

CHAPTER I INTRODUCTION

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INTRODUCTION

The overriding purpose of this study is to unravel the conundrum of complex inter-group transactions and their impact on the financial health of the Corporation itself, state and other stakeholder's.¹ The second purpose of this study is to critically examine the existing statutes and approach of judiciary towards prevention of abusive Transfer Pricing mechanism.

The increasing participation of multinational groups in economic activities in their respective countries have given rise to new and complex issues² emerging from transactions entered into between two or more enterprises belonging to the same multinational group.³ Complexities have also increased due to various transactions entered into between two of more units controlled by the same multinational group (hereinafter referred to as "Group") as a part of their tax strategy. It has been generally observed by taxation authorities in host countries⁴ that the profits of a unit⁵ in host country may be transferred out of such country by the Group by manipulative pricing of goods. Similarly, purchase and sale of units (controlled by the Group) are affected by Group companies with an intention to reduce the tax liability in host country which ultimately erodes revenues in the host country.⁶

¹ Stakeholders includes shareholders, taxing authorities, employees and others

² Transfer Pricing – A definitive guide available at http://www.itatonline.org/articles_new/transfer-pricing-a-definitive-guide/ (Last accessed on October 15, 2015).

³ Virginia Anne Taylor, The Transfer price conundrum, Vol. 5 (11) INTERNATIONAL BUSINESS & ECONOMICS RESEARCH JOURNAL (November, 2006) available at http://www.cluteinstitute.com/ojs/index.php/IBER/article/download/3524/3571&rct=j&frm=1&q=&esrc=s&sa=U&ei=CntQVcmwFIPTmgWR5ICYDg&ved=0CBoQFjAB&sig2=H2PUQKPXz0xiYVvFyrXGoA&usg=AFQjCNEPVFFqz0zHa9BBDK2M5_a0oQd8Htw (Last accessed on October 21, 2012)

⁴ Host Country in this study refers to the country where the assessee company is located.

⁵ Taxing unit in host country is referred to as Unit for the purpose of this study.

In today's globalized market, international foreign direct investment and worldwide procurement combine to create a complex, integrated and dynamic business environment.⁷ Transfer prices are the value assigned to goods, which move between the divisions of a vertically integrated firm. The transfer or movement of raw materials, parts, or partially finished goods may occur in the context of either national or international production process. Intra-firm trade which includes services, technology, capital goods, intermediate goods, and finished goods for resale, constitutes a significant portion of world trade. Transfer Prices are important for those transactions where transacting parties are located in different tax regimes, especially international transactions. Even for domestic transactions, the transfer price plays a pivot role where one or more of the transacting parties are enjoying tax holidays.

Enactment of various transfer pricing provisions/statutes by the legislature of various countries has led to computation of reasonable, fair and equitable profits and taxes in host countries. Different literatures on accounting and economics, government documents/ reports and scholarly works have revealed underlying rationale for enacting various Transfer Pricing regulations by Governments of respective countries. They indicate that the principal objective of transfer pricing regulation is to ensure that appropriate and transparent prices are charged for exchange of goods and services within entities controlled by a Group. The evolution of different transfer

⁶ Tax authorities detected as many as 672 cases of tax evasion, in the current financial year through September, valued at Rs 1,379.57 crore, Finance Minister of India, Mr. Arun Jaitley informed the Parliament on 4-Dec-2014. In the last preceding three financial years, 4,590 cases involving cross border tax evasion of Rs 9,951 crore were detected, Jaitley said in a written reply to the Lok Sabha. See BUSINESS TODAY, (December 5, 2014), available at <http://www.businesstoday.in/money/tax/arun-jaitley-on-cross-border-tax-evasion-cases-cbdt/story/213160.html> (Last accessed on January 10, 2015)

⁷ *Transfer Pricing – A definitive guide*, Available at http://www.itatonline.org/articles_new/transfer-pricing-a-definitive-guide/ (Last accessed on April 25, 2013)

pricing frameworks in each country has led to the development of much more complex environment for MNCs to operate in such countries. This has resulted in the augmentation of the cost of compliance for the companies and of taxation uncertainties.

