



Challenge Us

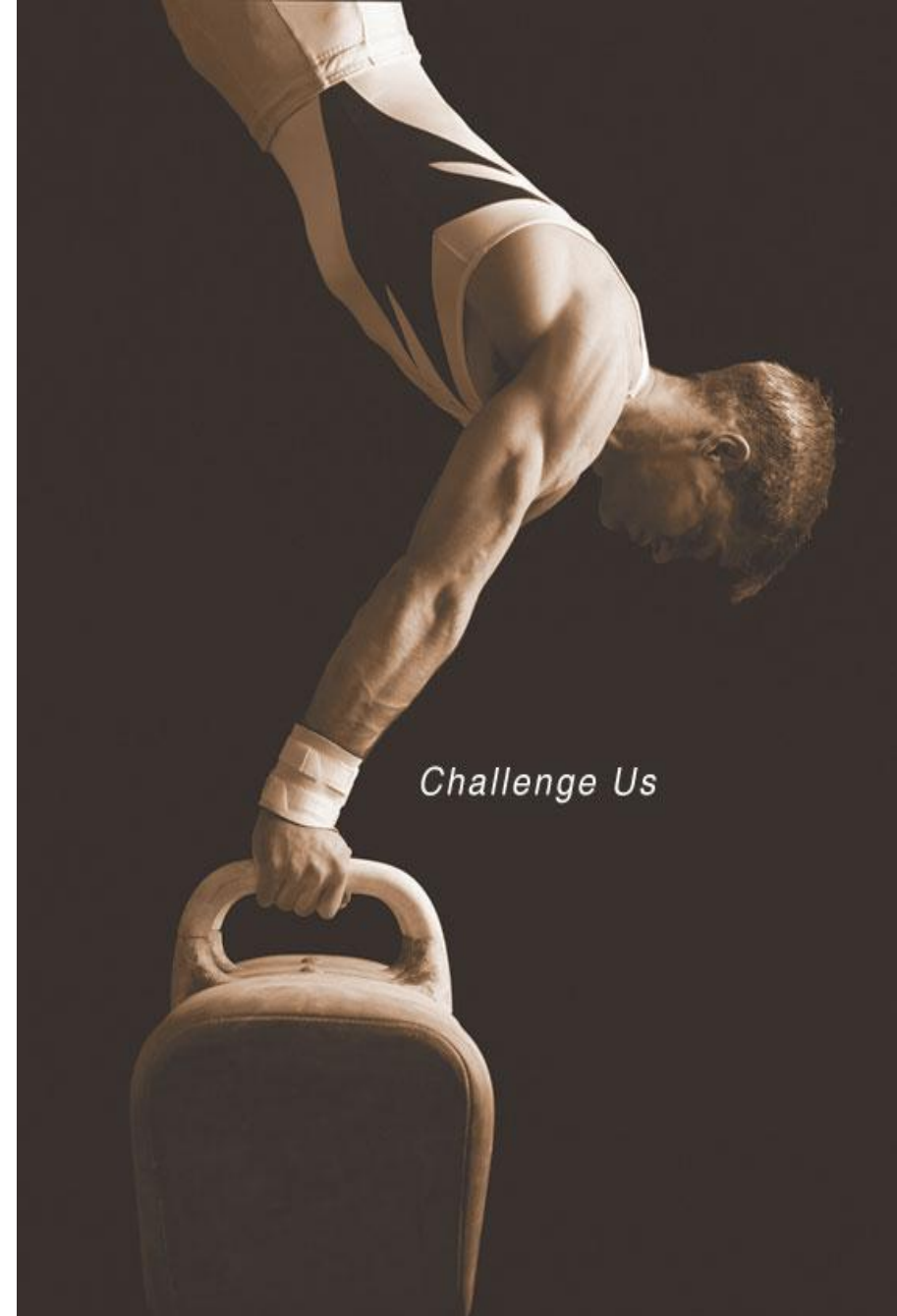
TRANSFER PRICING & PERMANENT ESTABLISHMENTS - INDIA UPDATE

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