SECRET COMPARABLES IN TRANSFER PRICING

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1. Introduction

In the present paper, I propose to deal with some of the cases decided in India in last couple of years by High Courts and Income Tax Tribunal on the issue which I am expected to deal, namely, the comparability of secret comparables by TPO while determining ALP.

I should inform you, the fellow members, that there are very few decided & reported cases yet from higher appellate & Constitutional Courts like Supreme Court of India at Delhi and 24 High Courts, from one of which, Rajasthan High Court, Jodhpur from where I come.

But there are quite a large number of cases decided by Income Tax Tribunal, which has 40 Benches with 80 members strength in our country and the said Tribunal, being the final fact finding authority under the Income Tax Act, 1961, these cases which I would discuss now, throw considerable light on the issue.

2. Ethics of Secret Comparables

Comparability analysis looks can be a laborious, difficult, time-consuming and, more often than not, costly exercise. Collecting information, analyzing all the data from various sources, documenting the analysis which Tax Advisories or Government appointed bodies do and income adjustments are all steps that require time and money. The aim should be to ensure that the compliance burden and costs borne by a taxpayer to identify possible comparables and obtain detailed information thereon are reasonable and proportionate to the complexity of the transaction. But that alone cannot be a reason for the dilution of comparability, permissible in theory.

Taxpayers and tax administrations should exercise fair judgment to determine whether particular comparables are reliable or not.

In my submission, allowing of income adjustments by determining ***ALP*** with comparison with secret comparables or cherry picking is not a very a healthy assessment practice. ***The principles of natural justice, fair play and equity does not permit such practices even in tax jurisprudence***. But it appears that with changing times, borderless trade, software technology and human ingenuity helping tax evasion may justify this & with even legislative prescriptions & permissiveness, this concept may gain the status of an established practice. The data bank of tax administrators has gradually increased to a level and with constant pouring in of such information in public domain & secretively both, the development of law will take place. Of course, the assessee company or PE of MNE is given the opportunity to rebut such comparability with other ALPs but the tug of war between tax payer and tax gatherer in this regard generally ends in favour of tax gatherer and the cost of litigation for the tax payer to establish his credibility of declared price or income is generally a negative factor.

That is why we the tax Judges in such Conferences like the 4th Congress of IATJ should discuss and guide the Tax Administrations worldwide for a more healthy, congenial and uniform system of tax assessments in the perspective of international trade, tax laws and double taxation avoidance treaties under OECD model law and UN Model laws, which also do not favour use of secret comparables, without allowing an opportunity to tax payer to distinguish or rebut those comparables.

Developed countries, such as the **US & UK** have an official policy of not using secret comparables. In **Australia and Netherlands**, where we have all assembled, under specific judicial pronouncements, secret comparables are not allowed. However, a few other countries such as **Japan, France, China, Germany and India** permit use of secret comparables. **Mexico** specifically allows such use.

In Japan, the latest legal position as per site of TPA Global, as per the requirements under Article 22-10(1) of the Enforcement Regulation for the Special Taxation Measures Law, if the taxpayers are unable to provide those documents in a timely manner upon request at the time of transfer pricing tax audit, they can trigger the tax examiner's authority to collect transactional data from comparable independent firms to use as a "secret comparable" for the taxpayer. The information that may be requested by

the NTA includes details of capital relationships, inter-company transactions, business activities, financial performance, method selection, search process and comparables selected.

Where the tested party is located in Japan, there is a requirement for comparables from the Japanese market. Detailed information and data on Japanese companies is available from a number of Japanese and regional financial databases, such as ORBIS etc. from Bureau van Dijk. There is a risk that secret comparables may be used in cases where the taxpayers do not prepare transfer pricing documentation.

The **Paris Court of Appeal** ruled in favour of **Nestle** in the case of Nestle's French subsidiary, Nestle Enterprises against the Minister of Economy and Finances (case no. 12PA00469) in relation to the use of secret comparables as per the French Tax Code article 57.

As per **French Tax Code** article 57, the tax authorities are allowed to use secret comparables in assessing the arm's length range of a taxpayer. In this case, the French tax authorities have used comparable cash pooling operations of three major groups listed on the French Stock Exchange. The arm's length compensation has been set at 0.5% on the borrowed amount of the cash pool at the end of the previous three financial years. As a result, the tax authorities performed adjustments to the tax base of the corporate income tax rate of 2002, plus the relevant penalties and interests.

Nevertheless, the court of appeal ruled that the tax authorities failed to use a valid comparable due to the fact that the three major groups were selected without any indication of the company names, terms and conditions of the cash pool agreements and if the guarantee of the selected comparables are comparable to Nestle Enterprises. Therefore, **court of appeal considered that secret comparables cannot be used as per article 57**.

Recently, in India, the Organization of Pharmaceutical Producers of India (OPPI) proposed a restriction on use of secret comparables by TPAs in Budget 2013. The Pharmaceutical industry is closely governed by Patent Law and their financial data are closely related to the production of their patented products and, therefore, analysis of secret comparables in their

case, on the one side has great revenue fetching scope and on the other side misuse of secret comparables at the same time.

Some Jurist rightly & aptly said, **"*While death & taxes, both are inevitable, being taxed to death is not*"**. Yet another saner sense pronounced, **"**The tax collection from subjects should be like collection of ***honey from the bees – gradual & drop by drop"*.** How true it is these days – is for all of us to ponder.

3. Some Decided Cases of High Courts of India.

➢ DELHI HIGH COURT DECISIONS

3.1 Commissioner of Income Tax Vs. Mentor Graphics (Noida) Pvt. Ltd. [2013] 215 Taxman 539 (Delhi) Decided on 4th April 2013.

On a question that, **"**Whether, in view of the first proviso to section 92C(2) of the Income Tax Act, 1961, the Tribunal was correct in holding that ***if one profit level indicator of a comparable***, out of a set of comparables, is lower than the profit level indicator of the taxpayer, then the transactions reported by the taxpayer is ***at an arm's length price*** as contemplated in sections 92, 92C and other related provisions of the said Act**"**.?

The Division bench of Delhi High Court in its recent pronouncement of ***4th April 2013*** in ***Commissioner of Income Tax Vs. Mentor Graphics (Noida) Pvt. Ltd. 2013 IV AD (Delhi) 477, [2013] 354 ITR 586(Delhi), [2013] 215 TAXMAN 539(Delhi)*** has held that

> **"**On an examination of TPO's order, it is apparent that the general grounds for rejection of the comparables submitted by the assessee were as under:-
>
> (a) The companies suggested by the assessee were actually not comparable in as much as their ***turnovers were widely different***;
>
> (b) The assessee had not ***used the data of the financial year*** ending 31.03.2002 which was the

relevant year for the purposes of determination of the arm's length price;

(c) The assessee did not include companies in its list of comparables which had a ***different product profile***. According to the TPO, companies having different product profiles also ought to have been included in as much as the TNMM method for arriving at the arm's length price allowed for ***functional differences***, which included differences in product profiles;

(d) The comparable companies suggested by the assessee were not companies involved in ***chip design software***; and

(e) The companies having a ***high ratio of trading activity*** had not been excluded by the assessee from its list of comparables.

We find that while these were the general reasons cited by the TPO for rejecting the comparables suggested by the assessee, ***the TPO had not indicated as to how each of the comparables suggested by the assessee did not fulfill the criteria*** which was adopted by him. The TPO suggested that the ***following filters should have been employed*** while searching out the comparables:-

(1) Companies engaged in ***software development having annual turnovers*** between Rs.50 lakhs and Rs.100 crores;

(2) Companies whose ***employees' cost*** is more than 10% of the turnover;

(3) Companies whose sales from ***manufacturing and trading*** does not exceed 10% of the total sales; and

(4) Companies which do not have any ***related party transactions.***

Based upon the said filters, the TPO conducted his own search from the ***'PROWESS'*** and ***'CAPITALINE' DATABASES*** and the ***NASSCOM DIRECTORY*** and short listed seven companies**”**.

The Court concluded that;

“The sum and substance of the Tribunal's order is that the criteria adopted by the TPO for searching comparables was not correct. Secondly, the TPO had not specifically rejected any of the comparables of the assessee. The Tribunal was of the view that the comparables of the assessee ought to have been accepted and, had that been the case, there would have been no need for the TPO to search for comparables. Of course, in passing the order, the Tribunal made certain general observations that unless and until the comparables drawn by the tax payer were rejected, a fresh search by the TPO could not be conducted. However, this has to be tempered with the relevant statutory provisions which are clearly set out in sub-section (3) of section 92C of the said Act which stipulates four situations where under the TPO may proceed to determine the arm's length price in relation to an international transaction. If any one of those four conditions are satisfied, it would be open to the TPO to proceed to determine the ALP. This clarification of the observation of the Tribunal was necessary and that is why we have done so.

We also note that the Tribunal had gone further and reduced the list of comparables to merely four as indicated in the impugned order. ***We do not think that it was the right approach to be adopted by the Tribunal***. The Tribunal should have stopped at the point where it decided on facts that the comparables given by the assessee were to be accepted and those searched by the TPO were to be rejected. ***The only option then left to***

the Tribunal was to derive the arithmetical mean of the profit level indicators of the comparables which were accepted by it. In this case such comparables happen to be those of the assessee.

The Tribunal, ***in selecting only one profit level indicator*** out of a set of profit level indicators ***had clearly erred in law***. However, in the facts of the present case that would not make any difference to the assessee's case in as much as even if the arithmetical mean of the comparables as accepted by the Tribunal are taken into account, ***the profit level indicator would, whether the seven companies*** are taken into consideration or all eight companies are taken into consideration, be less than ***6.99% which is the profit level indicator of the assessee for the relevant year, that is, financial year ending 31.03.2002***.

We may also make it clear that the reference to the ***OECD guidelines*** by the Tribunal in the impugned order are in the context of the reliance placed by the TPO on the very same guidelines, in particular, to paragraph 3.27 thereof (see Appendix 1). In the present case, there are specific provisions of sub-rules (2) and (3) of Rule 10B of the said Rules as also of ***the first proviso to section 92C(2) of the said Act which apply*** (see Appendix 3)**.** ***Therefore, the question of applying OECD guidelines does not arise at all***.

From the foregoing discussion, it is clear that the ***Tribunal was wrong in holding*** that if one profit level indicator of a comparable, out of a set of comparables, is lower than the profit level indicator of the taxpayer, then the transaction reported by the taxpayer is at an arm's length price. The proviso to section 92C(2) is explicit that where more than one price is determined by most appropriate method, the ALP shall be taken to be the ***arithmetical mean of such prices***. To this extent the

appeal is allowed. However, as pointed out above, if this principle is applied to the comparables suggested by the assessee (which have not been rejected by the TPO), the ALP suggested by the assessee would yet be acceptable in law.**"**

3.2 Moser Baer India Ltd. V. ADDL CIT (2008) TS 9 HC Del Decided on 19th Dec. 2008

Delhi High Court in another case of ***Moser Baer India Ltd. V. Addl CIT (2008) TS 9 HC Del.*** held that sec. 92CA (3) of Income Tax Act casts an obligation on the TPO ***to afford a personal hearing to the assesse before passing an order determining ALP***. The requirement of granting an ***oral hearing was 'mandatory' and could not be given a 'short shrift' by the TPO.*** HC observed that the TPO must give an option to the assessee, by issuing a show cause notice, ***to inspect the material available*** (presumably material including secret comparables available, which are sought to be used as yardstick against the assessee) with the TPO , furnish additional evidence, if the assesse so desired and seek personal hearing.

Thus while collection of secret comparables by TPO is not banned in law, use of the same against the assessee company without putting it to him with sufficient opportunity to rebut the same is not mandated by law, nor it is legally permissible.

- **Bombay High Court Decisions**

3.3 CIT VS. Carlyle India Advisors (P.) Ltd. [2013] 214 TAXMAN 4 (Bom), Decided on 22 Feb. 2013

On the questions

a) Whether on the facts and circumstances of the case, the Tribunal was correct in holding that comparable selected by the TPO ***were not functionally comparable while determining ALP?***

(b) Whether on the facts and circumstances of the case, the Tribunal was correct in allowing ***safe harbor margin of 5%*** to the assessee?

The Bombay High Court Division Bench ***22 Feb. 2013*** in the case of ***CIT Vs. Carlyle India Advisors (P.) Ltd. [2013] 214 TAXMAN 492(Bom)*** held that

"The basic dispute is the determination of Arms Length Price (ALP) in respect of ***investment advisory and related support services*** by the respondent-assessee to its Associated Enterprises (AE) in Hong Kong. ***It is undisputed that the Transaction Net Margin Method (TNMM) is the most appropriate method for determining the ALP. There was one comparable viz. M/s. IDC (India) Limited*** which was common between the Revenue and the assessee. However, eight more comparables were relied upon by the Revenue. On the basis of the mean so determined, the TPO concluded that the difference was in ***excess of 5% variables*** and, therefore, the ALP determined by the respondent-assessee was not accepted. The Tribunal by the impugned order held that the ***eight comparables*** other than M/s. IDC (India) Limited were not functionally comparable with the assessee and, therefore, could not be relied upon. The counsel for the Revenue states that for the subsequent assessment years, assessing officer himself has found that the eight comparables selected by the TPO were not functionally comparable with the respondent for determining the ALP. Moreover, in the impugned order the Tribunal has in detail pointed out why the selected comparables are not proper and failure of the assessing officer to consider the objections of the assessee. In this view of the matter, ***we see no reason to entertain question (a) as framed***(as they are not substantial question of law on which an appeal lies before High Court as per Sec. 260 A of the Act).

