SECTION - B
INTERNATIONAL TAXATION

Double Taxation and Avoidance Agreements (DTAA)

12

This Module includes:

12.1 Types of DTAA

12.2 Models of DTAAs (OECD and UN)

12.3 Interlink of DTAAs with Section 90 of Income Tax Act. 1961

12.4 Overview of Articles in DTAAs

Double Taxation and Avoidance Agreements (DTAA)

SLOB Mapped against the Module:

1. To develop understanding about various provisions of direct taxation laws and rules including international taxation laws, and inherent issues that are subject to interpretation with reference to case laws, etc.
2. To attain abilities to apply the acquired understanding for solving complex taxation problems and taking tax efficient business decision and execution thereof.

Module Learning Objectives:

After studying this module, the students will be able to -

- Identify the income which are subject to double taxation
- Analyse the various articles of the treaty or convention
- Apply the provision of income tax to provide relief

Introduction

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In home country, tax is an obligation, while in the host country, tax is a cost.

Every nation has a sovereign right to tax its residents/nationals on their global incomes. As a result, the income of a person can get taxed in both countries i.e. in the home country (country of his residence) as well the host country (country where income is generated) due to conflict of jurisdictions to tax. In such an environment, the benefits of international trade and competitive cost advantages would be lost. Double taxation is harmful for movement of capital, technology transfer, commerce, trade, and of course, people. In order to prevent the injury caused to international trade and commerce, Article 51 of the Indian Constitution has inter-alia provides that:

"The State shall endeavour to -

a. promote international peace and security;

b. maintain just and equitable relations between nations;

c. foster respect for international law and treaty obligations in the dealings of organised people with one another;

d. encourage settlement of international disputes by arbitration.

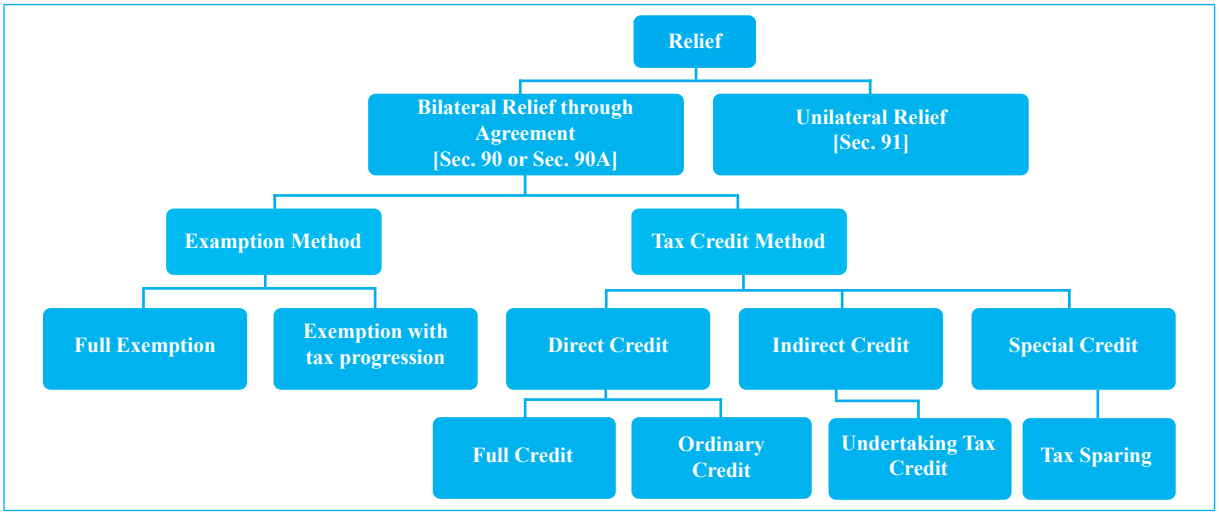
It is pertinent to note that entries 10 and 14 of list I of the seventh schedule confer the power on Parliament to legislate the treaties with foreign countries. Further, this power of Parliament has been delegated to the Central Government vide sec. 90 and 90A of the Income-tax Act, 1961.

Economic Double Taxation	Juridical Double Taxation
➢ Same income taxed in two or more country but in the hands of different taxpayers	➢ Two or more states levy taxes on same entity on same income for identical periods
➢ e.g. business profits and dividend in different countries	➢ Arises due to overlapping claims of tax jurisdictions
	➢ Tax treaties largely prevent / mitigate juridical double taxation

Generally, income is taxable on two basis viz. i) Source of income basis and ii) Residential Status basis, which results into double taxation of the same income of the person. Firstly, such income is taxed in the country in which such income is generated and again, the same income may be taxed on the basis of residential status of the person in another country. For instance, Mr. X, an ordinarily resident in India, earned bank interest of ₹ 1,00,000 on his money deposited into a bank located in US. In that case, such income is taxable in US on Source of income basis and again in India as he is an ordinarily resident India. In times when economies are going global and borders fading, double taxation is still one of the major obstacles to the development of inter-country economic relations. In order to prevent this hardship or to avoid double taxation, relief is provided to the tax-payer.

Such relief is provided by two ways:

- Bilateral Relief
- Unilateral Relief



Bilateral Relief

In this, the government of two countries enters into an agreement (known as 'treaties') to provide relief against double taxation of the same income. As per Article 2 of the Vienna Convention on Laws of Treaties, 1969, "Treaty"[1] means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation. The relief is granted on the basis of the terms of such agreement. Generally, such an agreement provides relief through the following methods:

Exemption Method: In this method, one country provides an exemption to such type of income. Generally, the residence country gave up its right and the country of source is then given the exclusive right to tax such incomes.

a. Full Exemption Method

   Under this method, income earned in the State of Source is fully exempt in the State of Residence.

b. Exemption with Progression

   Under this method, income from the State of Source is considered by the State of Residence only for the rate purpose.

E.g., an Indian Company has earned income from Indian sources of ₹ 75 Lacs. Income from foreign sources (relief available as per exemption with progression method) is ₹ 35 Lacs. As per the provisions of the Act, in India, an additional surcharge of 7% is levied in addition to normal income-tax liability if the total income exceeds ₹ 1 crore and at the rate of 12% if income exceeds ₹ 10 crores. Therefore, in the present case, total income for rate purpose only will exceed ₹ 1 crore and accordingly, effective rate for tax would be after considering the additional surcharge of 7%. However, the income on which the effective rate (inclusive of surcharge) would apply will be ₹ 75 Lacs only.

1 Tax Treaties attempt to eliminate double taxation and try to achieve balance and equity. They aim at sharing of tax revenues by the concerned states on a rational basis. Tax treaties do not always succeed in eliminating Double Taxation, but contain the incidence to a tolerable level. Tax Treaties or DTAAs are also known as AADT (Agreements for Avoidance of Double Taxation), or DTCs (Double Tax Conventions). These terms are used interchangeably.

Mathematically, it would work in this way:

Particulars	Amount (₹)
Income from India	75,00,000
Income from a foreign county	35,00,000
Total Income	**1,10,00,000**
Tax on above @ 30%	33,00,000
Add: Surcharge @ 7%	2,31,000
Tax and surcharge	35,31,000
Add: HEC @ 4%	1,41,240
Tax, Surcharge and Cess [A]	**36,72,240**
Average rate of tax [₹ 36,72,240 / ₹ 1,10,00,000 × 100]	33.38%
Relief [₹ 35,00,000 × 33.38%] [B]	**11,68,440**
Tax, Surcharge and Cess [A - B]	**25,03,800**
Which effectively [₹ 75,00,000 × 30% × 107% × 104%]. If foreign income is not considered then tax on ₹ 75,00,000 would be calculated without considering surcharge, in that case, total income would not exceed the threshold limit applicable for charging surcharge.	

Credit Method: In this method, the resident remains liable in the country of residence on its global income, however as far as the quantum of tax liabilities is concerned credit or deduction for tax paid in the source country is given by the residence country against its domestic tax as if the foreign tax were paid to the country of the residence itself.

Taxpoint: In this type of relief, the mechanism for granting relief is provided in the agreement itself.

a. Full Credit

Total tax paid in the State of Source is allowed as credit against tax payable in the State of Residence.

b. Ordinary Credit

State of Residence allows credit of tax paid in the state of Source restricted to that part of income tax which is attributable to the income taxable in the state of Residence.

Example

- Mr. A is a resident of country X, went on 3 months assignment to Country Y
- Salary income of Mr. A is ₹ 24,00,000
- Of the above, Country Y taxed 3 months income of ₹ 6,00,000 @ 28%

Compute tax liability of Mr. A considering full credit method and ordinary credit method.

Solution:

Computation of tax liability of Mr. A

Particulars	Country X	Country Y
Total Income	24,00,000	6,00,000
Tax rate	Slab	28%
Tax on above before relief	3,12,000	1,68,000
Relief:		
Full Credit	1,68,000	
Ordinary Credit [Lower of the following]	1,06,600	
- Tax paid in country Y	1,68,000	
- Tax paid in country X [₹ 3,12,000 x ₹ 6,00,000 / ₹ 24,00,000]	78,000	

c. Tax Sparing

State of Residence allows credit for deemed tax paid on income which is otherwise exempt from tax in the State of Source.

Example

- A Ltd, the parent company, being located in Country X has a branch in Country Y
- Branch earns a profit of ₹ 10,00,000
- Country X taxes residents on global income @ 30%
- Tax rate in country Y is 25%. However, as a measure to promote economic development therein (like special economic zones), country Y is not levying any tax.
- DTAA between Country X-Y has tax sparing provisions.

Compute tax sparing if branch operates in a specified area and is not taxed in Y

Solution:

Computation of tax liability of A Ltd

Particulars	Country X	Country Y
Total Income	10,00,000	10,00,000
Tax on above before relief	3,00,000	0
Relief as per tax sparing provision		
Relief [₹ 10,00,000 × rate of tax in foreign country i.e., 25%]	2,50,000	
Tax Payable	50,000	0

Relief is available in country X deeming that tax has been paid in the country Y @ 25% though no tax has been paid in the country Y.

d. Underlying Tax Credit

Underlying tax credit method attempts to mitigate the economic double taxation. Economic double taxation occurs where the same income is taxed more than once in the hands of different person in the same tax jurisdiction. E.g., The profits earned by the corporates are taxed at their hand and the same is again taxed when

it is distributed to shareholders as dividend. Under underlying credit method, credit is allowed to resident not only for the taxes withheld against the dividend income but also for the taxes paid on the underlying profits out of which the said dividend is paid by a company in the overseas jurisdiction. However, underlying credit may only apply if satisfaction of substantial shareholding requirement is met.

Example

- A Ltd, the parent company, being located in Country X has a subsidiary B Ltd in Country Y
- B Ltd out of its profits of ₹ 10,00,000 paid dividend to A Ltd ₹ 1,00,000
- Other income of A Ltd is ₹ 11,00,000
- Dividend withholding tax rates in Country Y – 15%
- Tax rate in country Y is 25 % and in Country X it is 30%
- DTAA between Country X-Y has an underlying tax credit (UTC) provision

Solution

Computation of tax liability

Particulars	A Ltd	B Ltd
Total Income	12,00,000	10,00,000
Tax on above before relief	3,60,000	2,50,000
Less: Tax credit for withholding tax	15,000	0
Tax Liability without relief	3,45,000	
Relief as per underlying tax credit		
Relief [₹ 10,00,000 × rate of tax in foreign country i.e., 25%]	2,50,000	
Tax Payable after relief	95,000	0

Unilateral Relief

The aforesaid method depends on the bilateral activity of both the countries. However, no country will have such an agreement with every country in the world. To avoid double taxation in such cases, the country of the residence itself may provide relief on a unilateral basis.

Types of DTAA

12.1

[2]DTAA can be of two types, limited or comprehensive. Limited DTAA are those which are limited to certain types of incomes only e.g. DTAA between India and Pakistan is limited to shipping and aircraft profits only.

Comprehensive DTAAs are those which cover almost all types of incomes covered by any model convention.

2 Presently India have DTAA with more than 90 countries

Models of DTAAs (OECD and UN)

12.2

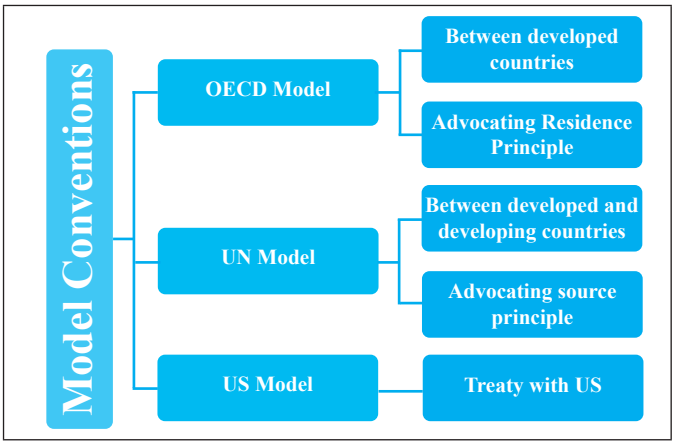
Global trade and commerce have made the world a single integrated market. In today's scenario, no country can claim that it is self-sufficient. This gives rise to import and export of goods and services. As and when the global trade started expanding its operations, economic transactions triggered tax provisions of various jurisdictions. In the absence of any agreement for avoidance of double taxation, the global business environment was affected. Therefore, a need was felt that there must be formulated a convention which would enable avoidance of double taxation. This led to series of model tax conventions by various bodies in different years.

Model tax treaties serve as the starting point (or can be termed as standard format) for negotiations between two countries. Although model treaties are not legally binding, their language often is incorporated verbatim (or with only minor alterations) in the text of bilateral treaties. However, sometimes they make changes as per their requirement and relationship with the other country.

Presently, the following are the model tax conventions which are in vogue –

a. Organisation for Economic Co-operation and Development (OECD) Model

The emergence of present form of OECD Model Convention can be traced back to 1927, when the Fiscal Committee of the League of Nations prepared the first draft of Model Form applicable to all countries. Since then, it has been revised several times and the latest being in the year 2017. OECD Model is essentially a model treaty between two developed nations. This model advocates residence principle, that is to say, it lays emphasis on the right of state of residence to tax the income.



b. United Nations (UN) Model

In 1968, the United Nations set up an Adhoc Group of Experts from various developed and developing countries to prepare a draft model convention between developed and developing countries. In 1980, this Group finalized the UN Model Convention in its present form. It has further been revised a number of times, the recent ones being in the year 2021. It gives more weight to the source principle as against the residence principle of the OECD Model. UN Model is designed to encourage flow of investments from the developed countries to developing countries. It takes into account sharing of tax-revenue with the country providing capital. Most of India's tax treaties are based on the UN Model.

c. US Model

The US Model convention was first published in 1976 and revised several times. US motel is used by the United States while entering into tax treaties with various country.

Articles in OECD Model and UN Model

In UN model, there are VII chapters which contains 31 articles whereas VII chapters of the OECD model contains 32 articles. List of articles are as under:

Article	OECD Model	UN Model
1	Person covered	Person covered
2	Taxes covered	Taxes covered
3	General definitions	General definitions
4	Resident	Resident
5	Permanent establishment	Permanent establishment
6	Income from immovable property	Income from immovable property
7	Business profits	Business profits
8	Shipping, inland waterways transport and air transport	Shipping, inland waterways transport and air transport (Alternative A & B)
9	Associated enterprise	Associated enterprise
10	Dividends	Dividends
11	Interest	Interest
12	Royalties	Royalties
12A	Fee for Technical Services	Fee for Technical Services
12B	--	Income from automated digital services
13	Capital Gains	Capital Gains
14	Deleted	Independent personal services
15	Income from employment	Dependent personal services
16	Directors' fees	Directors' fees and remuneration of top-level managerial officials
17	Entertainers and sportspersons	Artistes and sportspersons
18	Pensions	Pensions and Social Security Payments (Alternative A & B)
19	Government service	Government service
20	Students	Students
21	Other Income	Other Income
22	Capital	Capital
23A	Exemption method	Exemption method
23B	Credit method	Credit method
24	Non discrimination	Non discrimination
25	Mutual agreement procedure	Mutual agreement procedure (Alternative A & B)

Article	OECD Model	UN Model
26	Exchange of information	Exchange of information
27	Assistance in the collection of taxes	Assistance in the collection of taxes
28	Members of diplomatic missions and consular posts	Members of diplomatic missions and consular posts
29	Entitlement of benefits	Entitlement of benefits
30	Territorial extension	Entry in force
31	Entry in force	Termination
32	Termination	

In India, relief for the avoidance of double taxation is provided in both ways. Provisions relating thereto are enumerated here-in-below:

Interlink of DTAAs with Section 90 of Income Tax Act, 1961

12.3

Agreement with foreign countries [Sec. 90] [Bilateral Relief]

The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India:

a. for the granting of relief in respect of—

   (i) income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or

   (ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, to promote mutual economic relations, trade and investment, or

b. for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, as the case may be, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory); or

c. for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory, as the case may be, or investigation of cases of such evasion or avoidance, or

d. for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory, as the case may be,

and may make such provisions as may be necessary for implementing the agreement.

Taxpoint

- **Applicability of DTAA**
  - Where the Central Government has entered into an agreement with the Government of any country or specified territory outside India for granting relief of tax or avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee. However, the provisions of Chapter X-A of the Act (i.e., GAAR) shall apply to the assessee even if such provisions are not beneficial to him.
  - Example: If as per DTAA with a foreign country, fee for technical services is to be taxed at the rate of 25% whereas it is taxable u/s 115A of the Act @ 20%, then it will be beneficial to apply sec. 115A. On the other hand, if as per the provision of DTAA, it is either not taxable or taxable at a rate lower than 10%, then DTAA is applicable.
  - Sections 4 and 5 of the Income-tax Act provide for taxation of global income of an assessee but this is subject to the provisions of an agreement entered into between the Central Government and the Government of a foreign country for avoidance of double taxation. In case of any conflict between the provisions of

the agreement and the Act, the provisions of the agreement would prevail over the Act in view of the provisions of sec. 90(2) [CIT v Kulandagan Chettiar (P V A L) (2004) (SC)] If any matter or income is not covered by the agreement, the Income-tax Act shall be applicable.

- When tax rate is determined under DTAA then tax rate prescribed therein shall have to be followed strictly without any additional taxes thereon in form of surcharge or education cess [DCIT -vs.- BOC Group Ltd. (2016) 156 ITD 402 (Mum) (Trib)]
- The charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.
- In case of a remittance to a country with which a Double Taxation Avoidance Agreement is in force, the tax should be deducted at the rate provided in the Finance Act of the relevant year or at the rate provided in the Double Taxation Avoidance Agreement, whichever is more beneficial to the assessee.
- If no tax liability is imposed under this Act, the question of relief does not arise [UOI vs Azadi Bachao Andolan (2003) (SC)]
- Relief cannot be granted unless the income which has been taxed in one of the contracting countries has also suffered tax in the other contracting country. Proof has to be provided of the income having suffered double taxation.

- **Tax Residency Certificate:** An assessee, not being a resident, to whom DTAA applies, shall not be entitled to claim any relief under such agreement unless a certificate of his being a resident in any country outside India or specified territory outside India, as the case may be, is obtained by him from the Government of that country or specified territory. Further, the assessee shall also provide such other documents and information, as may be prescribed.
  - Where the Government of the State certified that a person is a resident of that state or has a permanent establishment in the State, the certificate is binding on the other Government [UOI vs Azadi Bachao Andolan (2003) (SC)]
- "Specified territory" means any area outside India which may be notified[3] as such by the Central Government.
- **Meaning of the terms**
  - Where any term used in an agreement is defined under the said agreement, the said term shall have the same meaning as assigned to it in the agreement; and where the term is not defined in the said agreement, but defined in the Act, it shall have the same meaning as assigned to it in the Act and explanation, if any, given to it by the Central Government.
  - Further, any term used but not defined in the Act or in the agreement shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government.
  - Further, where any term is used in any agreement and not defined under the said agreement or the Act, but is assigned a meaning to it in the notification issued, then, the meaning assigned to such term shall be deemed to have effect from the date on which the said agreement came into force.

3 Bermuda, British Virgin Islands, Cayman Islands, Gibraltar, Guernsey, Isle of Man, Netherlands Antilles, Macau, Hongkong and Sint Maarten

Illustration 1.

Mr. Ramesh, a resident Indian, has derived the following incomes for the previous year relevant to the A.Y. 2026-27:

a. Income from profession in India	₹ 12,44,000
b. Income from profession in country A (Tax paid in foreign country @ 5%)	₹ 4,50,000

Compute Indian tax liability of the assessee assuming that as per the treaty between India and Country A, ₹ 4,50,000 is taxable in India. However foreign tax can be set off against Indian tax liability.

Solution:

Computation of total income and tax liability of Mr. Ramesh for the A.Y. 2026-27

Particulars	Amount
Income from profession in India	12,44,000
Income from profession in Country A	4,50,000
Gross Total Income	**16,94,000**
Less: Deduction u/ch. VIA	NA
Total income	**16,94,000**
Tax on above	**1,38,800**
Add: Health & Education cess	5,552
Tax and cess payable	**1,44,352**
Less: Relief u/s 90 [₹ 4,50,000 × 5%]	22,500
Tax payable in India (Rounded off u/s 288B)	**1,21,850**

Illustration 2.

Shri Anuj, an ordinarily resident in India, provides the following details of his income for the previous year relevant to the A.Y. 2026-27

- Income from India ₹ 13,40,000
- Income from Country Z ₹ 12,00,000
- Investment in PPF ₹ 1,00,000

Further, it is to be noted that:

a) India has avoidance of double taxation agreement with Country Z. According to the said agreement, income is taxable in the country in which it is earned and not in the other country. However, in the other country, such income can be included for the purpose of computation of tax rate.

b) Foreign income has been taxed in Country Z @ 20%.

Compute Indian tax payable.

Solution:

Computation of total income and tax liability of Shri Anuj for the A.Y. 2026-27

Particulars	Amount
Income from India	13,40,000
Income from Country Z	12,00,000
Gross Total Income	25,40,000
Less: Deduction u/s 80C [Investment in PPF]	NA
Total income	**25,40,000**
Tax on above	3,42,000
Add: Health & Education cess	13,680
Tax and cess payable	**3,55,680**
Less: Relief u/s 90 [₹ 12,00,000 × 14.00%[1]]	1,68,000
Tax payable in India (Rounded off u/s 288B)	1,87,680

[1.] Average rate of Indian tax = ₹ 3,55,680 / ₹ 25,40,000 × 100 = 14.00%

Adoption by Central Government of agreements between specified associations for double taxation relief [Sec. 90A]

Any specified association in India may enter into an agreement with any specified association in the specified territory outside India and the Central Government may, by notification in the Official Gazette, make such provisions as may be necessary for adopting and implementing such agreement—

a) for granting of relief in respect of—
   (i) income on which have been paid both income-tax under this Act and income-tax in any specified territory outside India; or
   (ii) income-tax chargeable under this Act and under the corresponding law in force in that specified territory outside India to promote mutual economic relations, trade and investment, or

b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that specified territory outside India, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory); or

c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that specified territory outside India, or investigation of cases of such evasion or avoidance, or

d) for recovery of income-tax under this Act and under the corresponding law in force in that specified territory outside India.

Notes

- Specified association means any institution, association or body, whether incorporated or not, functioning under any law for the time being in force in India or the laws of the specified territory outside India and which may be notified as such by the Central Government for the purposes of this section.
- Specified territory means any area outside India which may be notified as such by the Central Government for the purposes of this section.
- **Tax Residency Certificate:** An assessee, not being a resident, to whom DTA applies, shall not be entitled to claim any relief under such agreement unless a certificate of his being a resident in any country outside India

or specified territory outside India, as the case may be, is obtained by him from the Government of that country or specified territory. Further, the assessee shall also provide such other documents and information, as may be prescribed.

- **Meaning of the terms**
  - Where any term used in an agreement entered into is defined under the said agreement, the said term shall have the same meaning as assigned to it in the agreement; and where the term is not defined in the said agreement, but defined in the Act, it shall have the same meaning as assigned to it in the Act and explanation, if any, given to it by the Central Government.
  - Where any term is used in any agreement and not defined under the said agreement or the Act, but is assigned a meaning to it in the notification issued, then, the meaning assigned to such term shall be deemed to have effect from the date on which the said agreement came into force.
- **GAAR:** Where a specified association in India has entered into an agreement with a specified association of any specified territory outside India and such agreement has been notified, for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee. However, the provisions of Chapter X-A of the Act (i.e., GAAR) shall apply to the assessee even if such provisions are not beneficial to him.

Certificate for claiming relief u/s 90 / 90A [Rule 21AB]

- For the purposes certificate discussed in sec. 90 and 90A, the following information shall be provided by an assessee in Form No. 10F:
  i. Status (individual, company, firm etc.) of the assessee;
  ii. Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others);
  iii. Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory of which the asseessee claims to be a resident;
  iv. Period for which the residential status, as mentioned in the certificate, is applicable; and
  v. Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned above, is applicable.
- The assessee may not be required to provide the information or any part thereof referred above, if the information is contained in the certificate.
- The assessee shall keep and maintain such documents as are necessary to substantiate the information and an income-tax authority may require the assessee to provide the said documents in relation to a claim by the said assessee of any relief under an agreement
- An assessee, being a resident in India, shall, for obtaining a certificate of residence for the purposes of an agreement referred to in sec. 90 and 90A, make an application in Form No. 10FA to the Assessing Officer.
- The Assessing Officer on receipt of an application and being satisfied in this behalf, shall issue a certificate of residence in respect of the assessee in Form No. 10FB.

