment of corporate group formations (Wittendorff, 2010). Because the arm's length principle puts associated and independent enterprises on a more equal footing for tax purposes, it should promote the growth of international trade and investment and thus lead to fair international income allocation.

Transfer Pricing Techniques

The law relating to transfer pricing is different in different countries, but, they have large degree of similarity with the OECD guidelines, and irrespective of the minor differences, they all aim at achieving a comparability test for the transactions between the MNCs and the associated enterprises. Indeed, the OECD has reiterated its principles that when transfer pricing does not reflect market forces and the arm's length principle, the tax liabilities of the associated enterprises and the tax revenues of the host countries could be distorted. Therefore, OECD member countries have agreed that for tax purposes the profits of associated enterprises may be adjusted to

correct any such distortions and thereby ensure that the arm's length principle is satisfied (OECD, 2010: p. 32). Accordingly, the OECD has devised a number of methods for transfer pricing with a view to achieving arm's length price. However, it is important to bear in mind that the need for the aforesaid adjustments to approximate arm's length transactions arises irrespective of any contractual obligation undertaken by the parties to pay a particular price or of any intention of the parties to minimize tax.

The "standard" transfer pricing methods include the following

Comparable Uncontrolled Price (CUP) Method

It is defined by OECD (2010) as a method that "compares the price for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances". CUP, by its very definition, contemplates an observable market price for the property and services in question. Therefore, as long as this condition is fulfilled, this is the most direct and reliable way to apply the arm's length principle. The method is commonly used to calculate arm's length interest rates on intercompany borrowings.

Cost-plus Method

This method involves selection of comparable business and calculation of an appropriate profit as a mark-up on the cost inputs of the representative firm. According to the OECD, this method is likely to be most useful where semi-finished goods are sold between associated parties, where associated parties have concluded joint facility agreements or long-term buy-and-supply arrangements, or where the controlled transaction is the provision of services.

• Resale Price Method

The OECD has defined it as a transfer pricing method based on the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. The resale price is reduced by the resale price margin. What is left after subtracting the resale price margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. custom duties), as an arm's length price of the original transfer of property between the associated enterprises.

Profit Split Method

This method is mainly applicable in international transactions involving transfer of unique intangibles or in multiple international transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction. Under such circumstances the profits split method identifies the combined profit to be split for the associated enterprises from a controlled transaction and then splits those profits between the associated enterprises based upon an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length.

Transactional Net Margin Method

As a variant of the profit split method, this method examines the net profit relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realizes from a controlled transaction. The net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is also computed and this is taken into account to arrive at an arm's length price in relation to the international transaction with the associated enterprise.

Unspecified Methods

Apart from the "standard methods" described above, the literature on international transfer pricing has identified a multiplicity of other methods to arrive at arm's length price. Such methods attempt to provide information on the prices or profits that the controlled entities could have realized by choosing a realistic alternative to the controlled transaction.

Advance Pricing Agreements and Safe Harbors

Even though the concept of arm's Length Pricing is well accepted by both the multinational tax payers and tax authorities, there are many practical difficulties. The rules relating to the ALP are not only different in different countries, but also the methodologies behind the ALP are not straightforward and, therefore, not amenable to unique interpretations by the tax payer and the tax collectors. In theory, ALP intends to look to the identical transaction under the same circumstances between uncontrolled entities. But in reality such identicalness rarely exists. As a practical matter, therefore, the determination of ALP, more often than not, is based on "comparable transactions" under "comparable conditions", making it more of a fact intensive process and judgmental in nature. In the process, the difference in perceptions and economic assumptions lead to disputes and harsh transfer pricing audits from the aggressive Revenues which are vying with each other to aggrandize its fair share of "legitimate tax". Countries which are noted for such aggressive transfer pricing policies include, in order of rank, Japan, India, China, Canada and the US (KPMG, 2011). For instance, at the end of the sixth cycle of transfer price audit in India, the Income-tax Department has made transfer price adjustments to the extent of INR 20,000 crores. If all the six transfer price audits conducted since its inception in 2003 are taken into consideration, the cumulative value of the adjustments would be well above INR 50,000 crores (PWC, 2011). The worst part of the story is that more than 99 per cent of these cases—that also involve disputes relating to royalty payments to principals are under litigation. some of the companies like Microsoft, Hindalco, Maruti, GE Capital and Oracle are some examples.

The penalties involved in non- compliance of Arms Length policy are very huge-ranging between 40-50 percent of the tax due in the case of United States; and 100to 200 percent in case of India. Due to such inherent risk of ALP, in 1991 Apple Computer became the first company which entered into an Advance Pricing Agreements with two tax authorities, the United States and Australia, to determine how its related party transactions should be valued for tax purposes (O'Connor, 2011). In the same year, the United Sates adopted formal advance pricing procedures on transfer pricing, which was soon emulated by Japan, the UK, Canada, Mexico, Australia, Germany, and some Scandinavian countries. Since then both the number of countries and the number of companies entering into APA agreements have been rising steadily. As of now, more than 900 companies have entered into Advance Pricing Agreements in the United States. The corresponding number of advance pricing agreements in Japan is about 600, 350 in Australia, 250 in China and 150 in Canada (KPMG, 2011). With the rising number of transfer pricing disputes and the escalating tax war among the nations, advance pricing agreements are fast becoming the new order of the international transfer pricing system.