The researcher has observed that Transfer Pricing is a very complicated subject and any improper action by a stakeholder⁸ can create a widespread impact on economic sustainability of the company and economic stability of the host country. A thumb-rule approach while adopting Transfer Pricing policy by an MNC or an application of a wrong methodology for deriving appropriate arm's length pricing by taxing authorities can lead to disputes. To avoid such time consuming and expensive disputes, both stakeholders of the transfer pricing mechanism should possess an in-depth knowledge of the business, impact of various transfer pricing procedures, and should be able to differentiate between tax planning within legitimate ways and tax avoidance by abusing the advantageous position. The two tables appended below are a glaring evidence of the increasing Transfer Pricing disputes in India.

Table 1: Key Statistics relating to controversy, income adjustment and tax collection⁹

⁸ Stakeholders in Transfer Pricing context refers to Shareholders, employees, customers, suppliers and Taxing Authorities in host country and the local unit of a group operating globally.

⁹ E&Y GLOBAL TAX ALERT (September 5, 2014) available at <http://www.EY.com/gl/en/services/tax/international-tax/tax=alert-library-5-sep-2014> (Last accessed on October 29, 2014)

S.No	TP audit year	Relevant FY	No. of TP audits completed	No. of adjusted cases	% of adjusted cases (rounded)	Amount of adjustment (in INR billion)
1	2005-06	2001-02	1,061	239	23	12.20
2	2006-07	2002-03	1,501	337	22	22.87
3	2007-08	2003-04	1,768	471	27	34.32
4	2008-09	2004-05	1,945	754	39	77.54
5	2009-10	2005-06	1,830	813	44	109.08
6	2010-11	2006-07	2,368	1,207	51	241.11
7	2011-12	2007-08	2,638	1,343	51	445.32
8	2012-13	2008-09	3,171	1,686	53	700.16
9	2013-14	2009-10	3,617	1,920	53	596.02

Table 2: Some recent cases are mentioned as follows:

<i>In the Matter of</i>	<i>Dispute</i>
<i>DCIT v. Air Liquide Engineering P. Ltd.</i> ¹⁰	Computation of Arm's Length Pricing- Royalty payment to Associated Enterprise on sale of products
<i>Alfa Laval (I) Ltd. v. DCIT</i> ¹¹	Computation of Arm's Length Pricing, applicability of TNMM vis-à-vis CPM
<i>Income Tax Officer v. Alumeco India Extrusion Ltd</i> ¹²	Computation of Arm's Length Pricing and selection of comparables
<i>Amadeus India P. Ltd. v. Assistant commissioner of Income Tax</i> ¹³	Computation of Arm's Length Pricing and selection of comparables
<i>American Express Services India Ltd v. DCIT</i> ¹⁴	Computation of Arm's Length Pricing and selection of comparables
<i>Aztec Software and Technology Software Ltd. v. ACIT</i> ¹⁵	Computation of Arm's length Pricing and processes to be followed for invoking Transfer Pricing assessment procedures
<i>Bausch & Lomb Eyecare (india) Pvt. Ltd. v. ACIT – Range</i> ¹⁶	Computation of Arm's Length Pricing adjustment on account of advertisement, marketing and promotional expenses
<i>Vodafone India Services P. Ltd. v. DCIT</i> ¹⁷	Computation of Arm's Length Price and selection of comparables
<i>BMW India Pvt Ltd. v. ACIT</i> ¹⁸	Computation of Arm's Length Price and selection of comparables
<i>Director of Income Tax v. BBC Worldwide Ltd.</i> ¹⁹	Agency commission on selling making advertisement and sponsorship

¹⁰ 2014 (31) ITR (Trib) 205 (Hyderabad)

¹¹ 2014 (149) ITD (Trib) 285 (Pune)

¹² 2014 (147) ITD (Trib) 585 (Hyderabad)

¹³ 2011 (8) ITR (Trib) 187 (Delhi)

¹⁴ 2013 (151) TTJ (Trib) 743 (Delhi)