Countries with which no agreement exists [Sec. 91] [Unilateral Relief]

If any person who is resident in India in any previous year proves that:

a) The income has accrued or arose during the previous year outside India (and which is not deemed to accrue or arise in India),

b) He has paid in any country income-tax on such income, by deduction or otherwise, under the law in force in that country

c) India does not have any agreement u/s 90 for the relief or avoidance of double taxation with that country

- then he shall be entitled to the deduction from the Indian income-tax payable by him

(i) of a sum calculated on such doubly taxed income at the average of Indian rate of tax or

(ii) of a sum calculated on such doubly taxed income at the average rate of tax of the said country,

- whichever is the lower, or at the Indian rate of tax if both the rates are equal.

Notes

a) The expression 'such doubly taxed income' really purports to indicate that it is only that portion of the income on which tax has been imposed and been paid by the assessee that is eligible for the double tax relief. Thus, where the foreign income which suffered tax in the foreign country was ₹ 88,535, and the income actually taxed in India after allowances and set off of losses (or deduction under chapter VIA) was ₹ 63,141, relief admissible would be calculated on ₹ 63,141 [CIT v. O.VR.SV.VR. Arunachalam Chettiar]

b) Relief u/s 91 is to be calculated on income country-wise and not on basis of aggregation or amalgamation of income of all foreign countries [CIT v. Bombay Burmah Trading Corpn. Ltd. (2003)]

c) No benefit is available on income which is deemed to accrue or arise in India, even though such income is doubly taxed.

Illustration 3.

Mr. Saha, a resident Indian, has derived the following incomes for the previous year relevant to the A.Y. 2026-27:

a.	Income from profession	₹ 3,74,000
b.	Royalty on books from foreign country Y (₹ 3,00,000 is eligible for deduction u/s 80QQB) (Tax paid in foreign country @ 20%)	₹ 5,00,000

Compute Indian tax liability, if he has opted for the old regime, assuming that India does not have any agreement with country Y.

Solution:

Computation of total income and tax liability of Mr. Saha for the A.Y. 2026-27

Particulars	Amount
Income from profession	3,74,000
Royalty earned in country Y	5,00,000
Gross Total Income	8,74,000
Less: Deduction u/s 80QQB	3,00,000
Total income	5,74,000

Particulars	Amount
Tax on above	27,300
Add: Health & Education cess	1,092
Tax and cess payable	28,392
Average rate of tax [₹ 28,392 / ₹ 5,74,000 × 100]	4.95%
Rate of tax in country Y	20%
Relief u/s 91 [4.95%1 of ₹ 2,00,000]	9,900
Tax payable (Rounded off u/s 288B)	18,490

1. Indian average tax rate: 04.95% Foreign average tax rate: 20.00%

Relief u/s 91 is available at lower of aforesaid rate. i.e., 4.95%

Illustration 4.

Arvind, a textile merchant and resident Indian is doing business in India and abroad. During the previous year 2025-26, he disclosed the following information:

	₹
Income from business in India	27,00,000
Income from business in Country- A with which	
India does not have agreement for avoidance of double taxation	15,00,000
Income-tax levied by government in Country-A	5,00,000
Loss from business in Country-B with which also	
India does not have agreement for avoidance of double taxation	(4,00,000)
Contribution to public provident fund	1,50,000
Payment of life insurance premium on the life of his Father and mother	20,000

Compute the tax liability of Arvind for the assessment year 2026-27.

Solution:

Computation of total income and tax liability for the A.Y. 2026-27

Particulars	Amount
Income from business in India	27,00,000
Income from business in Country A	15,00,000
Income from business in Country B	(-) 4,00,000
Gross Total Income	**38,00,000**
Less: Deduction u/s 80C	NA
Total income	**38,00,000**
Tax on above	7,20,000
Add: Health & Education cess	28,800
Tax and cess payable	**7,48,800**

Particulars	Amount
Average rate of tax [₹ 7,48,800 / ₹ 38,00,000 × 100]	19.71%
Rate of tax in country A	33.33%
Relief u/s 91 [19.71%[1] of ₹ 15,00,000]	**2,95,650**
Tax payable (Rounded off u/s 288B)	**4,53,150**

[1] Indian average tax rate: 19.71% Foreign average tax rate: 33.33%

Relief u/s 91 is available at lower of the aforesaid rates i.e., 19.71%

Illustration 5.

Amar, an individual, resident of India, receives the following payments after TDS during the previous year 2025-26:

(i)	Professional fees on 17.08.2025	12,40,000
(ii)	Professional fees on 04.03.2026	1,60,000

Both the above services were rendered in country X on which TDS of ₹ 50,000 and ₹ 30,000 respectively have been deducted. He had incurred an expenditure of ₹ 2,00,000 for earning both these receipts / income. His income from other sources in India is ₹ 5,00,000 and he has made payment of ₹ 70,000 towards LIC. Compute the tax liability of Amar and also the relief u/s 91, if any, for A.Y. 2026 - 27..

Solution:

Computation of total income and tax liability of Mr. Amar for the A.Y. 2026-27

Particulars	Amount	Amount
Income from profession from foreign	14,00,000	
Less: Expenses	2,00,000	12,00,000
Income from profession in India		5,00,000
Gross Total Income		17,00,000
Less: Deduction u/s 80C		NA
Total income		17,00,000
Tax on above		1,40,000
Add: Health & Education cess		5,600
Tax and cess payable		1,45,600
Average rate of tax [₹ 1,45,600 / ₹ 17,00,000 × 100]		8.56%
Rate of tax in Country X		16.67%
Relief u/s 91 [8.56%^ of ₹ 12,00,000]		1,02,720
Tax payable (Rounded off u/s 288B)		42,880

^ Relief u/s 91 is available at a lower rate i.e., 8.56%

Foreign Tax Credit [Rule 128]

An assessee, being a resident shall be allowed a credit for the amount of any foreign tax paid by him in a country or specified territory outside India, by way of deduction or otherwise, in the year in which the income corresponding to such tax has been offered to tax or assessed to tax in India, in the manner and to the extent as specified in this rule.

Taxpoint:

- **More than one year:** In a case, where such foreign income is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India.
- **No credit for interest, etc.:** The credit shall be available against the amount of tax, surcharge and cess payable under the Act but not in respect of any sum payable by way of interest, fee or penalty.
- **No credit for disputed tax:** No credit shall be available in respect of any amount of foreign tax or part thereof which is disputed in any manner by the assessee. However, the credit of such disputed tax shall be allowed for the year in which such income is offered to tax or assessed to tax in India if the assessee within 6 months from the end of the month in which the dispute is finally settled, furnishes evidence of settlement of dispute and an evidence to the effect that the liability for payment of such foreign tax has been discharged by him and furnishes an undertaking that no refund in respect of such amount has directly or indirectly been claimed or shall be claimed.

Meaning of Foreign Tax

In respect of	Foreign Tax
A country or specified territory with which India has entered into an agreement u/s 90 or 90A	Tax covered under the said agreement
Any other country or specified territory	Tax payable under the law of that country or specified territory in the nature of income-tax referred to in the Explanation to sec. 91 (i.e., "income-tax" in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country)

Taxpoint

The credit of foreign tax shall be the aggregate of the amounts of credit computed separately for each source of income arising from a particular country or specified territory outside India and shall be given effect to in the following manner:

- The credit shall be the lower of the tax payable under the Act on such income and the foreign tax paid on such income.
  - However, where the foreign tax paid exceeds the amount of tax payable in accordance with the provisions of the agreement for relief or avoidance of double taxation, such excess shall be ignored.
- The credit shall be determined by conversion of the currency of payment of foreign tax at the telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted.

Tax Payable under MAT or AMT

- In a case where any tax is payable u/s 115JB or 115JC, the credit of foreign tax shall be allowed against such tax in the same manner as is allowable against any tax payable under the provisions of the Act other than the provisions of the said sections (hereafter referred to as the "normal provisions").
- Where the amount of foreign tax credit available against the tax payable u/s 115JB or 115JC exceeds the amount of tax credit available against the normal provisions, then while computing the amount of credit u/s 115JAA or 115JD in respect of the taxes paid u/s 115JB or 115JC, as the case may be, such excess shall be ignored.

Documents Required for Credit

Credit of any foreign tax shall be allowed on furnishing the following documents by the assessee within due date of furnishing return of income:

- a statement of income from the country or specified territory outside India offered for tax for the previous year and of foreign tax deducted or paid on such income in Form No.67 and verified in the manner specified therein;
- certificate or statement specifying the nature of income and the amount of tax deducted therefrom or paid by the assessee:
  a) from the tax authority of the country or the specified territory outside India; or
  b) from the person responsible for deduction of such tax; or
  c) signed by the assessee:
    - The statement furnished and signed by the assessee shall be valid if it is accompanied by:
      A. an acknowledgement of online payment or bank counter foil or challan for payment of tax where the payment has been made by the assessee;
      B. proof of deduction where the tax has been deducted.

Taxpoint: Form No.67 shall also be furnished in a case where the carry backward of loss of the current year results in refund of foreign tax for which credit has been claimed in any earlier previous year or years.

Permanent Establishment (PE)

One of the important terms that occurs in all the Double Taxation Avoidance Agreements is the term 'Permanent Establishment' (PE) which has not been defined in the Income Tax Act. However as per the Double Taxation Avoidance Agreements, PE includes, a wide variety of arrangements i.e. a place of management, a branch, an office, a factory, a workshop or a warehouse, a mine, a quarry, an oilfield etc. Imposition of tax on a foreign enterprise is done only if it has a PE in the contracting state. Tax is computed by treating the PE as a distinct and independent enterprise.

Generally, in Indian context, the term permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on. The term "permanent establishment" shall also include:

a. a place of management;
b. a branch;
c. an office;
d. a factory;
e. a workshop;
f. a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;
g. a warehouse in relation to a person providing storage facilities for others;
h. a farm, plantation or other place where agricultural, pastoral, forestry or plantation activities are carried on;
i. premises used as a sales outlet or for receiving or soliciting orders;
j. an installation or structure, or plant or equipment, used for the exploration for or exploitation of natural resources;

k. a building site or construction, installation or assembly project, or supervisory activities in connection with such a site or project, where that site or project exists or those activities are carried on (whether separately or together with other sites, projects or activities) for more than specified months (generally 6 months).

Exclusion

An enterprise shall not be deemed to have a permanent establishment merely by reason of :

a. the use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;

b. the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;

c. the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

d. the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise; or

e. the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the enterprise.

An enterprise of one of the Contracting States shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, a general commission agent or any other agent of an independent status, where that person is acting in the ordinary course of the person's business as such a broker or agent. However, when the activities of such a broker or agent are carried on wholly or principally on behalf of that enterprise itself or on behalf of that enterprise and other enterprises controlling, or controlled by or subject to the same common control as, that enterprise, the person will not be considered a broker or agent of an independent status within the meaning of this paragraph.

Taxation of Business Process Outsourcing Units in India

Taxation of IT-enabled Business Process Outsourcing Units in India as provided in the Circular 05/2004 dated 28-9-2004 are as under:

1. A non-resident entity may outsource certain services to a resident Indian entity. If there is no business connection between the two, the resident entity may not be a Permanent Establishment of the non-resident entity, and the resident entity would have to be assessed to income-tax as a separate entity. In such a case, the non-resident entity will not be liable under the Income-tax Act, 1961.

2. However, it is possible that the non-resident entity may have a business connection with the resident Indian entity. In such a case, the resident Indian entity could be treated as the Permanent Establishment of the non-resident entity. The tax treatment of the Permanent Establishment in such a case is under consideration in this circular.

3. During the last decade or so, India has seen a steady growth of outsourcing of business processes by non-residents or foreign companies to IT-enabled entities in India. Such entities are either branches or associated enterprises of the foreign enterprise or an independent Indian enterprise. Their activities range from mere procurement of orders for sale of goods or provision of services and answering sales related queries to the provision of services itself like software maintenance service, debt collection service, software development service, credit card/mobile telephone related service, etc. The non-resident entity or the foreign company will be liable to tax in India only if the IT-enabled BPO unit in India constitutes its Permanent Establishment. The extent to which the profits of the non-resident enterprise is to be attributed to the activities of such Permanent Establishment in India has been under consideration of the Board.

4. A non-resident or a foreign company is treated as having a Permanent Establishment in India under Article 5 of the Double Taxation Avoidance Agreements entered into by India with different countries if the said non-resident or foreign company carries on business in India through a branch, sales office etc. or through an agent (other than an independent agent) who habitually exercises an authority to conclude contracts or regularly delivers goods or merchandise or habitually secures orders on behalf of the non-resident principal. In such a case, the profits of the non-resident or foreign company attributable to the business activities carried out in India by the Permanent Establishment becomes taxable in India under Article 7 of the Double Taxation Avoidance Agreements.

5. Paragraph 1 of Article 7 of Double Taxation Avoidance Agreements provides that if a foreign enterprise carries on business in another country through a Permanent Establishment situated therein, the profits of the enterprise may be taxed in the other country but only so much of them as is attributable to the Permanent Establishment. Paragraph 2 of the same Article provides that subject to the provisions of Paragraph 3, there shall in each contracting state be attributed to that Permanent Establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a Permanent Establishment. Paragraph 3 of the Article provides that in determining the profits of a Permanent Establishment there shall be allowed as deductions expenses which are incurred for the purposes of the Permanent Establishment including executive and general administrative expenses so incurred, whether in the State in which the Permanent Establishment is situated or elsewhere. What are the expenses that are deductible would have to be determined in accordance with the accepted principles of accountancy and the provisions of the Income-tax Act, 1961.

6. Paragraph 2 contains the central directive on which the allocation of profits to a Permanent Establishment is intended to be based. The paragraph incorporates the view that the profits to be attributed to a Permanent Establishment are those which that Permanent Establishment would have made if, instead of dealing with its Head Office, it had been dealing with an entirely separate enterprise under conditions and at prices prevailing in the ordinary market. This corresponds to the "arm's length principle". Paragraph 3 only provides a rule applicable for the determination of the profits of the Permanent Establishment, while paragraph 2 requires that the profits so determined correspond to the profit that a separate and independent enterprise would have made. Hence, in determining the profits attributable to an IT-enabled BPO unit constituting a Permanent Establishment, it will be necessary to determine the price of the services rendered by the Permanent Establishment to the Head office or by the Head office to the Permanent Establishment on the basis of "arm's length principle".

7. "Arm's length price" would have the same meaning as in the definition in sec. 92F(iii) of the Income-tax Act. The arm's length price would have to be determined in accordance with the provisions of sec. 92 to 92F of the Act.

Overview of Articles in DTAAs

12.4

Most of the world's income tax systems impose tax on the world-wide income of their residents and on profits with a source in the country where the income is derived by a non-resident. In the event of cross-border investments or business activities, two jurisdictions may wish to tax the same profits – the source country because the income is attributable to factors within that country and the residence country because all residents are taxed on their world-wide incomes. In the absence of any agreement between the source country and the residence country from which a cross-border investor or business is carried out, the source country would have primary taxing rights if only because it is in a position to extract the tax before the profits are repatriated to the residence country. Unless the residence country wished to double tax the income and in effect discourage any outward investment or business activities by its residents, it will have no choice but to forgo its claimed taxing rights and limit its tax to the difference, if any, between the tax rate imposed in the source country and that imposed in the residence country.

Wealthier countries, particularly OECD nations, very often enter into treaties with each other to divide taxing rights flowing from their competing claims to tax the same income. Treaties limit the source country's taxing rights, leaving more room for the country in which the investor or business is resident to tax the profits. Where two capital exporting nations enter into a tax treaty, the limitation of the source country's taxing rights has little overall impact as each jurisdiction will sacrifice to the other taxing rights of profits from cross-border investment and business. If one party to a treaty is a capital importing nation, the treaty will shift overall taxing rights (and tax revenue) from the poorer country to the richer country.

Country representatives commonly draw on two model treaties prepared by the OECD and UN respectively when negotiating tax treaties. The OECD treaty shifts more taxing powers to capital exporting countries while the UN treaty reserves more for capital importing countries.

Article-wise comparison of these two models are as under:

Para	OECD Model Tax Convention	UN Model Convention
	Article 1 "Persons Covered"	
1	his Convention shall apply to persons who are residents of one or both of the Contracting States. Taxpoint: Person is defined in article 3	
2	For the purposes of this Convention, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State but only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State.	
3	This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under paragraph 3 of Article 7, paragraph 2 of Article 9 and	This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under 8 paragraph 2 of Article 9, [paragraph 2 of Article

Para	OECD Model Tax Convention	UN Model Convention
	Articles 19, 20, 23 [A] [B], 24, 25 and 28.	18 (Alternative A) or paragraph 3 of Article 18 (Alternative B)] and Articles 19, 20, [23 A or 23 B], 24, [25 (Alternative A) or 25 (Alternative B)] and 2
	Article 2 "Taxes Covered"	
1	This Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.	
2	There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation. **Taxpoint** Tax imposed on the following are covered: ➢ Total income, ➢ Total capital, ➢ Elements of income or of capital, ➢ Gains from the alienation of movable or immovable property, ➢ Total amounts of wages or salaries paid by enterprises, ➢ Capital appreciation.	
3	The existing taxes to which the Convention shall apply are in particular: (a) (in State A): ..... (b) (in State B):	
4	The Convention shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of significant changes made to their tax law.	
	Article 3 "General Definitions"	
1	For the purposes of this Convention, unless the context otherwise requires:	
1(a)	The term "person" includes an individual, a company and any other body of persons;	
1(b)	The term "company" means any body corporate or any entity that is treated as a body corporate for tax purposes; Taxpoint: It includes unincorporated entity like partnership firm, trust, etc.	
1(c)	The term "enterprise" applies to the carrying on of any business --	
	Taxpoint: Enterprise generally means a profit making entity including carrying on any professional activity.	
1(d) of OECD Model and 1(c) of UN model	The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;	

Para	OECD Model Tax Convention	UN Model Convention
1(e) of OECD Model and 1(d) of UN model	The term "international traffic" means any transport by a ship or aircraft except when the ship or aircraft is operated solely between places in a Contracting State and the enterprise that operates the ship or aircraft is not an enterprise of that State; Taxpoint: Further refer article 8	
1(f) of OECD Model and 1(e) of UN model	The term "competent authority" means: (i) (in State A): ..... (ii) (in State B): ..... Taxpoint: This definition enables each contracting States, to nominate one or more authorities as being competent authorities to handle issue relating to the convention.	
1(g) of OECD Model and 1(f) of UN model	The term "national", in relation to a Contracting State, means: (i) any individual possessing the nationality or citizenship of that Contracting State; and (ii) any legal person, partnership or association deriving its status as such from the laws in force in that Contracting State	The term "national" means: (i) any individual possessing the nationality of a Contracting State (ii) any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State.
	Taxpoint: In UN Model, the word "citizenship" was excluded.	
1(h)	The term "business" includes the performance of professional services and of other activities of an independent character.	--
1(i) of OECD Model and 1(g) of UN Model	The term "recognised pension fund" of a State means an entity or arrangement established in that State that is treated as a separate person under the taxation laws of that State and: (i) that is established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals and that is regulated as such by that State or one of its political subdivisions or local authorities; or (ii) that is established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements referred to in subdivision (i).	
2	As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires or the competent authorities agree to a different meaning pursuant to the provisions of Article 25, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.	
	Taxpoint: If any term used under tax treaty is not defined there in then the meaning of that term can be adopted from tax laws of the relevant contracting states. However, where more than one meaning is given in the tax laws of a contracting State, the meaning which is provided for a particular provision for an issue, should be considered.	

<table>
<tr><th>Para</th><th>OECD Model Tax Convention</th><th>UN Model Convention</th></tr>
<tr><td colspan="3">Article 4 “Resident”</td></tr>
<tr><td>1</td><td>For the purposes of this Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof as well as a recognised pension fund of that State. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.</td><td>For the purposes of this Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of that person’s domicile, residence, place of incorporation, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof as well as a recognized pension fund of that State. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.</td></tr>
<tr><td>2</td><td colspan="2">Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:
a. He shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);
b. If the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;
c. If he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;
d. If he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.
Taxpoint:
Tie-breaker rules, as the name suggests, serve to determine which of two countries should tax an individual as his/her country of residence, in case there is a “tie” on the matter between two countries.
WHICH COUNTRY’S PRESIDENT AM I?
PERMANENT HOSE
➢ In which country do you have a permanent home (Owned or Rented) available to you?
➢ If you have permanent home in more than one country, move to the next question
CENTER OF VITAL INTEREST
➢ In which country are your personal and economic relations closer?
➢ If the center of vital interest cannot be determined, move to the text questions</td></tr>
</table>

Para	OECD Model Tax Convention	UN Model Convention
	WHICH COUNTRY'S PRESIDENT AM I?	
	HABITUAL ABODE	➢ In which country do you have an habitual abode? ➢ If you have an habitual abode in neither of the countries, move to the next question
	NATIONALITY	➢ In which country are you a national? ➢ If you are a national of both countries or of neither of them, move to the next question
	COMPETENT AUTHORITY	➢ The residency will be determined by mutual agreement between both the countries 'competent authority'
3	Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States. Taxpoint: This is tie-breaker rule for a person other than an individual.	
	Article 5 "Permanent Establishment"	
1	For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.	
2	The term "permanent establishment" includes especially: a) a place of management; b) a branch; c) an office; d) a factory; e) a workshop, and f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.	
3	A building site or construction or installation project constitutes a permanent establishment only if it lasts more than 12 months.	The term "permanent establishment" also encompasses: a. A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than 6 months; b. The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned.

Para	OECD Model Tax Convention	UN Model Convention
4	Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include: a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise; b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery; c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise; d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise; e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity; f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that such activity or, in the case of subparagraph f), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.	Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include: (a) The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise; (b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display; (c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise; (d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise; (e) The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity; (f) The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e), provided that such activity or, in the case of subparagraph (f), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.
	Taxpoint: Para 4(a) and 4(b) of the UN model does not include the word "delivery"	
4.1	Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and a. that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or	Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and: a. that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or

Para	OECD Model Tax Convention	UN Model Convention
	b. the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character, provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.	b. the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character, provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation
5	Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 6, where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are a. in the name of the enterprise, or b. for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or c. for the provision of services by that enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business (other than a fixed place of business to which paragraph 4.1 would apply), would not make this fixed place of business a permanent establishment under the provisions of that paragraph.	Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 7, where a person is acting in a Contracting State on behalf of an enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, if such a person: a. habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are i. in the name of the enterprise, or ii. for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or iii. for the provision of services by that enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business (other than a fixed place of business to which paragraph 4.1 would apply), would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or b. the person does not habitually conclude contracts nor plays the principal role leading to the conclusion of such contracts, but habitually maintains in that State a stock of goods or merchandise from which that person regularly delivers goods or merchandise on behalf of the enterprise.

Para	OECD Model Tax Convention	UN Model Convention
6	--	Notwithstanding the preceding provisions of this Article but subject to the provisions of paragraph 7, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person.
6 of OECD Model and 7 of UN Model	Paragraph 5 shall not apply where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.	Paragraphs 5 and 6 shall not apply where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.
	Taxpoint: In UN Model, provisions for both dependent agent and independent agent is discussed.	
7 of OECD Model and 8 of UN Model	The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.	
8 of OECD Model and 9 of UN Model	For the purposes of this Article, a person or enterprise is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person or enterprise shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person or enterprise possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise or in the two enterprises.	
	Article 6 "Income from Immovable Property"	
1 to 4	1. Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.	1. Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.

Para	OECD Model Tax Convention	UN Model Convention
	2. The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships and aircraft shall not be regarded as immovable property.	2. The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships and aircraft shall not be regarded as immovable property.
	3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property.	3. The provisions of paragraph 1 shall also apply to income derived from the direct use, letting, or use in any other form of immovable property.
	4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise.	4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of independent personal services
	Article 7 "Business Profits"	
1	Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State.	The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to a. that permanent establishment; b. sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or c. other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.

Para	OECD Model Tax Convention	UN Model Convention
	Taxpoint: Principle of Force of Attraction (FOA) Rule The basic principle underlying the principle of FOA rule is that when an enterprise establishes a PE in another country, it brings itself within the jurisdiction of that country to such an extent that such another country acquires right to tax all profits that enterprise derives from their country, whether through the involvement of that PE or otherwise. Therefore, under the FOA rule, mere existence of PE in another country leads to all the profits, that can be said to be derived from that another country, being treated as taxable in that another country. In substance, such extended scope empowers the source country to tax profits of the enterprise also from the direct sale of similar goods/services in the source country, without involvement of the PE. Force of Attraction (FOA) in a way expands the rights of the source country to tax such business income of an enterprise. UN model, includes this rule.	
2	For the purposes of this Article and Article [23 A] [23 B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.	Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.
	Taxpoint: In order to allocate profits, OECD Model uses the term like functions performed, asset used and risk assumed. However, these terms are not used in the UN model.	
3	Where, in accordance with paragraph 2, a Contracting State adjusts the profits that are attributable to a permanent establishment of an enterprise of one of the Contracting States and taxes accordingly profits of the enterprise that have been charged to tax in the other State, the other State shall, to the extent necessary to eliminate double taxation on these profits, make an appropriate adjustment to the amount of the tax charged on those profits. In determining such adjustment, the competent authorities of the Contracting States shall, if necessary, consult each other.	In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere.

Para	OECD Model Tax Convention	UN Model Convention
		However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission, for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than towards reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.
4	--	In so far as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be customary; the method of apportionment adopted shall, however, be such that the result shall be in accordance with the principles contained in this Article.
5	--	For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary
4 of OECD Model & 6 of UN Model	Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.	