An APA is basically a contractual arrangement with the tax administration of one or more countries to resolve potential tax disputes in an amicable and cooperative manner. The OECD (2010) has defined the term as "An arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time". According to the Internal Revenue Service (USA), APAs are designed to resolve actual or potential transfer pricing disputes in a principled, cooperative manner, as an alternative to adversarial process. It is a binding contract between the taxpayer and the tax administration of one or more countries (unilateral APA and multilateral APA) by which the latter agrees not to seek transfer pricing adjustments for a covered transaction, provided that the taxpayer follows the agreed transfer pricing method.

APAs have several advantages over the traditional transfer pricing system. From the taxpayers' point of view, it eliminates the uncertainty, provided the critical conditions are met. In the uncertain world of transfer pricing, it provides certainty to help the tax payer with a definite tax outcome and liability. As against the predatory transfer pricing ambience, it promotes a non-adversarial spirit and environment between the taxpayers and the tax administration, leading to free flow of information for mutual benefits. Costly and time-consuming examinations and litigation of major transfer pricing issues for taxpayers and tax administrations may also be avoided. Bilateral and multilateral APAs substantially reduce or eliminate the possibility of juridical or economic double or non-taxation since all the relevant countries participate in the process.

But APA is not without its pitfalls. It is a time-consuming process and can take significant amount of time and resources as compared to a tax audit. A unilateral APA may sometimes take 12 to 18 months, while a bilateral APA may involve more than 24 months. Obviously, such an arrangement may not be suitable for small organizations and non-repetitive nature of transactions. In contrast to APA, which is a taxpayer-specific arrangement, safe harbour is general in nature. Designed as a comfort mechanism, safe harbours provide for circumstances in which a certain category of taxpayers can follow a simple set of rules under which transfer prices are automatically accepted by the revenue authorities. According to the OECD (2010: Para 4.94), “a safe harbour is a statutory provision that applies to a given category of taxpayers and that relieves eligible taxpayers from certain obligations otherwise imposed by the tax code by substituting exceptional, usually simpler obligations”. The positive aspects of safe harbour include certainty with respect to tax obligations and administrative simplicity. But the most important aspect of safe harbour is of course compliance relief for a designated class of taxpayers who may be subjected to, instead of a specific transfer pricing method, a sort of presumptive tax.

Like APAs, safe harbours are also not without its flipside; it is arbitrary and it sacrifices accuracy in reporting Arm's Length Price, but this demerit is offset against the simplicity and compliance relief that the taxpayer is accorded. It also insulates the taxpayer against the hazards of arduous transfer price audits.

Evolving Landscape of Transfer Pricing in India

India is being considered a centripetal force of globalization and MNCs are making keen to enter the vast Indian market, especially in the lucrative sectors like multi-brand retailing, the country seems to be caught between the devil and the deep blue seas over its transfer pricing policies. The Vodafone case is not just an isolated issue, but the general uncertainty over international tax matters is manifest in the fact that at least INR 30,000 crores of tax revenues involving some 1,200 companies are locked in transfer pricing litigations pending before courts, income-tax tribunals and tax appeal commissioners. India now has the dubious distinction of having the most international transfer price disputes. However, the recent developments in transfer pricing matters are seen as a bellwether of change of India's ramshackle transfer pricing policy.

Although India's foray into a systematic international transfer pricing policy is traced to the Finance Bill, 2001, its attempt towards tackling the transfer pricing problems can be traced far back into the Income-tax provisions contained in the Act of 1922. Section 42(2) of the said Act, which corresponded to Section 92 of the Income-tax Act of 1961, dealt with the provisions relating to computation of income from transaction with non-residents. In *Mazagoan Dock Ltd v. CIT* [34 IT 3368], in which two non-resident shipping companies entered into an agreement with a resident company for providing repair services to the parent bodies free of cost, was held by the Supreme Court to be the income of the resident company (See *Palkhivala and Palkhivala*, 1990 : pp. 1004-05). Section 92 of the Income-tax Act, 1961 (the old section before it was replaced by the new Section 92 w.e.f. the assessment year 2002-03), which was a transmutation of section 42(2) of the old Act, brought about similar charges to the resident assessee and required the Assessing Officer to “determine the amount of profits which may reasonably be deemed to have been derived there from”. The transfer pricing provisions (if it can be at all called by that name at this juncture) under the old provision of the Act was no better than the guesstimates of the Income-tax department. However, in line with the global trend, India made a new beginning with its transfer pricing policy when it was carved out of the OECD guidelines and codified as law by the Finance Act, 2001 (effective from the assessment year 2002-03). The said Finance Act replaced the old Section 92 and in its place inserted a new Chapter X, containing eight sections, into the Income-tax Act 1961 (viz. Sections 92, 92A, 92B, 92C, 92CA, 92D, 92E and 92F). Subsequent developments include some major changes made in the Income-tax Act in 2009 and in 2012. With these developments, India now has more or less comparable transfer pricing mechanism.

