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# **Transfer Pricing Landscape & Audit Challenges in India & the U.S.**

April 4, 2023

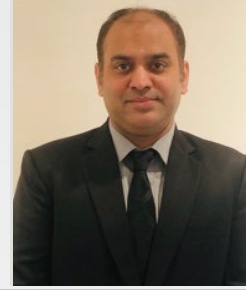
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# Agenda

- **Transfer Pricing Landscape in India/U.S.**
- **Dealing With Local Tax Authorities**
  - Court Cases
- **Other Considerations**
  - Business Restructuring
  - Safe Harbor
- **Q&A**

# Transfer Pricing Landscape in India/U.S.

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# Transfer Pricing Landscape in India/U.S.

- Trends
  - Transfer pricing has become a key focus area for tax authorities
  - Most countries have updated or implemented new transfer pricing documentation requirements as a result of the OECD's Base Erosion Profit Shifting (BEPS) Action Item 13
  - Transfer pricing compliance rules have increased significantly, imposing new administrative burdens on taxpayers
  - Attribution of profit rules being subjective can often lead to disputes or double taxation if transfer price policy is not well defined
  - In conjunction with more compliance requirements, data-gathering & reconciliation has become increasingly difficult for taxpayers
  - This will become even more difficult with the eventual adoption of Pillar Two
  - Growing reliance on data automation & compliance software

# Transfer Pricing Landscape in India/U.S.

Transfer Pricing Items	India (Due Dates – Oct 30, Nov 31, or Dec 31)	United States (Due Dates – Tax Return Filing Date – e.g., Oct 15)
Master File	Yes – 3CEAB master file designation form (if multiple Indian entities); & 3CEAA master file form Part A & Part B – <b>File</b> <i>Note – Part A applies to all Indian companies &amp; Part B only needs to be filed if certain threshold is met</i>	N/A
Local File/Transfer Pricing Documentation	Yes – if certain local file threshold is met – <u>Prepare</u>	Yes – no materiality threshold for transfer pricing documentation (Treas. Regs. 482 & 6662)
Country-by-Country (“CbC”) Report	Yes – 3CEAD form – Indian ultimate parent company or Indian subsidiary (if no CbC report exchange mechanism with parent jurisdiction or selected as surrogate parent entity) – <b>File</b>	Yes – Form 8975 – <b>File</b>
CbC Notification	Yes – 3CEAC form – <b>File</b>	N/A
Transfer Pricing Informative Returns	Yes – 3CEB form (Transfer Pricing Certificate) – <b>File</b>	Yes – Form 5471 & Form 5472, etc. – <b>File</b>