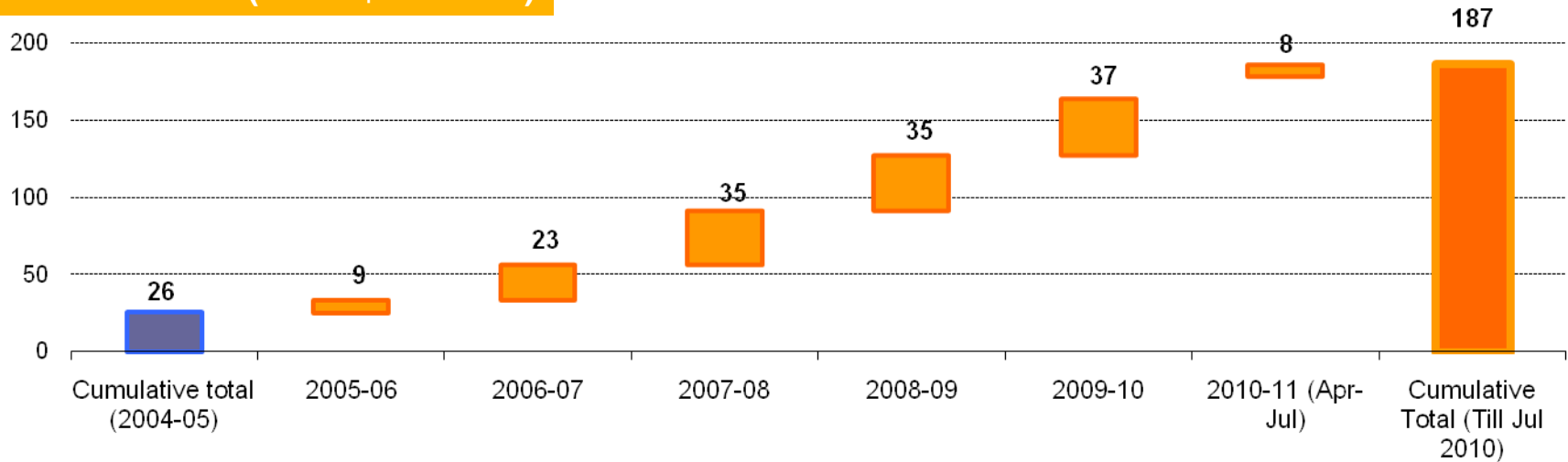
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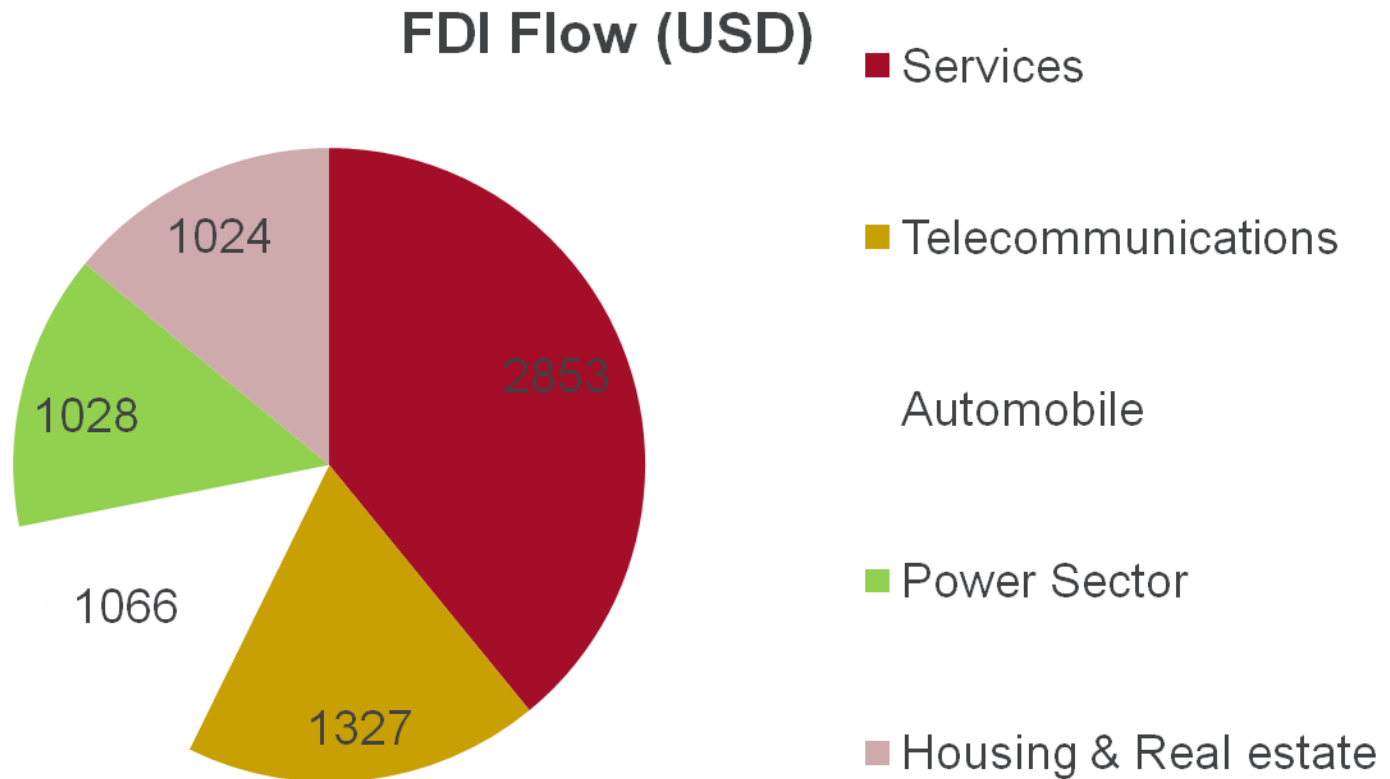
FDI INTO INDIA: COUNTRY BREAK-UP