An overview of the Indian transfer pricing mechanism is presented

Arm's length pricing With effect from the assessment year 2002-03, the sections mentioned above have been added to the Income-tax Act to delineate the arm's length pricing system for international transactions. Section 92



requires every assessee to compute income arising from international transactions with associated parties on the basis of arm's length price. Section 92A defines exhaustively the meaning of associated parties, while the meaning of international transactions is defined in Section 92B, which covers five types of transactions: loans or advances; performance of personal services; use of tangible property; transfer of/use of intangible property; and sale/purchase/lease of tangible property. The methods of computation of arm's length price contained in Section 92C are in conformity with the "standard methods" mentioned earlier. The Central Board of Direct Taxes (CBDT) has framed detailed Rules (Rule 10A, 10B and 10C) to define and determine arm's length price under Section 92C.

Transfer pricing in India requires an elaborate system of information and record keeping. The requirements of Section 93D, read with Rule 10D, are stringent enough. Also, an accountant's report detailing the international transactions entered into by the assessee is to be furnished in accordance with the requirements of Section 932E, Rule 10E and Form No. 3CEB.

Important Changes Made in 2009

International transfer pricing in India is in an evolutionary stage. Finance Act, 2009, has made the following additions to the existing transfer pricing regulations “

Safe Harbour Rules

with retrospective effect from the assessment year 2009-10, Finance (No.2) Act has inserted Section 92CB to provide for safe harbor rules for computing arm's length price. The CBDT has been empowered to make rules, which are likely to roll out anytime soon.

Dispute Resolution Panel (DRP)

Transfer pricing mechanisms, being subjective in nature, are inherently prone to disputation and prolonged litigations. To instil confidence in the foreign investors in India, Finance (No. 2) Act has inserted Section 144C to provide for alternate dispute resolution panel. As a result, unlike in the past, when the order passed by the Transfer Pricing Officer under Section 92CA was binding, Section 144C has removed the straightjacket by providing for the DRP.

As collegiums of three Commissioners of income tax, the DRP would hear the dispute within a period of nine months. No tax demands will be raised on the taxpayer until the final order is passed by the DRP. DRP decisions are final and binding on the revenue authorities. However, if aggrieved, the taxpayer is entitled to appeal before a higher appellate authority.

Significant Changes Made in 2012

Finance Bill 2012, which is awaiting passage, has added further momentum to the transfer pricing mechanism in India. The changes made by the Finance Bill are reflective of the resolve of the government, which is besotted with the problems of black money and tax avoidance. Important changes made here include Advance Pricing Agreements (APA) under the newly inserted Sections 92CC and 92CD; and General Anti-avoidance Rule (GAAR) under Section 95. These two issues were within the scheme of things in the proposed Direct Taxes Code (DTC), but the teething problems with the DTC still remaining unresolved, they have been included in the current Finance Bill to pre-empt implementations of these matters. The provisions of APA are more or less in conformity with those discussed above; GAAR intends to put a brake on aggressive tax planning by the foreign players as well as the domestic assesseees. Under the provisions of GAAR, the tax administrations in India are accoutered with wide discretionary powers.

Conclusion

Finance Bill 2012 has made a few more amendments which have far-reaching consequences for the MNCs and transfer pricing in India. First, Sections 9 and 195 have been amended to clarify that business located in India but owned by the foreign enterprises shall be deemed to be situated in India and accordingly, sale of assets of such

enterprises shall fall within the ambit of the Indian tax. As a result of retrospective amendments of these sections from 1.4.1962, Vodafone's purchase of Hutchison's stake in Vodafone India and Birla's acquisition of AT&T's stake in Idea, which were not taxable previously, would be taxable in India. Second, the clarification added to Section 9(1) (i) make payment for software acquired from abroad as a royalty. The implication of this amendment is that foreign companies supplying that software now will come within the purview of transfer pricing. Third, the amendment to Section 40A now empowers the Assessing Officers to decide on taxability of expenditure incurred in the process of transactions with the group companies. This will not only lead to higher taxes for the MNCs, but the wide discretionary powers enjoyed by the Assessing Officers will make it a potential weapon against the MNCs. But India is not alone in fleecing the MNCs. China has recently hardened its transfer pricing regulations, resulting in an explosion of transfer pricing controversies. The Canadian tax administration has asked Merck, a leader in the healthcare industry, to pay additional \$660 million in taxes due to transfer price adjustments, while the company has disputed a further claim for \$550 million. Hasbro, a toymaker, has faced a demand from the Mexican authorities for an extra \$98 million due to transfer price adjustments. In Germany, there is a spate of transfer price audits with adverse consequences for the MNCs. The question in particular is whether transfer pricing is the low hanging fruit or not that the revenue-starved governments would bend the branch at their sweet will to grab it.

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