# Dealing With Local Tax Authorities

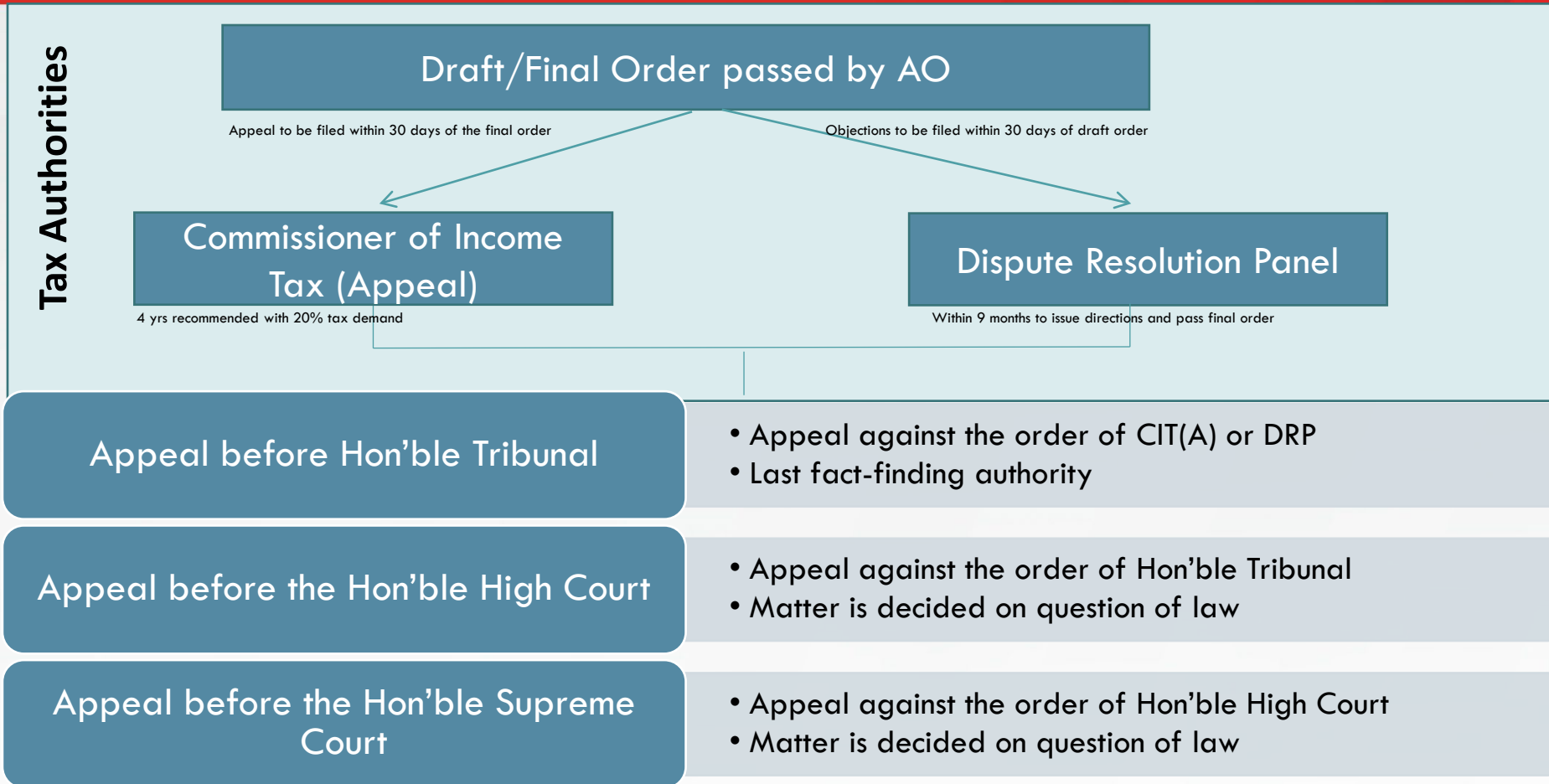
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# Litigation process in India