Para	OECD Model Tax Convention	UN Model Convention
	Article 8 "International Shipping and Air Transport"	
1	Profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.	Alternative A Profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.
2	The provisions of paragraph 1 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.	The provisions of paragraph 1 shall also apply to profits from the participation in a pool, a joint business or an international operating agency Alternative B 1. Profits of an enterprise of a Contracting State from the operation of aircraft in international traffic shall be taxable only in that State. 2. Profits of an enterprise of a Contracting State from the operation of ships in international traffic shall be taxable only in that State unless the shipping activities arising from such operation in the other Contracting State are more than casual. If such activities are more than casual, such profits may be taxed in that other State. The profits to be taxed in that other State shall be determined on the basis of an appropriate allocation of the overall net profits derived by the enterprise from its shipping operations. The tax computed in accordance with such allocation shall then be reduced by ___ per cent. (The percentage is to be established through bilateral negotiations.) 3. The provisions of paragraphs 1 and 2 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.
	Article 9 "Associated Enterprises"	
1	Where: a. an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or b. the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly	

Para	OECD Model Tax Convention	UN Model Convention
2	Where a Contracting State includes in the profits of an enterprise of that State—and taxes accordingly—profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of the Convention and the competent authorities of the Contracting States shall, if necessary, consult each other.	
3	The provisions of paragraph 2 shall not apply where judicial, administrative or other legal proceedings have resulted in a final ruling that by actions giving rise to an adjustment of profits under paragraph 1, one of the enterprises concerned is liable to penalty with respect to fraud, gross negligence or wilful default.	
	Article 10 "Dividends"	
1	Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.	
2	However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed: a. 5% of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25% of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend); b. 15 per cent of the gross amount of the dividends in all other cases. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.	However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed: a. ___ % (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25% of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend); b. ___ % (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends in all other cases. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

Para	OECD Model Tax Convention	UN Model Convention
3	The term "dividends" as used in this Article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.	The term "dividends" as used in this Article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.
4	The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident through a permanent establishment situated therein and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.	The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply
5	Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.	Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except in so far as such dividends are paid to a resident of that other State or in so far as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.
	Article 11 "Interest"	
1	Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.	
2	However, interest arising in a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10% of the gross amount of the interest. The competent authorities of the Contracting States shall by	However, interest arising in a Contracting State may also be taxed in that State and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed ___ % [the percentage is to be established through bilateral negotiations] of

Para	OECD Model Tax Convention	UN Model Convention
	mutual agreement settle the mode of application of this limitation.	the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation
3	The term "interest" as used in this Article means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.	
4	The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises through a permanent establishment situated therein and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.	The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt claim in respect of which the interest is paid is effectively connected with a. such permanent establishment or fixed base, or with b. business activities referred to in (c) of paragraph 1 of Article 7. In such cases the provisions of Article 7 or Article 14, as the case may be, shall apply.
5	Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated.	Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment or fixed base, then such interest shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.
6	Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.	

Para	OECD Model Tax Convention	UN Model Convention
	Taxpoint: Special relationship means a. direct or indirect participation in the management, control and capital b. relatives	
	Article 12 "Royalties"	
1	Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State.	Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State
2	--	However, royalties arising in a Contracting State may also be taxed in that State and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed ___% [the percentage is to be established through bilateral negotiations] of the gross amount of the royalties. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.
2 of OECD Model and 3 of UN Model	The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.	The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience.
3 of OECD Model and 4 of UN Model	The provisions of paragraph 1 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise through a permanent establishment situated therein and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.	The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties are paid is effectively connected with (a) such permanent establishment or fixed base, or with (b) business activities referred to in

Para	OECD Model Tax Convention	UN Model Convention
		(c) of paragraph 1 of Article 7. In such cases the provisions of Article 7 or Article 14, as the case may be, shall apply.
5	--	Royalties shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the royalties, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the liability to pay the royalties was incurred, and such royalties are borne by such permanent establishment or fixed base, then such royalties shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.
4 of OECD Model and 6 of UN Model	Where by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.	
	Article 12A "Fees for Technical Services"	
1 to 7	--	1. Fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State. 2. However, notwithstanding the provisions of Article 14 and subject to the provisions of Articles 8, 16 and 17, fees for technical services arising in a Contracting State may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the fees is a resident of the other Contracting State, the tax so charged shall not exceed ___ % of the gross amount of the fees [the percentage to be established through bilateral negotiations]. 3. The term "fees for technical services" as used in this Article means any payment in consideration for any service of a managerial, technical or consultancy nature, unless the payment is made:

Para	OECD Model Tax Convention	UN Model Convention
		(a) to an employee of the person making the payment; (b) for teaching in an educational institution or for teaching by an educational institution; or (c) by an individual for services for the personal use of an individual. 4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the fees for technical services arise through a permanent establishment situated in that other State, or performs in the other Contracting State independent personal services from a fixed base situated in that other State, and the fees for technical services are effectively connected with: (a) such permanent establishment or fixed base, or (b) business activities referred to in (c) of paragraph 1 of Article 7. In such cases the provisions of Article 7 or Article 14, as the case may be, shall apply. 5. For the purposes of this Article, subject to paragraph 6, fees for technical services shall be deemed to arise in a Contracting State if the payer is a resident of that State or if the person paying the fees, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the obligation to pay the fees was incurred, and such fees are borne by the permanent establishment or fixed base.

Para	OECD Model Tax Convention	UN Model Convention
		6. For the purposes of this Article, fees for technical services shall be deemed not to arise in a Contracting State if the payer is a resident of that State and carries on business in the other Contracting State through a permanent establishment situated in that other State or performs independent personal services through a fixed base situated in that other State and such fees are borne by that permanent establishment or fixed base. 7. Where, by reason of a special relationship between the payer and the beneficial owner of the fees for technical services or between both of them and some other person, the amount of the fees, having regard to the services for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the fees shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.
Article 12B "Income from Automated Digital Services"		
1	--	Income from automated digital services arising in a Contracting State, underlying payments for which are made to a resident of the other Contracting State, may be taxed in that other State.
2	--	However, subject to the provisions of Article 8 and notwithstanding the provisions of Article 14, income from automated digital services arising in a Contracting State may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the income is a resident of the other Contracting State, the tax so charged shall not exceed ___ % [the percentage is to be established through bilateral negotiations] of the gross amount of the payments underlying the income from automated digital services.

Para	OECD Model Tax Convention	UN Model Convention
3	--	The provisions of paragraph 2 shall not apply if the beneficial owner of the income from automated digital services, being a resident of a Contracting State, requests the other Contracting State where such income arises, to subject its qualified profits from automated digital services for the fiscal year concerned to taxation at the tax rate provided for in the domestic laws of that State. If the beneficial owner so requests, subject to the provisions of Article 8 and notwithstanding the provisions of Article 14, the taxation by that Contracting State shall be carried out accordingly. For the purposes of this paragraph, the qualified profits shall be 30% of the amount resulting from applying the profitability ratio of that beneficial owner's automated digital services business segment to the gross annual revenue from automated digital services derived from the Contracting State where such income arises. Where segmental accounts are not maintained by the beneficial owner, the overall profitability ratio of the beneficial owner will be applied to determine qualified profits. However, where the beneficial owner belongs to a multinational enterprise group, the profitability ratio to be applied shall be that of the business segment of the group relating to the income covered by this Article, or of the group as a whole in case segmental accounts are not maintained by the group, provided such profitability ratio of the multinational enterprise group is higher than the aforesaid profitability ratio of the beneficial owner. Where the segmental profitability ratio or, as the case may be, the overall profitability ratio of the multinational enterprise group to which the beneficial owner belongs is not available to the Contracting State in which the income from automated digital services arises, the provisions of this paragraph shall not apply; in such a case, the provisions of paragraph 2 shall apply.

Para	OECD Model Tax Convention	UN Model Convention
4	--	For the purposes of paragraph 3, "multinational enterprise group" means any "group" that includes two or more enterprises, the tax residence for which is in different jurisdictions. Further, for the purposes of paragraph 3, the term "group" means a collection of enterprises related through ownership or control such that it is either required to prepare Consolidated Financial Statements for financial reporting purposes under applicable accounting principles or would be so required if equity interests in any of the enterprises were traded on a public stock exchange.
5	--	The term "automated digital services" as used in this Article means any service provided on the Internet or another electronic network, in either case requiring minimal human involvement from the service provider.
6	--	The term "automated digital services" includes especially: (a) online advertising services; (b) supply of user data; (c) online search engines; (d) online intermediation platform services; (e) social media platforms; (f) digital content services; (g) online gaming; (h) cloud computing services; and (i) standardized online teaching services
7	--	The provisions of this Article shall not apply if the payments underlying the income from automated digital services qualify as "royalties" or "fees for technical services" under Article 12 or Article 12A as the case may be
8	--	The provisions of paragraphs 1, 2 and 3 shall not apply if the beneficial owner of the income from automated digital services, being a resident of a Contracting State, carries on business in the other Contracting State in which the income from automated digital services arises through a permanent establishment situated in that other State, or performs in the other Contracting State

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		independent personal services from a fixed base situated in that other State, and the income from automated digital services is effectively connected with: a. such permanent establishment or fixed base, or b. business activities referred to in para 1(c) of Article 7. In such cases the provisions of Article 7 or Article 14, as the case may be, shall apply
9	--	For the purposes of this Article and subject to paragraph 10, income from automated digital services shall be deemed to arise in a Contracting State if the underlying payments for the income from automated digital services are made by a resident of that State or if the person making the underlying payments for the automated digital services, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the obligation to make the payments was incurred, and such payments are borne by the permanent establishment or fixed base.
10	--	For the purposes of this Article, income from automated digital services shall be deemed not to arise in a Contracting State if the underlying payments for the income from automated digital services are made by a resident of that State which carries on business in the other Contracting State through a permanent establishment situated in that other State or performs independent personal services through a fixed base situated in that other State and such underlying payments towards automated digital services are borne by that permanent establishment or fixed base.
11	--	Where, by reason of a special relationship between the payer and the beneficial owner of the income from automated digital services or between both of them and some other person, the amount of the payments underlying such income, having regard to the services for

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		which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments underlying such income from automated digital services shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.
	Article 13 "Capital Gains"	
1	Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.	
2	Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other State.	Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.
3	Gains that an enterprise of a Contracting State that operates ships or aircraft in international traffic derives from the alienation of such ships or aircraft, or of movable property pertaining to the operation of such ships or aircraft, shall be taxable only in that State	
4	Gains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50% of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State.	Gains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50% of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State.
5	--	Gains, other than those to which paragraph 4 applies, derived by a resident of a Contracting State from the alienation of shares of a company, or comparable interests, such as interests in a partnership or trust, which is a resident of the other Contracting State, may be taxed in

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		that other State if the alienator, at any time during the 365 days preceding such alienation, held directly or indirectly at least ___ % (the percentage is to be established through bilateral negotiations) of the capital of that company or entity.
5 of OECD Model and 6 of UN Model	Gains from the alienation of any property, other than that referred to in aforesaid paragraphs shall be taxable only in the Contracting State of which the alienator is a resident.	Gains derived by a resident of a Contracting State from the alienation of a right granted under the law of the other Contracting State which allows the use of resources that are naturally present in that other State and that are under the jurisdiction of that other State, may be taxed in that other State.
7	--	Subject to paragraphs 4 and 5, gains derived by a resident of a Contracting State from the alienation of shares of a company, or comparable interests of an entity, such as interests in a partnership or trust, may be taxed in the other Contracting State if a. the alienator, at any time during the 365 days preceding such alienation, held directly or indirectly at least ___% [the percentage is to be established through bilateral negotiations] of the capital of that company or entity; and b. at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50% of their value directly or indirectly from i. a property any gain from which would have been taxable in that other State in accordance with the preceding provisions of this Article if that gain had been derived by a resident of the first-mentioned State from the alienation of that property at that time, or ii. any combination of property referred to in subdivision (i).
8	--	Gains from the alienation of any property other than that referred to in paragraphs 1 to 7 shall be taxable only in the Contracting State of which the alienator is a resident.

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Article 14 "Independent Personal Services"		
1 & 2	Deleted	1. Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State: a. If he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State; or b. If his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any 12 months period commencing or ending in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State. 2. The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.
Article 15 "Income from Employment" [OECD Model] / "Dependent Personal Services" [UN Model]		
1	Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.	
2	Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if: a. The recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; and	Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if: a. The recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; and

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	b. The remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and c. The remuneration is not borne by a permanent establishment which the employer has in the other State.	b. The remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and c. The remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.
3	Notwithstanding the preceding provisions of this Article, remuneration derived by a resident of a Contracting State in respect of an employment, as a member of the regular complement of a ship or aircraft, that is exercised aboard a ship or aircraft operated in international traffic, other than aboard a ship or aircraft operated solely within the other Contracting State, shall be taxable only in the first-mentioned State.	
	Article 16 "Directors' Fees"	
1	Directors' fees and other similar payments derived by a resident of a Contracting State in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other State.	
2	--	Salaries, wages and other similar remuneration derived by a resident of a Contracting State in his capacity as an official in a top-level managerial position of a company which is a resident of the other Contracting State may be taxed in that other State.
	Article 17 "Entertainers and Sportspersons"	
1	Notwithstanding the provisions of Article 15, income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as a sportsperson, from that resident's personal activities as such exercised in the other Contracting State, may be taxed in that other State.	Notwithstanding the provisions of Articles 14 and 15, income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as a sportsperson, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State.
2	Where income in respect of personal activities exercised by an entertainer or a sportsperson acting as such accrues not to the entertainer or sportsperson but to another person, that income may, notwithstanding the provisions of Article 15, be taxed in the Contracting State in which the activities of the entertainer or sportsperson are exercised.	Where income in respect of personal activities exercised by an entertainer or a sportsperson in his capacity as such accrues not to the entertainer or sportsperson himself but to another person, that income may, notwithstanding the provisions of Articles 7, 14 and 15, be taxed in the Contracting State in which the activities of the entertainer or sportsperson are exercised.
	Article 18 "Pensions" [OECD Model] / "Pensions and Social Security Payments" [UN Model]	
	Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State.	Alternative A 1. Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State.

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		2. Notwithstanding the provisions of paragraph 1, pensions paid and other payments made under a public scheme which is part of the social security system of a Contracting State or a political subdivision or a local authority thereof shall be taxable only in that State. Alternative B 1. Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment may be taxed in that State. 2. However, such pensions and other similar remuneration may also be taxed in the other Contracting State if the payment is made by a resident of that other State or a permanent establishment situated therein. 3. Notwithstanding the provisions of paragraphs 1 and 2, pensions paid and other payments made under a public scheme which is part of the social security system of a Contracting State or a political subdivision or a local authority thereof shall be taxable only in that State.
Article 19 "Government Service"		
1	a. Salaries, wages and other similar remuneration paid by a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State. b. However, such salaries, wages and other similar remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the individual is a resident of that State who: i. is a national of that State; or ii. did not become a resident of that State solely for the purpose of rendering the services.	a. Salaries, wages and other similar remuneration paid by a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State. b. However, such salaries, wages and other similar remuneration shall be taxable only in the other Contracting State if the services are rendered in that other State and the individual is a resident of that State who: i. is a national of that State; or ii. did not become a resident of that State solely for the purpose of rendering the services.

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2	a. Notwithstanding the provisions of paragraph 1, pensions and other similar remuneration paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State. b. However, such pensions and other similar remuneration shall be taxable only in the other Contracting State if the individual is a resident of, and a national of, that State.	a. Notwithstanding the provisions of paragraph 1, pensions and other similar remuneration paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State. b. However, such pensions and other similar remuneration shall be taxable only in the other Contracting State if the individual is a resident of, and a national of, that other State.
3	The provisions of Articles 15, 16, 17 and 18 shall apply to salaries, wages, pensions, and other similar remuneration in respect of services rendered in connection with a business carried on by a Contracting State or a political subdivision or a local authority thereof.	
	Article 20 "Students"	
	Payments which a student or business apprentice who is or was immediately before visiting a Contracting State a resident of the other Contracting State and who is present in the first-mentioned State solely for the purpose of his education or training receives for the purpose of his maintenance, education or training shall not be taxed in that State, provided that such payments arise from sources outside that State.	Payments which a student or business trainee or apprentice who is or was immediately before visiting a Contracting State a resident of the other Contracting State and who is present in the first-mentioned State solely for the purpose of his education or training receives for the purpose of his maintenance, education or training shall not be taxed in that State, provided that such payments arise from sources outside that State.
	Article 21 "Other Income"	
1	Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.	
2	The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein and the right or property in respect of which the income is paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.	The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply

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3		Notwithstanding the provisions of paragraphs 1 and 2, items of income of a resident of a Contracting State not dealt with in the foregoing Articles of this Convention and arising in the other Contracting State may also be taxed in that other State.
	Taxation of Capital	
	Article 22 "Capital"	
1	Capital represented by immovable property referred to in Article 6, owned by a resident of a Contracting State and situated in the other Contracting State, may be taxed in that other State.	
2	Capital represented by movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State may be taxed in that other State	Capital represented by movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or by movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services may be taxed in that other State.
3	Capital of an enterprise of a Contracting State that operates ships or aircraft in international traffic represented by such ships or aircraft, and by movable property pertaining to the operation of such ships or aircraft, shall be taxable only in that State	
4	All other elements of capital of a resident of a Contracting State shall be taxable only in that State. Taxpoint: In UN Model, it is also mentioned that the question of the taxation of all other elements of capital of a resident of a Contracting State is left to bilateral negotiations. Should the negotiating parties decide to include in the Convention an article on the taxation of capital, they will have to determine whether to use the wording of paragraph 4 as shown or wording that leaves taxation to the State in which the capital is located	
	Methods for the Elimination of Double Taxation	
	Article 23 A "Exemption Method"	
1	Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State, in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax. Taxpoint: Where the exemption method is followed, doubly taxed income or capital shall be exempted in the resident State and it will be taxable in the source State.	
2	Where a resident of a Contracting State derives items of income which, in accordance with the provisions of Articles 10, 11 (in UN Model 12, 12A and 12B also) may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income which may be taxed in that other State.	

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3	Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital. Taxpoint: The doubly taxed income may be considered for rate purpose in the resident State.	
4	The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10 or 11 to such income.	The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10, 11, 12 or 12A, or the provisions of Article 12B, to such income; in the case where the other Contracting State does not exempt the income, the first-mentioned State shall allow the deduction of tax provided for by paragraph 2
	Article 23 B "Credit Method"	
1	Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State, in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall allow: a. as a deduction from the tax on the income of that resident an amount equal to the income tax paid in that other State; b. as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State. Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the capital which may be taxed in that other State.	
2	Where, in accordance with any provision of this Convention, income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.	
	Article 24 "Non-Discrimination"	
1	Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.	

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2	Stateless persons who are residents of a Contracting State shall not be subjected in either Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of the State concerned in the same circumstances, in particular with respect to residence, are or may be subjected.	
3	The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.	
4	Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, or paragraph 4 of Article 12, apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.	Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, paragraph 6 of Article 12, paragraph 7 of Article 12A or paragraph 11 of Article 12B apply, interest, royalties, fees for technical services, payments underlying income from automated digital services, and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State
5	Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.	
6	The provisions of this Article shall, notwithstanding the provisions of Article 2, apply to taxes of every kind and description.	
	Article 25 "Mutual Agreement Procedure"	
1 to 5	1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of either Contracting State. The case must be presented within three years from the first notification of the	Alternative A 1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting

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	action resulting in taxation not in accordance with the provisions of the Convention. 2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States. 3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention. 4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs. 5. Where, a. under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and b. the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the date when all the information required by the competent authorities in order to address the case has been provided to both competent authorities, any unresolved issues arising from the case shall be submitted to arbitration if the person so requests in writing. These unresolved issues shall not, however, be submitted to arbitration	State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention. 2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with this Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States. 3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention. 4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs. The competent authorities, through consultations, may develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedure provided for in this Article. Alternative B 1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting

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	if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.	State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention. 2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with this Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States. 3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention. 4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs. The competent authorities, through consultations, may develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedure provided for in this Article. 5. Where, a. under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and

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		b. the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within three years from the presentation of the case to the competent authority of the other Contracting State, any unresolved issues arising from the case shall be submitted to arbitration if either competent authority so requests. The person who has presented the case shall be notified of the request. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. The arbitration decision shall be binding on both States and shall be implemented notwithstanding any time limits in the domestic laws of these States unless both competent authorities agree on a different solution within six months after the decision has been communicated to them or unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.
Article 26 "Exchange of Information"		
1	The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Articles 1 and 2.	The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws of the Contracting States concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. In particular, information shall be exchanged that would be helpful to a Contracting State in preventing avoidance or evasion of such taxes. The exchange of information is not restricted by Articles 1 and 2.

Para	OECD Model Tax Convention	UN Model Convention
2	Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions. Notwithstanding the foregoing, information received by a Contracting State may be used for other purposes when such information may be used for such other purposes under the laws of both States and the competent authority of the supplying State authorises such use.	Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and it shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions. Notwithstanding the foregoing, information received by a Contracting State may be used for other purposes when such information may be used for such other purposes under the laws of both States and the competent authority of the supplying State authorizes such use
3	In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation: a. To carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State; b. To supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State; c. To supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (ordre public).	
4	If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information	
5	In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.	
6	--	The competent authorities shall, through consultation, develop appropriate methods and techniques concerning the matters in respect of which exchanges of information under paragraph 1 shall be made

Para	OECD Model Tax Convention	UN Model Convention
	Article 27 "Assistance in the Collection of Taxes"	
1	The Contracting States shall lend assistance to each other in the collection of revenue claims. This assistance is not restricted by Articles 1 and 2. The competent authorities of the Contracting States may by mutual agreement settle the mode of application of this Article.	
2	The term "revenue claim" as used in this Article means an amount owed in respect of taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to this Convention or any other instrument to which the Contracting States are parties, as well as interest, administrative penalties and costs of collection or conservancy related to such amount	
3	When a revenue claim of a Contracting State is enforceable under the laws of that State and is owed by a person who, at that time, cannot, under the laws of that State, prevent its collection, that revenue claim shall, at the request of the competent authority of that State, be accepted for purposes of collection by the competent authority of the other Contracting State. That revenue claim shall be collected by that other State in accordance with the provisions of its laws applicable to the enforcement and collection of its own taxes as if the revenue claim were a revenue claim of that other State.	
4	When a revenue claim of a Contracting State is a claim in respect of which that State may, under its law, take measures of conservancy with a view to ensure its collection, that revenue claim shall, at the request of the competent authority of that State, be accepted for purposes of taking measures of conservancy by the competent authority of the other Contracting State. That other State shall take measures of conservancy in respect of that revenue claim in accordance with the provisions of its laws as if the revenue claim were a revenue claim of that other State even if, at the time when such measures are applied, the revenue claim is not enforceable in the first-mentioned State or is owed by a person who has a right to prevent its collection.	
5	Notwithstanding the provisions of paragraphs 3 and 4, a revenue claim accepted by a Contracting State for purposes of paragraph 3 or 4 shall not, in that State, be subject to the time limits or accorded any priority applicable to a revenue claim under the laws of that State by reason of its nature as such. In addition, a revenue claim accepted by a Contracting State for the purposes of paragraph 3 or 4 shall not, in that State, have any priority applicable to that revenue claim under the laws of the other Contracting State.	
6	Proceedings with respect to the existence, validity or the amount of a revenue claim of a Contracting State shall not be brought before the courts or administrative bodies of the other Contracting State.	
7	Where, at any time after a request has been made by a Contracting State under paragraph 3 or 4 and before the other Contracting State has collected and remitted the relevant revenue claim to the first-mentioned State, the relevant revenue claim ceases to be a. in the case of a request under paragraph 3, a revenue claim of the first-mentioned State that is enforceable under the laws of that State and is owed by a person who, at that time, cannot, under the laws of that State, prevent its collection, or b. in the case of a request under paragraph 4, a revenue claim of the first-mentioned State in respect of which that State may, under its laws, take measures of conservancy with a view to ensure its collection the competent authority of the first-mentioned State shall promptly notify the competent authority of the other State of that fact and, at the option of the other State, the first-mentioned State shall either suspend or withdraw its request.	