Insofar as question (b) is concerned, it becomes ***academic as*** if the eight comparables selected by the TPO are found not to be ***functionally comparable then*** the difference between the ***operating margin of the respondent at 15.05%*** as against the 18.97% of comparable ***companies being within the range of +/- 5%*** the amounts received by the assessee is within the statutory limits.**"**

3.4 Mitsui O.S.K. Lines Maritime (India) (P.) Ltd Vs. Deputy Commissioner of Income Tax-8(2) Mumbai [2012] 209 Taxman 151(Bom), Decided on 17 July 2012

In case of ***Mitsui O.S.K. Lines Maritime (India) (P.) Ltd Vs. Deputy Commissioner of Income Tax-8(2) Mumbai [2012] 209 TAXMAN 151(Bom),*** dated ***17/7/2012***, considering the ITAT order, the Bombay High Court held as under : -

> **"**In effect, the TPO and the AO ignored certain comparables including under the agreement on the ground that ***they pertain to loss making/ continuously loss making organizations.*** The appellant however contended that it was necessary to consider a variety of entities, both loss making and otherwise. The appellant disputed the approach on the one hand excluding the loss making entities but considering the entities that had abnormally high profits.
>
> Although the order of ITAT very fairly permits the appellant an opportunity of filing fresh comparables for the financial Year 2002-2003 in order to enable the appellant to make out its case properly, the appellant is willing to proceed before the Tribunal on the basis of the existing material including the comparables already furnished. It states that it does not wish to furnish any further material.
>
> In that event no purpose would be served by remanding the matter to the AO or for that matter, even before the CIT(A) for a fresh decision on the existing material. The AO and CIT(A) have already decided the same. The Tribunal has not held that it is not possible to arrive at the ALP on the basis of the existing material. The Tribunal must therefore now decide the matter. We wish to clarify that the power of the Tribunal ***in all respects is kept open and that the statement on*** behalf of the assessee does

not affect the same**."**

4. Some Decided Cases from Income Tax Tribunal, India

4.1 Trilogy E-Business Software India Ltd VS. DCIT (2013) 140 ITD 540, Decided on 23 Nov. 2012

Dealing with a case of applying filter for selection of comparables in the case of Software development services & differentiability between ***Onsite & Offshore provisions of such services***, the Bangalore Bench of ITAT in its recent decision ***of 23 Nov. 2012*** in ***Trilogy E-Business Software India Ltd Vs. DCIT (2013) 140 ITD 540***, held as under : -

> **"**The crux of the relevant Rules in 10 B of Income Tax Rules 1982, in so far as it relates to the contentions regarding application of the ***Onsite revenue filter***, is that comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the following, namely:--
>
> (a) ***the specific characteristics of the property transferred or services*** provided in either transaction;
>
> (b) ***the functions performed, taking into account assets employed or to be employed*** and the risks assumed, by the respective parties to the transactions;
>
> (c) ***the contractual terms*** (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;
>
> (d) ***conditions prevailing*** in the markets in which the respective parties to the transactions operate, including the ***geographical location and size of the markets, the laws and Government***

> ***orders in force, costs of labour and capital in the markets, overall economic development*** and level of competition and whether the markets are wholesale or retail.

It is ***only when there are no difference between the uncontrolled transaction and the international transaction as set*** out above or if there are differences but such difference will not affect the price or cost charged or paid or profit arising from such transactions or if there will be differences in price or cost charged or pair or profit arising from such transactions, such differences should be reasonably capable of being quantified and adjustment made to eliminate the effect of such differences.

The Indian software sector provides both ***on-site and offshore services***. The Assessee in the present case is mainly offshore service provider and it generates income only from ***offshore software development service***. Most of the uncontrolled enterprises follow hybrid model with revenue mix both from onsite and offshore. It is true that in terms of the functions performed both in the case of offshore service provider and onsite service provider, it is development of computer software. But having regard to Rule 10B(2)(b) it is necessary to have regard to the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions.

It is no doubt true that in TNMM it is only the margins in an uncontrolled transaction that is tested with reference to the controlled transaction but it is not possible to ignore the fact that pricing will have an effect on the margins obtained in a transaction. The argument that if pricing structure were to be considered as criteria, then it will have to be seen as to what is the pricing structure of all the comparable for various projects cannot be accepted because the TPO has not chosen any other onsite software

service provider with a revenue composition of more than 75% from onsite software services as comparable. As rightly observed by the TPO, the pricing is different in onsite when compared to offshore operations. The further observations of the TPO that the reasons for the same lie in the fact that while in the case of OFFSHORE projects most of the costs are incurred in India; an ONSITE project has to be carried out abroad significantly increasing the employee cost and other costs.

The companies who generate more than 75% of the export revenues from onsite operations outside India are effectively companies working outside India having their own geographical markets, cost of labour etc., and also return commensurate with the economic conditions in those countries. ***Thus assets and risk profile, pricing as well as prevailing market conditions are different in predominantly onsite companies from predominantly offshore companies like the taxpayer***. Since, the entire operations of the tax payer are taking place offshore i.e. in India; ***it is but natural that it should be compared with companies with major operations offshore***, due to the reason that the economics and profitability of onsite operations are different from that of offshore business model. As already stated the Assessee has limited its analysis only to functions but not to the assets, risks as well as prevailing market conditions in which both the buyer and seller of services located. Hence, the companies in which more than 75% of their export revenues come from onsite operations are to be excluded from the comparability study as they are not functioning in similar economic circumstances to that of the tax payer. Hence, it is held that this filter is appropriately applied by the TPO.

M/s. Indium India Ltd., a comparable considered by the Assessee in its TP study was rejected by the TPO as not comparable on the ground that the said company was

rendering ***software testing services***. It is the plea of the assessee that software testing is an integral part of software development cycle. It is further pointed out that the TPO in his analysis has selected ***Ishir Infotech Ltd., which renders software testing activities as comparable.*** This contention of the Assessee is not correct. According to the TPO's order, the objection of the Assessee for selecting Ishir Info Tech Ltd. as comparable is for the reason that this company was outsourcing software development and that the company does not satisfy ***25% employee cost filter***. Both these objections have been found to be not sustainable by the TPO. The question therefore would be as to whether software testing services would be equivalent to software development services. Software testing is only part of software development life cycle. ***It cannot be equated with software development services***. The TPO in our view rightly excluded this company for comparability purposes.**"**

Upholding the right of TPO to collect information from Secret Comparables, the Tribunal further held that,

"We are of the view that the TPO in the case of this company has not used information u/s. 133(6) of the Act and therefore the Assessee can have no grievance. If on the other hand the Assessee wants to show that ***information available in public domain is not correct then the onus would be on the Assessee to establish the same***. The Assessee ***cannot ask for a right to cross examine on a surmise*** that the information given in response to notice u/s. 133(6) of the Act would be correct and that given in the annual report is incorrect. The Assessee if he is able to show prima facie that the information available in public domain is incorrect then we will be persuaded to afford opportunity to the Assessee but not on a claim which lacks substance and is based on surmises.

The comparable now accepted as comparable and their operating margins before and after working capital adjustment are detailed in the table given below:-

Table 1-Turnover Range 1 To 200 Crores And After Considering Comparables Selected By The Assessee

Sl. No.	Name of the Company	Operating Revenues	Operating Margin on Cost	Adjusted Margin on Cost
1	Datamatics Ltd.	545,088,027	1.38%	0.58%
2	E-Zest Solution Ltd.	62,594,544	36.12%	37.23%
3	Geometric Ltd. (seg)	1,583,797,773	10.71%	10.81%
4	Helios & Matheson Information technology Ltd.	1,786,380,304	36.63%	35.62%
5	Ishir Infotech Ltd.	74,209,887	30.12%	31.60%
6	LGS Global Ltd. (Lanco Global Solutions Ltd.)	453,893,898	15.75%	16.36%
7	Lucid Software Ltd.	16,992,078	19.37%	18.24%
8	Mediasoft Solutions Pvt. Ltd.	18,508,785	3.66%	2.77%
9	Megasoft Ltd (Seg.)	637,132,545	23.11%	17.85%
10	Quintegra Solutions Ltd.	627,216,924	12.56%	10.42%
11	R S Software (India) Ltd.	1,010,449,441	13.47%	14.33%
12	R Systems International Ltd. (Seg)	1,120,172,651	15.07%	14.44%

Sl. No.	Name of the Company	Operating Revenues	Operating Margin on Cost	Adjusted Margin on Cost
13	SIP Technologies & Exports Ltd.	37,980,955	13.90%	11.90%
14	Thirdware Solutions Ltd. (Seg)	360,850,000	25.12%	22.71%
	Arithmetic Mean			17.508%

The differential between the margins of the assessee as above and of the comparable in the Table given above, ***is beyond the 5% range***. Applying, the proviso to section 92C(2), adjustment is required to be made to the reported values of the assesee's transactions with its associated enterprises. The AO is directed to make adjustment to the ALP adopting the arithmetic mean of 17.508% and consequent addition to the total income.**"**

4.2 Adaptec India Pvt. Ltd. Vs. DCIT *(2013) 154 TTJ 129*

In ***Adaptec (India Pvt. Ltd Vs. DCIT (2013) 154 TTJ 129***, ***Hyderabad Bench*** of Tribunal in its decision of ***31st Jan. 2013*** applying ***Turnover filter***, excluded comparables with extremely high turnover, ***even though functionally similar entities*** by observing that ,

> **"*Undisputedly assessee is a service provider operating with limited or no risk at all. Whereas both Infosys and Wipro are considered as giants in the sector of software development assuming all the risks,*** it is accepted principle that more the risk more is the profit. The dynamics of these companies also cannot be compared with the assessee. While the turnover of the assessee is about 15 crores only, the turnovers of Infosys and Wipro are Rs. 13149 crores and Rs. 9616 crores respectively. When the TPO has applied the ***turnover filter*** by excluding companies having turnover of less than Rs. 1 crore, he should have applied the same logic to exclude companies having extraordinarily high turnover compared to the

assessee. So far as learned Departmental Representative's contention that the assessee itself has selected Infosys as a comparable is concerned, there is merit in the contention of the learned AR that the ***TPO cannot adopt a pick and choose method while selecting comparables***, when he has rejected the entire TP study report of the assessee. Therefore IT & W cannot be taken as comparables in the case of assesse. Accordingly, the AO is directed to recompute the ALP after excluding IT & W as comparables."

4.3 Genisys Integrating Systems (India) P. Ltd. Vs. Dy. CIT

(2013) 152 TTJ 215 (Bangalore Bench)

The Tribunal in a case decided on ***5th August, 2011*** the Tribunal upheld collection of secret comparables by TPO u/s 133(6) of the Act but emphasized the need of putting them to assessee and allowing him to cross examine such comparables.

Brief Facts:

The brief facts of the case are that the assessee is a company which is engaged in the ***business of providing software development and IT enabled services***. It is part of M/s Genisys Group. The assessee exports its services to its AE and also other clients. For the year under consideration, a return of income was filed by the assessee declaring a total of income of Rs.81,75,080/-. During assessment proceedings u/s 143(3), it was also noticed that the assessee has received payments from its AE clients for providing the software development services and also IT enabled services exceeding Rs.15 Crores. In view of the same, a reference was made to the TPO u/s 92CA of the IT Act for determination of ALP of the international transaction. The TPO issued initial notice asking the assessee to furnish the documents required to be maintained u/s 92D and the same was furnished by the assessee. The TPO also issued notice relating to determination of ALP for Software Development Services and also with regard to the ***Information Technology Enabled Services (ITES in short).*** These notices contained remarks on assessee's study, ***new search methodology adopted***

for selecting the comparables, new comparables selected by the TPO and copies of replies received u/s 133(6) from these other companies. The assessee filed a detailed reply for both the notices and also raised ***various objections to the comparables selected by the TPO.*** The TPO however, was not convinced by these objections and made adjustments u/s 92CA of the Income-tax Act, by making the following observations:

(a) The assessee extends software development services and also extends its information technology enabled services to M/s Genesis MNC, which in turn helps its US customers through all the stages of the product life cycle i.e from visualization to post launch support. M/s Genesis has extensive experience in developing and supporting the Microsoft technology including SQL Server and related tools. It also has offshore development centre. In order to arrive at the ALP for the international transactions, ***the assessee, after making the search on the prowess and capitaline data bases***, has selected 15 comparables for the software development services and had adopted the ***TNMM (Transactional Net Margin Method) as the most appropriate method*** for arriving at the ALP.

The assessee applied the following filters for finalizing the 15 comparables.

1) Companies for which ***sufficient financial data*** was not available to undertake analysis

2) Selection of companies having ***sales turnover*** of more than 1 crore and less than 200 crores;

3) Elimination of companies having ***export sales*** less than 25% of their total revenues

4) Elimination of companies which are ***functionally different***

5) Companies which have been making persistent ***operating losses;***

6) Companies that had substantial (excess of 25%) ***transactions with related parties;***

7) Companies that had ***exceptional years of operation***.

