

TRANSFER PRICING **communiqué**



Volume 1, Issue 2

Editorial

Transfer Pricing continues to be the focus until the last quarter of the year. Following the Aztec decision, the Income-Tax Appellate Tribunal (Tribunal) Delhi Bench recently pronounced a landmark decision in the case of Mentor Graphics. The ruling reinforces the need for appropriate Transfer Pricing planning and documentation while multinationals continue to reap profits in attractive domestic market.

It is a gratifying moment for our Firm's Transfer Pricing practice, which was conferred an award by International Tax Review. We would like to take this opportunity to thank clients of the Firm and commit to live up to the high standards we have set for ourselves. We trust you enjoy this edition of Transfer Pricing Communiqué.

With the arrival of year end vacation season, we extend warm Christmas and new year greetings.

Regards

Mukesh Butani

Focus

Recent Mentor Graphic (Noida) Private Limited ruling by ITAT focuses on economic issues and recognizes commercial realities of businesses, which are the key in any Transfer Pricing analysis...

The selection of appropriate comparables and related analysis is a fundamental economic issue in any Transfer Pricing analysis. In the case of Mentor Graphics, the primary dispute before the Tribunal was the choice of comparables used for determining the arm's length price. Conclusions reached by the Tribunal would have far reaching implications on several Transfer Pricing cases.

On the lines of Aztec and Morgan Stanley rulings, the ruling of Mentor Graphics stresses on detailed and comprehensive analysis of functions, assets and risks. It was contended that Transfer Pricing is not an exact science but it has to be shown that analysis undertaken for Transfer Pricing study was 'judicial' and was done after taking into account all the relevant facts and circumstances of the case.

Feedback

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The Tribunal observed that any act of the Transfer Pricing Officer (TPO) based on 'inferences and presumptions' would be unacceptable if the taxpayer undertakes detailed documentation and has observed a proper screening for comparable companies based on analysis of functions, risks and assets. This observation was a result of Revenue's disregard of regulations, non-application of filters and inability to present adequate reasoning for rejection of comparables identified in its documentation by the taxpayer.

The ruling also discusses the substantive issue of determining arm's length price and provides general guidance on the right approach to be adopted in selecting the comparable data. In this regard, emphasis was placed on selection of comparable companies based on comparison of economically significant activities and responsibilities of the independent enterprises vis-à-vis the taxpayer. The Tribunal emphasized the importance of comparability adjustments with specific reference to adjustments for differences in working capital, risk and R & D.

Further, the Tribunal observed that as long as the taxpayer is within the arm's length range, the onus to prove an otherwise scenario rests with the Revenue. In the Tribunal's view, it is not necessary for the taxpayer to satisfy all points in the range; even if one point is satisfied, the taxpayer has established its case. By ignoring high profit and high loss making companies in the comparable set, the Tribunal's observation on the arm's length range is commensurate with use of an inter-quartile range as prevalent in other jurisdictions. Several aspects of the Tribunal ruling are in favour of the taxpayer.

In the midst of sizable Transfer Pricing controversies, the ruling has come as a welcome relief to the taxpayers. Though the Revenue is likely to appeal to the State court, the ruling provides a sense of assurance to the taxpayers that by maintaining adequate documentation and on presenting appropriate reasoning for selection of comparables, taxpayers can be assured of presenting a substantive case.

Read BMR's Tax Edge Special on [Mentor Graphics](#)

Get BMR insights on other recent decisions: [Morgan Stanley](#) | [Aztec](#)

Rolls-Royce under Tribunal scepter

Recently, the Delhi bench of Tribunal ordered Rolls Royce to pay 35 percent of profits earned from its Indian operations to tax.

The Tribunal in the case of Rolls Royce held that if a taxpayer holds certain place at its disposal for undertaking business activities for a reasonable period of time, such place would constitute a place of business/ Permanent Establishment (PE). Also, no legal right to use such space is required. For constituting a PE, the basic requirement was that the premises should be identifiable as a separate and distinct place on which the taxpayer is able to exercise control.