Para	OECD Model Tax Convention	UN Model Convention
8	In no case shall the provisions of this Article be construed so as to impose on a Contracting State the obligation: a. to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State; b. to carry out measures which would be contrary to public policy (ordre public); c. to provide assistance if the other Contracting State has not pursued all reasonable measures of collection or conservancy, as the case may be, available under its laws or administrative practice; d. to provide assistance in those cases where the administrative burden for that State is clearly disproportionate to the benefit to be derived by the other Contracting State.	
	Article 28 "Members of Diplomatic Missions and Consular Posts"	
	Nothing in this Convention shall affect the fiscal privileges of members of diplomatic missions or consular posts under the general rules of international law or under the provisions of special agreements.	
	Article 29 "Entitlement to Benefits"	
	Provision that, subject to paragraphs 3 to 5, restricts treaty benefits to a resident of a Contracting State who is a "qualified person" as defined in paragraph 2	Except as otherwise provided in this Article, a resident of a Contracting State shall not be entitled to a benefit that would otherwise be accorded by this Convention (other than a benefit under paragraph 3 of Article 4, paragraph 2 of Article 9 or Article 25) unless such resident is a "qualified person", as defined in paragraph 2, at the time that the benefit would be accorded.
	Article 30 "Territorial Extension"	
	1. This Convention may be extended, either in its entirety or with any necessary modifications [to any part of the territory of (State A) or of (State B) which is specifically excluded from the application of the Convention or], to any State or territory for whose international relations (State A) or (State B) is responsible, which imposes taxes substantially similar in character to those to which the Convention applies. Any such extension shall take effect from such date and subject to such modifications and conditions, including conditions as to	

Para	OECD Model Tax Convention	UN Model Convention
	termination, as may be specified and agreed between the Contracting States in notes to be exchanged through diplomatic channels or in any other manner in accordance with their constitutional procedures. 2. Unless otherwise agreed by both Contracting States, the termination of the Convention by one of them under Article 32 shall also terminate, in the manner provided for in that Article, the application of the Convention [to any part of the territory of (State A) or of (State B) or] to any State or territory to which it has been extended under this Article.	--
	Article 31 (OECD Model) / Article 30 (UN Model) "Entry into Force"	
	1. This Convention shall be ratified and the instruments of ratification shall be exchanged at _____ as soon as possible. 2. The Convention shall enter into force upon the exchange of instruments of ratification and its provisions shall have effect: (a) (In State A): ..... (b) (In State B):	
	Article 32 (OECD Model) / Article 31 (UN Model) "Termination"	
	This Convention shall remain in force until terminated by a Contracting State. Either Contracting State may terminate the Convention, through diplomatic channels, by giving notice of termination at least six months before the end of any calendar year after the year ..... In such event, the Convention shall cease to have effect: a) (in State A): ..... b) (in State B):	

Solved Case 1:

Mr. Amin, a resident individual in India (age 42) furnishes you the following particulars of income for the previous year 2025–26:

Particulars	₹
Income from business in India (computed)	11,00,000
Dividend received from Company incorporated in Country X (gross)	2,00,000
Royalty income from writing text book for schools in Country Y (gross)	6,00,000
Expenditure incurred for authoring text book	50,000
Business loss in Country Y (gross)	2,50,000
Health insurance premium paid for his father (age 67) a resident in India (His father is not dependent on Mr. Amin)	30,000

The business loss in Country Y is eligible for set off against other income as per the Income-tax law of that country.

There is no DTAA between India and Country "X" and Country "Y" given above. The rate of tax in Country "X" and Country "Y" may be taken as 10% and 25% respectively (without any threshold exemption limit).

On the basis of aforesaid information, you are requested to choose correct options for the following:

1. What will be his tax liability, assuming he has opted for old regime) before any relief u/s 90 or 91?
2. What is his average rate of tax?
3. State the eligible amount of relief u/s 90 or 91

Solution:

Computation of Total Income of Mr. Amin for A.Y. 2026–27

Particulars	₹	₹	₹
Profits and gains of Business or profession			
Income from business in India			11,00,000
Loss from business in Country "Y"		2,50,000	
Less: Set off against royalty income		2,50,000	-
Income from other Sources			
Dividend from companies in Country "X"		2,00,000	
Royalty income from Country "Y"	6,00,000		
Less: Expenditure thereon	50,000		
	5,50,000		
Loss from business in Country "Y"	2,50,000	3,00,000	5,00,000
Gross Total Income			16,00,000
Less: Deduction under Chapter VI-A			
Section 80D Health insurance premium for father, senior citizen is deductible even though he is not dependent on the assessee.		30,000	
Section 80QQB: As the assessee has authored text-book for schools in Country "Y" hence it is not eligible for deduction.		-	30,000
Total Income			15,70,000
Tax on above			2,83,500
Add: Cess			11,340
Tax and cess			2,94,840
Less: Relief u/s 91 [See Working]			76,339
Tax after relief			2,18,500

Working:

Average rate of tax in India ₹ 2,94,840 x 100 / ₹ 15,70,000	18.78%	
Average rate of tax in country X	10%	
Doubly taxed income of country X	2,00,000	
Relief u/s 91 would be 10% or average rate @ 18.78%, whichever is lower [10% on ₹ 2 lakhs]		₹ 20,000
Doubly taxed income of country Y (after set-off of business loss)	3,00,000	
Rate of tax country Y	25%	
Relief u/s 91 would be @ 18.78% or 25% whichever is lower [18.78% on ₹ 3 lakhs]		₹ 56,339
Relief under section 91		₹ 76,339

Exercise

A. Theoretical Questions

Multiple Choice Questions

1. In respect of DTAA, generally, India follows:
   a. UN Model
   b. UK Model
   c. OECD Model
   d. US Model
2. Sec. 91 deals with
   a. Bilateral Relief
   b. Unilateral Relief
   c. Both (a) and (b)
   d. None of the above

[Answer - 1 - a; 2 - b]

Short Essay Type Questions

1. State the provisions of sec. 91.
2. Write a brief note on Model tax conventions.

B. Numerical Questions

Comprehensive Numerical Problems

Anupam Gulati, a resident in India, is a famous badminton player, who plays in several tournaments. For the year ended 31-03-2026, he has derived income from playing in tournaments outside India and also share income from a firm, from nations with which no DTAA exists.

The summarized results of the income earned during the year are as under:

	₹
Income from tournaments in India	32,50,000
Income from tournaments outside India (as converted into INR)	16,00,000
Share of loss from a partnership firm abroad (Set off permitted in that nation)	2,00,000
Residential house property purchased at Colombo (including registration and stamp duty for ₹1,80,000)	4,00,00,000

On the foreign income, he has paid tax of ₹ 3,50,000. Compute relief u/s 90 or 91, assuming that he has opted for old regime?

[Ans: ₹ 3,50,000]

Case Studies - Unsolved

Question: 1

Suresh (age 61) an individual resident in India furnishes you particulars of income for the previous year 2025-26. He earned income in country M and India has not entered into double taxation avoidance agreement with that country.

Particulars	₹
Income from house property in country M	₹ 2,50,000
Business income in India	₹ 8,00,000
Royalty income country M (see note below)	₹ 4,00,000
Business income in country M	₹ 2,00,000
Dividend from country M	₹ 1,00,000
Income from house property in India	₹ 5,00,000
Donation to Prime Minister's National Relief Fund	₹ 50,000
Incurred medical expenses for his mother aged 85	₹ 50,000
Rate of tax in country M (no basic exemption limit)	20%

Note : He disputed royalty income in country M but paid the tax on that income in June, 2025 after the appeal was decided by the appellate authority. The royalty income is charged to tax at concessional rate of 15% in country M.

On the basis of aforesaid information, you are required to answer the following questions:

(i) Calculate the total income, if he has opted for old regime.

(ii) Evaluate his eligibility for any relief & rebate.

(iii) Calculate his tax liability as per old regime

[Hint: (i) ₹ ₹ 21,50,000; (ii) Yes, relief u/s 91; (iii) ₹ 3,03,245]

References

https://www.incometaxindia.gov.in/
https://www.incometax.gov.in/
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Transfer Pricing 13

This Module includes:

13.1 Transfer Pricing including Specified Domestic Transactions

13.2 Determination of Arm's Length Price

13.3 Advance Pricing Agreement- Concept and Application

13.4 Safe Harbour Rules, Thin Capitalisation and Secondary Adjustment

Transfer Pricing

SLOB Mapped against the Module:

1. To develop understanding about various provisions of direct taxation laws and rules including international taxation laws, and inherent issues that are subject to interpretation with reference to case laws, etc.
2. To attain abilities to apply the acquired understanding for solving complex taxation problems and taking tax efficient business decision and execution thereof.

Module Learning Objectives:

After studying this module, the students will be able to -

- Appreciate the meaning of various terms like international transaction, specified domestic transactions, etc.
- Appreciate the provision of income tax in respect of international transactions
- Appreciate the method of computing arm's length price
- Apply such method in computing arm's length price
- Understand the provision of advance pricing agreement, thin capitalisation, etc.

Introduction

13

"Globalisation and new electronic technologies can permit a proliferation of tax regimes designed to attract geographically mobile activities. Governments must take measures, in particular intensifying their international cooperation, to avoid the world-wide reduction in welfare caused by tax-induced distortions in capital and financial flows and to protect their tax bases.

International taxation is the study or determination of tax on a person or business subject to the tax laws of different countries or the international aspects of an individual country's tax laws. Governments usually limit the scope of their income taxation in some manner territorially or provide for offsets to taxation relating to extraterritorial income. The manner of limitation generally takes the form of a territorial, residency, or exclusionary system. Some governments have attempted to mitigate the differing limitations of each of these three broad systems by enacting a hybrid system with characteristics of two or more. Systems of taxation vary widely, and there are no broad general rules. These variations create the potential for double taxation (where the same income is taxed by different countries) and no taxation (where income is not taxed by any country). Income tax systems may impose tax on local income only or on worldwide income. Generally, where worldwide income is taxed, reductions of tax or foreign credits are provided for taxes paid to other jurisdictions. Limits are almost universally imposed on such credits. With any system of taxation, it is possible to shift or recharacterize income in a manner that reduces taxation. Jurisdictions often impose rules relating to shifting of income among commonly controlled parties, often referred to as transfer pricing rules. Residency based systems are subject to taxpayer attempts to defer recognition of income through use of related parties. A few jurisdictions impose rules limiting such deferral ("anti-deferral" regimes). Deferral is also specifically authorized by some governments for particular social purposes or other grounds. Agreements among governments (treaties) often attempt to determine who should be entitled to tax what. Most tax treaties provide for at least a skeleton mechanism for resolution of disputes between the parties. Tax laws in India are becoming more and more complex. Globalisation of economies, signing and review of free trade agreements, increase in the number of cross border transactions, mergers, acquisitions, tax treaties, transfer pricing etc. have added to these complexities.

Tax Heaven

Many fiscally sovereign territories and countries use tax and non-tax incentives to attract activities in the financial and other services sectors. These territories and countries offer the foreign investor an environment with a no or only nominal taxation which is usually coupled with a reduction in regulatory or administrative constraints. The activity is usually not subject to information exchange because, for example, of strict bank secrecy provisions. These jurisdictions are known as tax havens. In other words, any country which modifies its tax laws to attract foreign capital could be considered a tax haven. The central feature of a haven is that its laws and other measures can be used to evade or avoid the tax laws or regulations of other jurisdictions. A tax haven is a state or a country or territory where income tax are levied at a low rate or no tax at all is levied. Individuals and/or corporate entities can find it attractive to establish shell subsidiaries or move themselves to areas where reduced or nil tax is charged. This creates a situation of tax competition among governments though tax heaven countries may not always be

profitable. Some tax heavens have become failure like Beirut, Tangiers, Liberia, etc. Different jurisdictions tend to be havens for different types of taxes, and for different categories of people and/or companies.

Geoffrey Colin Powell (former economic adviser to Jersey) has defined it as under:

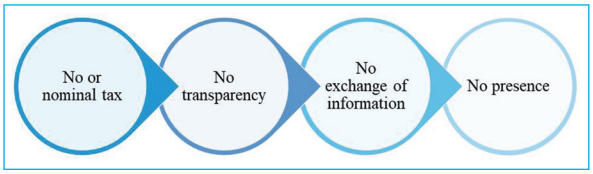
"What ... identifies an area as a tax haven is the existence of a composite tax structure established deliberately to take advantage of, and exploit, a worldwide demand for opportunities to engage in tax avoidance."

Some important destinations of tax heavens are:

In USA	Delaware, Nevada, Wyoming
In Europe	Andorra, Canary, Netherlands, Cyprus
In Asia	Mauritius, Singapore, Dubai
In Africa	Capetown, Nairobi

Key Factors

Four key factors are used to determine whether a jurisdiction is a tax haven:



- Imposes no or only nominal taxes: Tax havens impose nil or only nominal taxes (generally or in special circumstances) and offer themselves, or are perceived to offer themselves, as a place to be used by non-residents to escape high taxes in their country of residence.
- Lack of transparency: Transparency ensures that there is an open and consistent application of tax laws among similarly situated taxpayers and that information needed by tax authorities to determine a taxpayer's correct tax liability is available (e.g., accounting records and underlying documentation). A lack of transparency in the operation of the legislative, legal or administrative provisions is another factor used to identify tax havens. The OECD is concerned that laws should be applied openly and consistently, and that information needed by foreign tax authorities to determine a taxpayer's situation is available. Lack of transparency in one country can make it difficult, if not impossible, for other tax authorities to apply their laws effectively. 'Secret rulings', negotiated tax rates, or other practices that fail to apply the law openly and consistently are examples of a lack of transparency. Limited regulatory supervision or a government's lack of legal access to financial records are contributing factors.
- Lack of effective exchange of tax information with foreign tax authorities: Whether there are laws or administrative practices that prevent the effective exchange of information for tax purposes with other governments on taxpayers benefiting from the no or nominal taxation. Tax havens typically have laws or administrative practices under which businesses and individuals can benefit from strict rules and other protections against scrutiny by foreign tax authorities. This prevents the transmittance of information about taxpayers who are benefiting from the low tax jurisdiction.
- No requirement for a substantive local presence of the entity: The absence of a requirement that the activity be substantial is important because it suggests that a jurisdiction may be attempting to attract investment and transactions that are purely tax driven. It may also indicate that a country does not provide a legal or commercial environment or offer any economic advantages that would attract substantive business activities in the absence of the tax minimising opportunities it provides. The no substantial activities criterion was included in the 1998 Report as a criterion for identifying tax havens because the lack of such activities suggests that a

jurisdiction may be attempting to attract investment and transactions that are purely tax driven. In 2001, the OECD's Committee on Fiscal Affairs agreed that this criterion would not be used to determine whether a tax haven was co-operative or unco-operative.

With regard to exchange of information in tax matters, the OECD encourages countries to adopt information exchange on an "upon request" basis. Exchange of information upon request describes a situation where a competent authority of one country asks the competent authority of another country for specific information in connection with a specific tax inquiry, generally under the authority of a bilateral exchange arrangement between the two countries. An essential element of exchange of information is the implementation of appropriate safeguards to ensure adequate protection of taxpayers' rights and the confidentiality of their tax affairs.

Methodology

The methods followed in doing business through tax heavens, broadly, are as under:

Personal residency

Wealthy individuals from high-tax jurisdictions have sought to relocate themselves in low-tax jurisdictions. In most countries in the world, residence is the primary basis of taxation. In some cases the low-tax jurisdictions levy no, or only very low, income tax, capital gain tax and inheritance tax. Individuals who are unable to return to a higher-tax country in which they used to reside for more than a few days a year are sometimes referred to as tax exiles.

Asset holding

Asset holding involves utilizing a trust or a company, or a trust owning a company. The company or trust will be formed in one tax haven, and will usually be administered and resident in another. The function is to hold assets, which may consist of a portfolio of investments under management, trading companies or groups, physical assets such as real estate or valuable chattels. The essence of such arrangements is that by changing the ownership of the assets into an entity which is not resident in the high-tax jurisdiction, they cease to be taxable in that jurisdiction. Often the mechanism is employed to avoid inheritance tax.

Trading and other business activity

Many businesses which do not require a specific geographical location or extensive labour are set up in tax havens, to minimize tax exposure. Perhaps the best illustration of this is the number of reinsurance companies which have migrated to Bermuda over the years. Other examples include internet based services and group finance companies. In the 1970s and 1980s corporate groups were known to form offshore entities for the purposes of "reinvoicing". These reinvoicing companies simply made a margin without performing any economic function, but as the margin arose in a tax free jurisdiction, it allowed the group to "skim" profits from the high-tax jurisdiction. Most sophisticated tax codes now prevent transfer pricing schemes of this nature.

Financial intermediaries

Much of the economic activity in tax havens today consists of professional financial services such as mutual funds, banking, life insurance and pensions. Generally, the funds are deposited with the intermediary in the low-tax jurisdiction, and the intermediary then on-lends or invests the money (often back into a high-tax jurisdiction). Although such systems do not normally avoid tax in the principal customer's jurisdiction, it enables financial service providers to provide multi-jurisdictional products without adding an additional layer of taxation. This has proved particularly successful in the area of offshore funds.

Counteracting harmful tax practices

OECD has issued a report on Harmful Tax Competition and has made 19 specific recommendations, some of them are as follows:

a. Adopt Controlled Foreign Corporations (CFC) or equivalent rules

b. Consider foreign information reporting rules

c. Enter into Tax Information Exchange Agreement (TIEA)

d. Application of provision of withholding tax[1] while making payment to offshore recipients

e. Curbing 'treaty shopping nations' of existing treaties with tax heaven

f. Mutual assistance of tax authorities in the recovery of cross boarder tax claims

g. More international co-operation by establishing Forum to avoid Harmful Tax Practices

h. Other measures

- Adopt foreign investment fund or equivalent rules
- Considering restrictions on participation exemption and other systems of exempting foreign income in the context of harmful tax competition
- Formulation and adoption of transfer pricing rules
- Providing access to banking information for tax purposes
- Considering co-ordinated enforcement regimes (joint audits; co-ordinated training programmes, etc.)
- Guidelines to develop and actively promote Principles of Good Tax Administration

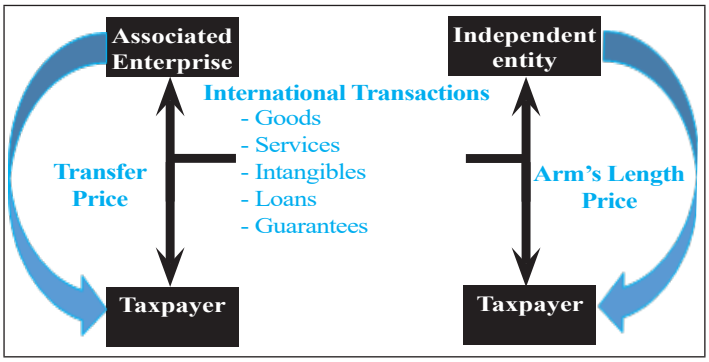
[1] Tax deducted at source

Transfer Pricing including Specified Domestic Transactions

13.1

The increasing participation of multinational groups in economic activities in the country has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, thereby, leading to erosion of tax revenues. In other words, the course of business between a resident person and an associated non-resident or not ordinarily resident person, is so arranged that the resident makes either no profit or less than the ordinary profit in that business. Such an arrangement would deprive that Indian revenue of the tax which would otherwise be payable by the resident.

With a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in case of such multinational enterprise, new set of special provisions relating to avoidance of tax have been introduced under chapter X in the Income tax Act. These provisions relate to computation of income from international transaction having regard to arm's length price, meaning of associated enterprises, meaning of international transaction, determination of arm's length price, keeping and maintaining of information and documents by persons entering into international transaction, furnishing of a report from an accountant by persons entering into such transactions.



Computation of income from international transaction or specified domestic transaction having regard to arm's length price [Sec. 92]

The provisions are as under:

Provisions	Example	Treatment	Impact on income
Any income arising from an international transaction shall be computed having regard to the arm's length price.	X Ltd., resident, sold goods or services to its associated enterprises, XY Plc. (a foreign company), for ₹ 5 lacs whereas the arm's length price of such goods or services is ₹ 9 lacs	While computing income of X Ltd., ₹ 9 lacs shall be considered as sale value	Income of X Ltd. will be increased by ₹ 4 lacs.

Provisions	Example	Treatment	Impact on income
The allowance for any expense or interest arising from an international transaction or specified domestic transaction[2] shall also be determined having regard to the arm's length price.	R Ltd. takes a loan of ₹20 lacs from an associated enterprise in Ireland @ 20% p.a. whereas the arm's length rate of interest is 12% p.a.	Interest @ 12% p.a. shall be allowed as deduction to R Ltd.	Income of R Ltd. will be increased by ₹ 1,60,000/-
Where in an international transaction or specified domestic transaction, • two or more associated enterprises • enter into a mutual agreement or arrangement for the apportionment of, or any contribution to, any cost incurred • in connection with a benefit, service or facility provided to any such enterprises, the cost apportioned to (contributed by), any such enterprise shall be determined having regard to the arm's length price of such benefit, service or facility.	An enterprise in Germany makes research on a new product and incurred ₹ 50 lacs. Out of this, ₹ 40 lacs has been allocated to its Indian associated enterprises dealing in the same product.	While computing income of Indian enterprise, it will be required to be examined whether the Indian enterprise is deriving proportionate benefit to the research expenditure allocated	If no such benefit is available to the Indian enterprise, total income of such enterprises is suitably increased by disallowing proportionate allocated cost.
The provisions (in any of aforesaid situation) shall not apply in a case where the computation of income or the determination of the allowance for any expense or interest or the determination of any cost or expense allocated or contributed has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be, computed on the basis of entries made in the books of account in respect of the previous year in which the international transaction or specified domestic transaction was entered into.	X Ltd., resident, sold goods or services to its associated enterprises, XY Plc. (a foreign company), for ₹ 5 lacs whereas the arm's length price of such goods or services is ₹ 3 lacs	The provision of transfer pricing is not applicable	No Impact

Arm's length price [Sec. 92F(ii)]

Arm's length price means

(i) a price which is applied or proposed to be applied in a transaction

(ii) between persons other than associated enterprises (i.e., unrelated person, resident or non-resident),

(iii) in uncontrolled conditions.

Taxpoint: There may be more than one arm's length price.

2 Any allowance for an expenditure or interest or allocation of any cost or expense or any income in relation to the specified domestic transaction shall be computed having regard to the arm's length price.

Process

The process to arrive at the appropriate arm's length price typically involves the following processes or steps:

(a) Comparability analysis

The concept of establishing comparability is central to the application of the arm's length principle. An analysis under the arm's length principle involves information on associated enterprises involved in the controlled transactions, the transactions at issue between the associated enterprises, the functions performed and the information derived from independent enterprises engaged in comparable transactions (i.e., uncontrolled transactions). The objective of comparability analysis is always to seek the highest practicable degree of comparability, recognising that there will be unique transactions and cases where any applied method cannot be relied on. It is clear that the closest approximation of the arm's length price will be dependent on the availability and reliability of comparables. There are many factors determining the comparability of transactions for transfer pricing analysis:

(i) Characteristics of the property or services

Property, tangible or intangible, as well as services, may have different characteristics which may lead to a difference in their values in the open market. Therefore, these differences must be accounted for and considered in any comparability analysis of controlled and uncontrolled transactions. Characteristics that may be important to consider are:

- In case of tangible property, the physical features, quality, reliability and availability of volume and supply;
- In the case of services, the nature and extent of such services; and
- In case of intangible property, the type and form of property, duration and degree of protection and anticipated benefits from use of property.

(ii) Functional analysis (Functions, Assets and Risks)

- In dealings between two independent enterprises, the compensation usually reflects the functions that each enterprise performs, taking into account assets used and risks assumed. Therefore, in determining whether controlled and uncontrolled transactions are comparable, a proper study of all specific characteristics of an international transaction or functional activity needs to be undertaken, including comparison of the functions performed, assets used and risks assumed by the parties. Such a comparison is based on a "functional analysis".
- A functional analysis seeks to identify and compare the economically significant activities and responsibilities undertaken by the independent and associated enterprises. An economically significant activity is considered to be any activity which materially affects the price charged in a transaction and the profits earned from that transaction.
- Functional analysis is thus a key element in a transfer pricing exercise. It is a starting point and lays down the foundation of the arm's length analysis. The purpose of functional analysis is to describe and analyse the operations of an enterprise and its associated enterprises.
- Functional analysis typically involves identification of 'functions performed', 'assets employed' and 'risks assumed' (therefore named a "FAR analysis") with respect to the international transactions of an enterprise. Functions that may need to be accounted for in determining the comparability of two transactions can include:
  - Research and development

- Product design and engineering;
- Manufacturing, production and process engineering;
- Product fabrication, extraction and assembly;
- Marketing and distribution functions, including inventory management and advertising activities;
- Transportation and warehousing; and
- Managerial, legal, accounting and finance, credit and collection, training and personnel management services.
- Outsourcing nature of work
- Business process management

- Risks that need to be considered while determining the degree of comparability between controlled and uncontrolled transactions include:
  - Financial risks including method of funding, funding of losses, foreign exchange risk
  - Product risk including design & development of product, after sales service, product liability risk, intellectual property risk, risks associated with R&D, obsolescence / upgrading of product
  - Market risks including fluctuations in prices and demand, business cycle risks, development of market including advertisement and product promotion
  - Credit and collection risks;
  - Entrepreneurial risk including risk of loss associated with capital investment
  - General business risks related to ownership of plant, property and equipment.
- Furthermore, it is not only necessary to identify the risks but to identify who bears such risks. The allocation of risk is usually based on contractual terms between the parties; however these may not always reflect the reality of a transaction or a relationship, and an allocation of risk between controlled taxpayers after the outcome of such risk is known or reasonably knowable lacks economic substance.
- Consider an example where company S, situated in country A, is the wholly-owned subsidiary of company P, situated in country B but a foreign manufacturer. The subsidiary company S acts as the distributor of goods manufactured by the parent company P and both parties execute an agreement that any product liability costs will be borne by the parent company P. However, in practice when product liability claims are raised, subsidiary company S always pays the resulting damages. In such a case the tax authorities will generally disregard the contractual arrangement and treat the risk as having been in reality assumed by subsidiary company S.

(iii) Contractual Terms

- The conduct of the contracting parties is a result of the terms of the contract between them and the contractual relationship thus warrants careful analysis when arriving at the transfer price. Other than a written contract, the terms of the transactions may be figured out from correspondence and communication between the parties involved. In case the terms of the arrangement between the two parties are not explicitly defined, then the terms have to be deduced from their economic relationship and conduct.
- One important point to note in this regard is that associated enterprises may not hold each other to the terms of the contract as they have common overarching interests, unlike independent enterprises,

who are expected to hold each other to the terms of the contract. Thus, it is important to figure out whether the contractual terms between the associated enterprises are a "sham" (something that appears genuine, but when looked closer lacks reality, and is not valid under many legal systems) and/or have not been followed in reality.