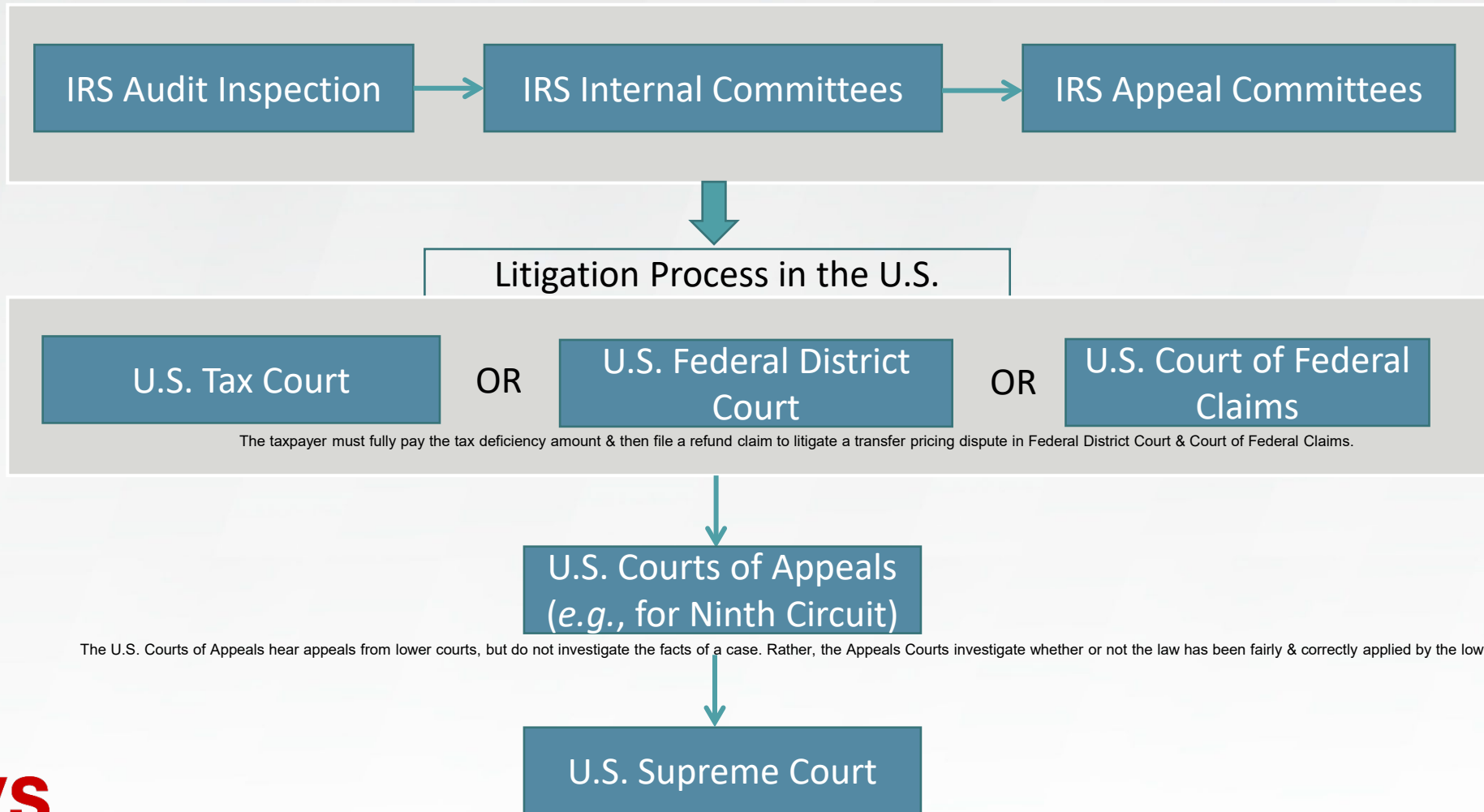
# Major Cases in the India

- **Rampgreen Solutions (P.) Ltd. v. Commissioner of Income-tax (2015) [Delhi High Court (HC)]:** Entities rendering Voice Call Center services and a Knowledge Process Outsourcing (KPO) service provider employ IT-based delivery systems, but characteristics of services are functionally different; and thus, it would be unreliable to benchmark a KPO service provider against a voice call center.
- **Gruner India (P.) Ltd. v. Director of Income-tax (Transfer Pricing), [2017] (Delhi HC):** Aggregation or segregation of transactions is an entirely fact dependent exercise and need to be viewed having regard to the nature of the transaction and the surrounding circumstances.
- **Principal Commissioner of Income-tax v. Kusum Health Care (P.) Ltd (2018) (Delhi HC):** Any outstanding receivable from associated enterprise may not be categorized as an international transaction merely because it is over-due.
- **Vodafone India Services ( P.) Ltd. v. Union of India [2014]/[2015] (Bombay HC):** Since no income/expenses arises or is affected by the issue or subscription of shares and being in the nature of capital account transactions, such transactions will not be subject to transfer pricing provisions.