(b) After applying the above filters, the assessee arrived at 15 comparables with an ***average profit margin of 6.36% on cost***. As the margin earned by the ***assessee was 6.61%*** i.e more than the adjusted mean margin, the assessee submitted that price charged by it in international transaction of software development services is to be treated as being at arm's length. The TPO, however held that the companies engaged in software development services were treated by the assessee as comparables irrespective of the ***verticals of software***. She held that the ***assessee is mostly an offshore software development provider*** i.e akin to software development service provider and derives 100% of its Revenue from export services to its AE in US. She held that the filters adopted by the assessee for arriving at the 15 comparables have several defects.

Contentions of Assessee

The TPO himself has rejected the companies which are making losses as comparables. This shows that there is a limit for the lower end for identifying the comparables. In such a situation, we are unable to understand as to ***why there should not be an upper limit also***. What should be upper limit is another factor to be considered. We agree with the contention of the learned counsel for the assessee that the ***size matters in business. A big company would be in a position to bargain the price and also attract more customers. It would also have a broad base of skilled employees*** who are able to give better output. A small company may not have these benefits and therefore, the turnover also would come down reducing profit margin. Thus, as held by the various benches of the Tribunal, ***when companies which are loss making are excluded from comparables, then the super profit making companies should also be excluded***. For the purpose of classification of companies on the basis of net sales or turnover, a reasonable classification has to be made. ***Dun & Bradstreet and NASSCOM have given different ranges***. ***Taking the Indian scenario*** into consideration, the ***classification made by Dun & Bradstreet is more suitable and reasonable.*** In view of the same, ***the turnover filter is very important*** and the companies having a turnover of Rs.1.00 core to 200 crores have to be taken as a particular range and the assessee being in that range having turnover of 8.15 crores, the companies

which also have turnover of 1.00 to 200.00 crores only should be taken into consideration for the purpose of making TP study.

Contention that the provision of sec.92D and Rule-10D is defeated if, the ***TPO takes the data which is available in the public domain after the specified date*** and the ALP would be fluid and there would be no certainty for the same is not sustainable. The ALP has to be determined by the TPO in accordance with law and the Act provides that the TPO shall take into consideration the ***contemporaneous data***. The assessee is only required to maintain the information and documents as may be necessary relating to the international transactions so that it can be made available to the TPO or the AO or any other authority in any proceedings under the Act

Decision of Tribunal

When he is making the search for ***a relevant comparable***, ***the TPO can issue notices to the parties whom he considers as relevant*** to gather requisite information and on being satisfied with regard to relevancy of the material which can be used against the assessee ***only then the assessee has to be given an opportunity of presenting its objections***. Thus, the ***TPO need not inform the assessee about the process used by him*** for issuing the notices u/s 133(6) ***nor is he under any obligation to furnish the entire information to the assessee***.

If any information is sought to be used against the assessee, the same has to be furnished to the assessee and thereafter, taking into consideration the assessee's objections, if any, only then can the TPO proceed to take a decision. If the assessee seeks an opportunity to cross examine the party, ***the assessee shall be provided such an opportunity***. It is only during a ***cross examination*** that the assessee ***can rebut the stand of that particular company***. The assessee has also brought out various defects in the additional comparables selected by the TPO and has brought out ***the glaring differences between the functions of those comparables*** as compared to assessee and also as to how the entire revenue of the assessee has been taken into consideration inspite of there being income from unrelated party transactions also.

When companies which are loss making are excluded from comparables***, then super profit making companies should also be excluded;*** for the purpose of classification of the companies on the basis of net sales or turnover, a reasonable classification has to be made:

(a) The operating revenue and the operating cost of the transactions relating to associated enterprises only shall be considered;

(b) The comparables having the turnover of more than 1.00 crore but less than 200.00 crores only shall be taken into consideration;

(c) All the ***information relating to comparables*** which are sought to be used against the assessee ***shall be furnished to the assessee;***

(d) The assessee shall be given an opportunity of ***cross examining*** the parties whose replies are sought to be used against the assessee if the assessee so desires;

(e) To consider the ***objections of the assessee*** that relate to additional comparables sought to be adopted by the TPO and pass a detailed order and

(f) To give the ***standard deduction of 5%*** under the proviso to sec.92C (2) of the Act.

4.4 Kodiak Networks (India) P.Ltd. v. ACIT (2013) 152 TTJ 98 (Bangalore Bench)

In **Kodiak Networks (India)** P.Ltd. **v. ACIT (2013) 152 TTJ 98,** the same bench of ITAT in its decision rendered on ***27 Jan. 2012***, following its earlier view in ***Genysis case above***, emphasized the need of limiting the selection ***of secret comparables in a range near the business volume of the assesse*** in source state and also to use the ***contemporaneous data*** of such comparables.

Brief Facts

The assessee is an Indian Company, a subsidiary of Kodiak Networks Inc., USA. It is engaged in the ***business of software development service to Kodiak Networks Inc, USA***. The return of income for concerned asst. year was filed on 28/11/2006 declaring an income of Rs. 11,97,597/-.

During the year, the assessee company had the following international transactions with its Associate Enterprise (i) rendering of software development services; (ii) marketing and customer support services; (iii) purchase of capital goods; (iv) sale of capital goods; and (v) reimbursement of expenses.

The appellant rendered software development services wholly to its AE. The total value of software development service was Rs. 24,06,82,087/. The appellant adopted Transactional Net Margin Method (TNMM) to justify the price charged in the international transactions. The appellant conducted a methodical search process on ***Prowess database to identify comparable companies***. After adopting ***various search filters***, the appellant selected 49 companies as comparables. The arithmetic mean of these comparables was 11.01%. The appellant's ***operating margin on cost*** was 10.70%. Since the appellant's margin of 11.01% was ***within the 5% range*** as provided in proviso to s. 92C (2), it was concluded that the international transactions relating to software development services are at arm's length.

The Tribunal held that the turnover of the company is in the range of 24 crores, therefore, the companies, which have ***turnover of Rs. 1.00 crores to 200 crores alone should be taken into consideration for the purpose of making TP study.*** In these circumstances, this issue requires to be remitted back to the file of the TPO for fresh consideration with the directions that the ***operating revenue and the operating cost of the transactions relating to associated enterprises only shall be considered.***

Emphasising the need to use contemporaneous date, the bench said that ALP has to be determined by the TPO by taking into consideration contemporaneous data relevant to the previous year in which the transaction has taken place and he is not restricted from using the information available in public domain beyond any cut-off date; though the ***TPO is not any obligation to furnish the entire information to the assessee,*** when any information is sought to be used against the assessee, it has to be given a reasonable opportunity of hearing on that material; TPO having not considered various defects pointed out by the assessee in the selection of additional comparables by the TPO and other infirmities in the

computation of ALP, matter is remitted back to the TPO for fresh consideration with specific directions.

However, upholding the collection of data from secret comparables units, the bench studied the provisions of sec. 92 F and Rule 10 D and held that the ***Act has not provided for any cut-off date upto which only the information available in public domain has to be taken into consideration by the TPO***, while making TP adjustments and arriving at ALP. The Tribunal thus upheld his powers by saying that when the TPO is making the search for a relevant comparable, he can issue notices to the parties whom he considers as relevant to gather requisite information and on being satisfied with regard to relevancy of the material which can be used against the assessee only then the assessee has to be given an opportunity of presenting its objections, if any. Thus, the TPO need not inform the assessee about the process used by him for issuing the notices u/s 133(6) of the Act nor is he under any obligation to furnish the entire information to the assessee.

4.5 Intervet India P Ltd. Vs. ACIT (2010) 130 TTJ 301

In ***Intervet India P Ltd. Vs. ACIT (2010) 130 TTJ 301***, ***Mumbai. Bench*** of Tribunal in its decision of ***31st March 2010*** emphasized that vast disparate economic conditions of Thailand & Vietnam could not be ignored merely on account of geographical proximity & suitable adjustment made for only volume discount, credit offered & credit risk was not sufficient & thus remanding the case back , the Tribunal held that,

> **"**While it is conceded that when there is a sale of identical product to an unrelated party, it will form the basis of determining the ALP in respect of sales to an AE, but one of the essential prerequisites is that reasonably accurate adjustments are to be made to eliminate material factors affecting price, cost or the profit arising from such transaction. But at least all material factors should be considered in arriving at the adjustments. The TPO and the CIT(A) have assumed similarity of markets and economic conditions and have made adjustments only for the volume discount, credit offered and a small adjustment of credit

risk. They have completely ignored the disparate economic and market conditions of Thailand and Vietnam and have made no adjustment for the same. Mere geographical contiguity of two countries need not mean similarity in economic or market conditions. How can the sale prices to wholesale agents in two different countries be comparable, when the sale price to the final user in one country is less than the sale price to the wholesale agent in another country, unless adjustment for the same has been considered. Thus the adjustments merely for volume off take, credit period and credit risk, though material, are not sufficient to make the sale price to AE in Thailand comparable with the sale to unrelated party in Vietnam. Scope of adjustments has to be widened and all the submissions of the assessee regarding the disparity between the two transactions should be considered and suitable adjustments made for the same. With the above directions the issue is set aside to the file of the learned CIT(A) for deciding the matter afresh after giving reasonable opportunity to the assessee to present their case.**"**

4.6 Philips Software Centre P Ltd Vs. ACIT (2008) 119 TTJ 721

In one of the rather earlier but detailed analysis of TP provisions, ***Bangalore Bench*** of ITAT in its decision dated ***26th Sep. 2008*** in the case of ***Philips Software Centre P Ltd, Vs. ACIT (2008) 119 TTJ 721*** held as under : -

"The Act and the Rules provide that while conducting the comparability analysis, the data to be used should be contemporaneous. In this regard, the requirement of law is two-fold: (a) Data to be used for analyzing the comparability of an uncontrolled transaction shall be the data relating to the financial year in which the international transaction has been entered into (Rule 10B(4)3; and (b) Amongst other things, the data which is

used for the comparability analysis should exist latest by the specified date (Rule 10D(4)). Accordingly for the purpose of conducting the comparability analysis, the data should : (a) relate to the relevant financial year if the provision to R. 10B(4) is not attracted]; (b) exist by the specified date. It should be noted that both the conditions are cumulative in nature. If any one condition is not satisfied, the relevant comparable ought not to be included in the comparability analysis.

In the TP study conducted by the assessee, the database used for conducting the comparability analysis was Capitaline 2000 ('Capitaline'). The said database is compiled by Capital Market Publishers India Ltd. and is a comprehensive interactive database of around 7,000 Indian companies, covering all companies listed on major stock exchanges like BSE/NSE plus other big unlisted companies. However, for the purpose of concluding the transfer pricing assessment, the TPO used another database (i.e., Prowess). The TPO did not: (a) question the database used by the assessee; (b) question the data which emanated from such database; (c) specifically reject the database used by the assessee; and (d) provide any reason for using the new database. There was no infirmity in the TP study conducted by the assesse and the TPO erred in disregarding the same for the purpose of framing the assessment and making the transfer pricing adjustment.

In theory, the comparability analysis in a transfer pricing documentation can be conducted either by cherry picking companies and considering them as comparables or starting with a set of all companies which are potentially comparables and following a methodical approach for eliminating non-comparable companies to leave a final set of comparables, consistent with the criteria used for elimination. The assessee has conducted a TP study using the second approach. The TPO has resorted to pick and

choose. In the TP study conducted by the assessee, comparable companies were arrived at after using a methodical search process on the Capitaline database. For the purpose of conducting the comparability analysis on Capitaline, the assessee selected all companies in the computer software industry, as the first step. The said search process was followed by applying a number of pre-defined filters, both quantitative (i.e., system based) and qualitative (i.e., manual based) Alters/eliminations. Thus, the final comparable companies were those which survived the elimination process and not the companies which were selected by the assessee. The final set of comparable companies were in accordance with the criterion mentioned in Rule 10B(2). It would also be relevant to note that the transfer pricing guidelines for MNE's and tax administrations issued by the OECD lays down the following five factors which should be considered for conducting a comparability analysis. The said five factors which are very similar to the provisions of R. 10B(2), are as follows : (i) characteristics of property or services; (ii) functional analysis; (iii) contractual terms; (iv) economic circumstances; and (v) business strategies. From the above it is clear that the focus is on the functions performed and the reference to other economic criterion is only in the context of the functions. It would also be relevant to note that in the order, the TPO has admitted that the comparables are functionally similar. However even after admitting that the comparables in the TP study are functionally similar to the assesse, the TPO has rejected the comparables in the TP study. The onus was on the TPO/AO to state and to show that the range of the turnover sizes chosen by the assesse was wrong.

As it is clear from R. 10A(a),for the purpose of comparability analysis, the comparables should not be having transactions with its AE. In other words, a company having any related party transactions (i.e., even a

single rupee of related party transaction) should not be considered as a comparable company. The above view is also supported by the OECD.**"**

DOMESTIC RESTRICTIONS AGAINST DISCLOSURE OF INFORMATION RELATING TO ASSESSEE NOT IN PUBLIC DOMAIN

In India the restriction or confidentiality of assessee's data under Income Tax law are contained in Sec. 137 (since omitted by the Finance Act, 1964, with effect from 1st April, 1964) & Sec. 138 of the Income Tax Act of 1961. The Supreme Court of India dealt with these provisions as discussed below. However it may be noted that the special provisions for TP assessments of international transactions to determine ALP were enacted later in the year 2001.