FDI INFLOWS (IN US \$ BILLION)



- Ranked second by UNCTAD in global foreign direct investments in 2010
- Would remain amongst the top 5 during 2010 -12
- 42% of the FDI from Mauritius followed by Singapore (9%) and USA (7%)
- UK (5%), Netherlands (4%), Germany (2%), France (2%)

FDI INTO INDIA: SECTORAL BREAK-UP



POLICY FRAMEWORK

- Transfer pricing & PE are evolving areas of taxation
- (Unfortunately) they are also most lucrative areas of taxation
- Current political scenario requires Government to act stiff against possible acts of tax avoidance and / or money-laundering
- Increasing fiscal deficit necessitates harsh tax policies (especially for those who have money and do not vote)
- “Best” officers are being imparted the “best” trainings
- Global orientation but localized application is yielding high returns for the Government
- Benefit of doubt is not granted to the taxpayer
- Identified industries being targeted
- Regulations are being made more rigid
- Government does not shy from litigating

NEW DEVELOPMENTS

- Introduction of anti-avoidance provisions wherein transactions with third parties in “notified jurisdictions” would also require transfer pricing compliances
- APAs to be introduced from April 2012
- While the text suggests Unilateral only – Government gearing for Bilateral APAs also
- Extension of due date for income tax return & transfer pricing compliances to November 30 (from September 30)
- General Anti Avoidance Rules (GAAR) to apply to a tax avoidance transaction
- CFCs and Branch Profit Tax to be introduced
- Vodafone case heard – ruling awaited

