

DRAFT RULES FOR TRANSFER PRICING

The Central Board of Direct Taxes has formulated draft rules for transfer pricing regulations. These draft rules A, B, C and D are given below.

Comments and suggestions are invited from trade associations, chambers, professionals and other related persons on the suggested rules. Such comments may be forwarded to the Joint Secretary, TPL-II, Central Board of Direct Taxes (Fax No. 011-3012988/e-mail: srivastavagirish@hotmail.com), latest by the 25th May, 2001.

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

(1) The arm's length price in relation to an international transaction shall be determined by one 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 in a comparable uncontrolled transaction is identified;
- ii) such price is adjusted to account for differences, if any, between the international transaction and the uncontrolled transaction or between the enterprises entering into such transaction, which could materially affect the price in the open market; and
- iii) the price so adjusted is taken to be the arm's length price in relation to the international transaction;

(b) resale price method, by which, -

- i) the price at which goods, articles or things purchased by the assessee from the associated enterprise are resold to an unrelated enterprise is identified;
- ii) such resale price is reduced by reasonable expenses incurred by the assessee or by an unrelated enterprise in connection with the purchase and resale of the same or similar goods, articles or things, in a comparable uncontrolled transaction;

- iii) the price so arrived at is further reduced by the amount of normal profit margin accruing to the assessee or to an unrelated enterprise from the purchase and resale of the same or similar property, in the comparable uncontrolled transaction;
- iv) the price so arrived at is adjusted to take into account the differences, if any, in the transactions being compared and between the enterprises entering into such transactions, which could materially affect such expenses or profit margin in the open market; and
- v) the price thus arrived at is taken to be the arm's length price in respect of the purchase of the goods, articles or things by the assessee from the associated enterprise;

(c) cost plus method, by which, -

- i) the costs incurred by the assessee in respect of goods, articles or things or intangible property transferred or services provided to the associated enterprise are determined;
- ii) the amount of normal profit margin arising from the provision of the same or similar property or services by the assessee, or by an unrelated enterprise, in a comparable uncontrolled transaction is determined;
- iii) the normal profit margin referred to in sub-clause (ii) is adjusted to take into account the differences, if any, between the transactions being compared and the enterprises entering into such transactions, which could materially affect such profit margins in the open market;
- iv) the costs referred to in sub-clause (i) are increased by the normal profit margin referred to in sub-clause (ii) or the adjusted profit margin referred to in sub-clause (iii), as the case may be;
- v) the sum so arrived at is taken to be the arm's length price in relation to the supply of the property or services;

(d) profit split method, which shall be applicable in cases involving multiple transactions amongst associated enterprises (including the international transaction between the assessee and an associated enterprise) 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 profits of all associated enterprises from all such interrelated transactions in which the enterprises are engaged, are determined;
- ii) the relative contribution made by each such associated enterprise including the assessee to the earning of such profits, is then evaluated on the basis of the functions performed, assets utilized 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;
- iii) the combined profits are then split amongst the enterprises in proportion to their relative contribution;
- iv) the profit thus apportioned to the assessee is taken into account to arrive at the arm's length price in relation to the international transaction:

Provided that the combined profit 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 transaction in which it is engaged, with reference to market returns achieved for similar transactions by independent enterprises, and thereafter, the residual profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution, and in such a case the aggregate of the profit allocated to the assessee in the first instance together with the profit apportioned to the assessee on the basis of his relative contribution shall be taken to be the profit arising to him from the international transaction;

(e) transactional net margin method, by which, -

- i) the net profit margin realized by the assessee from an international transaction, or group of interrelated international transactions, entered into with an associated enterprise, is computed in relation to costs incurred or sales effected or assets utilized by the assessee or having regard to any other relevant factor;
- ii) the net profit margin realized by the assessee or by an unrelated enterprise from a comparable uncontrolled transaction or group of transactions is computed having regard to the same factor;
- iii) the net profit margin referred to in clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the transactions being

compared and 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 realized by the assessee and referred to in clause (i) is established in conformity with the net profit margin referred to in clause (iii);
 - v) the net profit margin thus established is then taken into account to arrive at the arm's length price in relation to the international transaction.
- (2) The comparability of one transaction with another shall be judged with reference to the following, namely:-
- (a) the specific characteristics of the property or services transferred 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, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.
- (3) Two transactions shall be deemed to be comparable transactions, if -
- (a) none of the differences (if any) between the transactions being compared, or between the enterprises entering into such transaction, 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
 - (b) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

Explanation– For the purposes of this rule, an uncontrolled transaction means a transaction between enterprises other than associated enterprises in uncontrolled conditions.