In ***Dagi Ram Pindi Lall (1992) 2 SCC 13***, the Supreme court upheld the powers of civil court to summon Income Tax record of an assessee as an evidence but the Commissioner of Income Tax could claim privilege & subject to its determination by Civil Court itself. The Court said that,

"The repeal of Section 137 of the Act clearly discloses the legislative intent that it was felt by the legislature that it was no more necessary to keep the records of assessment by the Income Tax Department relating to an assessee as confidential from the courts and the bar with regard to the production of any part of the record was removed in so far as the courts are concerned. The finality which has been attached to the order of the Commissioner under Section138(1)b of the Act is, thus, restricted to the cases where the information etc. as contemplated by the Section is called for by any person, other than a court of law by a judicial order. The Commissioner of Income Tax under this Clause performs only an administrative function, on his subjective satisfaction as to whether it is in the public interest to furnish the information or not to any person seeking such information and his decision in that behalf is final and the aggrieved person cannot question it in a court of law. By

enacting this provision, the legislature could not be said to have intended that the Commissioner of Income Tax would have the authority to sit in judgment over the requisition made by a court of law requiring the production of record of assessment relating to an assessee in a case pending before the court. When a court of law, in any matter pending before it desires the production of record relating to any assessment after applying its judicial mind and hearing the parties and on being prima facie satisfied that the record required to be summoned is relevant for the decision of the controversy before it passes a judicial order summoning the production of that record from the party having possession of the record. The Commissioner of Income Tax cannot, therefore, refuse to send the record, as he certainly is not authorised to set at naught a judicial order of a court of law. He must obey the order of the court by sending the record to the court concerned. Indeed, it is open to the Commissioner of Income Tax to claim privilege, in respect of any document or record so summoned by a court of law, under Sections 123 and 124 of the Indian Evidence Act 1872 and even then it is for the court to decide whether or not to grant that privilege.**"**

Recently the Supreme Court in ***Girish Ramchandra Deshpande Vs. CIC (2013) 1 SCC 12*** in its Judgment dated ***3/10/2012*** rejected such disclosure to "any person" under Right to Information Act 2005 holding that

"The details disclosed by a person in his income tax returns are **"**personal information**"** which stand exempted from disclosure under Clause (j) of Section 8(1) of the RTI Act, unless it involves a larger public interest and the Central Public Information Officer or the State Public Information Officer or the Appellate Authority is satisfied that the larger public interest justifies the disclosure of such information, appropriate orders could be passed but

the petitioner cannot claim those details as a matter of right.**"**

However such restrictions would not prevent TPO to summon such information from any assessee under sec. 131 & sec. 133(6) of the Act which clothes the TPO with the powers of Civil Court. But such information collected has to be used very objectively & wisely to avoid loss of privacy & disclosure of information of competitors & leak it inadvertently into the public domain.

CONCLUSIONS

(i) The selection of secret comparables is permissible under TP provisions In Indian Tax Laws but their application to the case of tax payer has to be done subject to restriction in domestic law against disclosure of information not in public domain to the tax payer & after following procedure relating to giving of ***opportunity of hearing, cross examination*** of material & witnesses, adjustment for differentials of competitive entities & allowing standard deviation or ***permissible deviation of ALP of 5%*** of arithmetical mean of profit level of compared entities. In my submission the said deviation margin of 5% not attracting any income adjustment, deserves to be increased to atleast 10% because 5% margin is too narrow to jack up the declared ALP of international transactions of the tax payer. It will avoid time consuming & costly litigation & hair splitting exercise by tax administrations & tax payers**..** However, in India *this margin has been* ***further reduced to 3%*** by Parliament while extending the applicability of these provisions to Specific Domestic Transactions also in 2012 by amending sec. 92C proviso by Income Tax (Amendment) Act, 2011 w.e.f. 1st April 2013. This deserves to be reviewed & increased to 10% as suggested above.

(ii) While disclosing the data of secret comparables to the tax payer entity, the TPO should take an Undertaking from it that information with respect to third party will not be divulged by it to any other person nor the same will be used against the interest of such disclosed entity (competitors) otherwise it should be made punishable offense.

(iii) TPO should use data of comparables of contemporary period & the comparables should not be functionally different from the tax payer or else suitable adjustments should be made for such functional differences, if any.

APPENDIX - 1

OECD GUIDELINES

Chapter III

Comparability Analysis

A.4 Comparable uncontrolled transactions

A.4.1 In general

3.24 A comparable uncontrolled transaction is a transaction between two independent parties that is comparable to the controlled transaction under examination. It can be either a comparable transaction between one party to the controlled transaction and an independent party ***("internal comparable")*** or between two independent enterprises, neither of which is a party to the controlled transaction ***("external comparable").***

3.25 Comparisons of a tax payer's controlled transactions with other ***controlled transactions*** carried out by the same or another MNE group are irrelevant to the application of the arm's length principle and therefore should not be used by a tax administration as the basis for a transfer pricing adjustment or by a taxpayer to support its transfer pricing policy.

3.26 The presence of minority shareholders may be one factor leading to the outcomes of a taxpayer's controlled transactions being closer to arm's length, but it is not determinative in and of itself. The influence of minority shareholders depends on a number of factors, including whether the minority shareholder has a participation in the capital of the parent company or in the capital of a subsidiary, and whether it has and actually exercises some influence on the pricing of intra-group transactions.

A.4.2 Internal comparables

3.27 Step 4 of the typical process described at paragraph 3.4 is a review of existing internal comparables, if any. ***Internal comparables*** may have a more direct and closer relationship to the transaction under review than external comparables. The financial analysis ***may be easier and more***

reliable as it will presumably rely on identical accounting standards and practices for the internal comparable and for the controlled transaction. In addition, ***access to information*** on internal comparables may be both ***more complete and less costly***.

3.28 On the other hand, internal comparables are not always more reliable and it is not the case that any transaction between a taxpayer and an independent party can be regarded as a reliable comparable for controlled transactions carried on by the same taxpayer. Internal comparables where they exist must satisfy the ***five comparability factors*** in the same way as external comparables, see paragraphs 1.38-1.63. Guidance on comparability adjustments also applies to internal comparables, see paragraphs 3.47-3.54.Assume for instance that a taxpayer manufactures a particular product, sells a significant volume thereof to its foreign associated retailer and a marginal volume of the same product to an independent party. In such a case, the ***difference in volumes*** is likely to materially affect the comparability of the two transactions. If it is not possible to make a reasonably accurate adjustment to eliminate the effects of such difference, the transaction between the taxpayer and its independent customer is unlikely to be a reliable comparable.

A.4.3 External comparables and sources of information

3.29 There are various sources of information that can be used to identify potential external comparables. This sub-section discusses particular issues that arise with respect to ***commercial databases, foreign comparables*** and information undisclosed to taxpayers. Additionally, whenever reliable internal comparables exist, it may be unnecessary to search for external ones, see paragraphs 3.27-3.28.

A.4.3.1 Databases

3.30 A common source of information is commercial databases, which have been ***developed by editors who compile accounts*** filed by companies with the relevant administrative bodies and present them in an electronic format suitable for searches and statistical analysis. They can be a practical and sometimes cost-effective way of identifying external comparables and may provide the most reliable source of information, depending on the facts and circumstances of the case.

3.31 A number of ***limitations to commercial databases*** are frequently identified. Because these commercial databases rely on ***publicly available information, they are not available in all countries***, since not all countries have the same amount of publicly available information about their companies. Moreover, where they are available, they do not include the same type of information for all the companies operating in a given country because disclosure and filing requirements may differ depending on the legal form of the company and on whether or not it is listed. Care must be exercised with respect to whether and how these databases are used, given that they are compiled and presented for non-transfer pricing purposes. It is not always the case that commercial databases provide information that is detailed enough to support the chosen transfer pricing method. ***Not all databases include the same level of detail*** and can be used with similar assurance. Importantly, it is the experience in many countries that commercial databases are used to compare the results of companies rather than of transactions because ***third party transactional information is rarely available***. See paragraph 3.37 for a discussion of the use of non-transactional third party data.

3.32 It may be unnecessary to use a commercial database if reliable information is available from other sources, e.g. internal comparables. Where they are used, ***commercial databases should be used in an objective manner*** and genuine attempts should be made to use the databases to ***identify reliable comparable information***.

3.33 Use of commercial databases should not encourage quantity over quality. In practice, performing a comparability analysis using a commercial database alone may give rise to concerns about the reliability of the analysis, given the quality of the information relevant to assessing comparability that is typically obtainable from a database. To address these concerns, database searches may need to be refined with other publicly available information, depending on the facts and circumstances. Such a ***refinement of the database search with other sources of information is meant to promote quality over standardised approaches*** and is valid both for database searches made by taxpayers/practitioners and for those made by tax administrations. It should be understood in light of the discussion of

the costs and compliance burden created for the taxpayer at paragraphs 3.80-3.83.

3.34 There are also ***proprietary databases that are developed and maintained by some advisory firms***. In addition to the issues raised above for commercial databases that are more broadly commercialised, proprietary databases also raise a further concern with respect to their coverage of data if they are based on a more limited portion of the market than commercial databases. When a taxpayer has used a proprietary database to support its transfer prices, the tax administration may request access to the database to review the taxpayer's results, for obvious transparency reasons.

A.4.3.2 Foreign source or non-domestic comparables

3.35 Taxpayers do not always perform searches for comparables on a country-by-country basis, e.g. in cases where there are insufficient data available at the domestic level and/or in order to reduce compliance costs where ***several entities of an MNE group have comparable functional analyses. Non-domestic comparables should not be automatically rejected just because they are not domestic***. A determination of whether nondomestic comparables are reliable has to be made on a ***case-by-case*** basis and by reference to the extent to which they satisfy the ***five comparability factors***. Whether or not one regional search for comparables can be reliably used for several subsidiaries of an MNE group operating in a given region of the world depends on the particular circumstances in which each of those subsidiaries operates. See paragraphs 1.57-1.58 on market differences and multi-country analyses. Difficulties may also arise from ***differing accounting standards.***

A.4.3.3 Information undisclosed to taxpayers

3.36 Tax administrators may have information available to them from examinations of other taxpayers or from other sources of information that may not be disclosed to the taxpayer. However, ***it would be unfair to apply a transfer pricing method on the basis of such data unless the tax administration was able, within the limits of its domestic confidentiality requirements, to disclose such data to the taxpayer*** so that there would be an

adequate opportunity for the taxpayer to defend its own position and to safeguard effective judicial control by the courts.

A.4.4 Use of non-transactional third party data

3.37 The transactional focus of transfer pricing methods and the question of a possible aggregation of the taxpayer's controlled transactions are discussed at paragraphs 3.9-3.12. A different question is whether non transactional third party data can provide reliable comparables for a taxpayer's controlled transactions (or set of transactions aggregated consistently with the guidance at paragraphs 3.9-3.12). ***In practice, available third party data are often aggregated data,*** at a company-wide or segment level, depending on the applicable accounting standards. Whether such non transactional third party data can provide reliable comparables for the taxpayer's controlled transaction or set of transactions aggregated consistently with the guidance at paragraphs 3.9-3.12 depends in particular on whether the third party performs a range of materially different transactions. ***Where segmented data are available, they can provide better comparables than company-wide***, non-segmented data, because of a more transactional focus, although it is recognised that segmented data can raise issues in relation to the allocation of expenses to various segments. Similarly, company-wide third party data may provide better comparables than third party segmented data in certain circumstances, such as where the activities reflected in the comparables correspond to the set of controlled transactions of the taxpayer.

A.4.5 Limitations in available comparables

3.38 The identification of potential comparables has to be made with the objective of finding the most reliable data, recognising that they will not always be perfect. For instance, independent transactions may be scarce in certain markets and industries. A pragmatic solution may need to be found, on a case-by-case basis, such as ***broadening the search and using information on uncontrolled transactions*** taking place in the same industry and a ***comparable geographical market***, but performed by third parties that may have different business strategies, business models or other slightly different economic circumstances; information on uncontrolled transactions taking place in the same industry but in other geographical markets; or information on uncontrolled transactions taking place in the same geographical market but

in other industries. The choice among these various options will depend on the facts and circumstances of the case, and in particular on the significance of the expected effects of comparability defects on the reliability of the analysis.

3.39 A transactional profit split method might in appropriate circumstances be considered without comparable data, e.g. where the absence of comparable data is due to the presence of valuable, unique intangibles contributed by each party to the transaction (see paragraph 2.109). However, even in cases where comparable data are scarce and imperfect, ***the selection of the most appropriate transfer pricing method should be consistent with the functional analysis of the parties***, see paragraph 2.2.

APPENDIX - 2

United Nations Practical Manual on Transfer Pricing

Chapter 5

COMPARABILITY ANALYSIS

5.4.8. Use of Secret Comparables

5.4.8.1. Concern is often expressed by taxpayers, especially MNEs, over aspects of data collection by tax authorities and its confidentiality. Tax authorities have access to, as they need to, ***very sensitive and highly confidential information about taxpayers, such as data relating to margins, profitability and business contracts***. Confidence in the tax system means that this information needs to be treated carefully, especially as it may reveal sensitive business information about that taxpayer's profitability, business strategies and so forth.

5.4.8.2. A ***secret comparable generally refers to the use of information or data about a taxpayer by the tax authorities to form the basis of transfer pricing scrutiny of another taxpayer.*** The taxpayer under scrutiny is not given access to that information it may, for example, reveal confidential information about a competitor (i.e., the first taxpayer to which the data relates).