Accordingly, since the taxpayer had a fixed place of business at its disposal through which the business activities such as marketing, negotiating and sale (and not merely preparatory and auxiliary activities) were being carried out, the Indian office of the UK subsidiary was held to constitute its PE. Since, PE was undertaking marketing activities (and not

Other Resources

Transfer Pricing:

http://bmrtax.com/transfer_pricing.html

Industry Groups:

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India snippet

Transfer Pricing jurisdiction

As per notifications issued in August 2007 by the Central Board of Direct Taxes, the strength of Transfer Pricing Officers in India has increased from 18 (approx) to 70 in all jurisdictions with 20 officers in Delhi region, 22 in Mumbai and 6 in Bangalore. The Transfer Pricing jurisdiction has been extended to cities such as Pune and Ahmadabad thus emphasizing the importance accorded by the Revenue to this field of taxation. Henceforth, taxpayers in Pune and Ahmedabad will be subject to audits in their respective jurisdictions.

Reference: CBDT notification nos. 231, 232 and 233 dated 22 August 2007

manufacture), 35 percent of the profits of the taxpayer from sale of aircraft engines were attributed to such PE.

The ruling will bring to fore multinational companies' operations in India and force them to review the scope of their operations and inter-company relationships to make an assessment of potential permanent establishment risks. However, tax experts have questioned the justification for determining the profit attributed to Indian entity without regard to arm's length principle and use of scientific Transfer Pricing methodology. It should be noted, the decision was rendered for years in which India did not have comprehensive Transfer Pricing regulations.

Global window

USA: Treasury study on Transfer Pricing

On November 28, 2007, the Treasury department of USA issued a report to the Congress describing current issues relating to international taxation specifically dealing with issues regarding Transfer Pricing rules in USA. The report recommends modernization and finalization of Transfer Pricing guidance relating to cost sharing, services and global dealing. In particular, the study recommends revision of existing guidance on cost sharing, completion of related party services regulations to reflect legal, business and economic developments and issuance of regulations relating to global dealing. The report not only throws light on the current issues but also provides conclusions and recommendations for improving the existing Transfer Pricing rules.

If the US Congress undertakes any major change in the legislation following the issuance of the report, it would have bearing on Indian multinationals having outbound investments and may impact the remuneration models of large number of US multinationals with captive business processing units in India. Thus, any changes in the proposed regulations would be watched with interest in India.

Reference: [United States Department of Treasury](#)

IFA conference

Due to increasing cross-border transactions and the concomitant success of technology intensive sectors, Transfer Pricing and intangibles have attracted IFA's (www.ifa.nl) attention in the recent years. The 61st Annual Congress of the International Fiscal Association held in Kyoto, Japan, recently debated upon the scientific topic of "Transfer Pricing and Intangibles". Drawing from practical experience, the panelists comprising leading experts, including BMR, focused attention on complex issues relating to intangibles encountered by multinational corporations in conducting their cross-border business activities. The most prominent points discussed at the congress were relating to the definition of intangibles, ownership of intangibles and valuation of intangibles.

For more information, click [here](#).

India snippet

CBDT instruction on India-US double taxation avoidance agreement

The Competent Authorities of India and USA had entered into a Memorandum of Understanding (MoU) in 2003 in relation to suspension of collection of taxes during the pendency of Mutual Agreement Procedure (MAP). As per the notification of April 2003, only a resident of USA could apply for suspension of tax demand during MAP proceedings. In September 2007, Central Board of Direct Taxes issued an instruction to extend the applicability of the MoU to Indian resident entities by which Indian residents can apply for suspension of tax liability during the course of pendency of MAP invoked under Article 27 of the Indo-US Double Taxation Avoidance Convention.

