

Role of Transfer Pricing In Indian International Taxation: An Empirical Study

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Abstract

Transfer Pricing plays an important role in international trade and commerce, the growth in number and size of Multi National Enterprises has brought a number of opportunities, a part from faster economic development. At the same time, the MNCs have also brought a number of problems to face. Its scope has widened in recent years so much that now more than 60% of the international transactions of the globe belong to MNCs. This has constrained the governments to keep in place proper mechanism to plug the leakage of tax revenue as a result of manipulative pricing policies adopted by these related parties (MNCs). The study shows that the business and industry in India is comfortable about the specific and general issues studied in the paper. However, as regards to audit procedure, time period of 8 years to maintain documents and cooperation of Transfer Pricing authorities while dealing with assesses there is negative response and hence, these issues need thorough analysing and necessary modification in the structural aspects of the provisions under study. If this suggestion is implemented the Indian Transfer Pricing provisions positively contribute to the growth of the international trade.

Keywords: *Business, Industry, Audit Procedure, Transfer Pricing, International Trade, Multinational Enterprises*

1. Introduction

1. Transfer pricing at taxation practices in India plays a pivotal role in international trade and commerce when a transaction belongs to two or more associated enterprises based in different tax jurisdictions. It is an established process through which the tax jurisdictions try to levy tax on the relevant amount of income to which they are rightfully entitled. Recent origin of transfer pricing it has greatly influenced the international tax aspects of almost every country. Late starter in framing the

Transfer Pricing policy it has seriously worked in recent years to follow the foot prints of developed countries in India.

2. Transfer pricing also serves to ascertain the income of both the parties involved in the cross-border transaction. Therefore, it influences the tax base of the countries involved in cross-border transactions. In any cross border tax scenario, the parties involved are the related entities of the Multi National Enterprise group along with the tax authorities. When the tax authority of one country adjusts the profit of a member of the Multi National Enterprise group, this may have an effect on the tax base of another country. The outcome of this entirely different is that becomes a major tax issue for the companies. In other words, cross-border tax situations involve issues related to jurisdiction, allocation of income and valuation.

2. Review of Literature

1. The research area chosen for the study being 'International Taxation', the researchers reviewed the recent research works in the area of Transfer Pricing; the following important works have been reviewed:
2. **Pawan K Chugan 2007** "To throw some light on Transfer Pricing and describe advance pricing arrangement system as is being practiced by some of the developed and developing countries to attract more foreign investments and technology transfers"
3. **Ajit Kumar Jain 2015** "The author analyses the priority given to various transfer pricing methods from Indian perspective, as well as from the perspective of the OECD and various countries around the world."
4. **Bettignies, Jean-Etienne De and Ross, T.W, 2004** "The Economics of Public Private Partnerships", Canadian Public Policy-Analyse De Politiques

5. Akintoye, A., Hard castle, C., Beck. M., Chinyio, E., and Asenova, D., 2003 Achieving best value in private finance initiative project procurement, Construction Management and Economics.

3. Objectives of the Study

1. To review the Transfer Pricing mechanism in Indian Context.
2. To analyse and interpret corporate view about Transfer Pricing in Madurai city
3. To suggest measures for improvement of Transfer Pricing especially in Madurai city.

4. Scope of the Study

Geographically, the study covers the whole of Madurai city. Sample companies spreading across Madurai city and belonging to Tamilnadu. Manufacturing and service sector have been covered. The study deals with Transfer Pricing issues only.

Methodology

Sources of Data The data for the present study has been gathered from both the primary and the secondary sources. The study is mainly based on primary data. However, the secondary data have also been used. The reports of various committees, publications of the Government, professional and academic journals, prominent websites dealing with tax matters, and other literature relating to the subject have been used as secondary sources. The primary data in the form of respondents' opinion has been collected from the corporate bodies. Questionnaire using Likert Scale and alternative choice responses has been used.

Sample Size for the Study

1. The sample size adopted for the study was 50 companies (25 manufacturing and 25 service sector).
2. The profile of the respondents includes Directors, Executive Directors, Managers and Senior Managers (Taxation) of the respondent companies.

Table 1: Sector-Wise Distribution of Sample Corporate Undertakings

Sl. No.	Sector	Frequency	In Percent
1.	Manufacturing Sector	25	50
2.	Service Sector	25	50
Total		50	100.00

Source: Primary Data

5. Tools and Techniques of Data Analysis of the Study

The data gathered through the primary and secondary sources have been edited, tabulated and analyzed using simple statistical tools like percentage method is used to analyse the data which is qualitative in nature.