5.4.8.3. There is a ***need to exercise caution against the use of secret comparables unless the tax administration is able, within the limits of its domestic confidentiality requirements***, to disclose the data to the taxpayer whose transactions are being reviewed. This would enable an adequate opportunity for the taxpayer to defend its own position and to safeguard effective judicial control by the courts. Taxpayers contend that the use of such secret information is ***against the basic principles of equity***, as the taxpayer is required to benchmark its controlled transactions with comparables not available to it, ***without the opportunity to question comparability*** or argue that adjustments are needed. Taxpayers contend that it would be unfair if they face the consequences of adjustments made on this basis, such as additions to income, typically coupled with interest, penalties etc. Furthermore, ***double taxation may not be relieved if*** secret comparables cannot be disclosed to the competent authority of another country.

5.4.0. Overall Process Complexity

5.4.10.1. Comparability analysis looks simple in theory but in practice it can be a laborious, difficult, time-consuming and, more often than not, expensive exercise. Seeking information, analyzing all the data from various sources, documenting the analysis and substantiating adjustments are all steps that require time and money. It is therefore important to put the need for comparability analyses in perspective. Th e aim should be to ensure that the compliance burden and costs borne by a taxpayer to identify possible comparables and obtain detailed information thereon are reasonable and proportionate to the complexity of the transaction. It is recognised that the cost of obtaining information can be a real concern, especially for small to medium sized operations, but also for those MNEs that deal with a very large number of controlled transactions in many countries. However, it should be observed that the burden of cost cannot be a reason for the dilution of comparability standards.

5.4.10.2. These resource considerations apply at least as much to many developing countries, and efforts must be made to ensure that their position is not prejudiced by a lack of such resources in ensuring the arm’s length pricing of transactions in their jurisdictions.

5.4.10.3. When undertaking comparability analysis there is no requirement for an exhaustive search of all possible relevant sources of information. Taxpayers and tax administrations should exercise judgment to determine whether particular comparables are reliable.

5.5. Conclusion

5.5.1.1. Transfer pricing theory meets practice in comparability analysis — the translation of the arm's length principle into the selection of reliable comparables and of the appropriate transfer pricing method, eventually yielding the transfer price. This is all facilitated by comparability analysis.

5.5.1.2. ***A good comparability analysis is an essential step in any transfer pricing*** analysis in order to gain a correct understanding of the economically significant characteristics of the controlled transaction, and of the respective roles of the parties to the controlled transaction. This will assist in the selection of the most appropriate transfer pricing method in the circumstances of the case. This part of the process is fact-based and requires the taxpayer or tax administration to demonstrate an understanding of how business operates.

5.5.1.3. In most cases, the application of the selected transfer pricing method will then rely on the ***identification of uncontrolled comparable transactions***. This part of the process may be particularly complicated, especially in countries that have limited access to information on potential comparables. It is worth emphasizing that solutions exist to deal with this problem, including the collection of information on internal comparables (i.e. transactions between the taxpayer or its associated enterprise and a third party) where they exist; the collection of public information on third parties (e.g. competitors) that are likely to be involved in uncontrolled transactions comparable to the taxpayer's controlled transaction, or the possible use of databases from other countries.

5.5.1.4. It is clear that the ***comparability analysis should be as reliable*** as possible so as to arrive at the correct arm's length price or profit (or ***range of prices or profits***). In performing this comparability analysis, it may be necessary for the taxpayer or the tax authorities to undertake a

detailed functional analysis taking into consideration a wide variety of data sources, other factors and, if necessary, a series of comparability adjustments while arriving at a suitable set of benchmarks (or comparables). The choices made in the course of this analysis have to be substantiated and the overall process has to be thoroughly documented.

5.5.1.5. It is essential to put the need for comparability analyses into perspective given the extent of the compliance burden and costs that can arise to a taxpayer or tax administration in identifying possible comparables and obtaining detailed information. Taxpayers and tax administrations should exercise judgment to determine whether particular comparables are reliable.

5.5.1.6. Furthermore, as noted in the introduction, the lack of comparables for a given controlled transaction does not mean that it is or is not at arm's length or that the arm's length principle cannot be applied. This is especially important given the growing ***importance of integrated business models*** and of transactions involving unique intangibles for which comparables may not be available. The need for a reliable analysis must therefore be balanced with a pragmatic approach and one should not set unrealistic expectations for comparability analyses.

APPENDIX - 3

RELEVANT TP PROVISIONS

UNDER

INDIAN INCOME TAX ACT, 1961

&

INDIAN INCOME TAX RULES 1962

Section 92 - Computation of income from international transaction having regard to arm's length price

[(1) Any income arising from an international transaction shall be computed having regard to the arm's length price.

Explanation : For the removal of doubts, it is hereby clarified that the allowance for any expense or interest arising from an international transaction shall also be determined having regard to the arm's length price.

(2) Where in an [international transaction or specified domestic transaction], two or more associated enterprises enter into a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises, the cost or expense allocated or apportioned to, or, as the case may be, contributed by, any such enterprise shall be determined having regard to the arm's length price of such benefit, service or facility, as the case may be.

[(2A) Any allowance for an expenditure or interest or allocation of any cost or expense or any income in relation to the specified domestic transaction shall be computed having regard to the arm's length price.]

(3) The provisions of this section shall not apply in a case where the computation of income under [sub-section (1) or sub-section (2A)] or the determination of the allowance for any expense or interest under [sub-section (1) or sub-section (2A)], or the determination of any cost or expense allocated or apportioned, or, as the case may be, contributed under sub-section (2), [or sub-section (2A)] has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be, computed on the basis of entries made in the books of account in respect of the previous year in which the [international transaction or specified domestic transaction] was entered into.]

Section 92A - Meaning of associated enterprise

[(1) For the purposes of this section and sections 92, 92B, 92C, 92D, 92E and 92F, **"**associated enterprise**"**, in relation to another enterprise, means an enterprise –

(a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

(b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management control or capital of the other enterprise.

[(2) For the purposes of sub-section (1), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year,–]

(a) one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise; or

(b) any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises ; or

(c) a loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one per cent of the book value of the total assets of the other enterprise ; or

(d) one enterprise guarantees not less than ten per cent of the total borrowings of the other enterprise ; or

(e) more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise ; or

(f) more than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same

person or persons ; or

(g) the manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights ; or

(h) ninety per cent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise ; or

(i) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise ; or

(j) where one enterprise is controlled by an individual, the other enterprises also controlled by such individual or his relative or jointly by such individual and relative of such individual ; or

(k) where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family, or by a relative of a member of such Hindu undivided family, or jointly by such member and his relative ; or

(l) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than ten per cent interest in such firm, association of persons or body of individuals; or there exists between the two enterprises, any relationship of mutual interest, as may be prescribed.]

Meaning of international transaction.

92B. (1) For the purposes of this section and sections 92, 92C, 92D and 92E, "international transaction" means a transaction between two or more

associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

(2) A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be a transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise.

[*Explanation.*—For the removal of doubts, it is hereby clarified that

(*i*) the expression "international transaction" shall include—

(*a*) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;

(*b*) 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;

(c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising

during the course of business;

(*d*) provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;

(*e*) a transaction of business restructuring or reorganisation, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date;

(*ii*) the expression **"intangible property"** shall include—

(*a*) marketing related intangible assets, such as, trademarks, trade names, brand names, logos;

(*b*) technology related intangible assets, such as, process patents, patent applications, technical documentation such as laboratory notebooks, technical know-how;

(*c*) artistic related intangible assets, such as, literary works and copyrights, musical compositions, copyrights, maps, engravings;

(*d*) data processing related intangible assets, such as, proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters;

(*e*) engineering related intangible assets, such as, industrial design, product patents, trade secrets, engineering drawing and schema-tics, blueprints, proprietary documentation;

(f) customer related intangible assets, such as, customer lists, customer contracts, customer relationship, open purchase orders;

(g) contract related intangible assets, such as, favourable

supplier, contracts, licence agreements, franchise agreements, non-compete agreements;

(*h*) human capital related intangible assets, such as, trained and organised work force, employment agreements, union contracts;

(*i*) location related intangible assets, such as, leasehold interest, mineral exploitation rights, easements, air rights, water rights;

(*j*) goodwill related intangible assets, such as, institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value;

(*k*) methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data;

(*l*) any other similar item that derives its value from its intellectual content rather than its physical attributes.]

Meaning of specified domestic transaction.

92BA. For the purposes of this section and sections 92, 92C, 92D and 92E, **"**specified domestic transaction**"** in case of an assessee means any of the following transactions, not being an international transaction, namely:—

(i) any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;

(ii) any transaction referred to in section 80A;

(iii) any transfer of goods or services referred to in sub-section (8) of section 80- IA;

(iv) any business transacted between the assessee and other person as referred to in sub-section (10) of Section 80-IA;

(v) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or

(vi) any other transaction as may be prescribed,

and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of five crore rupees.]

Computation of arm's length price.

92C. (1) The arm's length price in relation to an international transaction [*or specified domestic transaction*] shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely :—

(*a*) comparable uncontrolled price method;

(*b*) resale price method;

(*c*) cost plus method;

(*d*) profit split method;

(*e*) transactional net margin method;

(*f*) such other method as may be prescribed by the Board.

(2) The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed :

[**Provided** that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices:

Provided further that if the variation between the arm's length price so determined and price at which the international transaction [*or specified domestic transaction*] has actually been undertaken does not exceed [such percentage [*not exceeding three per cent*] of the latter, as may be notified

by the Central Government in the Official Gazette in this behalf], the price at which the international transaction [*or specified domestic transaction*] has actually been undertaken shall be deemed to be the arm's length price.] **[See Notification No. SO 1871(E) dt. 17.8.2012 at the end of the Appendix No.3]**

[*Explanation.*—For the removal of doubts, it is hereby clarified that the provisions of the second proviso shall also be applicable to all assessment or reassessment proceedings pending before an Assessing Officer as on the 1st day of October, 2009.]

[(2A) Where the first proviso to sub-section (2) as it stood before its amendment by the Finance (No. 2) Act, 2009 (33 of 2009), is applicable in respect of an international transaction for an assessment year and the variation between the arithmetical mean referred to in the said proviso and the price at which such transaction has actually been undertaken exceeds five per cent of the arithmetical mean, then, the assessee shall not be entitled to exercise the option as referred to in the said proviso.]

[(2B) Nothing contained in sub-section (2A) shall empower the Assessing Officer either to assess or reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or

otherwise increasing the liability of the assessee under section 154 for any assessment year the proceedings of which have been completed before the 1st day of October, 2009.]

(3) Where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that—

(*a*) the price charged or paid in an international transaction [*or specified domestic transaction*] has not been determined in accordance with sub-sections (1) and (2); or

(*b*) any information and document relating to an international transaction [*or specified domestic transaction*] have not been kept and maintained by the assessee in accordance with the provisions contained in sub-section (1) of section 92D and the rules made in this behalf; or

(*c*) the information or data used in computation of the arm's length

price is not reliable or correct; or

(*d*) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of section 92D,

the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction [*or specified domestic transaction*] in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him:

Provided that an opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer.

(4) Where an arm's length price is determined by the Assessing Officer under sub-section (3), the Assessing Officer may compute the total income of the assessee having regard to the arm's length price so determined :

Provided that no deduction under section 10A [or section 10AA] or section 10B or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this sub-section :

Provided further that where the total income of an associated enterprise is computed under this sub-section on determination of the arm's length price paid to another associated enterprise from which tax has been deducted [or was deductible] under the provisions of Chapter XVIIB, the income of the other associated enterprise shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise

Reference to Transfer Pricing Officer.

92CA. (1) Where any person, being the assessee, has entered into an international transaction [*or specified domestic transaction*] in any previous year, and the Assessing Officer considers it necessary or expedient so to do,

he may, with the previous approval of the Commissioner, refer the computation of the arm's length price in relation to the said international transaction [*or specified domestic transaction*] under section 92C to the Transfer Pricing Officer.

(2) Where a reference is made under sub-section (1), the Transfer Pricing Officer shall serve a notice on the assessee requiring him to produce or cause to be produced on a date to be specified therein, any evidence on which the assessee may rely in support of the computation made by him of the arm's length price in relation to the international transaction [*or specified domestic transaction*] referred to in sub-section (1).

[(2A) Where any other international transaction [other than an international transaction referred under sub-section (1)], comes to the notice of the Transfer Pricing Officer during the course of the proceedings before him, the provisions of this Chapter shall apply as if such other international transaction is an international transaction referred to him under sub-section (1).]

[(2B) Where in respect of an international transaction, the assessee has not furnished the report under section 92E and such transaction comes to the notice of the Transfer Pricing Officer during the course of the proceeding before him, the provisions of this Chapter shall apply as if such transaction is an international transaction referred to him under sub-section (1).]

[(2C) Nothing contained in sub-section (2B) shall empower the Assessing Officer either to assess or reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year, proceedings for which have been completed before the 1st day of July, 2012.]