¹⁵ 2007 (107) ITD (Trib) 141 (Bangalore)

¹⁶ 2014 (32) ITR (Trib) 404 (Delhi)

¹⁷ 2014 (146) ITD (Trib) 78 (Mumbai)

¹⁸ 2014 (166) TTJ (Trib) 166 (Delhi)

¹⁹ 2011 (203) TAXMAN (HC) 554 (Delhi)

<i>Coca Cola India Inc. v. Commissioner of Income Tax and Ors.</i> ²⁰	Applicability of Chapter X tax evasion vis-à-vis computation of arm's length pricing
<i>DCIT v. Deloitte Consulting India Pvt. Ltd</i> ²¹	Computation of Arm's length pricing and selection of comparables for back office service
<i>Gap International Sourcing (Pvt) Ltd. v. ACIT, Circle</i> ²²	Arm's Length Pricing and adjustments to compare with the comparable Companies.
<i>General Motors India Pvt. Ltd v. DCIT</i> ²³	Computation of Arm's length price and selection of comparables

According to the figures published by Department of Commerce, US, worldwide two-way intra-firm trade increased from \$102 billion in 1977 to \$337 billion.²⁴ Regional trade agreements such as NAFTA and the European Union have accelerated this trend. In 2004, intra-company trade among corporate subsidiaries accounted for 46% of the \$1.33 trillion US imports and 31% of \$731 billion in exports.

FDI inflows have a direct impact on the economic development of the host country.²⁵ Some of the studies²⁶ found that FDI has a direct link with the economic growth of the host country. The taxing authorities in host countries sometimes become skeptical about transfer pricing methodologies adopted by a company and concludes that losses sustained by an entity controlled by an MNC group located in host country is the result of an abusive transfer

²⁰ 2011 (336) ITR (SC) 1

²¹ 2011 (177) MANU (Trib) IH

²² 2012 (149) TTJ (Trib) 437 (Delhi)

²³ 2013 (27) ITR (Trib) 373 (Ahmedabad)

²⁴ Tang R, *Transfer Pricing in 1990's, Tax and Management Perspective* (Quarom, Wetport, Conn) 1993

²⁵ See generally, IBR, INTERNATIONAL BUSINESS RESEARCH, Vol.1 (2) April 2008

²⁶ Abdul Khaliq and Ilan Noy, *Foreign Direct investment and Economic Growth: Empirical evidence from Sectoral Data in Indonesia*, (Department of Economics, Andalas University, Indonesia, 2007) available at http://www.economics.hawaii.edu/research/workingpapers/WP_07-26.pdf (Last accessed on March 24, 2014)

pricing between the associated enterprises of that Group.²⁷ The transfer price is a sensitive matter since the same has an impact on the economic stability of the Group. and also because it creates a business environment that is conducive to the host country. Beyond doubt, there are instances of abusive transfer pricing leading to tax avoidance but a legitimate tax planning through legitimate transfer pricing mechanism is the right of an MNC. The recent dispute in case of Vodafone²⁸ matter is an example of sensitivity of the subject matter.

RESEARCH QUESTIONS

The research questions for this study are:-

- 1) Should revenue authorities be only stakeholder about abusive transfer pricing?
- 2) Are all related party transactions detrimental to stakeholders?
- 3) How legitimate related party transaction can be differentiated from abusive related party transaction?
- 4) Whether transfer of profit is possible without entering into a transaction?
- 5) Does Corporate Governance have a role to play for prevention of abusive related party transaction or to avert an influenced decision detrimental to the stakeholders of a business unit?

²⁷ OECD, *White Paper on Transfer Pricing Documentation*, (2013) Para 54, available at <http://www.oecd.org/ctp/transfer-pricing/white-paper-transfer-pricing-documentation.pdf> (Last accessed on October 21, 2014)

²⁸ The economic reporters have reported that transfer pricing dispute between Government of India and Vodafone Plc. has reduced the confidence of the business community and overseas investor about the taxation uncertainty and India. The country has experience a significant reduction in Foreign Direct Investment between the years 2012-2014.