# Major Cases in the India

- **Maruti Suzuki India Ltd. v. CIT[2015] (Delhi HC):** Advertisement Marketing Promotion (AMP) expenditure incurred by manufacturer exclusively for its own business, cannot be disallowed by attributing some part of the said expenditure to promoting the brand of the foreign Associated Enterprise as the same was not at arm's length. Quantitative determination of proportionate AMP expenditure should form the basis of the transfer price determination exercise.
- **CIT v. Cushman and Wakefield India (P.) Ltd [2015] (Delhi HC):** Whether it is commercially prudent or not to conduct this activity is a matter that lies within the taxpayer's exclusive domain and cannot be second-guessed by income tax authorities. The authority of transfer pricing officer is to conduct a transfer pricing analysis to determine the arm's length price and not to determine whether there is a service or not from which the taxpayer benefits.

# Litigation process in U.S.



# Major Cases in the U.S.

- ***3M Co. v. Commissioner (2023)***: Applicability of foreign restrictions on royalty payments (**IRS' recent milestone win**)
- ***Eaton Corp. v. Commissioner (2023)***: Whether the IRS can cancel an advance pricing agreement (APA)
- ***Medtronic v. Commissioner (2022)***: Selecting the best method—comparable uncontrolled price (CUP)/comparable uncontrolled transaction (CUT) or comparable profits method (CPM)
- ***Coca-Cola v. Commissioner (2021)***: Whether prior closing agreements between the IRS & a taxpayer are applicable indefinitely or each audit cycle stands on its own & profit shifting via royalties & cost sharing (**IRS' recent milestone win**)
- ***Altera Corp. v. Commissioner (2019)***: Whether stock-based cost (SBC), which includes stock option compensation of employees, should be included in cost-sharing agreements (CSAs)
- ***Amazon v. Commissioner (2019)***: Definition & valuation of intellectual property (IP)
- ***Facebook v. Commissioner (Ongoing)***: IP valuation methodology in 2010 related to additional \$9B tax bill