(3) On the date specified in the notice under sub-section (2), or as soon thereafter as may be, after hearing such evidence as the assessee may produce, including any information or documents referred to in sub-section (3) of section 92D and after considering such evidence as the Transfer

Pricing Officer may require on any specified points and after taking into account all relevant materials which he has gathered, the Transfer Pricing Officer shall, by order in writing, determine the arm's length price in relation to the international transaction [*or specified domestic transaction*] in accordance with sub-section (3) of section 92C and send a copy of his order to the Assessing Officer and to the assessee.

[(3A) Where a reference was made under sub-section (1) before the 1st day of June, 2007 but the order under sub-section (3) has not been made by the Transfer Pricing Officer before the said date, or a reference under sub-section (1) is made on or after the 1st day of June, 2007, an order under sub-section (3) may be made at any time before sixty days prior to the date on which the period of limitation referred to in section 153, or as the case may be, in section 153B for making the order of assessment or reassessment or recomputation or fresh assessment, as the case may be, expires.]

[(4) On receipt of the order under sub-section (3), the Assessing Officer shall proceed to compute the total income of the assessee under sub-section (4) of section 92C in conformity with the arm's length price as so determined by the Transfer Pricing Officer.]

(5) With a view to rectifying any mistake apparent from the record, the Transfer Pricing Officer may amend any order passed by him under sub-section (3), and the provisions of section 154 shall, so far as may be, apply accordingly.

(6) Where any amendment is made by the Transfer Pricing Officer under sub-section (5), he shall send a copy of his order to the Assessing Officer who shall thereafter proceed to amend the order of assessment in conformity with such order of the Transfer Pricing Officer.

(7) The Transfer Pricing Officer may, for the purposes of determining the arm's length price under this section, exercise all or any of the powers specified in clauses (*a*) to (*d*) of sub-section (1) of section 131 or sub-section (6) of section 133 [or section 133A].

Explanation.—For the purposes of this section, "Transfer Pricing Officer" means a Joint Commissioner or Deputy Commissioner or

Assistant Commissioner authorised by the Board to perform all or any of the functions of an Assessing Officer specified in sections 92C and 92D in respect of any person or class of persons.]

Power of Board to make safe harbour rules.

92CB. (1) The determination of arm's length price under section 92C or section 92CA shall be subject to safe harbour rules.

(2) The Board may, for the purposes of sub-section (1), make rules for safe harbour.

***Explanation.*—**For the purposes of this section, "safe harbour" means circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee**.**

Advance pricing agreement.

92CC. (1) The Board, with the approval of the Central Government, may enter into an advance pricing agreement with any person, determining the arm's length price or specifying the manner in which arm's length price is to be determined, in relation to an international transaction to be entered into by that person.

(2) The manner of determination of arm's length price referred to in sub-section (1), may include the methods referred to in sub-section (1) of section 92C or any other method, with such adjustments or variations, as may be necessary or expedient so to do.

(3) Notwithstanding anything contained in section 92C or section 92CA, the arm's length price of any international transaction, in respect of which the advance pricing agreement has been entered into, shall be determined in accordance with the advance pricing agreement so entered.

(4) The agreement referred to in sub-section (1) shall be valid for such period not exceeding five consecutive previous years as may be specified in the agreement.

(5) The advance pricing agreement entered into shall be binding—

(*a*) on the person in whose case, and in respect of the transaction in relation to which, the agreement has been entered into; and

(*b*) on the Commissioner, and the income-tax authorities subordinate to him, in respect of the said person and the said transaction.

(6) The agreement referred to in sub-section (1) shall not be binding if there is a change in law or facts having bearing on the agreement so entered.

(7) The Board may, with the approval of the Central Government, by an order, declare an agreement to be *void ab initio*, if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts.

(8) Upon declaring the agreement *void ab initio*,—

(*a*) all the provisions of the Act shall apply to the person as if such agreement had never been entered into; and

(*b*) notwithstanding anything contained in the Act, for the purpose of computing any period of limitation under this Act, the period beginning with the date of such agreement and ending on the date of order under sub-section (7) shall be excluded:

Provided that where immediately after the exclusion of the aforesaid period, the period of limitation, referred to in any provision of this Act, is less than sixty days, such remaining period shall be extended to sixty days and the aforesaid period of limitation shall be deemed to be extended accordingly.

(9) The Board may, for the purposes of this section, prescribe a scheme specifying therein the manner, form, procedure and any other matter generally in respect of the advance pricing agreement.

(10) Where an application is made by a person for entering into an agreement referred to in sub-section (1), the proceeding shall be deemed to be pending in the case of the person for the purposes of the Act.

Effect to advance pricing agreement.

92CD. (1) Notwithstanding anything to the contrary contained in section 139, where any person has entered into an agreement and prior to the date of entering into the agreement, any return of income has been furnished under the provisions of section 139 for any assessment year relevant to a previous year to which such agreement applies, such person shall furnish,

within a period of three months from the end of the month in which the said agreement was entered into, a modified return in accordance with and limited to the agreement.

(2) Save as otherwise provided in this section, all other provisions of this Act shall apply accordingly as if the modified return is a return furnished under section 139.

(3) If the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the agreement applies have been completed before the expiry of period allowed for furnishing of modified return under sub-section (1), the Assessing Officer shall, in a case where modified return is filed in accordance with the provisions of sub-section (1), proceed to assess or reassess or recompute the total income of the relevant assessment year having regard to and in accordance with the agreement.

(4) Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the agreement applies are pending on the date of filing of modified return in accordance with the provisions of sub-section (1), the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the agreement taking into consideration the modified return so furnished.

(5) Notwithstanding anything contained in section 153 or section 153B or section 144C,—

(*a*) the order of assessment, reassessment or recomputation of total income under sub-section (3) shall be passed within a period of one year from the end of the financial year in which the modified return under sub-section (1) is furnished;

(*b*) the period of limitation as provided in section 153 or section 153B or section 144C for completion of pending assessment or reassessment proceedings referred to in sub-section (4) shall be extended by a period of twelve months.

(6) For the purposes of this section,—

(*i*) "agreement" means an agreement referred to in sub-section (1)

of section 92CC;

(*ii*) the assessment or reassessment proceedings for an assessment year shall be deemed to have been completed where—

(*a*) an assessment or reassessment order has been passed; or

(*b*) no notice has been issued under sub-section (2) of section 143 till the expiry of the limitation period provided under the said section.

Maintenance and keeping of information and document by persons entering into an international transaction [or specified domestic transaction].

92D. (1) Every person who has entered into an international transaction [*or specified domestic transaction*] shall keep and maintain such information and document in respect thereof, as may be prescribed.

(2) Without prejudice to the provisions contained in sub-section (1), the Board may prescribe the period for which the information and document shall be kept and maintained under that sub-section.

(3) The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceeding under this Act, require any person who has entered into an international transaction [*or specified domestic transaction*] to furnish any information or document in respect thereof, as may be prescribed under sub-section (1), within a period of thirty days from the date of receipt of a notice issued in this regard :

Provided that the Assessing Officer or the Commissioner (Appeals) may, on an application made by such person, extend the period of thirty days by a further period not exceeding thirty days.

Report from an accountant to be furnished by persons entering into international transaction [or specified domestic transaction].

92E. Every person who has entered into an international transaction [*or specified domestic transaction*] during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date in the prescribed form duly signed and verified in the prescribed manner by such accountant and setting forth such particulars as may be prescribed.

Definitions of certain terms relevant to computation of arm's length price, etc.

92F. In sections 92, 92A, 92B, 92C, 92D and 92E, unless the context otherwise requires,—

(*i*) **"**accountant**"** shall have the same meaning as in the *Explanation* below sub-section (2) of section 288;

(*ii*) **"**arm's length price**"** means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions;

(*iii*) **"**enterprise**"** means a person (including a permanent establishment of such person) who is, or has been, or is proposed to be, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights, or the provision of services of any kind, [or in carrying out any work in pursuance of a contract,] or in investment, or providing loan or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, whether such activity or business is carried on, directly or through one or more of its units or divisions or subsidiaries, or whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or places;

[(*iiia*) "permanent establishment", referred to in clause (*iii*), includes a fixed place of business through which the business of the enterprise is wholly or partly carried on;]

[(*iv*) "specified date" shall have the same meaning as assigned to "due date" in *Explanation 2* below sub-section (1) of section 139;]

(*v*) "transaction" includes an arrangement, understanding or action in concert,—

(*A*) whether or not such arrangement, understanding or action is formal or in writing; or

(*B*) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceeding.]

Avoidance of income-tax by transactions resulting in transfer of income to non-residents.

93. (1) Where there is a transfer of assets by virtue or in consequence whereof, either alone or in conjunction with associated operations, any income becomes payable to a non-resident, the following provisions shall apply—

(*a*) where any person has, by means of any such transfer, either alone or in conjunction with associated operations, acquired any rights by virtue of which he has, within the meaning of this section, power to enjoy, whether forthwith or in the future, any income of a non-resident person which, if it were income of the first-mentioned person, would be chargeable to income-tax, that income shall, whether it would or would not have been chargeable to income-tax apart from the provisions of this section, be deemed to be income of the first-mentioned person for all the purposes of this Act;

(*b*) where, whether before or after any such transfer, any such first- mentioned person receives or is entitled to receive any capital sum the payment whereof is in any way connected with the transfer or any associated operations, then any income which, by virtue or in consequence of the transfer, either alone or in conjunction with associated operations, has become the income of a non-resident shall, whether it would or would

not have been chargeable to income-tax apart from the provisions of this section, be deemed to be the income of the first-mentioned person for all the purposes of this Act.

Explanation.—The provisions of this sub-section shall apply also in relation to transfers of assets and associated operations carried out before the commencement of this Act.

(2) Where any person has been charged to income-tax on any income deemed to be his under the provisions of this section and that income is subsequently received by him, whether as income or in any other form, it shall not again be deemed to form part of his income for the purposes of this Act.

(3) The provisions of this section shall not apply if the first-mentioned person in sub-section (1) shows to the satisfaction of the [Assessing] Officer that—

(*a*) neither the transfer nor any associated operation had for its purpose or for one of its purposes the avoidance of liability to taxation; or

(*b*) the transfer and all associated operations were *bona fide* commercial transactions and were not designed for the purpose of avoiding liability to taxation.

Explanation.—For the purposes of this section,—

(*a*) references to assets representing any assets, income or accumulations of income include references to shares in or obligation of any company to which, or obligation of any other person to whom, those assets, that income or those accumulations are or have been transferred;

(*b*) any body corporate incorporated outside India shall be treated as if it were a non-resident;

(*c*) a person shall be deemed to have power to enjoy the income of a non-resident if—

(*i*) the income is in fact so dealt with by any person as to be calculated at some point of time and, whether in the form of income or not,

to enure for the benefit of the first-mentioned person in sub-section (1), or

(*ii*) the receipt or accrual of the income operates to increase the value to such first-mentioned person of any assets held by him or for his benefit, or,

(*iii*) such first-mentioned person receives or is entitled to receive at any time any benefit provided or to be provided out of that income or out of moneys which are or will be available for the purpose by reason of the effect or successive effects of the associated operations on that income and assets which represent that income, or

(*iv*) such first-mentioned person has power by means of the exercise of any power of appointment or power of revocation or otherwise to obtain for himself, whether with or without the consent of any other person, the beneficial enjoyment of the income, or

(*v*) such first-mentioned person is able, in any manner whatsoever and whether directly or indirectly, to control the application of the income;

(*d*) in determining whether a person has power to enjoy income, regard shall be had to the substantial result and effect of the transfer and any associated operations, and all benefits which may at any time accrue to such person as a result of the transfer and any associated operations shall be taken into account irrespective of the nature or form of the benefits.

(4) (*a*) "Assets" includes property or rights of any kind and "transfer" in relation to rights includes the creation of those rights ;

(*b*) "associated operation", in relation to any transfer, means an operation of any kind effected by any person in relation to—

(*i*) any of the assets transferred, or

(*ii*) any assets representing, whether directly or indirectly, any of the assets transferred, or

(*iii*) the income arising from any such assets, or

(*iv*) any assets representing, whether directly or indirectly, the

accumulations of income arising from any such assets ;

(*c*) "benefit" includes a payment of any kind ;

(*d*) "capital sum" means—

(*i*) any sum paid or payable by way of a loan or repayment of a loan ; and

(*ii*) any other sum paid or payable otherwise than as income, being a sum which is not paid or payable for full consideration in money or money's worth.

Avoidance of tax by certain transactions in securities.

94. (1) Where the owner of any securities (in this sub-section and in sub-section (2) referred to as "the owner") sells or transfers those securities, and buys back or reacquires the securities, then, if the result of the transaction is that any interest becoming payable in respect of the securities is receivable otherwise than by the owner, the interest payable as aforesaid shall, whether it would or would not have been chargeable to income-tax apart from the provisions of this sub-section, be deemed, for all the purposes of this Act, to be the income of the owner and not to be the income of any other person.

Explanation.—The references in this sub-section to buying back or reacquiring the securities shall be deemed to include references to buying or acquiring similar securities, so, however, that where similar securities are bought or acquired, the owner shall be under no greater liability to income-tax than he would have been under if the original securities had been bought back or reacquired.

(2) Where any person has had at any time during any previous year any beneficial interest in any securities, and the result of any transaction relating to such securities or the income thereof is that, in respect of such securities within such year, either no income is received by him or the income received by him is less than the sum to which the income would have amounted if the income from such securities had accrued from day to day and been apportioned accordingly, then the income from such securities for such year shall be deemed to be the income of such person.