- 6) Whether existing statutory framework and procedure is effective to uncover the abusive nature of a complex inter-group transaction?
- 7) How to calculate an arm's length pricing for a controlled transaction?
- 8) Whether it is necessary to review applicability and liability under statutes other than Taxation rules before adoption of any policy?
- 9) Whether adoption of a biased transfer pricing policy will be economically beneficial for the Group?

STATEMENT OF PROBLEM

The dividing line between tax management and tax avoidance in all controlled transactions²⁹ is very thin (blurred) and it is difficult to unravel manipulative pricing due to the complex nature of transactions within the prevailing statutory framework and existing procedures. Through abusive inter-group transactions, profits may be transferred from high tax-rate countries to low-tax countries to maximize the disposable profits; but genuine related party transactions at arm's length pricing are legitimate and not to be discouraged by the state, unfortunately these are all viewed with skepticism. Decisions taken by the management or Board of Directors of a unit located in host country are influenced by the Group. Each member of the group is a separate legal person, having its own assets and liabilities. The members, creditors and employees of each of these entities are also different. Although a transaction entered into by two entities of a group are the parties to acquiring rights and incurring liabilities and therefore it can be perceived as internal transaction not impacting any third party, but these inter group transactions can impact revenue of two different countries if these entities are situated in different tax jurisdiction or can reduce the wealth of the minority shareholders, if there are minority shareholders in one of these companies or

²⁹ Controlled Transactions refers to a transaction entered between related parties.

in both the companies. In Group Companies, although tangible and intangible assets are held in the name of a legal entity, the product risks, market risks and economic volume risk may be borne by another entity within the Group. The transactions entered into by a unit located in the host country are considered in nature of a dependent agent resulting in the application of Permanent Establishment clauses of the Income Tax Act, 1961 or clauses of Double Taxation Avoidance Agreement. Investors and market observers are also concerned that inter-group transactions are harmful to the minority shareholders, employees, state and other important stakeholders of the unit. Corporate group intends to use Transfer Pricing to minimize tax burden of the Company and to make cash available in the country from where dividend to the shareholders would be distributed. Inaccurate transfer pricing has a long term impact on the profitability, compliance of other tax laws and financial viability of the Group.

HYPOTHESIS

Although complex inter-group and related party transaction may be abusive and detrimental to the shareholders, a genuine transaction with arm's length pricing should not be discouraged. To uncover the reason for an intergroup transaction, it should be unraveled in a systematic way for prevention of abuse. A proactive adoption of systematic approach by a Group will help to sustain the economic stability of the group since a *postfacto* thumb rule approach may lead to inaccurate procurement and other erroneous business decisions.

RESEARCH OBJECTIVE

Though Transfer Pricing has a deep impact on economy of nations and business—entities, both from the commercial as well as regulatory

perspective, there is limited academic research & empirical study to unravel the complex nature of inter-company transactions and the consequences thereof. Moreover, there is vagueness in the existing standard processes to derive arm's length pricing for different sets of transactions which will be acceptable to all stakeholders.

The aim of this study is to examine issues in Transfer Pricing by performing a SWOT³⁰ analysis on existing global laws, rules and regulations, documentation requirements, current practices and judicial interpretation. This study also aims to unravel the financial consequences and liabilities under various statutes on account of the adoption of a thumb rule approach to derive arm's length pricing. Finally, researcher intends to suggest a Transfer Pricing Model which will satisfy the legitimate expectations of all stakeholders. Since the RPT also have impact on the corporate governance regime, this study also undertakes an examination of the corporate governance issues pertinent to related party transactions.

RESEARCH METHODOLOGY

The researcher has predominantly used empirical research based on the analysis of the data mainly collected by him throughout his professional career and on the basis of data assembled from various multinational companies. It has been supplemented by analysis of primary sources viz. critical study of case law, statutory provisions and academic writings. In that sense, this research can also be called an analytical study.