- Also, explicit contractual terms of a transaction involving members of a MNE may provide evidence as to the form in which the responsibilities, risks and benefits have been assigned among those members. For example, the contractual terms might include the form of consideration charged or paid, sales and purchase volumes, the warranties provided, the rights to revisions and modifications, delivery terms, credit and payment terms etc. This material may also indicate the substance of a transaction, but will usually not be determinative on that point.
- It must be noted that contractual differences can influence prices as well as margins of transactions. The party concerned should document contractual differences and evaluate them in the context of the transfer pricing methods discussed in detail in a later chapter of this Manual, in order to judge whether comparability criteria are met and whether any adjustments need to be made to account for such differences.

(iv) Market Conditions

Market prices for the transfer of the same or similar property may vary across different markets owing to cost differentials prevalent in the respective markets. Markets can be different for numerous reasons; it is not possible to itemise exhaustively all the market conditions which may influence transfer pricing analysis but some of the key market conditions which influence such an analysis are as follows:

Geographical location – In general, uncontrolled comparables ordinarily should be derived from the geographic market in which the controlled taxpayer operates, because there may be significant relevant differences in economic conditions between different markets. If information from the same market is not available, an uncontrolled comparable derived from a different geographical market may be considered if it can be determined that (i) there are no differences between the market relevant to the transaction or (ii) adjustments can be made to account for the relevant differences between the two markets.

Another aspect of having different geographic markets is the concept of "location savings" which may come into play during transfer pricing analysis. Location savings are the cost savings that a MNE realises as a result of relocation of operations from a high cost jurisdiction to a low cost jurisdiction. Typically, cost savings include costs of labour, raw materials and tax advantages offered by the new location. However, there might be disadvantages in relocating also; the "dis-savings" on account of relocation might be high costs for transportation, quality control, etc. The savings attributable to location into a low-cost jurisdiction (offset by any "dis-savings") are referred to collectively as the "location savings". The important point, where there are such location savings, is not just the amount of the savings, but also the issues of to whom these savings belong (i.e. the captive service provider or the principal). In this respect, the allocation of location savings depends especially on the relative bargaining positions of the parties. Relative bargaining power of buyer, seller and end user is dependent on issues such as the beneficial ownership of intangible property and the relative competitive position.

The computation of location savings might seem simple in theory; however its actual computation may pose many difficulties. Moving to an offshore location might be accompanied by changes in technologies, productions volumes or production processes. In such a circumstance, the additional profit derived cannot be treated as only due to location savings as the profitability is due both to low costs and introduction of new technology. A simple comparison before and after in such a scenario would give a distorted picture of location savings.

If the tax authorities were to administer transfer pricing principles to "shift" profits without any consideration of market forces prevalent in the respective countries, then such reconfiguration of economic profile, and consequently the financial statements in the host country, would be against the principles of transfer pricing and may result in unrelieved double taxation if the tax authority in another country does not agree to reduce the profits of an associated enterprise in its country.

Government rules and regulations – Generally, government interventions in the form of price controls, interest rate controls, exchange controls, subsidies for certain sectors, anti- dumping duties etc, should be treated as conditions of the market in the particular country and in the ordinary course they should be taken into account in arriving at an appropriate transfer price in that market. The question becomes whether, in light of these conditions, the transactions by controlled parties are consistent with "uncontrolled" transactions between independent enterprises.

An example of where government rules affect the market are the Export Oriented Units (EOU's) which may be subject to beneficial provisions under the taxation laws of the country; ideally companies which enjoy similar privileges should be used as the comparables, and if that is not possible, adjustments may need to be made as part of the comparability analysis.

Level of Market – For example, the price at the wholesale level (sale to other sellers) and retail levels (sale to consumers) would generally differ, and there may be many levels of wholesalers before a product reaches the consumer.

Other market conditions – Some other market conditions which influence the transfer price include costs of production (including costs of land, labour and capital), availability of substitutes (both goods and services), level of demand/supply, transport costs, size of the market, the extent of competition.

(v) Business Strategies

- Business strategies relating to new product launches, innovations, market penetration or expansion of market share may require selling products cheaper as part of such a strategy and thus earning lower profit in the anticipation of increased profits in the coming years, once the product has become more established in the market. Such strategies must be taken into account when determining the comparability of controlled and uncontrolled transactions. E.g., "start-up" companies are prone to incurring losses during their early life and it would not generally be appropriate to include such start-ups when the tested party (i.e. the party in the controlled transaction to whom the transfer pricing method is applied) is a company with a track record over many years.
- The evaluation of the claim that a business strategy was being followed which decreased profits in the short-term but provided for higher long-term profits is one that has to be considered by the tax authorities carefully after weighing several factors. One factor being - who bears the cost of the market penetration strategy? Another factor to consider is whether the nature of relationship reflects the taxpayer bearing the cost of the business strategy –for example, a sales agent with little responsibility or risk typically cannot be said to bear costs for a market penetration strategy. Another factor is whether the business strategy itself is prima- facie plausible or needs further investigation; an endless "market penetration strategy" that has yielded no profits in many years might under examination have no such real basis in practice.

(b) Transaction analysis

The arm's length price must be established with regard to transactions actually undertaken; the tax authorities should not substitute other transactions in the place of those that have actually happened and should not disregard those transactions actually undertaken unless there are special circumstances - such as that the real

economic substance of the transaction differs from its form or the transaction arrangements are not structured in the commercially rational manner that would be expected between independent enterprises. In general, restructuring of transactions should not be undertaken lightly as it may lead to double taxation due to divergent views by the nation states on how the transactions are structured. Whether authorities are able to do so will ultimately depend on their ability to do so under applicable local law, and even where it is possible, a good understanding of business conditions and realities is necessary for a fair "reconstruction". These issues are relevant not only to the administration of transfer pricing, but also to developing the underlying legislation at the beginning of a country's transfer pricing "journey" to allow effective administration (and to assist, and reduce the costs of, compliance by taxpayers) during the course of that journey.

(c) Evaluation of separate and combined transactions

- An important aspect of transfer pricing analysis is whether this analysis is required to be carried out with respect to individual international transactions or a group of international transactions having close economic nexus. In most cases, it has been observed that application of the arm's length principle on a transaction-by-transaction basis becomes cumbersome for all involved, and thus recourse is often had to the "aggregation" principle.
- For example with transactions dealing with intangible property such as the licensing of "know-how" (practical technical knowledge of how to do something, such as of an industrial process, that is not widely-held) to associate enterprises it may prove difficult to separate out the transactions involved. Similarly long-term service supply contracts and pricing of closely linked products are difficult to separate out transaction-wise.
- Another important aspect of combined transactions is the increasing presence of composite contracts and "package deals" in an MNE group; a composite contract and/or package deal may contain a number of elements including royalties, leases, sale and licenses all packaged into one deal. The tax authorities would generally consider the deal in its totality and arrive at the appropriate transfer price; in such a case comparables need to be similar (deals between independent enterprises). In certain cases, the tax authorities might find it appropriate for various reasons to allocate the price to the elements of the package or composite contract. It must be noted that any application of the arm's length principle, whether on a transaction by transaction basis or on aggregation basis, needs to be evaluated on a case to case basis, applying the relevant methodologies to the facts as they exist in that particular case.

(d) Use of an arm's length range

- The arm's length principle as applied in practice usually results in an arm's length range (that is, a range of acceptable/comparable prices) rather than a single transfer price for a controlled transaction. The range of transfer prices exists because the transfer pricing methods attempt to reflect prices and conditions between independent parties. However at times it is difficult to make highly precise adjustments due to differences between controlled transactions and uncontrolled transactions. If only one transfer pricing method is applied, the method may indicate a single acceptable price range. If more than one transfer pricing method is being used, each method may indicate different ranges. If the range of prices that are common to the methods is used, the range is more likely to be reliable in fairly reflecting business conditions.
- If the transfer prices used by a taxpayer are within the arm's length range, adjustments should not be required. If the transfer prices used by a taxpayer are outside the range of prices determined by a tax authority, the taxpayer should be given an opportunity to explain the differences.
- If a taxpayer is able to explain the difference and provides its own transfer pricing documentation used in setting its transfer prices which supports this, a tax authority will usually decide not to make adjustment. On the other hand, if the taxpayer is unable to justify its transfer prices an adjustment may be required.

(e) Use of multiple year data

- When economic and financial data is being tested, previous years' data may truly represent the results achieved by both the controlled and uncontrolled taxpayers. The use of multiple year data allows the data to be better harmonised, as it tends to average the results over a period of time. Multiple year data can also uncover relevant abnormal economic factors affecting the results, such as strikes or other adverse conditions. Such an approach also tries to test the data thrown up in typical business cycles and thus eliminates the risk of testing data of only a particularly bad or good year.
- Furthermore, in certain industries which are more cyclical in nature the multiple year data may give a better standard of comparison than use of single year data; the automotive industry can be one example of such a cyclical industry. That is not to say, however, that use of multiple year data prevents authorities from challenging artificial attempts to take advantage of such an approach by, for example, wrongly pricing in the last year of the data in the hope that such pricing will be "absorbed" into the wider data set. Some countries consider that they are legally required to consider data on a year-by year basis; that will be a matter for domestic law, but if the choice exists when setting up a transfer pricing regime, it would generally be preferable to have a multi-year approach to deal with legitimate variations in business conditions across years.
- While using multi-year data for comparability analysis, it is in any case necessary to adjust for factors such as the occurrence of significant events in the preceding years and the role of inflation in changing prices of commodities and services.
- Overall, multiple year data provides information about the relevant business and product life cycles of the comparables; differences in business or product life cycles may have an effect on the conditions which determine comparability. Data from previous years can show whether an independent enterprise engaged in comparable transactions was affected by similar economic conditions so as to be used as a comparable or not.

(f) Losses

- In an MNE group, one of the enterprises might be suffering a loss, even a recurring one, but the overall group may be extremely profitable. The fact that there is an enterprise making losses that is doing business with profitable members of its MNE group may warrant scrutiny by the tax authorities concerned. Such a situation perhaps indicates that the loss-making enterprise is not receiving adequate compensation from the MNE group of which it is a part in relation to the benefits derived from its activities.
- However there are many facets of these losses that have to be studied such as the nature of the loss (spread across group, history of loss-making within entity and group etc), the reasons for the loss (economic downtime, business cycle, start-up business, poor management, excessive risk etc), and the period of loss (short-term, long-term) as all these factors play a significant role in determining how the loss should be treated with respect to transfer pricing.

(g) Intentional set-offs

- A deliberate or intentional set-off occurs when an associated enterprise has provided a benefit to another associated enterprise within the MNE group and is compensated in return by that other enterprise with some other benefits. These enterprises may claim that the benefit that each has received should be set-off against the benefit each provided and only the net gain or loss if any on the transactions needs to be considered for tax assessment.

- Set-offs can be quite complex; they might involve a series of transactions and not just a simple "one transaction, two party" set-off. Ideally the parties disclose all set-offs accurately and have enough documentation to substantiate their set-off claims so that after taking account of set-offs, the conditions governing the transactions are consistent with the arm's length principle.
- The tax authorities may evaluate the transactions separately to determine which of the transactions satisfy the arm's length principle. However, the tax authorities may also choose to evaluate the set-off transactions together, in which case comparables have to be carefully selected; set-offs in international transactions and in domestic transactions may not be easily comparable, such as due to the differences in the tax treatment of the set-offs under the taxation systems of different countries.

(h) Use of custom valuations

- The General Agreement on Trades and Tariff (GATT, Article VII), now part of the World Trade Organization (WTO) set of agreements, has laid down the general principles for an international system of custom valuation. Customs valuation is the procedure applied to determine the customs value of imported goods. Member countries of WTO typically harmonise their internal legislation dealing with the customs valuation with the WTO Agreement on Customs Valuation.
- In appropriate circumstances, the documented custom valuation may be used for justifying the transfer prices of imported goods in international transactions between associated enterprises. The arm's length principle is applied by many customs administrations as a principle of comparison between the value attributable to goods imported by associated enterprises and the value of similar goods imported by independent enterprises. However when there is no customs duty imposed and goods are valued only for statistical purposes, and for items which have no rate of duty, this approach would not be useful. Even when utilising the custom valuation for imports in a transfer pricing context, certain additional upward or downward adjustments may be required to derive the arm's length price for the purpose of taxation.
- Internationally, there is a great deal of focus on the interplay of transfer pricing methods on the one hand and custom valuation methods on the other hand. Debates have centred on the feasibility and desirability of the convergence of the systems surrounding the two sets of value determination. The issue is considered in more detail in a later chapter.

(i) Use of transfer pricing methods

- It is important to note at the outset that there is no one transfer pricing method which is generally applicable to every possible situation. The bottom line is that comparables play a critical role in arriving at arm's length prices; it is also abundantly clear that computing an arm's length price using transfer pricing analysis is a complex task; it requires a lot of effort and goodwill from both the taxpayer and the tax authorities in terms of documentation, groundwork, analysis and research.

Enterprise [Sec. 92F(iii)]

Enterprise means a person (including a permanent establishment[1] of such person) who is, or has been, or is proposed to be, engaged:

- in any activity, relating to the production, storage, supply, distribution, acquisition or control of:
  - (a) articles or goods; or
  - (b) know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature; or

(c) any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights; or

- in the provision of services of any kind; or
- in carrying out any work in pursuance of a contract; or
- in investment, or providing loan; or
- in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate,

whether such activity or business is carried on, directly or through one or more of its units or divisions or subsidiaries; or

whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or places.

[1.] Permanent establishment includes a fixed place of business through which the business of the enterprise is wholly or partly carried on [Sec. 92F(iiia)]

Meaning of international transaction [Sec. 92B]

- International transaction means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of

  (i) purchase, sale or lease of tangible or intangible property, or

  (ii) provision of services, or

  (iii) lending or borrowing money, or

  (iv) any other transaction having a bearing on the profits, income, losses or assets of such enterprises; &

  shall include a mutual agreement or arrangement between two or more associated enterprises

  a. for the allocation or apportionment of, or

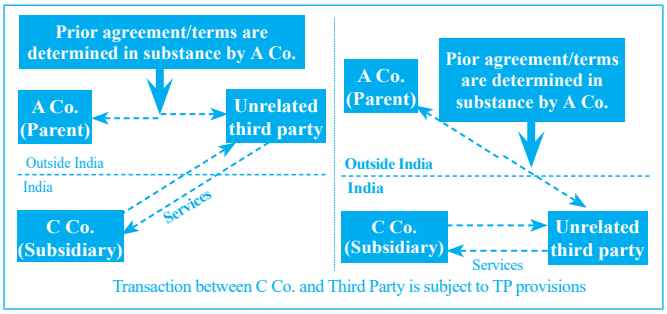
  b. any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises [Sec. 92B(1)]

- A transaction entered into by an enterprise with a person other than an associated enterprise shall, be deemed to be an international transaction entered into between two associated enterprises,

  (i) if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise; or

  (ii) the terms of the relevant transaction are determined in substance between such other person and the associated enterprise

  where the enterprise or the associated enterprise or both of them are non-residents irrespective of whether such other person is a non-resident or not [Sec. 92B(2)]



E.g. C Co., an Indian company, and A Co., a foreign company, are associated enterprise. Z Plc., a foreign company, (not an associated enterprise of C Co.) and A Co. enters into an agreement for determining the terms of transactions between C Co. and Z Plc. The transaction as may be entered between C Co. and Z Plc., which is governed by such an agreement existing between A Co. and Z Plc. shall be deemed to be a transaction between two associated enterprises.

Taxpoint

- Non-resident means a person who is not a 'resident' including a person who is not ordinarily resident [Sec. 2(30)]
- Transaction includes an arrangement, understanding or action in concert,—

  (A) whether or not such arrangement, understanding or action is formal or in writing; or

  (B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceeding. [Sec. 92F(v)]
- For a transaction to be an international transaction, it should satisfy the following two conditions cumulatively:

  a) It must be a transaction between two associated enterprises; and

  b) At least one of the two enterprises must be a non-resident.

Deemed International Transaction

International transaction shall include:

a. the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;

b. the purchase, sale, transfer, lease or use of intangible property[3], including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer

3 Intangible property shall include:

a. marketing related intangible assets, such as, trademarks, trade names, brand names, logos;

b. technology related intangible assets, such as, process patents, patent applications, technical documentation such as laboratory notebooks, technical know-how;

c. artistic related intangible assets, such as, literary works and copyrights, musical compositions, copyrights, maps, engravings;

d. data processing related intangible assets, such as, proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters;

e. engineering related intangible assets, such as, industrial design, product patents, trade secrets, engineering drawing and schema-tics, blueprints, proprietary documentation;

f. customer related intangible assets, such as, customer lists, customer contracts, customer relationship, open purchase orders;

g. contract related intangible assets, such as, favourable supplier, contracts, licence agreements, franchise agreements, non-compete agreements;

h. human capital related intangible assets, such as, trained and organised work force, employment agreements, union contracts;

i. location related intangible assets, such as, leasehold interest, mineral exploitation rights, easements, air rights, water rights;

j. goodwill related intangible assets, such as, institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value;

k. methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data;

l. any other similar item that derives its value from its intellectual content rather than its physical attributes.

list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;

c. capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;

d. provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;

e. a transaction of business restructuring or reorganisation, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date;

Meaning of Specified Domestic Transactions [Sec. 92BA]

"Specified Domestic Transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely:

i. any transaction referred to in sec. 80A;

ii. any transfer of goods or services referred to in sec. 80-IA(8);

iii. any business transacted between the assessee and other person as referred to in sec. 80-IA(10);

iv. any transaction, referred to in any other section under Chapter VI-A or sec. 10AA, to which provisions of sec. 80-IA(8) or (10) are applicable; or

v. any business transacted between the persons referred to in sec. 115BAB(4);

vi. any business transacted between the assessee and other person[4] as referred to in sec. 115BAE(4);

vii. any other transaction as may be prescribed,

and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of ₹ 20 crore.

Example 1:

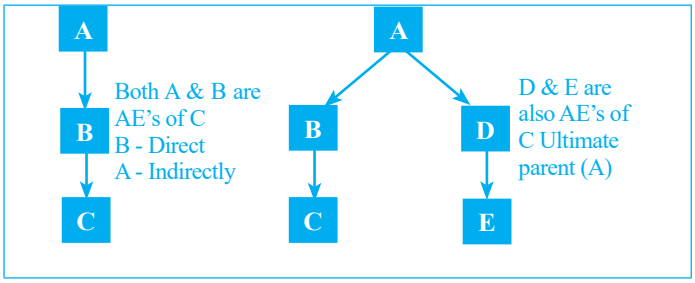
Sultan Ltd. took services of one of its group company, an associated enterprise enjoying tax holiday. The transaction is a specified domestic transaction. Sultan Ltd. paid ₹ 28,40,00,000 for the said service to the group company. The arms length price of such service is ₹ 17,00,00,000. The arms length price, i.e., the fair value of the service is ₹ 17,00,00,000 but by paying higher charges, Sultan Ltd. claimed a higher deduction and reduced its profit by ₹ 11,40,00,000. In this case the provisions of sec. 92 will be applicable and the income of Sultan Ltd. will be recomputed by taking into account the arms length price of the specified domestic transaction.

In other words, the taxable income of Sultan Ltd. will have to be computed by allowing deduction of only ₹ 17,00,00,000 on account of service charges instead of the actually paid amount of ₹ 28,40,00,000.

If in the above example, the transaction is not a specified domestic transaction, then the provisions of sec. 92 will not apply.

4 certain new manufacturing co-operative societies

Meaning of associated enterprise [Sec. 92A]



Associated enterprise, in relation to another enterprise, means an enterprise:

(a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

(b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

Deemed associated enterprise [Sec. 92A(2)]

For the above purpose, two enterprises shall be deemed to be associated enterprises if, at any time during the previous year fulfill any of the following conditions (if one of following conditions are not satisfied, then mere participation in management or control or capital of the other enterprise, etc. shall not make them associate):

(a) one enterprise holds (directly or indirectly) shares carrying not less than 26% of the voting power (i.e., equity shares in case of company) in the other enterprise; or

(b) any person or enterprise holds (directly or indirectly) shares carrying not less than 26% of the voting power in each of such enterprises; or

(c) the manufacture or processing of goods or articles or business carried out by one enterprise is wholly (not partially) dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights; or

(d) 90% or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise; or

(e) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; or

(f) where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; or

(g) where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family, or by a relative of a member of such Hindu undivided family, or jointly by such member and his relative; or

(h) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than 10% interest in such firm, association of persons or body of individuals; or

(i) a loan advanced by one enterprise to the other enterprise constitutes not less than 51% of the book value of the total assets of the other enterprise; or

Taxpoint: Revaluation of asset shall not be ignored.

(j) one enterprise guarantees not less than 10% of the total borrowings of the other enterprise; or

(k) more than ½ of the board of directors or members of the governing board, or one (not ½ of total number of executive director) or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or

Taxpoint: Mere power to appoint director is not sufficient, such power must be exercised.

(l) more than ½ of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons; or

(m) there exists between the two enterprises, any relationship of mutual interest, as may be prescribed.

HOLDING	MANAGEMENT	ACTIVITIES	CONTROL
• >= 26% Direct / Indirect holding by enterprise (or) • By SAME PERSON in each enterprise • LOAN >= 51% of total assets • GUARANTEES >= 10% of debt • > 10% INTEREST in Firm/AOP/BOI	• Appointment > 50% of DIRECTORS/ one or more Executive Director by an enterprise (or) • Appointment by same person in each enterprise	• 100% DEPENDENCE on use of Intangibles for manufacture/ processing/business • Direct/Indirect Supply of >= 90% RAW MATERIALS under influenced prices and conditions • Sale under INFLUENCED prices and conditions	• One enterprise controlled BY AN INDIVIDUAL and the other by himself or his relative or jointly • One enterprise controlled BY HUF and the other by - a member of HUF his relative or Jointly by member and relative

Determination of Arm's Length Price

13.2

Computation of arm's length price [Sec. 92C]

- The arm's length price in relation to an international transaction or specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely:

  Transaction Based Methods

  a. comparable uncontrolled price method;

  b. resale price method;

  c. cost plus method;

  Profit Based Methods

  d. profit split method;

  e. transactional net margin method;

  f. such other method as may be prescribed by the Board.

  See Rule 10B & Rule 10AB as given in Annexure 1.

- The most appropriate method shall be applied, for determination of arm's length price, in the manner as may be prescribed.

  More than one arm's length price: Where more than one price is determined by the most appropriate method, the arm's length price shall be computed in such manner as may be prescribed.

- Computation by the Assessing Officer: As per sec. 92C(3), where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that:

  (a) the price charged or paid in an international transaction or specified domestic transaction has not been determined in accordance with above provision; or

  (b) any information and document relating to an international transaction or specified domestic transaction have not been kept and maintained by the assessee in accordance with the provisions contained in sec. 92D(1) and the rules made in this behalf; or

  (c) the information or data used in computation of the arm's length price is not reliable or correct; or

  (d) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued u/s 92D(3),

  the Assessing Officer may proceed to determine the arm's length price (in accordance with above provisions)

in relation to the said international transaction or specified domestic transaction, on the basis of such material or information or document available with him.

However, an opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer.

- Where an arm's length price is determined by the Assessing Officer, the Assessing Officer may compute the total income of the assessee having regard to the arm's length price so determined u/s 92C(4). However:
  - No deduction u/s 10AA or under Chapter VIA shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income by the assessing officer.
  - Where the total income of an associated enterprise is computed by assessing officer on determination of the arm's length price paid to another associated enterprise from which tax has been deducted or was deductible, the income of the other associated enterprise shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise.

Due to application of transfer pricing provisions, there should be no loss to the revenue.

Reference to Transfer Pricing Officer (TPO) [Sec. 92CA]

- Where any person, being the assessee, has entered into an international transaction or specified domestic transaction in any previous year, and the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval of the Commissioner, refer the computation of the arm's length price in relation to the said international transaction or specified domestic transaction u/s 92C to the Transfer Pricing Officer.Where a reference is made, the Transfer Pricing Officer shall serve a notice on the assessee requiring him to produce or cause to be produced on a date to be specified therein, any evidence on which the assessee may rely in support of the computation made by him of the arm's length price in relation to such international transaction or specified domestic transaction.
- On the date specified in the notice or as soon thereafter as may be, after hearing such evidence as the assessee may produce, including any information or documents referred to in sec. 92D and after considering such evidence as the Transfer Pricing Officer may require on any specified points and after taking into account all relevant materials which he has gathered, the Transfer Pricing Officer shall, by order in writing, determine the arm's length price in relation to the international transaction or specified domestic transaction [in accordance with sec. 92C(3)] and send a copy of his order to the Assessing Officer and to the assessee.

  The arm's length price, being determined in relation to the international transaction or the specified domestic transaction for any previous year shall apply to similar international transaction or specified domestic transaction for the 2 consecutive previous years immediately following such previous year, on fulfilment of the following conditions, namely:—

  a. the assessee exercises an option or options to the above effect for the said 2 consecutive previous years;
  b. such option or options are exercised in such form, manner and within such period as prescribed; and
  c. the Transfer Pricing Officer shall, within 1 month from the end of the month in which such option or options are exercised, by an order in writing, declare that such option or options are valid subject to the conditions, as prescribed.

  However, this provisions shall not apply to any proceedings under Chapter XIV-B.