(3) The provisions of sub-section (1) or sub-section (2) shall not apply if the owner, or the person who has had a beneficial interest in the securities, as the case may be, proves to the satisfaction of the [Assessing] Officer—

(*a*) that there has been no avoidance of income-tax, or

(*b*) that the avoidance of income-tax was exceptional and not systematic and that there was not in his case in any of the three preceding years any avoidance of income-tax by a transaction of the nature referred to in sub- section (1) or sub-section (2).

(4) Where any person carrying on a business which consists wholly or partly in dealing in securities, buys or acquires any securities and sells back or retransfers the securities, then, if the result of the transaction is that interest becoming payable in respect of the securities is receivable by him but is not deemed to be his income by reason of the provisions contained in sub-section (1), no account shall be taken of the transaction in computing for any of the purposes of this Act the profits arising from or loss sustained in the business.

(5) Sub-section (4) shall have effect, subject to any necessary modifications, as if references to selling back or retransferring the securities included references to selling or transferring similar securities.

(6) The [Assessing] Officer may, by notice in writing, require any person to furnish him within such time as he may direct (not being less than twenty-eight days), in respect of all securities of which such person was the owner or in which he had a beneficial interest at any time during the period specified in the notice, such particulars as he considers necessary for the purposes of this section and for the purpose of discovering whether income-tax has been borne in respect of the interest on all those securities.

[(7) Where—

(*a*) any person buys or acquires any securities or unit within a period of three months prior to the record date;

[(*b*) such person sells or transfers—

(*i*) such securities within a period of three months after such date; or

(*ii*) such unit within a period of nine months after such date;]

(*c*) the dividend or income on such securities or unit received or receivable by such person is exempt,

then, the loss, if any, arising to him on account of such purchase and sale of securities or unit, to the extent such loss does not exceed the amount of dividend or income received or receivable on such securities or unit, shall be ignored for the purposes of computing his income chargeable to tax.]

[(8) Where—

(*a*) any person buys or acquires any units within a period of three months prior to the record date;

(*b*) such person is allotted additional units without any payment on the basis of holding of such units on such date;

(*c*) such person sells or transfers all or any of the units referred to in clause (*a*) within a period of nine months after such date, while continuing to hold all or any of the additional units referred to in clause (*b*),

then, the loss, if any, arising to him on account of such purchase and sale of all or any of such units shall be ignored for the purposes of computing his income chargeable to tax and notwithstanding anything contained in any other provision of this Act, the amount of loss so ignored shall be deemed to be the cost of purchase or acquisition of such additional units referred to in clause (*b*) as are held by him on the date of such sale or transfer.]

Explanation.—For the purposes of this section,—

(*a*) "interest" includes a dividend ;

[(*aa*) "record date" means such date as may be fixed by—

(*i*) a company for the purposes of entitlement of the holder of the securities to receive dividend; or

(*ii*) a Mutual Fund or the Administrator of the specified undertaking or the specified company as referred to in the *Explanation* to clause (*35*) of section 10, for the purposes of entitlement of the holder of the units to

receive income, or additional unit without any consideration, as the case may be;]

(*b*) "securities" includes stocks and shares ;

(*c*) securities shall be deemed to be similar if they entitle their holders to the same rights against the same persons as to capital and interest and the same remedies for the enforcement of those rights, notwithstanding any difference in the total nominal amounts of the respective securities or in the form in which they are held or in the manner in which they can be transferred;

[(*d*) "unit" shall have the meaning assigned to it in clause (*b*) of the *Explanation* to section 115AB.]

[**Special measures in respect of transactions with persons located in notified jurisdictional area.**

94A. (1) The Central Government may, having regard to the lack of effective exchange of information with any country or territory outside India, specify by notification in the Official Gazette such country or territory as a notified jurisdictional area in relation to transactions entered into by any assessee.

(2) Notwithstanding anything to the contrary contained in this Act, if an assessee enters into a transaction where one of the parties to the transaction is a person located in a notified jurisdictional area, then—

(*i*) all the parties to the transaction shall be deemed to be associated enterprises within the meaning of section 92A;

(*ii*) any transaction in the nature of purchase, sale or lease of tangible or intangible property or provision of service or lending or borrowing money or any other transaction having a bearing on the profits, income, losses or assets of the assessee including a mutual agreement or arrangement for allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided by or to the assessee shall be deemed to be an international transaction within the meaning of section 92B, and the provisions of sections 92, 92A, 92B, 92C [except the second

proviso to sub-section (2)], 92CA, 92CB, 92D, 92E and 92F shall apply accordingly.

(3) Notwithstanding anything to the contrary contained in this Act, no deduction,—

(*a*) in respect of any payment made to any financial institution located in a notified jurisdictional area shall be allowed under this Act, unless the assessee furnishes an authorisation in the prescribed form authorising the Board or any other income-tax authority acting on its behalf to seek relevant information from the said financial institution on behalf of such assessee; and

(*b*) in respect of any other expenditure or allowance (including depreciation) arising from the transaction with a person located in a notified jurisdictional area shall be allowed under any other provision of this Act, unless the assessee maintains such other documents and furnishes such information as may be prescribed, in this behalf.

(4) Notwithstanding anything to the contrary contained in this Act, where, in any previous year, the assessee has received or credited any sum from any person located in a notified jurisdictional area and the assessee does not offer any explanation about the source of the said sum in the hands of such person or in the hands of the beneficial owner (if such person is not the beneficial owner of the said sum) or the explanation offered by the assessee, in the opinion of the Assessing Officer, is not satisfactory, then, such sum shall be deemed to be the income of the assessee for that previous year.

(5) Notwithstanding anything contained in any other provisions of this Act, where any person located in a notified jurisdictional area is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVII-B, the tax shall be deducted at the highest of the following rates, namely:—

(*a*) at the rate or rates in force;

(*b*) at the rate specified in the relevant provisions of this Act;

(*c*) at the rate of thirty per cent.

(6) In this section,—

(*i*) "person located in a notified jurisdictional area" shall include,—

(*a*) a person who is resident of the notified jurisdictional area;

(*b*) a person, not being an individual, which is established in the notified jurisdictional area; or

(*c*) a permanent establishment of a person not falling in sub-clause (*a*) or sub-clause (*b*), in the notified jurisdictional area;

(*ii*) "permanent establishment" shall have the same meaning as defined in clause (*iiia*) of section 92F;

(*iii*) "transaction" shall have the same meaning as defined in clause (*v*) of section 92F.]

Power regarding discovery, production of evidence, etc.

131. (1) The [Assessing] Officer, [Deputy Commissioner (Appeals)], [Joint Commissioner] [Commissioner (Appeals)] [Chief Commissioner or Commissioner and the Dispute Resolution Panel referred to in clause (*a*) of sub-section (15) of section 144C] shall, for the purposes of this Act, have the same powers as are vested in a court under the Code of Civil Procedure, 1908 (5 of 1908), when trying a suit in respect of the following matters, namely :—

(*a*) discovery and inspection;

(*b*) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;

(*c*) compelling the production of books of account and other documents; and

(*d*) issuing commissions.

[(1A) [If the Director General or Director or [Joint] Director or Assistant Director [or Deputy Director], or the authorised officer referred to in sub-section (1) of section 132 before he takes action under clauses (*i*) to (*v*) of that sub-section,] has reason to suspect that any income has been concealed,

or is likely to be concealed, by any person or class of persons, within his jurisdiction, then, for the purposes of making any enquiry or investigation relating thereto, it shall be competent for him to exercise the powers conferred under sub-section (1) on the income-tax authorities referred to in that sub-section, notwithstanding that no proceedings with respect to such person or class of persons are pending before him or any other income-tax authority.]

[(2) For the purpose of making an inquiry or investigation in respect of any person or class of persons in relation to an agreement referred to in section 90 or section 90A, it shall be competent for any income-tax authority not below the rank of Assistant Commissioner of Income-tax, as may be notified by the Board in this behalf, to exercise the powers conferred under sub-section (1) on the income-tax authorities referred to in that sub-section, notwithstanding that no proceedings with respect to such person or class of persons are pending before it or any other income-tax authority.]

(3) Subject to any rules made in this behalf, any authority referred to in sub-section (1) [or sub-section (1A)] [or sub-section (2)] may impound and retain in its custody for such period as it thinks fit any books of account or other documents produced before it in any proceeding under this Act :

Provided that an [Assessing] Officer [or an [Assistant Director [or Deputy Director]]] shall not—

(*a*) impound any books of account or other documents without recording his reasons for so doing, or

(*b*) retain in his custody any such books or documents for a period exceeding fifteen days (exclusive of holidays) without obtaining the approval of the [Chief Commissioner or Director General or Commissioner or Director therefor, as the case may be.]]

SECTION 133

Section 133 - Power to call for information

The Assessing Officer, the Deputy Commissioner (Appeals), the [1][Joint Commissioner] or the Commissioner (Appeals) may, for the purposes of this Act,

(1) ----

(2) ----

(3) ----

(4) ----

(5) ----

(6) ***require any person***, including a banking company or any officer thereof, ***to furnish information in relation to such points or matters, or to furnish statements of accounts and affairs verified in the manner specified*** by the Assessing Officer, the Deputy Commissioner (Appeals), the [Joint Commissioner] or the Commissioner (Appeals), giving information in relation to such points or matters as, in the opinion of the Assessing Officer, the Deputy Commissioner (Appeals), the [Joint Commissioner] or the Commissioner (Appeals), ***will be useful for, or relevant to, any inquiry or proceeding under this Act:***

(7)Provided that the powers referred to in clause (6), may also be exercised by the Director General, the Chief Commissioner, the Director and the Commissioner.

(8)Provided further that the power in respect of an inquiry, in a case where no proceeding is pending, shall not be exercised by any income-tax authority below the rank of Director or Commissioner without the prior approval of the Director or, as the case may be, the Commissioner.

(9)[Provided also that for the purposes of an agreement referred to in section 90 or section 90A, an income-tax authority notified under sub-section (2) of section 131 may exercise all the powers conferred under this section, notwithstanding that no proceedings are pending before it or any other income-tax authority.]

Section 137. Omitted by the Finance Act, 1964.

Prior to its deletion, the sec. 137 read as under **: -**

Section 137. ***Disclosure of information prohibited****.—*

(1) All particulars contained in any statement made, return furnished or accounts or documents' produced under the provisions of this Act, or in any evidence given, or affidavit or deposition made in the course of any proceedings under this Act, other than proceedings under Chapter XXII, or in any record of any assessment proceeding, or any proceeding relating to recovery of a demand, prepared for the purposes of this Act, shall be treated as confidential, and notwithstanding anything contained in the Indian Evidence Act, 1872 (1 of 1872), no court shall, save as provided in this Act, be entitled to require any public servant to produce before it any such return, accounts, documents or record or any part of any such record, or to give evidence before it in respect thereof.

(2) No public servant shall disclose any particulars contained in any such statement, return, accounts, documents, evidence, affidavit, deposition or record.

(3) Nothing in this section shall apply to the disclosure –

(i) to (xxi) provide exceptions to this section.

(4) Nothing in this section shall apply to the production by a public servant before a court of any document, declaration or affidavit filed, or the record of any statement or deposition made in a proceeding under section 171 or sections 184 to 186 or to the giving of evidence by a public servant in respect thereof.

(5) Nothing in this section shall be construed as prohibiting the voluntary disclosure of any particulars referred to in sub-section (1) by the person by whom the statement was made, the return finished, the accounts or documents produced, the evidence given or the affidavit or deposition made, as the case may be.

Explanation – in sub-section (1),(2) and (4), 'public servant' means any public servant employed in the execution of this Act."

Section 138

Section 138 - Disclosure of information respecting assessees (1)(a) The Board or any other income-tax authority specified by it by a general or special order in this behalf may furnish or cause to be furnished to –

(i) any officer, authority or body performing any functions under any law relating to the imposition of any tax, duty or cess, or to dealings in foreign exchange as defined in [clause (n) of section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999)] ; or

(ii) such officer, authority or body performing functions under any other law as the Central Government may, if in its opinion it is necessary so to do in the public interest, specify by notification in the Official Gazette in this behalf, any such information received or obtained by any income-tax authority in the performance of his functions under this Act, as may, in the opinion of the Board or other income-tax authority, be necessary for the purpose of enabling the officer, authority or body to perform his or its functions under that law.

(b) Where a person makes an application to the Chief Commissioner or Commissioner in the prescribed form for any information relating to any assessee received or obtained by any income-tax authority in the performance of his functions under this Act, the Chief Commissioner or Commissioner may, if he is satisfied that it is in the public interest so to do, furnish or cause to be furnished the information asked for and his decision in this behalf shall be final and shall not be called in question in any court of law.

(2) Notwithstanding anything contained in sub-section (1) or any other law for the time being in force, the Central Government may, having regard to the practices and usages customary or any other relevant factors, by order notified in the Official Gazette, direct that no information or document shall be furnished or produced by a public servant in respect of such matters relating to such class of assessees or except to such authorities as may be specified in the order.

Disclosure of particulars by public servants.

280. (1) If a public servant [furnishes any information or produces any document in contravention of the provisions of sub-section (2) of section 138], he shall be punishable with imprisonment which may extend to six months, and shall also be liable to fine.

(2) No prosecution shall be instituted under this section except

with the sanction of the Central Government.

