



Budget 2016 – Transfer Pricing Amendments

Background

The fiscal budget was announced in India on 29 February 2016. Like every year the government released several measures to accelerate growth and development in the country. One of the most important developments from a Transfer Pricing (TP) regulations perspective was introduction of Country-by-Country (CbyC) reporting norms for TP documentation with effect from Assessment Year (AY) 2017-18. These norms are based on recommendations issued by the Organisation of Economic and Commercial Development (OECD) and G20's - Base Erosion and Profit Shifting (BEPS) action plan 13.

Many countries that are members of OECD and the G20 member countries have already introduced these TP documentation norms in their local regulations. These norms are based on one of the most important objective of transparency impressed upon by the OECD for prevention of BEPS.

OECD had recommended three-tier TP documentation including:

- **Master file** – requirement to provide an overview of the Multinational Enterprises (MNEs) business and explain the MNE's TP policies in the context of its global economic, legal, financial and tax profile.

- **Local file** – to demonstrate that the taxpayer has complied with the arm's length principle in its material intragroup transactions. Entities need to
 - Demonstrate arm's length nature of transactions;
 - Contains the comparable analysis.
- **Country by Country (CbyC) report** –to provide information to a tax authority to enable it to undertake a TP risk assessment, data may also be used to assess wider BEPS related risks. It is required to:
 - provide jurisdiction-wise information on global allocation of income, taxes paid/accrued, the stated capital, accumulated earnings, number of employees and tangible assets
 - provide entity-wise details of main business activities which will portray the value chain of inter-company transactions.

Based on the above OECD recommendations India has proposed to introduce CbyC reporting norms in their local tax and TP regulations.

Master file and local file

The Memorandum to the Finance Bill states that a master file will have to be maintained and the detailed rules regarding the same will be notified at a later date. However, no threshold for preparation of master file has been prescribed.

Local file related regulations that already exist in the law may continue or may be aligned to the recommendations of the OECD, however the same can be clear only once the detailed Rules in this regards are issued.

CbyC reporting

A new section or provision (proposed Section 286 of the Income-tax Act, 1961) on CbyC reporting has been introduced. The CbyC provisions in the budget require the Indian Parent entity of an international multinational group or any other designated group entity in India (referred to as **alternate reporting entity**) to file a CbyC report for financial year 2016-17 before the due date of filing of Return of Income i.e. 30 November 2017. The threshold for filing the CbyC report has been maintained at EUR750 million and the format shall be notified in the Rules at a later date. However, it is proposed in the memorandum that the OECD prescribed template will be adopted.

1. The CbyC report will be required to furnish the following:
 - a) the aggregate information in respect of the amount of revenue, profit or loss before income-tax, amount of income-tax paid, amount of income-tax accrued, stated capital, accumulated earnings, number of employees and tangible assets not being cash or cash equivalents, with regard to each country or territory in which the group operates;
 - b) the details of each constituent entity of the group including the country or territory in which such constituent entity is incorporated or organised or established and the country or territory where it is resident;
 - c) the nature and details of the main business activity or activities of each constituent entity.
 - d) any other information as may be prescribed

2. Responsibility of the local constituent entity: The CbyC report will have to be furnished by the local constituent Indian entity if the parent entity is resident of a country:

- a) with which India does not have an agreement providing for exchange of information under the CbyC report; or
- b) there has been a **systemic failure** of that country and the said failure has been intimated by the prescribed authority to such constituent entity.

'Systemic failure' with respect to a country means that the country has an agreement with India providing for exchange of CbyC report, but:

- a) in violation of the said agreement, it has suspended automatic exchange; or
- b) has persistently failed to automatically provide to India the report in its possession in respect of any international group having a constituent entity resident in India.

3. A 'constituent entity' means:

- a) any separate entity of an international group that is included in the consolidated financial statement of the said group for financial reporting purposes, or is included for the said purpose, if the equity share of any entity of the international group were to be listed on a stock exchange;
- b) any such entity that is excluded from the consolidated financial statement of the international group solely on the basis of size or materiality; or
- c) any permanent establishment of any separate business entity of the international group included in (a) or (b) above, if such business unit prepares a separate financial statement

4. An 'international group' means any group that includes:

- a) two or more enterprises which are resident of different countries; or
- b) an enterprise, being a resident of one country, which carries on any business through a permanent establishment in other countries.

5. Where there are more than one constituent entities of the international group, resident in India, the CbyC report shall be furnished by any one constituent entity, if:

- a) the international group has designated such entity to furnish the CbyC report on behalf of all the constituent entities resident in India; and
- b) the information has been conveyed in writing on behalf of the international group to the prescribed Indian tax authorities.