  Effect of exercise of such option: No reference for computation of the arm's length price in relation to an international transaction or a specified domestic transaction shall be made, if the Transfer Pricing Officer has declared that option exercised by the assessee in relation to such transaction is valid for such previous year.

  Further, if any reference for an international transaction or a specified domestic transaction, in respect of a

previous year, for which the option is declared valid is made before or after such declaration by the Transfer Pricing Officer, this provisions shall have the effect as if no reference is made for such transaction.

- Where a reference was made, an order may be made at any time before 60 days prior to the date on which the period of limitation referred to in sec. 153 for making the order of assessment or reassessment or recomputation or fresh assessment, as the case may be, expires.
- In case assessment proceedings stayed in any circumstances referred to in Explanation (1) [clause (ii) or (x)] to sec. 153 and the period of limitation available to the Transfer Pricing Officer for making an order is less than 60 days, such remaining period shall be extended to 60 days and the aforesaid period of limitation shall be deemed to have been extended accordingly.
- On receipt of the order, the Assessing Officer shall proceed to compute the total income of the assessee u/s 92C(4) in conformity with the arm's length price as so determined by the Transfer Pricing Officer.

  Where the Transfer Pricing Officer has declared an option exercised by the assessee as valid op-tion, he shall examine and determine the arm's length price in relation to such similar transaction for 2 consecutive previous years immediately following such previous year, in the order and on receipt of such order, the Assessing Officer shall proceed to recompute the total income of the assessee for the said 2 consecutive previous years as per the provisions of sec. 155(21).
- With a view to rectifying any mistake apparent from the record, the Transfer Pricing Officer may amend any order passed by him and the provisions of section 154 shall, so far as may be, apply accordingly.
- Where any amendment is made by the Transfer Pricing Officer, he shall send a copy of his order to the Assessing Officer who shall thereafter proceed to amend the order of assessment in conformity with such order of the Transfer Pricing Officer.
- Where any other international transaction or specified domestic transaction [other than an international transaction or a specified domestic transaction] referred above], comes to the notice of the Transfer Pricing Officer during the course of the proceedings before him, the provisions of this Chapter shall apply as if such other international transaction or a specified domestic transaction is an international transaction or a specified domestic transaction referred to him.
- Where in respect of an international transaction or a specified domestic transaction, the assessee has not furnished the report u/s 92E and such transaction comes to the notice of the Transfer Pricing Officer during the course of the proceeding before him, the provisions of this Chapter shall apply as if such transaction is an international transaction or a specified domestic transaction referred to him.
- The Transfer Pricing Officer may, for the purposes of determining the arm's length price under this section, exercise all or any of the powers specified in sec. 131(1) or 133(6) or 133A.
- The Central Government may make a scheme, for the purposes of determination of the arm's length price, so as to impart greater efficiency, transparency and accountability by—

  a. eliminating the interface between the Transfer Pricing Officer and the assessee or any other person to the extent technologically feasible;

  b. optimising utilisation of the resources through economies of scale and functional specialisation;

  c. introducing a team-based determination of arm's length price with dynamic jurisdiction.

  The Central Government may, for the purpose of giving effect to the scheme, direct that any of the provisions of this Act shall not apply or shall apply with such exceptions, modifications and adaptations as may be specified.
- Transfer Pricing Officer means a Joint Commissioner or Deputy Commissioner or Assistant Commissioner authorised by the Board to perform all or any of the functions of an Assessing Officer specified in sections 92C and 92D in respect of any person or class of persons.

Advance Pricing Agreement – Concept and Application

13.3

Advance Pricing Agreement [Sec. 92CC]

- APA is a contract
- Usually for multiple years
- Between a taxpayer and at least one tax authority
- Mainly to prospectively resolve real or potential transfer pricing issues
- Involving transactions between related parties

Advance Pricing Agreement is an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time in future. The APAs offer better assurance on transfer pricing methods and are conducive in providing certainty and unanimity of approach. A framework for advance pricing agreement are as under:

- The Board, with the approval of the Central Government, may enter into an advance pricing agreement with any person, determining the—
  a. arm's length price or specifying the manner in which the arm's length price is to be determined, in relation to an international transaction to be entered into by that person;
  b. income referred to in sec. 9(1)(i), or specifying the manner in which said income is to be determined, as is reasonably attributable to the operations carried out in India by or on behalf of that person, being a non-resident.
- The manner of determination of arm's length price, may include the methods referred to in sec. 92C or any other method, with such adjustments or variations, as may be necessary or expedient so to do.
- The arm's length price of any international transaction, in respect of which the advance pricing agreement has been entered into, shall be determined in accordance with the advance pricing agreement so entered.
- The agreement shall be valid for such period not exceeding 5 consecutive previous years as may be specified in the agreement.
- The advance pricing agreement entered into shall be binding:
  a. on the person in whose case, and in respect of the transaction in relation to which, the agreement has been entered into; and
  b. on the Commissioner, and the income-tax authorities subordinate to him, in respect of the said person and the said transaction.
- The agreement shall not be binding if there is a change in law or facts having bearing on the agreement so entered.
- The Board may, with the approval of the Central Government, by an order, declare an agreement to be void ab initio, if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts.

- Upon declaring the agreement void ab initio,:
  a. all the provisions of the Act shall apply to the person as if such agreement had never been entered into; and
  b. for the purpose of computing any period of limitation under this Act, the period beginning with the date of such agreement and ending on the date of such order shall be excluded.

  However, where immediately after the exclusion of the aforesaid period, the period of limitation, referred to in any provision of this Act, is less than 60 days, such remaining period shall be extended to 60 days and the aforesaid period of limitation shall be deemed to be extended accordingly.
- The agreement may, subject to such conditions, procedure and manner as may be prescribed, provide for determining
  a. the arm's length price or specify the manner in which arm's length price shall be determined in relation to the international transaction entered into by the person
  b. income referred to in sec. 9(1)(i), or specifying the manner in which the said income is to be determined, as is reasonably attributable to the operations carried out in India by or on behalf of that person, being a non-resident

  during any period not exceeding four previous years preceding the first of the previous years referred to in sec. 92CC(4), and the arm's length price of such international transaction or the income of such person shall be determined in accordance with the said agreement
- Where an application is made by a person for entering into an agreement, the proceeding shall be deemed to be pending in the case of the person for the purposes of the Act.
- The Board may prescribe a scheme specifying therein the manner, form, procedure and any other matter generally in respect of the advance pricing agreement. Following scheme has been framed by the Board in respect of Advance Pricing Agreement

Meaning of expressions used in matters in respect of advance pricing agreement [Rule 10F]

a) "agreement" means an advance pricing agreement entered into between the Board and the applicant, with the approval of the Central Government, as referred to in sec. 92CC(1);

b) "application" means an application for advance pricing agreement made under rule 10-I;

c) "applicant" means a person who has made an application;

d) "bilateral agreement" means an agreement between the Board and the applicant, subsequent to, and based on, any agreement referred to in rule 44GA between the competent authority in India with the competent authority in the other country regarding the most appropriate transfer pricing method or the arms' length price;

e) "competent authority in India" means an officer authorised by the Central Government for the purpose of discharging the functions as such for matters in respect of any agreement entered into under section 90 or 90A of the Act;

f) "covered transaction" means the international transaction or transactions for which agreement has been entered into;

g) "critical assumptions" means the factors and assumptions that are so critical and significant that neither party entering into an agreement will continue to be bound by the agreement, if any of the factors or assumptions is changed;

h) "most appropriate transfer pricing method" means any of the transfer pricing method, referred to in sec. 92C(1) of the Act, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or function performed by such persons or such other relevant factors prescribed by the Board under rules 10B and 10C;

i) "multilateral agreement" means an agreement between the Board and the applicant, subsequent to, and based on, any agreement referred to in rule 44GA between the competent authority in India with the competent authorities in the other countries regarding the most appropriate transfer pricing method or the arms' length price;

j) "rollback year" means any previous year, falling within the period not exceeding four previous years, preceding the first of the previous years referred to in sec. 92CC(4);

k) "tax treaty" means an agreement under section 90, or section 90A of the Act for the avoidance of double taxation;

l) "team" means advance pricing agreement team consisting of income-tax authorities as constituted by the Board and including such number of experts in economics, statistics, law or any other field as may be nominated by the Director General of Income-tax (International Taxation);

Unilateral APA	Bilateral APA	Multilateral APA
• APA entered into between a taxpayer and the tax administration of the country where it is subject to taxation	• APA entered into between the taxpayers, the tax administration of the host country and the foreign tax administration	• APA entered between the taxpayers, the tax administration of the host country and more than one foreign tax administrations

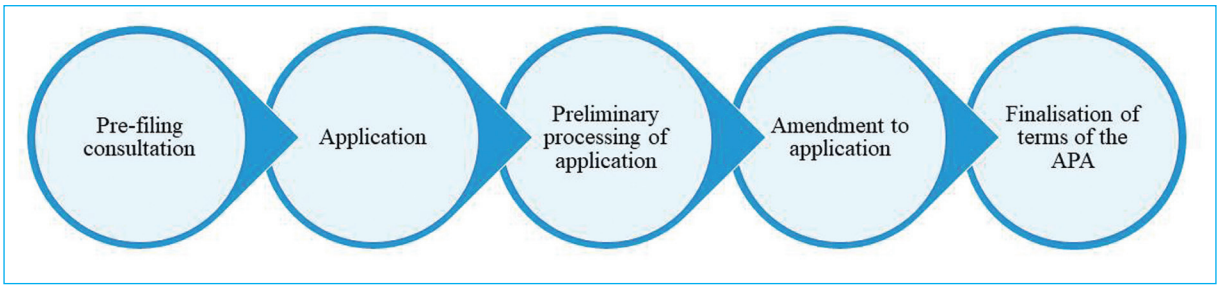
Persons eligible to apply [Rule 10G]

Any person who –

(i) has undertaken an international transaction; or

(ii) is contemplating to undertake an international transaction,

shall be eligible to enter into an agreement under these rules.



Process of APA

Pre-filing Consultation [Rule 10H]

1. Any person proposing to enter into an agreement under these rules may, by an application in writing, make a request for a pre-filing consultation.
2. The request for pre-filing consultation shall be made in Form No. 3CEC to the Director General of Income Tax (International Taxation).
3. On receipt of the request in Form No. 3CEC, the team shall hold pre-filing consultation with the person referred to in rule 10G.

4. The competent authority in India or his representative shall be associated in pre-filing consultation involving bilateral or multilateral agreement.
5. The pre-filing consultation shall, among other things,-
   (i) determine the scope of the agreement;
   (ii) identify transfer pricing issues;
   (iii) determine the suitability of international transaction for the agreement;
   (iv) discuss broad terms of the agreement.
6. The pre-filing consultation shall–
   (i) not bind the Board or the person to enter into an agreement or initiate the agreement process;
   (ii) not be deemed to mean that the person has applied for entering into an agreement.

Application for advance pricing agreement [Rule 10-I]

1. Any person, referred to in rule 10G may, if desires to enter into an agreement furnish an application in Form No. 3CED alongwith the requisite fee.
2. The application shall be furnished to Director General of Income Tax (International Taxation) in case of unilateral agreement and to the competent authority in India in case of bilateral or multilateral agreement.
3. Application in Form No. 3CED may be filed by the person referred to in rule 10G at any time–
   i. before the first day of the previous year relevant to the first assessment year for which the application is made, in respect of transactions which are of a continuing nature from dealings that are already occurring; or
   ii. before undertaking the transaction in respect of remaining transactions.
4. Every application in Form No. 3CED shall be accompanied by the proof of payment of specified fees.
5. The fees payable shall be in accordance with following table based on the amount of international transaction entered into or proposed to be undertaken in respect of which the agreement is proposed:

Amount of international transaction entered into or proposed to be undertaken in respect of which agreement is proposed during the proposed period of agreement.	Fee ₹
Amount not exceeding ₹ 100 crores	10 lacs
Amount not exceeding ₹ 200 crores	15 lacs
Amount exceeding ₹ 200 crores	20 lacs

Withdrawal of application for agreement [Rule 10J]

1. The applicant may withdraw the application for agreement at any time before the finalisation of the terms of the agreement.
2. The application for withdrawal shall be in Form No. 3CEE.
3. The fee paid shall not be refunded on withdrawal of application by the applicant.

Preliminary processing of application [Rule 10K]

1. Every application filed in Form No. 3CED shall be complete in all respects and accompanied by requisite documents.
2. If any defect is noticed in the application in Form No. 3CED or if any relevant document is not attached thereto or the application is not in accordance with understanding reached in any pre-filing consultation referred to in rule 10H, the Director General of Income-tax (International Taxation) (for unilateral agreement) and competent authority in India (for bilateral or multilateral agreement) shall serve a deficiency letter on the applicant before the expiry of 1 month from the date of receipt of the application.
3. The applicant shall remove the deficiency or modify the application within a period of 15 days from the date of service of the deficiency letter or within such further period which, on an application made in this behalf, may be extended, so however, that the total period of removal of deficiency or modification does not exceed 30 days.
4. The Director General of Income Tax (International Taxation) or the competent authority in India, as the case may be, on being satisfied, may pass an order providing that application shall not be allowed to be proceeded with if the application is defective and defect is not removed by applicant in accordance with aforesaid rule.
5. No such order shall be passed without providing an opportunity of being heard to the applicant and if an application is not allowed to be proceeded with, the fee paid by the applicant shall be refunded.

Procedure [Rule 10L]

1. If the application referred to in rule 10K has been allowed to be proceeded with, the team or the competent authority in India or his representative shall process the same in consultation and discussion with the applicant in accordance with provisions of this rule.
2. For this purpose, it shall be competent for the team or the competent authority in India or its representative to:
   i. hold meetings with the applicant on such time and date as it deem fit;
   ii. call for additional document or information or material from the applicant;
   iii. visit the applicant's business premises; or
   iv. make such inquiries as it deems fit in the circumstances of the case.
3. The applicant may, if he considers it necessary, provide further document and information for consideration of the team or the competent authority in India or his representative.
4. For bilateral or multilateral agreement, the competent authority shall forward the application to Director General of Income-tax (International Taxation) who shall assign it to one of the teams.
5. The team, to whom the application has been assigned, shall carry out the enquiry and prepare a draft report which shall be forwarded by the Director General of Income-tax (International Taxation) to the competent authority in India.
6. If the applicant makes a request for bilateral or multilateral agreement in its application, the competent authority in India shall in addition to the procedure provided in this rule invoke the procedure provided in rule 44GA.
7. The Director General of Income-tax (International Taxation) (for unilateral agreement) or the competent authority in India (for bilateral or multilateral agreement) and the applicant shall prepare a proposed mutually agreed draft agreement enumerating the result of the process including the effect of the arrangement referred to in rule 44GA(5) which has been accepted by the applicant in accordance with rule 44GA(8).

8. The agreement shall be entered into by the Board with the applicant after its approval by the Central Government.
9. Once an agreement has been entered into the Director General of Income-tax (International Taxation) or the competent authority in India, as the case may be, shall cause a copy of the agreement to be sent to the Commissioner of Income-tax having jurisdiction over the assessee.

Terms of the agreement [Rule 10M]

1. An agreement may among other things, include –
   i. the international transactions covered by the agreement;
   ii. the agreed transfer pricing methodology, if any;
   iii. determination of arm"s length price, if any;
   iv. definition of any relevant term to be used in items (ii) or (iii);
   v. critical assumptions;
   vi. rollback provision referred to in rule 10MA;
   vii. the conditions if any other than provided in the Act or these rules.
2. The agreement shall not be binding on the Board or the assessee if there is a change in any of critical assumptions or failure to meet conditions subject to which the agreement has been entered into.
3. The binding effect of agreement shall cease only if any party has given due notice of the concerned other party or parties.
4. In case there is a change in any of the critical assumptions or failure to meet the conditions subject to which the agreement has been entered into, the agreement can be revised or cancelled, as the case may be.
5. The assessee which has entered into an agreement shall give a notice in writing of such change in any of the critical assumptions or failure to meet conditions to the Director General of Income Tax (International Taxation) as soon as it is practicable to do so.
6. The Board shall give a notice in writing of such change in critical assumptions or failure to meet conditions to the assessee, as soon as it comes to the knowledge of the Board.
7. The revision or the cancellation of the agreement shall be in accordance with rules 10Q and 10R respectively.

Roll Back of the Agreement [Rule 10MA]

Sec. 92CC of the Act provides for Advance Pricing Agreement (APA). It empowers the Central Board of Direct Taxes, with the approval of the Central Government, to enter into an APA with any person for determining the Arm's Length Price (ALP) or specifying the manner in which ALP is to be determined in relation to an international transaction which is to be entered into by the person. The agreement entered into is valid for a period, not exceeding 5 previous years, as may be mentioned in the agreement. Once the agreement is entered into, the ALP of the international transaction, which is subject matter of the APA, would be determined in accordance with such an APA.

In many countries the APA scheme provides for "roll back" mechanism for dealing with ALP issues relating to transactions entered into during the period prior to APA. The "roll back" provisions refers to the applicability of the methodology of determination of ALP, or the ALP, to be applied to the international transactions which had already been entered into in a period prior to the period covered under an APA. However, the "roll back" relief is provided on case to case basis subject to certain conditions. Providing of such a mechanism in Indian legislation

would also lead to reduction in large scale litigation which is currently pending or may arise in future in respect of the transfer pricing matters.

1. Subject to the provisions of this rule, the agreement may provide for determining the arm's length price or specify the manner in which arm's length price shall be determined in relation to the international transaction entered into by the person during the rollback year (hereinafter referred to as "rollback provision").

2. The agreement shall contain rollback provision in respect of an international transaction subject to the following:

   i. the international transaction is same as the international transaction to which the agreement (other than the rollback provision) applies;

   ii. the return of income for the relevant rollback year has been or is furnished by the applicant before the due date specified u/s 139;

   iii. the report in respect of the international transaction had been furnished in accordance with sec. 92E;

   iv. the applicability of rollback provision, in respect of an international transaction, has been requested by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant; and

   v. the applicant has made an application seeking rollback in Form 3CEDA in accordance with sub-rule (5);

3. Rollback provision shall not be provided in respect of an international transaction for a rollback year, if:

   i. the determination of arm's length price of the said international transaction for the said year has been subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement; or

   ii. the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year.

4. Where the rollback provision specifies the manner in which arm's length price shall be determined in relation to an international transaction undertaken in any rollback year then such manner shall be the same as the manner which has been agreed to be provided for determination of arm's length price of the same international transaction to be undertaken in any previous year to which the agreement applies, not being a rollback year.

5. The applicant may, if he desires to enter into an agreement with rollback provision, furnish along with the application, the request for the same in Form No. 3CEDA with proof of payment of an additional fee of ₹ 5 lakh.

Amendments to Application [Rule 10N]

1. An applicant may request in writing for an amendment to an application at any stage, before the finalisation of the terms of the agreement.

2. The Director General of Income Tax (International Taxation) (for unilateral agreement) or the competent authority in India (for bilateral or multilateral agreement) may, allow the amendment to the application, if such an amendment does not have effect of altering the nature of the application as originally filed.

3. The amendment shall be given effect only if it is accompanied by the additional fee, if any, necessitated by such amendment in accordance with fee as provided in rule 10-I.

Furnishing of Annual Compliance Report [Rule 10-O]

1. The assessee shall furnish an annual compliance report to Director General of Income Tax (international Taxation) for each year covered in the agreement.
2. The annual compliance report shall be in Form 3CEF.
3. The annual compliance report shall be furnished in quadruplicate, for each of the years covered in the agreement, within 30 days of the due date of filing the income tax return for that year, or within 90 days of entering into an agreement, whichever is later.
4. The Director General of Income Tax (International Taxation) shall send one copy of annual compliance report to the competent authority in India, one copy to the Commissioner of Income Tax who has the jurisdiction over the income-tax assessment of the assessee and one copy to the Transfer Pricing Officer having the jurisdiction over the assessee.

Compliance Audit of the agreement [Rule 10P]

1. The Transfer Pricing Officer having the jurisdiction over the assessee shall carry out the compliance audit of the agreement for each of the year covered in the agreement.
2. The Transfer Pricing Officer may require:
   i. the assessee to substantiate compliance with the terms of the agreement, including satisfaction of the critical assumptions, correctness of the supporting data or information and consistency of the application of the transfer pricing method;
   ii. the assessee to submit any information, or document, to establish that the terms of the agreement has been complied with.
3. The Transfer Pricing Officer shall submit the compliance audit report, for each year covered in the agreement, to the Director General of Income Tax (International Taxation) in case of unilateral agreement and to the competent authority in India, in case of bilateral or multilateral agreement, mentioning therein his findings as regards compliance by the assessee with terms of the agreement.
4. The Director General of Income Tax (International Taxation) shall forward the report to the Board in a case where there is finding of failure on part of assessee to comply with terms of agreement and cancellation of the agreement is required.
5. The compliance audit report shall be furnished by the Transfer Pricing Officer within 6 months from the end of the month in which the Annual Compliance Report referred to in rule 10-O is received by the Transfer Pricing Officer.
6. The regular audit of the covered transactions shall not be undertaken by the Transfer Pricing Officer if an agreement has been entered into under rule 10L except where the agreement has been cancelled under rule 10R.

Revision of an agreement [Rule 10Q]

1. An agreement, subsequent to it having been entered into, may be revised by the Board, if.-
   i. there is a change in critical assumptions or failure to meet a condition subject to which the agreement has been entered into;
   ii. there is a change in law that modifies any matter covered by the agreement but is not of the nature which renders the agreement to be non binding ; or

iii. there is a request from competent authority in the other country requesting revision of agreement, in case of bilateral or multilateral agreement.

2. An agreement may be revised by the Board either suo-moto or on request of the assessee or the competent authority in India or the Director General of Income Tax (International Taxation).
3. Except when the agreement is proposed to be revised on the request of the assessee, the agreement shall not be revised unless an opportunity of being heard has been provided to the assessee and the assessee is in agreement with the proposed revision.
4. In case the assessee is not in agreement with the proposed revision the agreement may be cancelled in accordance with rule-10R.
5. In case the Board is not in agreement with the request of the assessee for revision of the agreement, the Board shall reject the request in writing giving reason for such rejection.
6. For the purpose of arriving at the agreement for the proposed revision, the procedure provided in rule 10 L may be followed so far as they apply.
7. The revised agreement shall include the date till which the original agreement is to apply and the date from which the revised agreement is to apply.

Cancellation of an agreement [Rule 10R]

1. An agreement shall be cancelled by the Board for any of the following reasons:
   i. the compliance audit referred to in rule 10P has resulted in the finding of failure on the part of the assessee to comply with the terms of the agreement;
   ii. the assessee has failed to file the annual compliance report in time;
   iii. the annual compliance report furnished by the assessee contains material errors; or
   iv. the agreement is to be cancelled under rule 10Q(4) or rule 10RA(7).
2. The Board shall give an opportunity of being heard to the assessee, before proceeding to cancel an application.
3. The competent authority in India shall communicate with the competent authority in the other country or countries and provide reason for the proposed cancellation of the agreement in case of bilateral or multilateral agreement.
4. The order of cancellation of the agreement shall be in writing and shall provide reasons for cancellation and for non acceptance of assessee‟s submission, if any.
5. The order of cancellation shall also specify the effective date of cancellation of the agreement, where applicable.
6. The order under the Act, declaring the agreement as void ab initio, on account of fraud or misrepresentation of facts, shall be in writing and shall provide reason for such declaration and for non acceptance of assessee‟s submission, if any.
7. The order of cancellation shall be intimated to the Assessing Officer and the Transfer Pricing Officer, having jurisdiction over the assessee.

Procedure for giving effect to rollback provision of an Agreement [Rule 10RA]

1. The effect to the rollback provisions of an agreement shall be given in accordance with this rule.
2. The applicant shall furnish modified return of income referred to in sec. 92CD in respect of a rollback year to which the agreement applies along with the proof of payment of any additional tax arising as a consequence of and computed in accordance with the rollback provision.

3. The modified return referred above shall be furnished along with the modified return to be furnished in respect of first of the previous years for which the agreement has been requested for in the application.

4. If any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is the subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant before furnishing the modified return for the said year.

5. If any appeal filed by the Assessing Officer or the Principal Commissioner or Commissioner is pending before the Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the Assessing Officer or the Principal Commissioner or the Commissioner, as the case may be, within 3 months of filing of modified return by the applicant.

6. The applicant, the Assessing Officer or the Principal Commissioner or the Commissioner, shall inform the Dispute Resolution Panel or the Commissioner (Appeals) or the Appellate Tribunal or the High Court, as the case may be, the fact of an agreement containing rollback provision having been entered into along with a copy of the same as soon as it is practicable to do so.

7. In case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled.

Renewing an agreement [Rule 10S]

Request for renewal of an agreement may be made as a new application for agreement, using the same procedure as outlined in these rules except pre filing consultation as referred to in rule 10H.

Miscellaneous [Rule 10T]

1. Mere filing of a application for an agreement under these rules shall not prevent the operation of Chapter X of the Act for determination of arms‟ length price under that Chapter till the agreement is entered into.

2. The negotiation between the competent authority in India and the competent authority in the other country or countries, in case of bilateral or multilateral agreement, shall be carried out in accordance with the provisions of the tax treaty between India and the other country or countries.

Procedure to deal with requests for bilateral or multilateral advance pricing agreements [Rule 44GA]

1. Where a person has made request for a bilateral or multilateral advance pricing agreement in an application filed in Form No. 3CED in accordance with rule 10-I, the request shall be dealt with subject to provisions of this rule.