Rule B. Most appropriate method

- (1) For the purposes of sub-section (1) of 92C, the most appropriate method shall be the method which is best suited to the facts and circumstances of each particular transaction, and which provides the most reliable measure of an arm's length price.
- (2) The most appropriate method shall be selected having regard to the following, namely:-
 - i) the nature and class of the international transaction;
 - ii) the class or classes of associated enterprises entering into the transaction and the functions performed by them;
 - iii) the availability, coverage and reliability of data necessary for application of the method;
 - iv) the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;
 - v) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the transactions being compared and the enterprises entering into such transactions;
 - vi) the nature, extent and reliability of assumptions required to be made in application of a method;
- (3) In a case where the factors referred to in sub-rule(2) indicate more than one method as the most appropriate method, the method providing a result consistent with the result obtainable by application of a method other than such methods may be taken as the most appropriate method.
- (4) Without prejudice to this provisions of sub-rules (1) to (3), and to the extent possible, the comparable uncontrolled price method, or the resale price method or the cost plus method shall be considered to be more appropriate than the profit split method or the transactional net margin method.

Rule C. Information and documents to be kept and maintained under section 92D by persons entering into an international transaction.

- (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 with details of shares or other ownership interest held by other enterprises;
 - (b) names and addresses of all associated enterprises within the meaning of sub-section (2) of section 92A, with details of the relationship with each such enterprise;
 - (c) the nature and terms (including prices) of international transactions entered into with each associated enterprise, and the quantum and the value of each such transaction;
 - (d) an overview of the business of the assessee and a description of the business of the associated enterprises with whom the assessee has transacted;
 - (e) all commercial agreements setting forth the terms and conditions of transactions with associated enterprises as well as with third parties;
 - (f) a record of any forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately;
 - (g) details of the property or services to which the international transactions relate;
 - (h) a description of the functions performed, risks assumed and assets utilised by the assessee and by the associated enterprises involved in the international transaction;
 - (i) a record of transactions taken into account for determining the price of the international transactions, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the international transactions;
 - (j) the data collected and the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;
 - (k) a description of the methods considered for determining the arm's length price in relation to each international transaction, the method selected as the most appropriate method along with reasons and explanations as to why such method was so selected, and how such method was applied in each case;
 - (l) details of the comparable data used in applying the most appropriate method, giving details of the analyses made to

evaluate the comparability of transactions and details of adjustments if any which were made to account for differences in the transactions being compared or the enterprises entering into such transactions;

- (m) the assumptions, policies and price negotiations, if any, which influenced the determination of the arm's length price;
- (n) accounts of the associated enterprise potentially relevant to the pricing of the international transaction and the tax treatment accorded or likely to be accorded to the transaction by the tax authorities of the country of residence of the associated enterprise;
- (o) any other information, data or document considered relevant by the assessee to determination of an arm's length price:

Provided that in a case where the aggregate value of international transactions entered into by the assessee does not exceed one crore rupees, the information and documents specified in this sub-rule shall be maintained to the extent possible in the facts and circumstances of the case, so, however, that the information and documents maintained is adequate in demonstrating that the price relating to each international transaction entered into by the assessee is an arm's length price.

- (2) The information specified in sub-rule (1) shall be supported by authentic documentation, which may include the following:
 - i) Official publications, reports, studies and data bases from the Government of the country of residence of the associated enterprise;
 - ii) Reports of market research studies carried out by recognized institutions;
 - iii) Technical publications brought out by recognized institutions;
 - iv) Price publications including stock exchange and commodity market quotations.
 - v) Agreements and contracts entered into with associated enterprises or with unrelated enterprises, which may be of relevance to the international transactions;
 - vi) Letters and other correspondence documenting any terms negotiated between the assessee and the associated enterprise;
 - vii) Documents normally issued in connection with various transactions.

- (3) The information and documents specified under sub rules (1) and (2), 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 years, 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, and in case of such significant change, fresh documentation as may be necessary under sub-rules (1) and (2) shall be maintained detailing the impact of the change on pricing of the international transaction.

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

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

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..... [and be verified in the manner indicated therein].

FORM NO.

[See rule]

Report from an accountant to be furnished under section 92E relating to international transaction(s)

1. *I/We have examined the accounts and records of (name and address of the assessee with PAN) relating to the international transactions entered into by the assessee during the previous year ending on 31st March,
2. In *my/our opinion proper information and documents as prescribed have been kept by the assessee in respect of the international transaction(s) entered into so far as appears from *my/our examination of the records of the assessee.
3. The particulars required to be furnished under section 92E are given in the Annexure to this Form. In *my/our opinion and to the best of my/our information and according to the explanations given to *me/us, the particulars given in the Annexure are true and correct.

**Signed

Name _____

Address _____

Membership No. _____

Place:

Date:

Notes:

1. *Delete whichever is not applicable.
2. **This report has to be signed by –
 - i) a chartered accountant within the meaning of the Chartered Accountants Act, 1949 (38 of 1949); or
 - ii) any person who, in relation to any State, is, by virtue of the provisions in sub-section (2) of section 226 of the companies Act, 1956 (1 of 1956), entitled to be appointed to act as an auditor of companies registered in that State.

ANNEXURE TO FORM NO.