The Study Transfer Pricing Mechanism in India

Transfer Pricing - Concept and Meaning:

Transfer Pricing, for tax purposes, is the pricing of inter-company transactions that take place between affiliated businesses. Otherwise the price or value attached to transfer of goods and services in related party transactions of an organization is known as transfer pricing

Transfer Pricing – Indian Provisions and Rules

The Transfer Pricing provisions under the Indian Income Tax Act, 1961, were introduced in the year 2001 by way of Section 92 and 92A to 92F. Then ahead the relevant provisions have been under constant amendment and modification. As relevance, the width and breadth of the concept has been restructured in recent years. This mechanism has been tightened so much so that the escape of revenue is avoided to the maximum extent. Table 2 states the Transfer Pricing aspects covered under different Sections and Rules under the Income Tax Act 1961 and Income Tax Rules 1962.

Table 2: Transfer Pricing Provisions and Rules under Indian Income Tax Act and Rules

Sections	Issues Covered
92	Computation of Income from International transaction having regard to arm's length price
92A	Meaning of Associated Enterprise
92B	Meaning of International transaction
92C	Computation of arm's length price
92CA	Reference to Transfer Pricing Officer (TPO)
92CB	Power of Board to make Safe Harbour Rules
92CC	Advance Pricing Agreement
92CD	Effect of Advance Pricing Agreement
92D	Maintenance, keeping of information and documents by persons entering into an international transaction or specified domestic transaction
92E	Report from an accountant to be furnished by persons entering into international transaction or specified domestic transaction
92F	Definitions of certain terms relevant to computation of arm's length price. etc.
94A	Special measures in respect of transactions with persons located in notified jurisdictional area
144C	Reference to Dispute Resolution Panel
271AA	Penalty for failure to keep and maintain information and documentation in respect of certain transactions
271BA	Penalty for failure to furnish report under Section 92E
271G	Penalty for failure to furnish information or document under Section 92D.
10A	Computation of income from international transactions involving Transfer Pricing having regard to arm's length price and meaning of Act
10B	Arm's length price - Determination
10C	Most appropriate method of Transfer Pricing
10D	Maintenance of documents and information
10E	Report from an accountant to be furnished under section 92E.

Source: Compiled from Income Tax Act 1961 and Income Tax Rules 1962.

Results and Discussions

The data gathered from researchers' survey of 50 companies, belonging to manufacturing (24 companies) and service (25 companies) sectors were studied, tabulated and interpreted by classifying information as specific issues of Transfer Pricing and general issues of Transfer Pricing.

Specific Issues

The researchers studied five specific issues concerning the Transfer Pricing practices in India. HS – Highly Satisfied, S – Satisfied, NSNDS – Neither Satisfied Nor Dissatisfied, DS – Dissatisfied and HDS – Highly Dissatisfied. M-Manufacturing and S – Service Sector.

Table 3 shows that the documentation procedure prescribed under the provisions of Income Tax Act

(ITA) pertaining to Transfer Pricing has been accepted by more than 88 percent of the respondents, so also the stages of clearance involved in deciding the arm's length price, which is accepted by more than 86 percent of the respondents. However, as regards to audit procedure and the cooperation of Transfer Pricing authorities in Transfer Pricing decision process the corporate participants expressed their reservations.

Table 3: Respondents' Opinion about Specific Issues Pertaining To Transfer Pricing in India

Sl.No.	Transfer Pricing aspects	Sector	HS	S	NSNDS	DS	HDS	Total
1	Documentation procedure	M	15	1	4	2	3	25
		S	13	4	3	5	00	25
		Total	28	5	7	7	3	50
		In %	56	10	14	14	6	(100)
2	Stages of clearances	M	6	7	8	4	0	25
		S	5	11	7	1	1	25
		Total	11	18	15	05	1	50
		In %	22	36	30	10	2	(100)
3	Methods applied in deciding Arm's Length Price	M	1	12	7	1	4	25
		S	2	9	6	5	3	25
		Total	3	21	13	6	7	50
		In %	6	42	26	12	14	(100)
4	Audit procedure	M	0	5	4	9	7	25
		S	1	1	9	8	6	25
		Total	1	6	13	17	13	50
		In %	2	12	26	34	26	(100)
5	Cooperation of Transfer Pricing authorities in Transfer Pricing decision process	M	2	6	2	8	7	25
		S	2	8	9	4	2	25
		Total	4	14	11	12	9	50
		In %	8	28	22	24	18	(100)

Source: Primary Data

General Issues

In recent years, India has been viewed as an attractive and rapid investment destination, and has witnessed an increased presence of multinational enterprises (MNEs) and a significant increase in

international trade. The researchers sought, as a part of their study, the questions pertaining to five general issues in connection with Transfer Pricing.