CHAPTERS OVERVIEW

This study is spread over 6 chapters. The remainder of the paper proceeds as follows. The researcher is of the opinion that systematic study of the topic

³⁰ Strengths, Weaknesses, Opportunities and Threats.

warrants an understanding of certain key concepts in the legal and commercial matrix. This is reported in **Chapter 2**, titled “**Key Concepts**”. In this chapter, prevailing concepts related to Transfer Pricing is examined to understand the applicability on various inter-group transaction. This chapter examines Transfer Pricing concept in global parlance. The discussion on Transfer Pricing continues to uncover the acceptable process of deriving transfer pricing in case of a controlled transaction and tries to understand the root cause of dispute in Transfer Pricing calculation between a Group and revenue authorities. This chapter continues with discussion on “Related Party”, another relevant concept in context of this study. The discussion focuses on the concept of related party and probability of abuse in related party transactions. The discussion also aims to underline on the importance of scrutinising related party transaction to prevent a potential abuse. The Chapter further progresses with an aim to differentiate a legitimate related party transaction from an abusive one . Since the concept of related party is defined under various statutes, they are examined in the subsequent pages of this Chapter. This discussion is important to understand the magnitude of influence of a related party in a controlled transaction. The concept of ‘related party’ as provided under Indian Accounting Standard ³¹ , International Accounting Standard³², Companies Act, 2013³³, Income Tax Act, 1961³⁴ and Central Excise Act, 1944 ³⁵ is discussed in this section. The Chapter progresses with an understanding of arm’s length price calculation methods specified under various statutes. The Chapter also emphasizes on the importance of deriving an arm’s length pricing under different statutes apart from the Income Tax Act. The discussion reveals the root cause of increasing scrutiny of Related Party transactions by the authorities. The further

³¹ See ICAI, Accounting Standard, AS-18 – Related Party Disclosure

³² See IFRS, Accounting Standard IAS-24 – Related Party Disclosure

³³ See Companies Act, 2013 § 188,189 and Schedule III

³⁴ See Income Tax Act,1961 § 40A(2)(b)

³⁵ See Central Excise Act, 1944 § 4(3)(b)

discussion in this Chapter reveals that Revenue Authorities globally, have enacted stringent transfer pricing rules to prevent abusive pricing. The Chapter then progresses with the discussion on the concept of arm's length pricing. The subsequent discussion in this Chapter reveals that since the accuracy of transfer pricing depends on correct selection of arm's length pricing method, it is important to first classify the transactions accurately. Different methods to derive arm's length pricing and their applicability on different types of transactions are discussed in subsequent pages of this Chapter. Since selection of arm's length pricing is one of the contentious issues, subsequent discussion in this Chapter discusses approach of judiciary for selection of arm's length pricing method for different transaction. The applicability of different calculation method of deriving arm's length price is elaborated with help of the data analysis in subsequent pages of this Chapter. The discussion further continues with the steps involved in each of the methods for calculation of arm's length pricing. Additionally, the discussion in this segment of the Chapter aims at performing a SWOT analysis on each of the method applied for arm's length pricing calculation. The Chapter ends with a discussion on various available external databases to perform a comparison of the financial result derived by applying suitable arm's length pricing calculation method with the result of a similar business under uncontrolled environment.

The **third chapter** in this study titled "**Evolution of Global Transfer Pricing Regulations**" aims to discuss the background of enactment of Transfer Pricing regulation. The discussion starts with revealing the political and economic reasons for enactment of Transfer Pricing regulations by each country to prevent the transfer of profits resulting in erosion of revenue. The Chapter progresses with a discussion on the business model generally adopted by a Group to minimize the overall tax burden. The section also discusses the reasons for adopting a biased transfer pricing policy favouring