2. The process for bilateral or multilateral advance pricing agreement shall not be initiated unless the associated enterprise situated outside India has initiated process of advance pricing agreement with the competent authority in the other country.

3. The competent authority in India shall, on intimation of request of the applicant for a bilateral or multilateral agreement, consult and ascertain willingness of the competent authority in other country or countries, as the case may be, for initiation of negotiation for this purpose.

4. In case of willingness of the competent authority in other country or countries, as the case may be, the competent authority in India shall enter into negotiation in this behalf and endeavour to reach a set of terms which are acceptable to the competent authority in India and the competent authority in the other country or countries, as the case may be.

5. In case of an agreement after consultation, the competent authority in India shall formalise a mutual agreement procedure arrangement with the competent authority in other country or countries, as the case may be, and intimate the same to the applicant.
6. In case of failure to reach agreement on such terms as are mutually acceptable to parties mentioned in sub-rule (4), the applicant shall be informed of the failure to reach an agreement with the competent authority in other country or countries.
7. The applicant shall not be entitled to be part of discussion between competent authority in India and the competent authority in the other country or countries, as the case may be; however the applicant can communicate or meet the competent authority in India for the purpose of entering into an advance pricing agreement.
8. The applicant shall convey acceptance or otherwise of the agreement within thirty days of it being communicated.
9. The applicant, in case the agreement is not acceptable may at its option continue with process of entering into an advance pricing agreement without benefit of mutual agreement process or withdraw application in accordance with rule 10J

Effect to Advance Pricing Agreement [Sec. 92CD]

- Where any person has entered into an agreement and prior to the date of entering into the agreement, any return of income has been furnished u/s 139 for any assessment year relevant to a previous year to which such agreement applies, such person shall furnish, within a period of 3 months from the end of the month in which the said agreement was entered into, a modified return in accordance with and limited to the agreement.
- Save as otherwise provided in this section, all other provisions of this Act shall apply accordingly as if the modified return is a return furnished u/s 139.
- If the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the agreement applies have been completed before the expiry of period allowed for furnishing of modified return, the Assessing Officer shall, in a case where modified return is filed, pass an order modifying the total income of the relevant assessment year determined in such assessment or reassessment, as the case may be having regard to and in accordance with the agreement.
- Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the agreement applies are pending on the date of filing of modified return, the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the agreement taking into consideration the modified return so furnished.
- The order shall be passed within a period of 1 year from the end of the financial year in which the modified return is furnished.
- The period of limitation as provided in sec. 153, 153B or 144C for completion of pending assessment or reassessment proceedings shall be extended by a period of 12 months.
- The assessment or reassessment proceedings for an assessment year shall be deemed to have been completed where:

  (a) an assessment or reassessment order has been passed; or

  (b) no notice has been issued u/s 143(2) till the expiry of the limitation period provided under that sub-section.

Maintenance, keeping of information and document by persons entering into an international transaction or specified domestic transaction [Sec. 92D]

- Every person,—
  a. who has entered into an international transaction or specified domestic transaction shall keep and maintain such information and document in respect thereof as may be prescribed;
  b. being a constituent entity[4] of an international group, shall keep and maintain such information and document in respect of an international group as may be prescribed.
- The Board may prescribe the period for which the information and document shall be kept and maintained[5] under the said sub-section.
- The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceeding under this Act, require any person referred to in (a) to furnish any information or document referred therein, within a period of 10 days from the date of receipt of a notice issued in this regard. However, such period may, on an application made by such person, extend the period of ten days by a further period not exceeding 30 days.
- The person referred to in (b) shall furnish the information and document referred therein to the authority prescribed u/s 286(1), in such manner, on or before such date, as may be prescribed.
- If constituent entity fails to furnish the information and documents, penalty of ₹ 5,00,000 shall be levied on that person u/s 271AA. In other case, a sum equal to 2% of the value of each international transaction or specified domestic transaction entered into by such person shall be levied as penalty

Report from an accountant to be furnished by persons entering into international transaction or specified domestic transaction [Sec. 92E]

Every person who has entered into an international transaction or specified domestic transaction during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date (i.e., 31st Oct, being one month prior the due date of filing of return of income) in the prescribed form [Form 3CEB] duly signed and verified in the prescribed manner by such accountant and setting forth such particulars as may be prescribed.

Special measures in respect of transactions with persons located in notified jurisdictional area [Sec. 94A]

- The Central Government may, having regard to the lack of effective exchange of information with any country or territory outside India, specify by notification in the Official Gazette such country or territory as a notified jurisdictional area in relation to transactions entered into by any assessee.
- If an assessee enters into a transaction where one of the parties to the transaction is a person located in a notified jurisdictional area, then—
  i. all the parties to the transaction shall be deemed to be associated enterprises within the meaning of sec. 92A;
  ii. any transaction in the nature of purchase, sale or lease of tangible or intangible property or provision of service or lending or borrowing money or any other transaction having a bearing on the profits,

4 "constituent entity" and "international group" shall have the meaning assigned to it in sec. 286(9).
5 8 years from the end of the relevant assessment year

income, losses or assets of the assessee including a mutual agreement or arrangement for allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided by or to the assessee shall be deemed to be an international transaction within the meaning of sec. 92B,

and the provisions of sec. 92, 92A, 92B, 92C [except the second proviso to sec. 92C(2)], 92CA, 92CB, 92D, 92E and 92F shall apply accordingly.

- **Person located in a notified jurisdictional area shall include:**

  a. a person who is resident of the notified jurisdictional area;

  b. a person, not being an individual, which is established in the notified jurisdictional area; or

  c. a permanent establishment of a person not falling above, in the notified jurisdictional area;

- No deduction,—

  i. in respect of any payment made to any financial institution located in a notified jurisdictional area shall be allowed under this Act, unless the assessee furnishes an authorisation in the prescribed form authorising the Board or any other income-tax authority acting on its behalf to seek relevant information from the said financial institution on behalf of such assessee; and

  ii. in respect of any other expenditure or allowance (including depreciation) arising from the transaction with a person located in a notified jurisdictional area shall be allowed under any other provision of this Act, unless the assessee maintains such other documents and furnishes such information as may be prescribed [under rule 10FC], in this behalf.

- Where, in any previous year, the assessee has received or credited any sum from any person located in a notified jurisdictional area and the assessee does not offer any explanation about the source of the said sum in the hands of such person or in the hands of the beneficial owner (if such person is not the beneficial owner of the said sum) or the explanation offered by the assessee, in the opinion of the Assessing Officer, is not satisfactory, then, such sum shall be deemed to be the income of the assessee for that previous year.

- Where any person located in a notified jurisdictional area is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVII-B, the tax shall be deducted at the highest of the following rates:

  a. 30%

  b. at the rate or rates in force;

  c. at the rate specified in the relevant provisions of this Act;

Penalty

Failure to keep and maintain information and document in respect of international transaction or specified domestic transaction [Sec. 271AA]

If any person in respect of an international transaction or specified domestic transaction:

i. fails to keep and maintain any such information and document as required by sec. 92D;

ii. fails to report such transaction which he is required to do so; or

iii. maintains or furnishes an incorrect information or document,

the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to 2% of the value of each international transaction or specified domestic transaction entered into by such person.

Penalty for failure to furnish report under section 92E [Sec. 271BA]

If any person fails to furnish a report from an accountant as required by sec. 92E, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of ₹ 1,00,000.

Penalty for failure to furnish information or document under section 92D [Sec. 271G]

If any person who has entered into an international transaction or specified domestic transaction fails to furnish any such information or document as required by sec. 92D(3), the Transfer Pricing Officer or Assessing Officer or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to 2% of the value of the international transaction or specified domestic transaction for each such failure.

However, where assessee shows reasonable cause, then no penalty u/s 271AA or 271BA or 271G shall be levied [Sec. 273B]

Safe Harbour Rules, Thin Capitalisation and Secondary Adjustment

13.4

Power of Board to make safe harbour rules [Sec. 92CB]

The determination of—

a. income referred to in sec. 9(1)(i); or

b. arm's length price u/s 92C or 92CA,

- shall be subject to safe harbour rules.

Taxpoint

- The Board may make rules for safe harbour[6].
- "Safe harbour" means circumstances in which the income-tax authorities shall accept the transfer price or income, deemed to accrue or arise u/s 9(1)(i), as the case may be, declared by the assessee.

Safe Harbour [Rule 10TD]

Where an eligible assessee has entered into an eligible international transaction and the option exercised by the said assessee is not held to be invalid under rule 10TE, the transfer price de-clared by the assessee in respect of such transaction shall be accepted by the income-tax authori-ties, if it is in accordance with the circumstances as specified here in below:

<table>
<tr><th>Sl.</th><th>Eligible International Transaction</th><th>Circumstances</th></tr>
<tr><td>1.</td><td>Provision of software development services
Software development services means:
i. business application software and information system development using known methods and existing software tools;
ii. support for existing systems;
iii. converting or translating computer languages;
iv. adding user functionality to application programmes;
v. debugging of systems;
vi. adaptation of existing software; or
vii. preparation of user documentation,
but does not include any research and development services whether or not in the nature of contract research and development services.</td><td>The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is:
<table>
<tr><th>Where the value of international transaction</th><th>Not less than</th></tr>
<tr><td>➢ does not exceed a sum of ₹ 100 crore</td><td>17%</td></tr>
<tr><td>➢ exceeds ₹ 100 crore but does not exceed ₹ 300 crore</td><td>18%</td></tr>
</table>
</td></tr>
</table>

6 Rule 10TA to Rule 10THD

<table>
<tr><th>Sl.</th><th>Eligible International Transaction</th><th>Circumstances</th></tr>
<tr><td>2.</td><td>Provision of information technology enabled services
Information technology enabled services means the following business process outsourcing services provided mainly with the assistance or use of information technology:
i. back office operations;
ii. call centres or contact centre services;
iii. data processing and data mining;
iv. insurance claim processing;
v. legal databases;
vi. creation and maintenance of medical transcription excluding medical advice;
vii. translation services;
viii. payroll;
ix. remote maintenance;
x. revenue accounting;
xi. support centres;
xii. website services;
xiii. data search integration and analysis;
xiv. remote education excluding education content development; or
xv. clinical database management services excluding clinical trials,
but does not include any research and development services whether or not in the nature of contract research and development services;</td><td>The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is:
<table><tr><th>Where the aggregate value of such international transaction entered into during the previous year</th><th>Not less than</th></tr><tr><td>➢ does not exceed a sum of ₹ 100 crore</td><td>17%</td></tr><tr><td>➢ exceeds ₹ 100 crore but does not exceed ₹ 300 crore</td><td>18%</td></tr></table></td></tr>
<tr><td>3.</td><td>Provision of knowledge process outsourcing services
Knowledge process outsourcing services means the following business process outsourcing services provided mainly with the assistance or use of information technology requiring application of knowledge and advanced analytical and technical skills,:
i. geographic information system;
ii. human resources services;
iii. engineering and design services;
iv. animation or content development and management;
v. business analytics;
vi. financial analytics; or
vii. market research,
but does not include any research and development services whether or not in the nature of contract research and development services</td><td>The value of international transaction does not exceed ₹ 200 crore and the operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is:
<table><tr><th>Not less than</th><th>Employee Cost in relation to the Operating Expense is</th></tr><tr><td>24%</td><td>is at least 60%</td></tr><tr><td>21%</td><td>is 40% or more but less than 60%</td></tr><tr><td>18%</td><td>does not exceed 40%</td></tr></table></td></tr>
</table>

<table>
<tr><th>Sl.</th><th>Eligible International Transaction</th><th>Circumstances</th></tr>
<tr><td>4.</td><td>Advancing of intra-group loans where the amount of loan is denominated in Indian Rupees (INR)

Intra-group loan means loan advanced to an associated enterprise being a non-resident, where the loan:

i. is not advanced by an enterprise, being a financial company including a bank or a financial institution or an enterprise engaged in lending or borrowing in the normal course of business; and

ii. does not include credit line or any other loan facility which has no fixed term for repayment</td><td>The interest rate declared in relation to the eligible international transaction is not less than the 1-year marginal cost of funds lending rate of State Bank of India as on 1st April of the relevant previous year plus:

<table><tr><th>Plus %</th><th>Credit rating of the associated enterprise</th></tr><tr><td>1.75%</td><td>between AAA to A</td></tr><tr><td>3.25%</td><td>BBB-, BBB or BBB+</td></tr><tr><td>4.75%</td><td>between BB to B</td></tr><tr><td>6.25%</td><td>between C to D</td></tr><tr><td>4.25%</td><td>Where credit rating of the associated enterprise is not available and the amount of loan advanced to all associated enterprise in Indian Rupees does not exceed ₹ 100 crore in the aggregate as on 31st March of the relevant previous year.</td></tr></table></td></tr>
<tr><td>5(a).</td><td>Advancing of intra-group loans referred to in item (iv) of rule 10TC where the amount of loan is denominated in foreign currency and amount of loan advanced to the associated enterprise including loans to all associated enterprises does not exceed a sum equivalent to ₹ 250 crore in the aggregate as on 31st March of the relevant previous year</td><td>The interest rate declared in relation to the eligible international transaction is not less than the reference rate of the relevant foreign currency as on 30th September of the relevant previous year plus,—

<table><tr><th>Plus %</th><th>Credit rating of the associated enterprise</th></tr><tr><td>1.50%</td><td>between AAA to A-</td></tr><tr><td>3.00%</td><td>BBB-, BBB or BBB+</td></tr><tr><td>4.00%</td><td>other rating or where credit rating is not available</td></tr></table></td></tr>
<tr><td>5(b)</td><td>Advancing of intra-group loans referred to in item (iv) of rule 10TC where the amount of loan is denominated in foreign currency and amount of loan advanced to the associated enterprise including loans to all associated enterprises exceeds a sum equivalent to ₹ 250 crore in the aggregate as on 31st March of the relevant previous year</td><td>The interest rate declared in relation to the eligible international transaction is not less than the reference rate of the relevant foreign currency as on 30th September of the relevant previous year plus,—

<table><tr><th>Plus %</th><th>Credit rating of the associated enterprise</th></tr><tr><td>1.50%</td><td>between AAA to A-</td></tr><tr><td>3.00%</td><td>BBB-, BBB or BBB+</td></tr><tr><td>4.50%</td><td>BB+, BB, BB-, B+, B, B-</td></tr><tr><td>6.00%</td><td>other rating or where credit rating is not available</td></tr></table></td></tr>
</table>

Sl.	Eligible International Transaction	Circumstances
6.	Providing corporate guarantee Corporate guarantee means explicit corporate guarantee extended by a company to its wholly owned subsidiary being a non-resident in respect of any short-term or long-term borrowing. However, explicit corporate guarantee does not include letter of comfort, implicit corporate guarantee, performance guarantee or any other guarantee of similar nature	The commission or fee declared in relation to the eligible international transaction is @ not less than 1% p.a. on the amount guaranteed.
7.	Provision of contract research and development services wholly or partly relating to software development Contract research and development services wholly or partly relating to software development means the following: i. research and development producing new theorems and algorithms in the field of theoretical computer science; ii. development of information technology at the level of operating systems, programming languages, data management, communications software and software development tools; iii. development of Internet technology; iv. research into methods of designing, developing, deploying or maintaining software; v. software development that produces advances in generic approaches for capturing, transmitting, storing, retrieving, manipulating or displaying information; vi. experimental development aimed at filling technology knowledge gaps as necessary to develop a software programme or system; vii. research and development on software tools or technologies in specialised areas of computing (image processing, geographic data presentation, character recognition, artificial intelligence and such other areas);or viii. upgradation of existing products where source code has been made available by the principal, except where the source code has been made available to carry out routine functions like debugging of the software	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 24%, where the value of the international transaction does not exceed ₹ 300 crore.
8.	Provision of contract research and development services wholly or partly relating to generic pharmaceutical drugs Generic pharmaceutical drug means a drug that is comparable to a drug already approved by the regulatory authority in dosage form, strength, route of administration, quality and performance characteristics, and intended use	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 24%, where the value of the international transaction does not exceed ₹ 300 crore.

Sl.	Eligible International Transaction	Circumstances
9.	Manufacture and export of core auto components Core auto components means: i. engine and engine parts, including piston and piston rings, engine valves and parts cooling systems and parts and power train components; ii. transmission and steering parts, including gears, wheels, steering systems, axles and clutches; iii. suspension and braking parts, including brake and brake assemblies, brake linings, shock absorbers and leaf springs iv. lithium-ion batteries for use in electric or hybrid electric vehicles	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 12%.
10.	Manufacture and export of non-core auto components Non-core auto components mean auto components other than core auto components	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 8.5%
11.	Receipt of low value-adding intra-group services Low value-adding intra-group services means services that are performed by one or more members of a multinational enterprise group on behalf of one or more other members of the same multinational enterprise group and which: i. are in the nature of support services; ii. are not part of the core business of the multinational enterprise group, i.e., such services neither constitute the profit-earning activities nor contribute to the economically significant activities of the multinational enterprise group; iii. are not in the nature of shareholder services or duplicate services; iv. neither require the use of unique and valuable intangibles nor lead to the creation of unique and valuable intangibles; v. neither involve the assumption or control of significant risk by the service provider nor give rise to the creation of significant risk for the service provider; and vi. do not have reliable external comparable services that can be used for determining their arm's length price, but does not include the following services: i. research and development services; ii. manufacturing and production services;	The entire value of the international transaction, including a mark-up not exceeding 5%, does not exceed ₹ 10 crore. The method of cost pooling, the exclusion of shareholder costs and duplicate costs from the cost pool and the reasonableness of the allocation keys used for allocation of costs to the assessee by the overseas associated enterprise, is certified by an accountant.

Sl.	Eligible International Transaction	Circumstances
	iii. information technology (software development) services; iv. knowledge process outsourcing services; v. business process outsourcing services; vi. purchasing activities of raw materials or other materials that are used in the manufacturing or production process; vii. sales, marketing and distribution activities; viii. financial transactions; ix. extraction, exploration, or processing of natural resources; and x. insurance and reinsurance	

Taxpoint

- Operating expense means the costs incurred in the previous year by the assessee in relation to the international transaction during the course of its normal operations including costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the asso-ciated enterprises of the assessee to the employees of the assessee, reimbursement to associ-ated enterprises of expenses incurred by the associated enterprises on behalf of the assessee, amounts recovered from associated enterprises on account of expenses incurred by the as-sessee on behalf of those associated enterprises and which relate to normal operations of the assessee and depreciation and amortisation expenses relating to the assets used by the as-sessee, but not including the following:
  - i. interest expense;
  - ii. provision for unascertained liabilities;
  - iii. pre-operating expenses;
  - iv. loss arising on account of foreign currency fluctuations;
  - v. extraordinary expenses;
  - vi. loss on transfer of assets or investments other than assets, on which depreciation is in-cluded in the operating expenses;
  - vii. expense on account of income-tax; and
  - viii. other expenses not relating to normal operations of the assessee:
    - Reimbursement to associated enterprises of expenses incurred by the associated enterpris-es on behalf of the assessee shall be at cost.
    - Amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of the associated enterprises and which relate to normal operations of the assessee shall be at cost
- Operating revenue means the revenue earned by the assessee in the previous year in relation to the international transaction during the course of its normal operations including costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the asso-ciated enterprises of the assessee to the employees of the assessee but not including the fol-lowing:
  - i. interest income;

ii. income arising on account of foreign currency fluctuations;

iii. income on transfer of assets or investments other than assets, on which depreciation is in-cluded in the operating expense

iv. refunds relating to income-tax;

v. provisions written back;

vi. extraordinary incomes; and

vii. other incomes not relating to normal operations of the assessee.

- Operating profit margin in relation to operating expense means the ratio of operating profit, being the operating revenue in excess of operating expense, to the operating expense ex-pressed in terms of percentage.
- Relevant previous year means the previous year relevant to the assessment year in which the option for safe harbour is validly exercised
- Reference Rate means,—

a. for US dollar, 6-month Term Secured Overnight Financing Rate (SOFR), currently admin-istered by Chicago Mercantile Exchange (CME), as increased by 45 basis points;

b. for Euro, 6-month Euro Inter Bank Offered Rate (EURIBOR), currently administered by European Money Markets Institute;

c. for UK Pound Sterling, 6-month Term Sterling Overnight Index Average (SONIA), cur-rently administered by ICE Benchmark Administration/Refinitiv, as increased by 30 basis points;

d. for Japanese Yen, 6-month Tokyo Term Risk Free Rate (TORF), currently benchmarked by QUICK Benchmarks Inc, as increased by 10 basis points;

e. for Australian dollar, 6-month Bank Bill Swap Rates (BBSW) currently administered by Australian Securities Exchange; and

f. for Singapore dollar, 6-month Compounded Singapore Overnight Rate Average (SORA), currently administered by Monetary Authority of Singapore, as increased by 45 basis points;

- Credit Rating means the credit rating assigned to the associated enterprise by a Securities and Exchange Board of India registered and Reserve Bank of India accredited credit rating agen-cy which is applicable for the relevant previous year, so however that—

a. where the associated enterprise has only one credit rating, then such rating shall be taken as its credit rating; and

b. where the associated enterprise has a credit rating from more than one such credit rating agency, then the least of such ratings shall be taken as its credit rating

- Accountant means an accountant referred to in the Explanation to 288(2) of the Act and in-cludes any person recognised for undertaking cost certification by the Government of the country where the associated enterprise is registered or incorporated or any of its agencies, who fulfils the following conditions:

I. if he is a member or partner in any entity engaged in rendering accountancy or valuation services then:

i. the entity or its affiliates have presence in more than two countries; and

ii. the annual receipt of the entity in the year preceding the year in which cost certifica-tion is undertaken exceeds ₹ 10 crore;

II. if he is pursuing the profession of accountancy individually or is a valuer then:

i. his annual receipt in the year preceding the year in which cost certification is under-taken, from the exercise of profession, exceeds ₹ 1 crore; and

ii. he has professional experience of not less than 10 years.

- Employee cost includes,—
  - i. salaries and wages;
  - ii. gratuities;
  - iii. contribution to Provident Fund and other funds;
  - iv. the value of perquisites as specified in sec. 17(2);
  - v. employment related allowances, like medical allowance, dearness allowance, travel allow-ance and any other allowance;
  - vi. bonus or commission by whatever name called;
  - vii. lump sum payments received at the time of termination of service or superannuation or voluntary retirement, such as gratuity, severance pay, leave encashment, voluntary re-trenchment benefits, commutation of pension and similar payments;
  - viii. expenses incurred on contractual employment of persons performing tasks similar to those performed by the regular employees;
  - ix. outsourcing expenses, to the extent of employee cost, wherever ascertainable, embedded in the total outsourcing expenses:

    However, where the extent of employee cost embedded in the total outsourcing expenses is not ascertainable, 80% of the total outsourcing expenses shall be deemed to be the em-ployee cost embedded in the total outsourcing expenses;
  - x. recruitment expenses;
  - xi. relocation expenses;
  - xii. training expenses;
  - xiii. staff welfare expenses; and
  - xiv. any other expenses related to employees or the employment
- Second proviso to sec. 92C(2) provides that if the variation between the arm's length price and price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed such percentage not exceeding 3% of the latter, as may be noti-fied, the price at which the international transaction or specified domestic transaction has ac-tually been undertaken shall be deemed to be the arm's length price. However, no such compa-rability adjustment and allowance shall be made to the transfer price declared by the eligible assessee and accepted under this.
- The provisions of sec. 92D (Maintenance of documents, etc.) and 92E (Report from an Ac-countant) in respect of an international transaction shall apply irrespective of the fact that the assessee exercises his option for safe harbour in respect of such transaction.
- Eligible assessee means a person who has exercised a valid option for application of safe har-bour rules in accordance with rule 10TE, and:
  - i. is engaged in providing software development services or information technology enabled services or knowledge process outsourcing services, with insignificant risk, to a non-resident associated enterprise (hereinafter referred as foreign principal);

ii. has made any intra-group loan;

iii. has provided a corporate guarantee;

iv. is engaged in providing contract research and development services wholly or partly relat-ing to software development, with insignificant risk, to a foreign principal;

v. is engaged in providing contract research and development services wholly or partly relat-ing to generic pharmaceutical drugs, with insignificant risk, to a foreign principal;

vi. is engaged in the manufacture and export of core or non-core auto components and where 90% or more of total turnover during the relevant previous year is in the nature of original equipment manufacturer sales; or

vii. is in receipt of low value-adding intra-group services from one or more members of its group.

- For exercise of the option for safe harbour, the assessee shall furnish a Form 3CEFA to the Assessing Officer on or before the due date for furnishing the return of income for
  a) the relevant assessment year, in case the option is exercised only for that assessment year;
  b) or the first of the assessment years, in case the option is exercised for more than one as-sessment year:
- The return of income should be furnished on or before the date of submitting such Form.
- The option for safe harbour validly exercised shall continue to remain in force for the period specified in Form 3CEFA or a period of 3 years whichever is less (in some cases applicable for only one assessment year).
- The eligible assessee may opt out of the safe harbour, for the relevant assessment year, by fur-nishing a declaration to that effect, to the Assessing Officer:

Safe harbour rules not apply [Rule 10TF]

Nothing contained in rules 10TA, 10TB, 10TC, 10TD or rule 10TE shall apply in respect of eligi-ble international transactions entered into with an associated enterprise located in any country or territory notified u/s 94A or in a no tax or low tax country or territory

- No tax or low tax country or territory means a country or territory in which the maximum rate of income-tax is less than 15%.