INDIAN INCOME TAX RULES, 1962

[**Meaning of expressions used in computation of arm's length price.**

10A. For the purposes of this rule and rules 10B to 10E,—

(*a*) "uncontrolled transaction" means a transaction between enterprises other than associated enterprises, whether resident or non-resident;

(*b*) "property" includes goods, articles or things, and intangible property;

(*c*) "services" include financial services;

(*d*) "transaction" includes a number of closely linked transactions.

[Other method of determination of arm's length price.

10AB. For the purposes of clause (f) of sub-section (1) of section 92C, the other method for determination of the arms' length price in relation to an international transaction shall be any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.**]**

Determination of arm's length price under section 92C.

10B. (1) For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely :—

(*a*) ***Comparable uncontrolled price method,*** by which

(*i*) the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;

(*ii*) such price is adjusted to account for differences, if any, between the

international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the price in the open market;

(*iii*) the adjusted price arrived at under sub-clause (*ii*) is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction;

(*b*) ***resale price method,*** by which,—

(*i*) the price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise, is identified;

(*ii*) such resale priceis reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;

(*iii*) the price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;

(*iv*) the price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;

(*v*) the adjusted price arrived at under sub-clause (*iv*) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise;

(*c*) ***cost plus method,*** by which,—

(*i*) the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;

(*ii*) the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;

(*iii*) the normal gross profit mark-up referred to in sub-clause (*ii*) is adjusted to take into account the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;

(*iv*) the costs referred to in sub-clause (*i*) are increased by the adjusted profit mark-up arrived at under sub-clause (*iii*);

(*v*) the sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise;

(*d*) ***profit split method***, which may be applicable mainly 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, by which—

(*i*) the combined net profit of the associated enterprises arising from the international transaction in which they are engaged, is determined;

(*ii*) the relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;

(*iii*) the combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under sub-clause (*ii*);

(*iv*) the profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction :

Provided that the combined net profit referred to in sub-clause (*i*) may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution in the manner specified under sub-clauses (*ii*) and (*iii*), and in such a case the aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction;

(*e*) ***transactional net margin method***, by which,—

(*i*) the net profit margin realised by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;

(*ii*) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

(*iii*) the net profit margin referred to in sub-clause (*ii*) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;

(*iv*) the net profit margin realised by the enterprise and referred to in sub- clause (*i*) is established to be the same as the net profit margin referred to in sub-clause (*iii*);

(*v*) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction.

[*(f)Any other method as provided in rule 10AB.***]**

(2) For the purposes of sub-rule (1), the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the following, namely:—

(*a*) the specific characteristics of the property transferred or services provided in either transaction;

(*b*) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;

(*c*) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

(*d*) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

(3) An uncontrolled transaction shall be comparable to an international transaction if—

(*i*) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or

(*ii*) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

(4) The data to be used in analysing the comparability of an uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into :

Provided that data relating to a period not being more than two years prior

to such financial year may also be considered if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared.

Most appropriate method.

10C. (1) For the purposes of sub-section (1) of section 92C, the most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction, and which provides the most reliable measure of an arm's length price in relation to the international transaction.

(2) In selecting the most appropriate method as specified in sub-rule (1), the following factors shall be taken into account, namely:—

(*a*) the nature and class of the international transaction;

(*b*) the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;

(*c*) the availability, coverage and reliability of data necessary for application of the method;

(*d*) the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;

(*e*) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;

(*f*) the nature, extent and reliability of assumptions required to be made in application of a method.

Information and documents to be kept and maintained under section 92D.

10D. (1) Every person who has entered into an international

transaction shall keep and maintain the following information and documents, namely:—

(*a*) a description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises;

(*b*) a profile of the multinational group of which the assessee enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions have been entered into by the assessee, and ownership linkages among them;

(*c*) a broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the associated enterprises with whom the assessee has transacted;

(*d*) the nature and terms (including prices) of international transactions entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;

(*e*) a description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involved in the international transaction;

(*f*) a record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately, which may have a bearing on the international transactions entered into by the assessee;

(*g*) a record of uncontrolled transactions taken into account for analysing their comparability with the international transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions;

(*h*) a record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;

(*i*) a description of the methods considered for determining the arm's length price in relation to each international transaction or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case;

(*j*) a record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions;

(*k*) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price;

(*l*) details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under these rules and consequent adjustment made to the total income for tax purposes;

(*m*) any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

(2) Nothing contained in sub-rule (1) shall apply in a case where the aggregate value, as recorded in the books of account, of international transactions entered into by the assessee does not exceed one crore rupees :

Provided that the assessee shall be required to substantiate, on the basis of material available with him, that income arising from international transactions entered into by him has been computed in accordance with section 92.

(3) The information specified in sub-rule (1) shall be supported by authentic documents, which may include the following :

(*a*) official publications, reports, studies and data bases from the Government of the country of residence of the associated enterprise, or of any other country;

(*b*) reports of market research studies carried out and technical

publications brought out by institutions of national or international repute;

(*c*) price publications including stock exchange and commodity market quotations;

(*d*) published accounts and financial statements relating to the business affairs of the associated enterprises;

(*e*) agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions;

(*f*) letters and other correspondence documenting any terms negotiated between the assessee and the associated enterprise;

(*g*) documents normally issued in connection with various transactions under the accounting practices followed.

(4) The information and documents specified under sub-rules (1) and (2), should, as far as possible, be contemporaneous and should exist latest by the specified date referred to in clause (*iv*) of section 92F:

Provided that where an international transaction continues to have effect over more than one previous year, fresh documentation need not be maintained separately in respect of each previous year, unless there is any significant change in the nature or terms of the international transaction, in the assumptions made, or in any other factor which could influence the transfer price, and in the case of such significant change, fresh documentation as may be necessary under sub-rules (1) and (2) shall be maintained bringing out the impact of the change on the pricing of the international transaction.

(5) The information and documents specified in sub-rules (1) and (2) shall be kept and maintained for a period of eight years from the end of the relevant assessment year.

Report from an accountant to be furnished under section 92E.

10E. The report from an accountant required to be furnished under section 92E by every person who has entered into an international transaction during a previous year shall be in Form No. 3CEB and be verified in the manner indicated therein.

Notified Percentage under section 92C(2), second proviso – In exercise of the powers conferred by the second proviso to sub-section 92C of the Income Tax Act, 1961 (43 of 1961), the Central Government hereby notifies that where the variation between the arm,s length price determined under section 92C and the price at which the international transactional has actually been undertaken does not exceed ***5 percent of the latter***, the price at which the international transaction has actually been undertaken shall be deemed to be the arm's length price for assessment year 2012-13. - ***Notification No, SO 1871(E), dated 17-8-2012.***

APPENDIX - 4

Source:
http://www.incometaxindia.gov.in/archive/BreakingNews_FinalStatement_14082013.pdf

Statement by CBDT on Draft 'Safe Harbour Rules' Under Section 92CB of the Act for comments.

In order to reduce the increasing number of transfer pricing audits and prolonged disputes, the Finance (No.2) Act, 2009 w.r.e.f 1.4.2009 inserted a new section 92CB to provide that determination of arm's length price under section 92C or Section 92CA shall be subject to safe harbour rules. Vide this amendment, the Government of India had empowered the CBDT to make Safe Harbour rules. "Safe harbour" was defined to mean circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee.

Thereafter, the issuance of the Safe Harbour Rules was examined and discussed at various points of time, but no finality could be reached. Since a number of representations were received from different stakeholders to prescribe the safe harbor rules, the Prime Minister on July, 30, 2012 approved the constitution of a Committee to Review Taxation of Development Centres and the IT sector consisting of Shri N. Rangachary,

Chairman of the Committee and three others (hereinafter called the Rangachary Committee) with broad terms of reference as under:

1. Engage in consultations with stakeholders and related government departments to finalize the approach to Taxation of Development Centres and suggest any circulars that need to be issued.
2. Engage in sector-wise consultations and finalize the safe harbour provisions announced in Budget 2010, sector-by-sector. The Committee will also suggest any necessary circulars that may need to be issued.
3. Examine issues relating to taxation of IT sector and suggest any clarifications that may be required

Subsequently, the Government of India vide OM dated 12th September, 2012 approved the considered suggestion of the Rangachary Committee that it may finalize the Safe Harbour Rules in the following sector/ activities:

(i) IT Sector
(ii) ITES Sector
(iii) Contract R&D in the IT and Pharmaceutical Sector
(iv) Financial transactions-Outbound loans
(v) Financial Transactions-Corporate Guarantees
(vi) Auto Ancillaries-Original Equipment Manufacturers

The Rangachary Committee consulted various stakeholders including sector related government departments, NASSCOM, CII, FICCI, ASSOCHAM, ICAI, etc. and submitted six reports on Taxation of Development Centres and IT Sector and other sectors as referred to in the OM dated 12th September, 2012.

On the basis of the recommendations of the Rangachary Committee in the first report on Taxation of Development Centres and IT Sector (which was posted on the website of the income tax department www.incometaxindia.gov.in on 30th June, 2013),
CBDT has issued the following circulars:

- Circular No. 1/2013 dtd. 17th January, 2013 on issues relating to Export of Computer Software under sections 10A, 10AA and 10B of the Act.

- Circular No. 6/2013 dtd. 29th June, 2013 on Conditions Relevant to Identify Development Centres engaged in Contract R&D Services with Insignificant Risk.

The Government of India has considered the other five reports of the Rangachary Committee. The major recommendations of the Rangachary Committee have been accepted, with some modifications, and the following decisions have been taken by Government:

(1) Safe harbour for the sectors recommended by the Rangachary Committee shall be applicable for two assessment years beginning from 2013-14.

(2) Safe harbour for various sectors, subject to certain ceilings, shall be as under –

S. No. ***(1)***	***International Transaction*** ***(2)***	***Circumstances*** ***(3)***
1	Provision of software development services other than contract R&D where the total value of international transaction does not exceed Rs.100 crores.	The operating profit margin declared in relation to operating expense incurred is 20 per cent or more.
2	Provision of information technology enabled services other than contract R&D where the total value of international transaction does not exceed Rs 100 crore	The operating profit margin declared in relation to operating expense is 20 percent or more.

S. No. *(1)*	*International Transaction* *(2)*	*Circumstances* *(3)*
3	Provision of information technology enabled services being knowledge processes outsourcing services other than contract R&D where the total value of international transaction does not exceed Rs 100 crore.	The operating profit margin declared in relation to operating expense is 30 percent or more.
4	Advancing of intra-group loan to wholly owned subsidiary where the amount of loan does not exceed Rs 50 crore .	The Interest rate declared in relation to the international transaction, is equal to or greater than the base rate of State Bank of India (SBI) as on 30th June of the relevant previous year plus 150 basis points.
5	Advancing of intra-group loans to wholly owned subsidiary where the amount of loan exceeds Rs. 50 crore.	The Interest rate declared in relation to the international transaction is equal to or greater than the base rate of SBI as on 30th June of the relevant previous year plus 300 basis points.
6	Providing explicit corporate guarantee to wholly owned subsidiary where the amount guaranteed does not exceed Rs. 100 crore.	The commission or fee declared in relation to the international transaction is at the rate of 2 per cent or more per annum on the amount guaranteed.

S. No. *(1)*	*International Transaction* *(2)*	*Circumstances* *(3)*
7	Provision of specified contract research and development services wholly or partly relating to software development	The operating profit margin declared in relation to operating expense incurred is 30 per cent. or more
8	Provision of contract research and development services wholly or partly relating to generic pharmaceutical drugs.	The operating profit margin declared in relation to operating expense incurred is 29 percent or more.
9	Manufacture and export of core auto components	The operating profit margin declared in relation to operating expense is 12 percent or more
10	Manufacture and export of noncore auto components.	The operating profit margin declared in relation to operating expense is 8.5 percent or more.

(3) Safe harbour rules shall not be applicable in respect of an international transaction entered into with an associated enterprise located in any country or territory notified under section 94A of the Income-tax Act, 1961, or in a no tax or low tax country or territory.

(4) Safe harbour rules shall be applicable only where a taxpayer exercises his option to be governed by such rules in a specified form to be furnished before the due date of filing of return.

(5) Where the Transfer Pricing Officer is of the opinion that the option exercised by the assessee is valid, he shall intimate acceptance of transfer price declared by the assessee to the assessing officer and the assessee within a period of six months from the end of the month in which reference under section 92CA is received from the assessing officer. Where he is of

the opinion that the option exercised is not valid, he shall proceed to determine the arm's length price in respect of the international transactions entered into by the assessee in accordance with sections 92C and 92CA without having regard to the safe harbour margin or price as specified in the rules.

(6) A taxpayer opting for safe harbour rules shall not be allowed to invoke Mutual Agreement Procedure (MAP) provided under the relevant DTAAs.

(7) Where the safe harbour rules are not applicable in the case of an assessee, engaged in providing contract research and development services with insignificant risks, the Transactional Net Margin Method (TNMM) shall be considered as the most appropriate method for the determination of arm's length price unless it is shown by the assessee that it is not feasible to apply this method in the facts and circumstances of the case.

The draft rules along with the Second to the Sixth report of the Rangachary Committee have been posted on the website of the Income-tax Department. All stakeholders are requested to provide their comments, if any, by 26th August, 2013 to the Director (FT&TR) at her email id batsala.yadav@nic.in.