a country where dominant party is located. This segment of the chapter advocates the necessity for adjusting the profit in Tax Returns in certain cases rather than following a biased transfer pricing policy which may be detrimental to the economic stability of the Group. The Chapter also attempts to uncover the objective of a manipulative transfer pricing by using sample data. The data collated for the study is used in this section of the Chapter to prove the theory that an MNC Group is capable of shifting profits from a high tax-rate country to a low tax-rate country. The motive of a Group in setting an artificial or abusive transfer pricing is discussed in this Chapter by data analysis under different business scenarios. The Chapter further discusses the approach of judiciary and statutory authorities with regard to Transfer Pricing and provides statistics on increasing disputes in this context. The root cause of dispute is further uncovered by analyzing various judicial pronouncements in this regard. The Chapter also analyses the impact of an aggressive transfer pricing policy on the economic stability of the country. Another important aspect of Transfer Pricing issue highlighted in this Chapter is the impact of the transfer pricing on the economic growth of a country. This is done with reference to select studies conducted in this field. The Chapter further advocates the need for business ethics in transfer pricing matters. The Researcher's recommendation is that business houses should follow ethical business practices. Although tax planning is a legitimate right of any business groups, he strongly urges that sufficient measures must be taken by Corporations to ensure that tax planning is not aimed at tax avoidance. This is further elaborated with the help of examples and case studies. The chapter then also makes an elaborate analysis of Transfer Pricing regulation in India and other carefully selected countries. The countries apart from India were selected with an aim to cover major countries where majority of international trade is carried out. A comparison of the rules and procedures recommended under the statutes of different countries for compliance is also attempted in

this Chapter. The Indian regulation is further elaborated and analysed in light of some landmark judgments.

The researcher is of the opinion that it is important to understand the treatment of different types of related party transactions under relevant statutes. **Chapter 4** titled “**Importance of Corporate Governance in Related Party Transaction and Transfer Pricing**” encompasses the abovementioned objective and discusses various types of transactions carried on by related parties which attract Transfer Pricing regulations. Since the treatment under Transfer Pricing regulation is different for each type of transactions, this Chapter starts with classifying transactions for assets into transactions for tangible assets and intangible assets. The chapter progresses with sub-classification of intangible assets into Manufacturing intangibles and Marketing intangibles. Classification of services rendered by related parties is done subsequently in this chapter. This classification helps to understand the treatment of this particular nature of Related Party transactions under various statutes. The researcher observed that in many cases, service charge on a taxing unit is levied by another unit controlled by the Group as allocation of general and administrative cost without any proof for services rendered. These charges are termed as “Shareholder Service Charges”. Compliance risk under Transfer Pricing regulation with regard to these charges is discussed in the subsequent paragraph of this Chapter. The researcher submits that Inter-company loan is one of the contentious issues under Transfer Pricing regulation, if the debt equity ratio is abnormal in any company. This chapter discusses various types of inter-company Loan and their usage in business. Based on the classification done in this Chapter, a pictorial representation of various types of transactions and their approval matrix as per Companies Act, 2013³⁶ is provided in this Chapter. Since Domestic Transfer Pricing is a new concept in India, a detailed discussion on

³⁶ See Companies Act, 2013 § 188

Domestic Transfer pricing in accordance with Section 92BA of Income Tax Act, 1961 is done. The Chapter continues with a discussion on important aspects of Specified Domestic transactions (SDT) which include type of person and nature of transactions covered under this regulation. The discussion continues with the probable challenges of the provisions and documentations required for compliance under SDT.

The Chapter contains a separate section on the need of Corporate Governance in relation to Related Party transaction and Transfer Pricing. This section of the Chapter progresses with a detailed discussion on the need and importance of Corporate Governance to curb probable abuse of Related Party transactions. The discussion in this section includes critical examination of selected study conducted on this issue. Additionally, the study conducted by OECD, which focuses on the improvement of Corporate Governance in India is referred to for discussion in this Chapter. Further S.188 of Companies Act, 2013 is critically examined in detail to understand the statutory obligations in India with regard to Related Party Transactions.