This shall benefit Indian resident taxpayers especially in cases involving Transfer Pricing, where the resident enterprise is liable to pay taxes on such income which may have been charged to tax in the hands of the associated enterprise in USA.

Reference: *CBDT Instruction no 10/2007*

Events

BMR hosts Taxand global conference

Recently, BMR hosted the Taxand Board Meeting and Conference on December 5-7, 2007, at New Delhi, India. Taxand network conference was a definitive event that brought together tax experts and visionaries from across several countries, who discussed and shared experiences that will shape developments for the future. It was for the first time since inception of the network that the Taxand Conference was hosted outside Europe. The conference was attended by Government of India representatives, senior counsels, industry representatives along with the Taxand partners and discussed various issues including Transfer Pricing developments across the globe. Guest speakers included Mr P K Bansal, Minister of State for Finance; Dr Parthasarathy Shome, Advisor to Finance Minister; Justice P V Reddy, Chairman, Authority of Advance Rulings; Justice M N Venkatachaliah, Former Chief Justice of India; Mr Mohan Parasaran, Additional Solicitor General of India; Mr T Vishwanathan, Law Secretary and Mr Vimal Gandhi, President, Income Tax Appellate Tribunal.

For more information, click [here](#).

IFA - OECD international tax conference

The India branch of International Fiscal Association, in association with OECD, is organising International Tax Conference "At the Crossroads of Tax Cooperation" from January 23-25, 2008, at JW Marriott Hotel, Mumbai. The conference, supported by BMR amongst others, marks India's increased participation in international affairs by being admitted as observer country to the OECD Committee on Fiscal Affairs.

For more information, click [here](#).

Seminar on service tax

CCH India in association with BMR will host consecutive seminars on Service Tax - The Law and Its Recent Controversies, at Inter Continental, Nehru Place, New Delhi and Inter Continental, Sahar, Mumbai, on February 1 and February 8, 2008 respectively.

For more information, click [here](#).

Awards

Team BMR – Transfer Pricing Firm of the Year, 2007

In the recently concluded International Tax Review Asia Tax Awards 2007 in Hong Kong, BMR was adjudged the best Transfer Pricing Firm in India. This award is a testimony to the quality and commitment that our team has demonstrated in serving clients. The BMR Transfer Pricing team comprises accountants, lawyers, economists and valuation analysts with industry competencies across consumer electronics, financial services, FMCG, information technology and oil and gas sectors. The team works

India snippet

High level view on introduction of APA

In a recent meeting between representatives from Indian Revenue and senior tax professionals, the possibility of introduction of Advanced Pricing Arrangement (APA) in India was examined. This was pursuant to a proposal from a CBDT subgroup that advocated introduction of APA's in India.

Various aspects of APA's relating to its applicability were discussed in the meeting. It was suggested that the validity of APA should be for three to five years and that any company applying for such an agreement should be assured that past closed years will not be audited based on the transfer price agreed in the APA. It is envisaged that some of the changes suggested by the subgroup and discussed in the meeting be looked at for incorporation in the forthcoming budget.

in close co-ordination with its network partners across the globe on various cross-border supply chain structuring, documentation and controversy projects.

To know more about the team and the capabilities, click [here](#).

Know our team



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Gokul Chaudhri is a Partner with the Firm's Corporate Tax and regulatory practice and specializes in Corporate Tax and Transfer Pricing matters for Energy & Infrastructure industry. He has considerable experience in advising domestic and international energy clients and vertically integrated energy giants. He is an acknowledged expert in the area of upstream, mid-stream and oilfield services taxation in general and more specifically in the taxation of farm-out transactions, engineering, procurement and construction arrangements and LNG contracting structuring.

He is a member of The Energy Institute, London, (erstwhile the Institute of Petroleum) and Federation of Indian Mineral Industries. He has contributed to fiscal reform initiatives of the Government of India, specifically for the energy and mining industry and was a member of the task force on tax reforms for the mining industry.

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