Table 4: Respondents' Opinion about General Issues of Transfer Pricing in India

Sl.No.	General Issues of Transfer Pricing	Yes		No	
		M	S	M	S
1.	Transfer Pricing has become the most discussed tax topic today in corporate	25	25	0	0
2.	Transfer Pricing is one of the most complex tax issues faced by the business.	25	20	3	2
3.	Coping with frequently changing Transfer Pricing provisions is a difficult task.	15	5	18	12
4.	Whether the time period of 8 years to keep and maintain the necessary information after the assessment year is acceptable.	17	11	12	10
5.	Indian Government has not put enough effort to solve the problem of increasing Transfer Pricing litigations.	20	12	8	10

Source: Primary Data

The Table 4 deals with the sector-wise response of the respondents pertaining to certain general issues of Transfer Pricing in India. An overwhelming 100 percent respondents belonging to both manufacturing and service sectors, have said that Transfer Pricing is most discussed tax topic today. Transfer pricing is the most complex tax issue faced by the business and industry and coping with frequently changing Transfer Pricing provisions is a difficult task. However, the time limit of 8 years to keep and maintain the necessary information after the assessment year is rejected by majority of both the types of respondents. More than 80 percent of respondents of both the sectors have expressed their discomfort towards the Transfer Pricing decisions of IT department in general. The results for respondents as a whole, is also the same which indicates that the opinion of the respondents based on sector is not different to that of the total respondents with a minor variation which does not affect the direction of findings.

Findings

Specific Issues of Transfer Pricing in India

1. 88% of the total corporate-respondents consider that Transfer Pricing documentation procedure prevailing in India is acceptable. Sector-wise 88.37% of manufacturing sector respondents and 87.5% of service sector respondents have accepted the Transfer Pricing documentation procedure prevailing in India.
2. The study reveals that more than 86% of the total corporate-respondents agree to the stages of clearance pertaining to Transfer Pricing. Sector-wise 86.04% of manufacturing sector respondents and 85.93% of service sector respondents have accepted to the stages of clearance pertaining to Transfer Pricing in India.
3. The study shows that more than 62% of the total corporate-respondents are happy with the methods adopted in deciding arm's length price. Sector-wise 65.11% of manufacturing sector respondents and 59.37% of service sector respondents agree to the methods adopted in deciding arm's length price. The study exhibits that a significant number (41.35%) of the total corporate-respondents did not agree to audit procedure in India. Sector-wise 40.69% of the manufacturing sector respondents and 42.18% of service sector respondents are not happy with the audit procedure in India.
4. 62% (aggregate of dissatisfied and highly dissatisfied) of the corporate-respondents belonging

to both manufacturing sector and service sector have opined that the cooperation of authorities in Transfer Pricing process is not adequate.

General Issues of Transfer Pricing in India

1. It was found that, all the corporate-respondents of the study (100%) have opined that Transfer Pricing is most discussed tax topic today in corporate.
2. More than 40% of service sector respondents and more than 50% of manufacturing sector respondents have opined that Transfer Pricing is a very complex issue faced by the businesses.
3. Majority (30%) of the manufacturing sector respondents and 10% of service sector respondents have agreed that adopting to changing Transfer Pricing provisions is a difficult task.
4. Transfer Pricing provisions' condition that the corporate should maintain documentary evidence and information for at least 8 years' time period, after the assessment year is not accepted by 24% of the respondents belonging to manufacturing sector and 20% of the respondents belonging to service sector. 40% of manufacturing sector respondents and 24% of service sector respondents felt that the effort put by the Indian government in solving the problem of Transfer Pricing litigation is inadequate.

6. Conclusions

The study shows that the business and industry in India is comfortable about the specific and general issues studied in the paper. However, as regards to audit procedure, time period of 8 years to maintain documents and cooperation of Transfer Pricing authorities while dealing with assesses there is negative response and hence, these issues need thorough investigation and necessary modification in the structural aspects of the provisions under study. If this suggestion is implemented the Indian Transfer Pricing provisions positively contribute to the growth of the international trade for future growth of India.

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