In **Chapter 5** titled “**Impact of Transfer Pricing and allied issues**”, discussion focuses on various related issues in Transfer Pricing. The researcher observes that enterprise planners customarily address the issues associated only with taxation while adopting a Transfer Pricing Policy. The discussion in this Chapter highlights various challenges for a Group which may evolve under different statutes in host country apart from Taxation laws, if an incorrect Transfer Pricing policy is adopted by the Group. The Chapter starts with a discussion on impact of Transfer Pricing policy on Indirect Taxation. The discussion highlights the conflicting objectives of Income Tax authorities and Customs authorities. The conflicting objective of these two authorities is a hurdle for a Group for adopting a balanced Transfer Pricing policy, which may satisfy objectives of both Customs and Income Tax

authorities. Although the concept of Arm's Length pricing is applicable for valuation of Related Party transactions under both Income Tax and Customs, the discussion in this Chapter examines and elaborates the reason for conflicts. The researcher further elaborates that although a higher Transfer Pricing will be beneficial for the purpose of Customs valuation in the country where purchasing unit is located, it will reduce the profitability of the taxing unit importing the materials and therefore the Income Tax payment will be reduced. The Chapter further progresses with the discussion on issues related to transfer pricing of intangible assets. This chapter suggests suitable Transfer Pricing methodologies for various types of transactions, which will help to balance conflicting objectives of both Customs and Income Tax authorities. This Chapter further discusses the indirect impact of Transfer Pricing of Intangible assets and Service charges on Customs valuation of tangible goods. The chapter further proceeds with the understanding of the impact of Transfer Pricing on Competition Law³⁷. The impact of improper transfer pricing in context of predatory pricing³⁸ is the topic of the discussion. This discussion reveals that objective of abusive Transfer Pricing is not limited to Income Tax, but the objective of abusive Transfer Pricing may be aimed to set up a predatory pricing, leading to unfair competition in the market. This section concludes with a discussion on relevant clauses of tax treaties and impact on taxation liabilities. The applicability of Permanent Establishment clause³⁹, procedure for relief from double taxation⁴⁰ and applicability of clauses of Double Taxation Avoidance agreements related to dependent agent and its impact on tax liabilities are the main focus of the discussion in this section of the Chapter. Then the discussion in this Chapter

³⁷ The Competition Act, 2002

³⁸ See, Competition Act, 2002 Explanation (b) of § 4(2)(a)(ii)

³⁹ See, Double Taxation Avoidance Agreements of India, Article 5 (1)

⁴⁰ Double Taxation avoidance agreement (DTAA) also referred as Tax Treaty is a bilateral agreement between two nations aims to avoid or eliminate double taxation of the same income in two countries

focuses on burden of proof under Transfer Pricing regulation and its obligation.

The research findings are narrated in **Chapter 6** titled “**Research Findings**”. The section starts with narrating the data collection methodology for this empirical study. This methodology adopted for a survey conducted for this study and the result is reported in subsequent section of this study.

The Chapter reports an elaborated analytical research finding about conflicting objectives of Corporation and Legislature. The discussion progressed with analysis of root causes of disputes in Transfer Pricing. The research finding proceeds with analysis of transactions regularly entered by a Group and proves with data analysis that economic objective of a Corporation may not be ultimately achieved by applying a thumb rule approach or a biased Transfer Pricing methodology. The Chapter further proceeds with a discussion on probable objectives of a Group for adopting a particular Transfer Pricing policy. Whether a Group can achieve its objective by adopting a biased Transfer Pricing methodology, is tested with the help of data collated for the study. This section of the Chapter continues to analyse data for examining whether adopting a biased Transfer Pricing methodology would be ideal for a Group to reduce its tax burden. By analyzing various business situations and scrutiny of financial data, it is established that arm's length pricing for Related Party transaction is the best way to achieve the economic stability of a Company. The section proceeds with critical analysis of existing Transfer Pricing assessment procedure and documentation requirement. Through this testing of data, the Chapter establishes that abusive transfer pricing is not the only reason for losses sustained by a taxing unit in host country. Various other probable reasons for losses, apart from abusive transfer pricing, are discussed in subsequent paragraphs of this section. Various types of adjustments required in operating profit of assessee

for a benchmark study with comparable companies, are discussed in the subsequent paragraphs in this section⁴¹. The subsequent section of this Chapter discusses the need for complete and appropriate documentation for all Related Party transactions due to increasing skepticism among revenue authorities about the Transfer Pricing policy adopted for these transactions. It is recommended in this Chapter that Groups should prepare a detailed documentation before a Related Party transaction is entered into, since the burden of proving the correctness of Arm's Length pricing lies on the assessee.