# Other Considerations

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# Business Restructuring

## Data Gathering/ Automation

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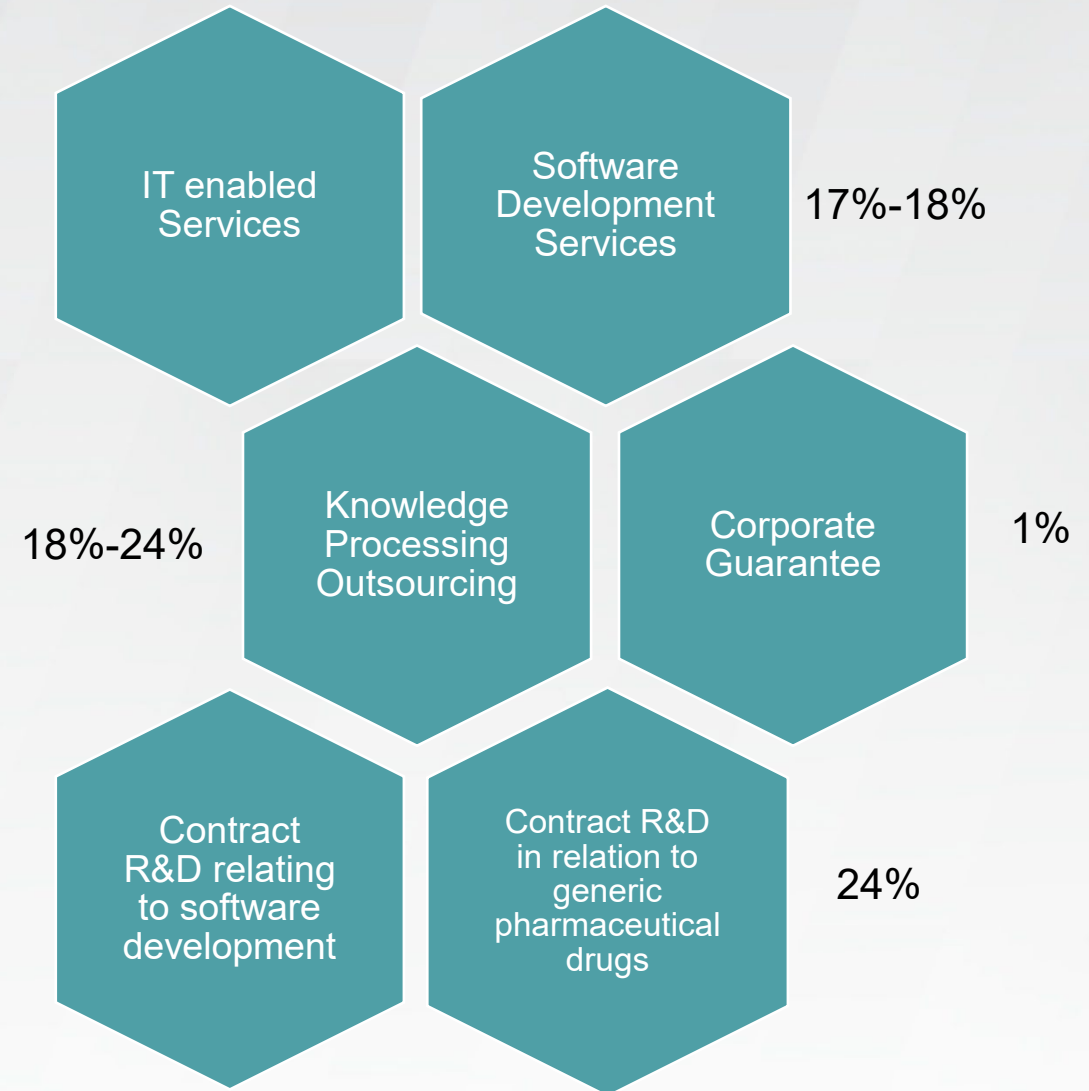
- Business restructurings typically lead to a realignment of Functions, Assets, Risk (FAR). As such, FAR realignment usually results in a commensurate realignment of income
- When dealing with the transfer of intangibles, DEMPE functions as a litmus test
  - DEMPE is designed to ensure that allocation of the returns from the exploitation of intangibles, & allocation of costs related to intangibles, is performed by compensating MNE group entities for functions performed, assets used, & risks assumed in the **development, enhancement, maintenance, protection, & exploitation** of intangibles
- As tax departments increasingly grapple with growing compliance requirements, data integrity/gathering roadblocks, & reduced headcount, data automation becomes increasingly important
- Pillar Two data input requirements will only make compliance more difficult & time-consuming

# Safe Harbor in India

Safe harbor rules can be adopted by eligible Assessee's wherein transfer pricing mark-up in the range prescribed is adopted.

Being the recommended range, the Assessee is offered compliance relief, administrative simplicity, certainty and the lesser risk of litigation.

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# Safe Harbor in U.S.

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Certain  
Intercompany  
Loans &  
Advances

Safe haven interest rates based on Applicable Federal Rate, per Treas. Regs. §1.482-2(a)(2)(iii)

Certain  
Support  
Services  
Transactions

Specified covered services (provided in in Rev. Proc. 2007-13), per Treas. Regs. §1.482-9(b)(3)(i); &

Low margin covered services (with median comparable markup at 7 percent or less), per Treas. Regs. §1.482-9(b)(3)(ii)

# Transfer Pricing Best Practices in the U.S. & India

- Yearly identification of transfer pricing compliance requirements (preparation or filing requirements) & planning needs
- Filing of relevant transfer pricing items timely, if meeting relevant threshold
- Maintenance of as many relevant supporting documents internally as possible, including original accounting records, financial statements, pricing documents, intercompany agreements, etc.
- Reevaluation of intercompany transaction pricing policies at a reasonable frequency & adjust the policies as the fact pattern around intercompany transactions change
- Optimizing transaction pricing calculations & adjustments through regular monitoring & automation implementation

# Q&A

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