Particulars relating to international transactions required to be furnished under section 92E of the Income-tax Act, 1961

PART A

1. Name of the assessee
2. Address
3. Permanent account number
4. Status
5. Previous year ended
6. Assessment year

PART B

7. List of associated enterprises with whom the assessee has entered into international transactions, with the following details:
 - (a) Name of the associated enterprise
 - (b) Nature of the relationship with the associated enterprise as referred to in section 92A(2).
 - (c) Brief description of the business carried on by the associated enterprise
8. Particulars in respect of transactions in tangible property
- A. Has the assessee entered into any international transaction(s) in respect of purchase/sale of raw material, consumables and other supplies for assembling/processing/ manufacturing of goods/articles from/to associated

Yes/No

enterprises?

If 'yes', provide the following details in respect of each associated enterprise and each transaction or class of transaction:

- (a) Name and address of the associated enterprise with whom the international transaction has been entered into.
- (b) Nature of transaction and quantity purchased/ sold.
- (c) Total value of transaction –
 - i) as per books of account.
 - ii) As computed by the assessee at arm's length price.
- (d) Method used for determining the arm's length price [See section 92C(1)]

B. Has the assessee entered into any international transaction(s) in respect of purchase/sale of traded/finished goods? Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each transaction or class of transaction:

- (a) Name and address of the associated enterprise with whom the international transaction has been entered into.
- (b) Nature of transaction and quantity purchased/sold.
- (c) Total value of transaction –
 - i) as per books of account.
 - ii) as computed by the assessee at arm's length price.
- (d) Method used for determining the arm's length price [See section 92C(1)]

C. Has the assessee entered into any international transaction(s) in respect of purchase/sale of any other tangible moveable/immovable property or lease of such property? Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each transaction.

- (a) Name and address of the associated enterprise with whom the international transaction has been entered into.
- (b) Description of the property and nature of transaction.
- (c) Number of units of each category of moveable/ immovable property involved in the transaction.
- (d) Value of each transaction of purchase/sale, or lease rent in respect of each lease provided/entered into-
 - i) as per books of account.
 - ii) as computed by the assessee at arm's length price.
- (e) Method used for determining the arm's length price [See section 92C(1)]

9. Particulars in respect of transactions in intangible property:

Has the assessee entered into any international transaction(s) in respect of purchase/sale/use of intangible property such as know-how, patents, copyrights, licenses, etc.?

Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each category of intangible property

- (a) Name and address of the associated enterprise with whom the transaction has been entered into.
- (b) Description of intangible property and nature of transaction.
- (c) Amount paid/received or payable/receivable for purchase/sale/use of each category intangible property –

- i) as per books of account;
- ii) as computed by the arm's length price.

(d) The method used for determining the arm's length price [See section 92C(1).

10. Particulars in respect of providing of services:

Has the assessee entered into any international transaction(s) in respect of services such as financial, administrative, technical, commercial services, etc.?

Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each category of service.

(a) Name and address of the associated enterprise with whom the transaction has been entered into.

(b) Description of services provided/availed to/from the associated enterprise.

(c) Total value of the services provided/taken –

- i) as per books of account;
- ii) as computed by the assessee at arm's length price;

(d) Method used for determining the arm's length price [See section 92C(1)]

11. Particulars in respect of lending or borrowing money:

Has the assessee entered into any international transaction(s) in respect of granting/receiving loans/ advances to or from associated enterprises?

Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each

loan/advance.

(a) Name and address of the associated enterprise with whom the transaction has been entered into.

(b) Nature of financing agreement.

(c) Currency in which loan/advance granted/received.

(d) Interest rate charged/paid in respect of each loan/advance –

i) as per books of account;

ii) as computed by the assessee at arm's length price;

(e) Method used for determining the arm's length price [See section 92C(1).

12. Particulars in respect of mutual agreement or arrangement:

Yes/No

Has the assessee entered into any international transaction with an associated enterprise by way of 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?

If 'yes' provide the following details in respect of each agreement/arrangement.

(a) Name and address of the associated enterprise.

(b) Description of such mutual agreement or arrangement.

(c) Value of each such transaction –

i) as per books of account;

ii) as computed by the assessee at arm's length price.

(d) Method used for determining the arm's length price [See section 92C(1)].

13. Particulars in respect of any other transaction: Yes/No

Has the assessee entered into any other international transaction not specifically referred to above, with associated enterprises?

If 'yes' provide the following details in respect of each associated enterprise and each transaction:

(a) Name and address of the associated enterprise.

(b) Description of the transaction.

(c) Value of the transaction –

i) as per books of account;

ii) as computed by the assessee at arm's length price.

(d) Method used for determining the arm's length price [See section 92C(i)]

*Signed

Name: _____

Address: _____

Place:

Date:

Notes: **This annexure has to be signed by –

i) a chartered accountant within the meaning of the Chartered Accountants Act, 1949 (38 of 1949); or

ii) any person who, in relation to any State, is, by virtue of the provisions in sub-section (2) of section 226 of the companies Act,

1956 (1 of 1956), entitled to be appointed to act as an auditor of companies registered in that State.