This section proceeds with critical examination of important court rulings in relation to the issue of Transfer Pricing. Relevant case laws are carefully selected for examining the root cause of different types of disputes between a multinational group and Transfer Pricing authorities. The importance of transaction level functional and risk analysis is discussed in the succeeding section of this Chapter. The section further proceeds with analysis of different types of transactions and establishes rationale for separate functional and risk analysis of each genus of transaction. It is argued, based on analysis of data and critical analysis of judicial pronouncement, that adoption of a Transfer Pricing policy should be done only based on risk and reward relationship. For rewarding a trading partner based on the risk assumed by it, the importance of unravelling the business model of both related parties is discussed in subsequent section of this Chapter. This discussion establishes the risk that the exchequer may assume in terms of revenue loss, in case the business model of a multinational group is not uncovered during assessment proceeding. This section proves that abuse of transfer pricing mechanism may be done even without entering into any transaction. This section also

⁴¹ A comparison of financials with that of a unit operating in uncontrolled environment is required for the purpose of transfer pricing assessment to verify the correctness of arm's length pricing

analyses the applicability of Section 9 of the Income Tax Act, 1961 which elaborates the processes to be followed for profit-sharing with a permanent establishment in India for an overseas entity. This Chapter further analyses the importance of Corporate Governance to prevent abusive transfer pricing. This section highlights the importance of independence in business decisions and importance of Board's independence to prevent the abuse of Transfer Pricing Mechanism. Finally this section discusses the importance of value addition based pricing mechanism for an effective transfer pricing policy. By analyzing data, this section proves that the pricing should be different for a similar activity with difference in value addition at each stage. With the help of an example, this section proves with rationale that why a distributor with Inventory and Market risk should not be compensated at the same rate with a distributor without a Market or Inventory risk. The section of this Chapter also recommends suitable Transfer Pricing methodology that can be adopted for various kinds of activities. This section also proves that results for comparison will be changed by way of detailed analysis of financial numbers and application of a recommended tool. Major activities and business result is analysed in this section. Based on the examination of data and critical analysis of the court rulings, this section of the chapter recommends four simplified steps for adoption of an accurate Transfer Pricing policy, which would be acceptable to all stakeholders.

Chapter 7 titled as “**Issues, suggestion and recommendation**” is designed to submit the conclusion for this study. This section is sub-divided into A) Issues and B) Recommendation. Some of the pertinent observations are provided in the section A. This section concludes with reasons why a biased transfer pricing methodology is not appropriate. This sub-section also performs a SWOT analysis on all transfer pricing methodologies and proves through data analysis that a biased transfer pricing methodology is not only detrimental to the revenue authorities but also does not help a company to

achieve its financial objectives. This Chapter progresses with conclusion that all transfer pricing policies should be adopted after aligning with the requirements of other statutes to avoid non-compliance cost. Since burden of proof lies on the assessee, this section concludes that documentation should be comprehensive and pro-active, since any *post facto* documentation or adoption of policy will be detrimental to the Corporation. The various issues in relation to Transfer Pricing are discussed in subsequent sections of this Chapter which concludes that the root causes of Transfer pricing disputes include interpretation of statutes, lack of documentation, and incorrect selection of methodology and improper segmentation of business.

The recommendation section is divided into 4 sub-sections. The first part recommends the processes and procedures to be followed by a company to avoid disputes and to help it achieve economic objectives. This sub-section elaborates the processes recommended by the researcher for adoption of a correct Transfer Pricing policy and also present a tool designed to achieve this objective. The other recommendations include suggestions for required amendment of the existing statutes and procedures for better compliance and avoidance of complexity. The recommendation also includes an "Alternate Tax" on all entities which are not able to submit the documentation required for an exhaustive analysis of data for assessment. Finally, there are some recommendations given to the consultants engaged in this field and researcher's opinion about the steps needed to further improve this study.