GENERAL APPROACH - ATTRIBUTION

- Domestic regs rests on wider approach of ‘business connection’
- No specific guidance on attribution
- Profits ‘reasonably attributable’ to operations in India
- Rule 10 gives wide discretionary powers to the tax officers to determine ‘reasonable’ profits (not consistent with TP regs)
- Indian tax treaties broadly based on UN MC
- Use of term ‘directly or indirectly attributable’ in some treaties – [Linklaters controversy]
- Application of ‘force of attraction’
- Attribution of assets, risks, and capital to the PE based on functional analysis
- Courts generally follow OECD commentaries (but not always)

JURIS PRUDENCE – MORGAN STANLEY (SC)

- Existence of ‘economic nexus’ as opposed to legal and financial nexus important for profit attribution
- PE to be considered as a distinct and independent enterprise
- No further attribution required if PE is compensated at arms’ length
- Compensation to PE – based on FAR analysis and adequate transfer pricing documentation

JURIS PRUDENCE – ROLLS ROYCE (HC)

- 35 percent of the global profits attributable to the ‘marketing activities’ by PE
- R&D expenses incurred outside India to be excluded while computing profits for attribution purpose
- ALP to be justified by Transfer Pricing analysis
- 10 percent of profits attributable to supply of spares by DAPE held justified

JURIS PRUDENCE – SET SATELLITE (HC)

- Reliance placed on Morgan Stanley and CBDT Circular No 23 of 1969
- Attribution of income to DAPE
- Profit attribution is restricted to the DA services
- No further attribution required if DAPE is compensated at arms' length
- Pending before Supreme Court

HOT TOPICS IN TRANSFER PRICING

- Marketing intangibles becoming a hot issue in India - has impacted most of the FMCG / consumer electronics companies
- India looking towards the West for jurisprudence
 - GSK case for pharma industry which talked about appropriate 'CUP'
 - Increasing use of OECD Guidelines to tax Indian companies
- Transfer pricing principles applied for Attribution of profits to PE
- Deductibility of global cost allocations becoming difficult owing to a strong "benefits test" being applied by the Indian revenue
- Revenue imputing interest income on longstanding receivables from associated enterprises
- Introduction of safe harbors being shelved off
- Domestic TP regime may be introduced soon in light of a recent Supreme Court ruling
- Transactions with third parties in "notified jurisdictions" also to comply with transfer pricing norms

TRENDS

- Litigation on all time high
- Contrary decisions at the Tax Court
- Most tax court rulings being challenged either by taxpayers or Revenue Authorities
- Revenue Authorities are getting more sophisticated – increasing sharing information and experiences
- Access and use of data in not in public domain prevalent during TP audits
- Captive R&D centres alleged to be PEs
- Benefit of doubt not to the taxpayer
- Expectation to submit elaborate documentation increasing (on part of the Indian Revenue)
- Difficult to obtain stay of tax demand during litigation
- Wide powers to TPOs to conduct surveys at taxpayer locations

MUTUAL AGREEMENT PROCEDURE

- Transfer Pricing related Mutual Agreement Procedures (MAPs) for India on an increase
- Cost Plus Margins proposed / agreed under the MAP are very high and unrealistic from a commercial perspective
- Agreed margins range between 17 – 24 percent for ITES
- Most of the US companies who have been part of this process are discontent with these margins
- Next round of MAP under process
- Companies still retaining the right to appeal for future years with Indian appellate authorities
- Aggressive approach of the Indian CA and lack of transparency in negotiation hindering the process

RISK MITIGATION STRATEGIES

- Creative structures being implemented till the introduction of GAAR (April 2012)
- Increased reliance on MAP to resolve transfer pricing disputes
- MNCs hedging their risks by applying for Advance Rulings (not applicable for TP)
- Re-visit Transfer Pricing / PE positions
- Review inter-company agreements and identify risks
- Detailed review of break-up of AMP expenses (under broad categories) is required to distinguish between routine and non-routine AMP spend
- Get your transfer pricing consultants to talk to your business teams
- Collate and document as much factual data as possible
- Important to have a global perspective
- Documentation is the key

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