6. If any other alternate reporting entity of the international group has furnished the CbyC report with the tax authority of their country, there will be no need for the local constituent entity to furnish the same again locally if the following conditions are satisfied:

- a) the CbyC report is required to be furnished under the local law of that country;
- b) that country has entered into an agreement with India providing for exchange of the CbyC report in respect of the international group;
- c) that country's prescribed authority has not conveyed any systemic failure in respect of the said country to any constituent entity resident in India;
- d) the said country or territory has been informed in writing by the constituent entity that it is the alternate reporting entity on behalf of the international group.

7. The Indian revenue authorities may, for the purpose of determining accuracy of the information furnished under the CbyC report, ask the reporting entity to furnish such information or documents as may be deemed necessary, after giving a 30-60 days' notice.

8. Annual accounting period, for which data has to be furnished will be an accounting period with respect to which the parent entity of the international group prepares its financial statements under their local laws and local accounting standards.

9. Penalty provisions relating to TP documentation

- a) Failure to furnish information and documentation under the proposed three-tier documentation structure by the due date will be INR500,000 (approximately USD7,500).

b) Pursuant to a transfer pricing adjustment, following specific penalty provisions have been proposed in situations wherein the tax payer has failed to maintain appropriate documentation or failed to disclose international transaction:

- Penalty at 50 percent of the tax payable on under-reported transaction
- Penalty at 200 percent of the tax payable on misreporting of transaction

c) Failure on account of CbyC reporting:

Particulars	Delay upto one month	Delay beyond one month	Delay in payment of penalty after receipt of instructions to pay
Failure to furnish CbyC report by the due date of filing of return of income	INR5,000 (USD75) per day	INR15,000 (USD230) per day	INR50,000 (USD750) per day
Failure to furnish additional information and documents sought by the Revenue authorities	INR5,000 (USD75) per day from the day on which the period for furnishing the information and document expires		INR50,000 (USD750) per day
Inaccurate information filed under the CbyC report *	INR500,000 (USD7500)		

*Where the information filed under the CbyC report is inaccurate, a penalty of INR500,000 (approximately USD7,500) will be levied if:

- the entity has knowledge of the inaccuracy at

the time of furnishing the CbyC report but fails to inform the prescribed authority; or

- the entity discovers the inaccuracy after the CbyC report is furnished and fails to inform the prescribed authority and furnish a correct report within a period of fifteen days of such discovery; or
- the entity furnishes inaccurate information or document in response to request for additional information and documents.

Administrative TP proposals

There are a few administrative amendments proposed by the budget from a TP perspective:

- Since time limit for completion of regular income tax audits proposed to be reduced to three months, the time limit for completion of TP audits will also consequentially be reduced by three months
- The Revenue authorities will have no right to appeal against the instructions issued by the Dispute Resolution Panel.
- In the circumstances wherein the time limit for completion of assessment proceedings is stayed (i) by an order or injunction of any court or (ii) for a period to obtain information under the agreement referred in Section 90 or 90 A of the Act, the period for completion of assessment proceedings by the Transfer Pricing officer, subsequent to such stay shall be minimum 60 days.

Our comments

The budget covered various growth initiatives like agriculture and rural development, infrastructure, education, various tax reforms etc. However one of the most important tax reforms was the government's effort to move to a non-litigious approach. This approach is likely to usher positive sentiment in the country.

Regarding CbyC reporting it is important to note that earlier the prescribed TP documentation was only to be prepared by the due date of filing the return and was to be furnished only a few years later during assessment proceedings. Now it has to be furnished alongwith the return of income. This requirement coupled with the limited period of eight months allowed from the end of the financial year (from 31 March 2017) to prepare such extensive documentation could pose a challenge to the Indian taxpayers who would be preparing such documentation for the first time.

Regarding the master file, since no threshold has been prescribed, it may be deduced that it can be applicable to all multinationals operating in India whether headquartered in India or otherwise, unlike CbyC reporting which is triggered only if groups' revenue exceeds EUR750 million. This again could have huge implications in the way TP documentation will be prepared and could amount to disproportionate cost and burden for taxpayers.

Specifically regarding CbyC reporting it is important for taxpayers to relook at their global value chains and examine whether there is parity in profits/income reported in various countries vis-à-vis the level of operations there. They should begin looking at the data that needs to be plotted in the CbyC report critically and identify areas where corrective measures are required. Though the due date for filing of CbyC report for tax year 2016-17 will be 30 November 2017, it is important that taxpayers gear up from now and ensure that they are able to comply with the deadline to avoid paying steep penalties.



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