Mutual Agreement Procedure not to apply [Rule 10TG]

Where transfer price in relation to an eligible international transaction declared by an eligible as-sessee is accepted by the income-tax authorities u/s 92CB, the assessee shall not be entitled to invoke mutual agreement procedure under an agreement for avoidance of double taxation en-tered into with a country or specified territory outside India as referred to in sec. 90 or 90A

Safe Harbour Rules in case of Specified Domestic Transaction [Rule 10THC]

Where an eligible assessee has entered into an eligible specified domestic transaction in any pre-vious year relevant to an assessment year and the option exercised by the said assessee is treated to be validly exercised under rule 10THD, the transfer price declared by the assessee in respect of such transaction for that assessment year shall be accepted by the income-tax authorities, if it is in accordance with the circumstances as specified here in below:

Sl.	Eligible specified do-mestic transaction	Circumstances
1.	Supply of electricity, transmission of electrici-ty, wheeling of electrici-ty	The tariff in respect of supply of electricity, transmission of electricity, wheeling of electricity, as the case may be, is determined or the methodol-ogy for determination of the tariff is approved by the Appropriate Com-mission in accordance with the provisions of the Electricity Act, 2003

Sl.	Eligible specified do-mestic transaction	Circumstances
2.	Purchase of milk or milk products	The price of milk or milk products is determined at a rate which is fixed on the basis of the quality of milk, namely, fat content and Solid Not FAT (SNF) content of milk; and— a) the said rate is irrespective of,: i. the quantity of milk procured; ii. the percentage of shares held by the members in the co-operative society; iii. the voting power held by the members in the society; and b) such prices are routinely declared by the co-operative society in a transparent manner and are available in public domain.

- No comparability adjustment and allowance under the second proviso to sec. 92C(2) shall be made to the transfer price declared by the eligible assessee and accepted.
- The provisions of sec. 92D and 92E in respect of a specified domestic transaction shall apply irrespective of the fact that the assessee exercises his option for safe harbour in respect of such transaction.
- As per Rule 10THA, eligible assessee means a person who has exercised a valid option for ap-plication of safe harbour rules in accordance with the provisions of rule 10THC, and:
  - i. is a Government company engaged in the business of generation, supply, transmission or distribution of electricity; or
  - ii. is a co-operative society engaged in the business of procuring and marketing milk and milk products.
- For opting safe harbor, the assessee shall require to furnish a Form 3CEFB to the Assessing Officer on or before the due date of furnishing the return of income for the relevant assess-ment year.
- The return of income should be furnished on or before the date of submitting such Form.

Limitation on interest deduction in certain cases [Sec. 94B]

Thin Capitalization

A company is typically financed or capitalized through a mixture of debt and equity. The way a company is capitalized often has a significant impact on the amount of profit it reports for tax purposes as the tax legislations of countries typically allow a deduction for interest paid or payable in arriving at the profit for tax purposes while the dividend paid on equity contribution is not deductible. Therefore, the higher the level of debt in a company, and thus the amount of interest it pays, the lower will be its taxable profit. For this reason, debt is often a more tax efficient method of finance than equity. Multinational groups are often able to structure their financing arrangements to maximize these benefits. For this reason, country's tax administrations often introduce rules that place a limit on the amount of interest that can be deducted in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, and thus aim to protect a country's tax base.

Under the initiative of the G-20 countries, the Organization for Economic Co-operation and Development (OECD) in its Base Erosion and Profit Shifting (BEPS) project had taken up the issue of base erosion and profit shifting by way of excess interest deductions by the MNEs in Action plan 4. The OECD has recommended several measures in its final report to address this issue.

In view of the above, sec. 94B was inserted in line with the recommendations of OECD BEPS Action Plan 4, to

provide that interest expenses claimed by an entity to its associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is less.

The provisions are enumerated here-in-below:

Applicable to

Indian company, or a permanent establishment of a foreign company in India, being the borrower

- Permanent establishment includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

Conditions

a) The borrower has debt issued by a non-resident, being an associated enterprise of such borrower.

   - Debt means any loan, financial instrument, finance lease, financial derivative, or any arrangement that gives rise to interest, discounts or other finance charges that are deductible in the computation of income chargeable under the head "Profits and gains of business or profession";

b) He incurs any expenditure by way of interest or of similar nature exceeding ₹ 1 crore;

c) Such expenditure is deductible in computing income chargeable under the head "Profits and gains of business or profession"

Effect

If all the aforesaid conditions are satisfied then, excess interest shall not be deductible in computation of income under the said head.

- Excess interest means lower of the following:

  a) An amount of total interest paid or payable in excess of 30% of earnings before interest, taxes, depreciation and amortisation (EBITDA) of the borrower in the previous year; or

  b) Interest paid or payable to associated enterprises for that previous year

Taxpoint

- **Guarantee:** Where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to have been issued by an associated enterprise.
- **Exception:**

  The provision of sec. 94B is not applicable:

  a) to an Indian company or a permanent establishment of a foreign company which is engaged in the business of banking or insurance or a Finance Company located in any International Financial Services Centre or notified non-banking financial companies (NBFC)

  b) to interest paid in respect of a debt issued by a lender which is a permanent establishment in India of a non-resident, being a person engaged in the business of banking

- **Carry forward:** Where for any assessment year, the interest expenditure is not wholly deducted against income under the head "Profits and gains of business or profession", so much of the interest expenditure as has not been so deducted, shall be carried forward to the following assessment year(s), and it shall be allowed as a deduction against the profits and gains, if any, of any business or profession carried on by it and assessable for that assessment year to the extent of maximum allowable interest expenditure.

- **Maximum carried forward:** No interest expenditure shall be carried forward for more than 8 assessment years immediately succeeding the assessment year for which the excess interest expenditure was first computed.

Example 2:

Computation of interest expenses disallowed u/s 94B:

₹ in crore

Particulars	Case 1	Case 2	Case 3
EBIDTA of the Indian Borrower	100	100	100
30% of the above [A]	30	30	30
Interest payable to associated enterprise [B]	35	Nil	15
Interest payable to non-associated enterprise [C]	Nil	35	20
Total Interest expense incurred [D = B + C]	35	35	35
Total interest expenses incurred in excess of 30% of EBITDA [E = D – A]	5	5	5
Interest payable to associated enterprise [B]	35	Nil	15
Excess interest [lower of (E) and (B)] being disallowed u/s 94B	5	Nil	5

Secondary adjustment in certain cases [Sec. 92CE]

"Secondary adjustment" means an adjustment in the books of account of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.

The provisions are enumerated here-in-below:

- Where a primary adjustment to transfer price,:
  - i. has been made suo motu by the assessee in his return of income;
  - ii. made by the Assessing Officer has been accepted by the assessee;
  - iii. is determined by an advance pricing agreement entered into by the assessee u/s 92CC on or after 01-04-2017;
  - iv. is made as per the safe harbour rules framed u/s 92CB; or
  - v. is arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into u/s 90 or 90A for avoidance of double taxation,
  - the assessee shall make a secondary adjustment.
- Exception: Nothing contained in this section shall apply, if:
  - i. the amount of primary adjustment made in any previous year does not exceed ₹ 1 crore; or
  - ii. the primary adjustment is made in respect of an assessment year commencing on or before 01-04-2016.
- Where, as a result of primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss, as the case may be, of the assessee, the excess money (or part thereof) which is available with its associated enterprise, if not repatriated to India within the time as may be prescribed, shall be deemed to be an advance made by the assessee to such associated enterprise and the interest on such advance, shall be computed in such manner as may be prescribed [Sec. 92CE(2)]

- Excess money means the difference between the arm's length price determined in primary adjustment and the price at which the international transaction has actually been undertaken;
- Primary adjustment to a transfer price, means the determination of transfer price in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the assessee;
- Excess money (or part thereof) may be repatriated from any of the associated enterprises of the assessee which is not a resident in India.

Example 3:

An Indian company sells certain products to its Associated Enterprise for INR 100 crores, whereas the Arm's Length Price (ALP) of such transaction is INR 150 crores. The TPO confirms an upward adjustment (Primary adjustment) of INR 50 crores, the difference between the Selling price INR 100 crores and the ALP INR 150 crores, which is taxed in the hands of Indian company.

Subsequently, for the purpose of Secondary adjustment, it would be deemed that the AE owes INR 50 crores to Indian company (the difference between ALP and actual transfer price), which will be deemed to be a Loan or an Advance by Indian company to its AE. As a consequence, an interest would be imputed on such Loan or Advance and an Adjustment (Secondary adjustment) would be carried out in the hands of the Indian company.

Optional Scheme

- Where the excess money (or part thereof) has not been repatriated within the prescribed time, the assessee may, at his option, pay additional income-tax @ 18% (plus surcharge @ 12% + cess) on such excess money.
- The tax so paid by the assessee shall be treated as the final payment of tax in respect of such money not repatriated and no further credit therefor shall be claimed by the assessee or by any other person in respect of the amount of tax so paid.
- No deduction shall be allowed to the assessee in respect of the amount on which tax has been paid.
- Where the additional income-tax is paid by the assessee, he shall not be required to make secondary adjustment and compute interest from the date of payment of such tax

Computation of interest income pursuant to secondary adjustments [Rule 10CB]

1. For the purposes of sec. 92CE(2), the time limit for repatriation of excess money or part thereof shall be on or before 90 days,—
   i. from the due date of filing of return u/s 139(1) where primary adjustments to transfer price has been made suo-moto by the assessee in his return of income;
   ii. from the date of the order of Assessing Officer or the appellate authority, as the case may be, if the primary adjustments to transfer price as determined in the aforesaid order has been accepted by the assessee;
   iii. in a case where primary adjustment to transfer price is determined by an advance pricing agreement entered into by the assessee u/s 92CC in respect of a previous year,-
      a. from the date of filing of return u/s 139(1) if the advance pricing agreement has been entered into on or before the due date of filing of return for the relevant previous year;
      b. from the end of the month in which the advance pricing agreement has been entered into if the said agreement has been entered into after the due date of filing of return for the relevant previous year

iv. from the due date of filing of return u/s 139(1) in the case of option exercised by the assessee as per the safe harbour rules u/s 92CB; or

v. from the date of giving effect by the Assessing Officer under rule 44H to the resolution arrived at under mutual agreement procedure, where the primary adjustment to transfer price is determined by such resolution under a Double Taxation Avoidance Agreement entered into u/s 90 or 90A.

2. The imputed per annum interest income on excess money or part thereof which is not repatriated within the time limit as per sec. 92CE(1) shall be computed,—

i. at the 1 year marginal cost of fund lending rate of State Bank of India as on 1st of April of the relevant previous year plus 325 basis points in the cases where the international transaction is denominated in Indian rupee; or

ii. at 6 months London Interbank Offered Rate* as on 30th September of the relevant previous year plus 300 basis points in the cases where the international transaction is denominated in foreign currency.

3. The aforesaid interest shall be chargeable on excess money or part thereof which is not repatriated—

a. in cases referred to in sub-rule (1)(i), (iii)(a) and (iv), from the due date of filing of return u/s 139(1);

b. in cases referred to in sub-rule (1)(ii), from the date of the order of Assessing Officer or the appellate authority, as the case may be;

c. in cases referred to in sub-rule (1)(iii)(b), from the end of the month in which the advance pricing agreement has been entered into by the assessee u/s 92CC;

d. in cases referred to in sub-rule (1)(v), from the date of giving effect by the Assessing Officer under rule 44H to the resolution arrived at under mutual agreement procedure.

Taxpoint

- "International transaction" shall have the same meaning as assigned to it in sec. 92B;
- The rate of exchange for the calculation of the value in rupees of the international transaction denominated in foreign currency shall be the telegraphic transfer buying rate of such currency on the last day of the previous year in which such international transaction was undertaken and the "telegraphic transfer buying rate" shall have the same meaning as assigned in the Explanation to rule 26 [i.e., "telegraphic transfer buying rate", in relation to a foreign currency, means the rate or rates of exchange adopted by the State Bank of India, for buying such currency, having regard to the guidelines specified from time to time by the Reserve Bank of India for buying such currency, where such currency is made available to that bank through a telegraphic transfer.

Annexure 1

Determination of income in the case of non-residents [Rule 10]

In any case in which the Assessing Officer is of the opinion that the actual amount of the income accruing or arising to any non-resident person whether directly or indirectly, through or from any business connection in India or through or from any property in India or through or from any asset or source of income in India or through or from any money lent at interest and brought into India in cash or in kind cannot be definitely ascertained, the amount of such income for the purposes of assessment to income-tax may be calculated:

i. at such percentage of the turnover so accruing or arising as the Assessing Officer may consider to be reasonable, or

* Now a days, LIBOR is not used

ii. on any amount which bears the same proportion to the total profits and gains of the business of such person (such profits and gains being computed in accordance with the provisions of the Act), as the receipts so accruing or arising bear to the total receipts of the business, or

iii. in such other manner as the Assessing Officer may deem suitable.

Determination of arm's length price under section 92C [Rule 10B]

- For the purposes of sec. 92C(2), the arm's length price in relation to an international transaction or a specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, in the following manner:

  a. comparable uncontrolled price (CUP) method, by which,—

     i. the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;

        - Uncontrolled transaction means a transaction between enterprises other than associated enterprises, whether resident or non-resident – Rule 10A
        - Transaction includes a number of closely linked transactions

     ii. such price is adjusted to account for differences, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the price in the open market;

     iii. the adjusted price arrived at under (ii) is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction or the specified domestic transaction

        - Property includes goods, articles or things, and intangible property;
        - Services include financial services

  Taxpoint:

  - Typical transactions in respect of which the comparable uncontrolled price method may be adopted are:

     a. Transfer of goods;

     b. Provision of services;

     c. Intangibles;

     d. Interest on loans.

  - CUP can be either of the following:

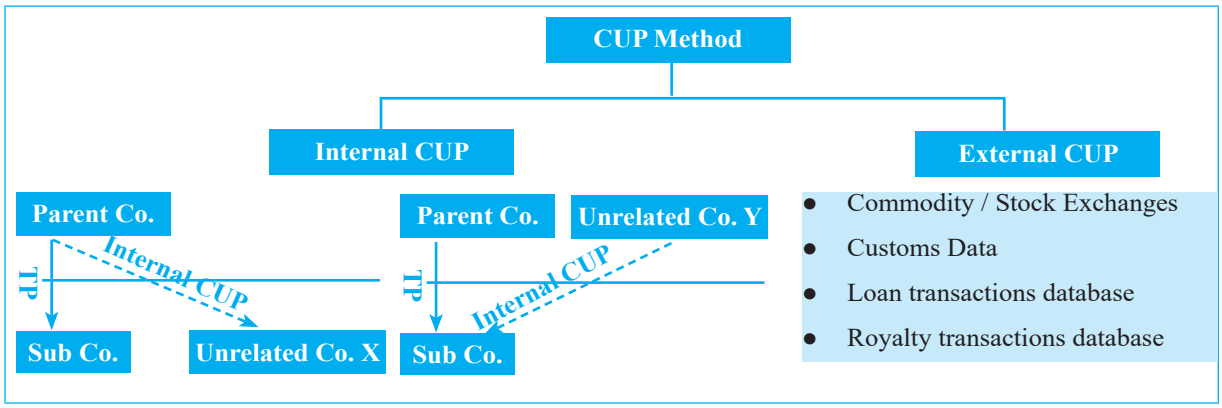
     1. Internal CUP: this would be available if the taxpayer (or one of its group entities) enters into a comparable transaction with an unrelated party where the goods or services under consideration are same or similar.

        Situations where Internal CUP may be applicable:

a. The tax payer or any other member of the group sells similar goods in similar quantities and under similar terms to an independent enterprise in a similar market.

b. The tax payer or another member of the group buys similar goods in similar quantities and under similar terms from an independent enterprise in a similar market (an internal comparable).

2. External CUP: this would be applicable if a transaction between two independent enterprises involves comparable goods or services under comparable conditions.
   a. An independent enterprise sells the particular product in similar quantities and under similar terms to another independent enterprise in a similar market;
   b. An independent enterprise buys similar goods in similar quantities and under similar terms from another independent enterprise in a similar market.



- Compare the prices charged for property or services
- Price under 'controlled transaction' is compared with 'uncontrolled transaction'
- It requires close similarity in products, property or services that are involved
- Where the prices of the product fluctuate regularly, timing of the transaction also relevant

Example 4:

AE1 Ltd., is an Indian company. The shareholding pattern of AE1 Ltd., is as follows:

Shareholder's name	Status	% holding
AE2 Ltd.	Foreign Company	30
AE3 Ltd.	Indian Company	30
Financial Institutions	Indian Company	10
Public		30

AE1 Ltd., is a manufacturer of compact disc (CD) writers and its customers, inter alia, include AE2 Ltd, and M Ltd.

AE1 Ltd., during the year has supplied 10,000 nos. of the product to AE2 Ltd. at a price of ₹ 2,000 per unit and 200 nos. of the same product to AE3 Ltd., at a price of ₹ 2,750 per unit. AE1 Ltd., has sold 100 units of the same product to M Ltd. at ₹ 3,000 per unit.

Analysis of the international transaction with comparable uncontrolled transaction

	International transaction (with AE2 Ltd.)	Comparable uncontrolled transaction (with M Ltd.)	
Price	FOB	CIF	Freight and insurance ₹ 550
Quantity discount	Yes	No	One CD of ₹ 10 each for every CD writer plus ₹ 20 per CD writer
Credit	One month	Cash and carry	Cost of credit 1.25% per month
Warranty	No warranty	Six months warranty	Cost of warranty is ₹ 250 per unit

Factors to be considered while determining ALP:

a. In the CUP method, one has to start from the price charged in the case of the comparable uncontrolled transaction.

b. In this illustration one has to start with the price charged by AE1 Ltd., to M Ltd.

c. The price charged to AE3 Ltd., cannot be considered as AE3 Ltd., is itself an associated enterprise of AE1 Ltd.

d. The price charged to M Ltd., will have to be increased by the value of credit which is at the rate at 1.25% p.m. (i.e. 15% p.a.). If the similar credit were offered to M Ltd., the price charged to M Ltd. would have been higher, after factoring this cost.

e. The price charged to M Ltd., will have to be reduced by the following;

   i. ₹ 550 representing the freight and insurance –This is for the reason that if the price to M Ltd., had been on FOB basis, it would have been less by ₹ 550.

   ii. ₹ 250 per unit representing the estimated cost of warranty execution for a period of 6 months on the basis of a technical analysis and past experience - This is for the reason that if the warranty was not given, the price to M Ltd. would have been lower, without factoring this cost.

   iii. ₹ 10 representing the cost of each CD – This is for the reason that if similar gift had been offered to M Ltd., the effective price to M Ltd., would have been less.

   iv. ₹ 20 representing a quantity discount - This is for the reason that if similar discount had been offered to M Ltd., the effective price to M Ltd., would have been less.

The following points are to be noticed:

i. All adjustments in the course of applying this method are to be made to the price charged in the uncontrolled transaction. The presence or absence of any specific features in the uncontrolled transaction as compared to the international transaction is to be adjusted for. These Methods of Computation of Arm's Length Price features are to be evaluated in monetary terms. This is a subjective process based on objective facts.

ii. Only differences that would materially affect the price in the open market are required to be adjusted. Two points may be noted. Firstly, materiality would have to be judged in the light of various circumstances. If there are numerous adjustments, which are individually not material but collectively material, the necessary adjustments are required to be made. Secondly, the term 'open market', though not defined, would mean a transaction between a knowledgeable and a willing purchaser and a knowledgeable and willing seller where neither of them is influenced or compelled to act in a particular manner.

   b. resale price method, by which,—

      i. the price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise, is identified;

ii. such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;

iii. the price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;

iv. the price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;

v. the adjusted price arrived at under (iv) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise.

Taxpoint

- The steps involved in the application of this method are:

i. identify the international transaction of purchase of property or services;

ii. identify the price at which such property or services are resold or provided to an unrelated party (resale price);

iii. identify the normal gross profit margin in a comparable uncontrolled transaction whether internal or external. The normal gross profit margin is that margin which an enterprise would earn from purchase of the similar product from an unrelated party and the resale of the same to another unrelated party.

iv. deduct the normal gross profit from the resale price.

v. deduct expenses incurred in connection with the purchase of goods;

vi. adjust the resultant amount for the differences between the uncontrolled transaction and the international transaction. These differences could be functional and other differences including differences in accounting practices. Further these differences should be such as would materially affect the amount of gross profit margin in the open market;

vii. the price arrived at is the arm's length price of the international transaction;

- RPM is a method based on the price at which a product that has been purchased from a related party is resold to an unrelated enterprise.
- The resale price is reduced by the resale price margin/ gross profit margin.
- This is further reduced by the expenses incurred in connection with the purchase of product or obtaining of services.
- When goods are purchased from AE or Unrelated party and same are sold to AE, this method cannot be applied, since it can be applied only in a situation where goods are purchased from AE and same are sold to Unrelated party.

- The application of the resale price method can be understood with the following example:

AE1 Ltd., is an Indian company. The shareholding pattern of AE1 Ltd., is as follows;

Shareholder's name	Status	% holding
AE2 Ltd.	Foreign Company	30
AE3 Ltd.	Indian Company	30
Financial Institutions	Indian Company	10
Public		30

AE1 Ltd., trades in compact disc (CD) writers. AE1 Ltd., procures CD writers both locally and in the international market. Its imports consist of CD writers purchased from AE2 Ltd. as well as other manufacturers (Non AEs).

AE1 Ltd., during the year purchased 100 CD writers from AE2 Ltd. at ₹ 2,900 per unit. These are resold to A Ltd., at a price of ₹ 3,000 per unit.

AE1 Ltd., has also purchased similar products from an unrelated supplier, viz. K Ltd., and has resold the same to M Ltd., who is also an unrelated party and has earned a gross profit of 15% on sales.

Analysis of the sales transactions

	Sales to A Ltd.	Sales to M Ltd.	
Price	Ex shop	FOR Destination with cost of freight and insurance estimated at 2% of GP	Impact of Freight and insurance on GP is 2% as the sale price increases but corresponding expenses are not debited to trading account but to profit and loss account
Quantity discount	Yes - the cost of the same is estimated at 1% of GP	No	Impact of quantity discount on GP is 1%
Free gifts	No	One CD pack for every CD writer with no change in sale price	As cost of gift is not debited to trading account but to P & L Account, there is no impact on GP
Warranty	No	6 months warranty (without change in sale price) - cost of warranty is estimated at ₹250 per unit	As cost of warranty is not debited to trading account but to P&L Account, there is no impact on GP

Analysis of the purchase transactions

	Purchase from AE2 Ltd. (International transaction)	Purchase from K Ltd.	
Customs duty	₹ 25 per unit	₹ 25 per unit	No impact
Freight inwards	₹ 10 per unit	Nil	Cost of purchase from K Ltd., is lower
Quantity discount	₹ 15 per unit	Nil	Cost of purchase from K Ltd., is higher
Warranty	Nil	6 months warranty purchase price remaining unchanged	No impact

Factors to be considered while determining ALP:

a. In the above example, the international transaction is the purchase transaction entered into by AE1 Ltd., with AE2 Ltd. which should be determined on the basis of arm's length price;

Purchase from AE2 Ltd. ⟶ [AE1] ⟶ Sales to A Ltd.

b. The comparable uncontrolled transaction is the purchase transaction entered into by AE1 Ltd., with K Ltd.

Purchase from K Ltd. ⟶ [AE1 Ltd] ⟶ Sales to M Ltd.

c. The starting point for arriving at the ALP of such purchase transaction is the resale price charged to A Ltd. viz. ₹ 3,000 [Rule 10B(1)(b)(i)].

d. From the said resale price, the normal gross profit margin which AE1 Ltd., would earn in a comparable uncontrolled transaction should be reduced. In this example, the actual gross profit margin earned by AE1 Ltd., in respect of its purchase from K Ltd, and its resale to M Ltd, is 15%.

e. The following adjustments are made to arrive at the normal GP;

Actual gross profit margin with M Ltd.		15%
Less:		
1. Difference between Ex-shop and FOR prices	2%	
2. Difference due to quantity discount	1%	3%
Normal gross profit margin with M Ltd.		12%

Note: While arriving at normal gross profits from the actual gross profits, only the differences in the sale transactions of AE1 Ltd., with A Ltd., and M Ltd., have been taken. The differences in the purchase transactions of AE1 Ltd., with AE2 Ltd. and K Ltd., affecting the gross profits are taken separately as provided in sub rule (iv).

f. The resale price of ₹ 3,000 to M Ltd., is reduced by the normal gross profit margin of 12%. The resultant cost of sales is ₹ 2,640 (i.e. 3,000 - 360) [Rule 10B(1)(b)(ii)].

g. The cost of sales so arrived at is reduced by the expenses incurred in connection with the purchase (international transaction) i.e. freight of ₹ 10 and customs duty of ₹ 25. The resultant amount is ₹ 2,605 (i.e. 2640 – 25 - 10) [Rule 10B(1)(b)(iii)].

h. The above amount is further adjusted to take into account functional and accounting differences between the

international transaction and the comparable uncontrolled transaction with AE2 Ltd the purchase transaction with K Ltd., which will affect the amount of gross profit margin as explained below.

i. The aforesaid amount of ₹ 2605 should be increased by ₹ 10 being the freight incurred by AE1 Ltd., in the case of purchase from AE2 Ltd., but not incurred in case of purchase from K Ltd., This is for the reason that if a similar freight had been paid in respect of transaction with K Ltd, the gross profit margin from K Ltd., would have been lower and the resultant price would have been higher.

j. A decrease by ₹ 15 representing the quantity discount allowed by AE2 Ltd., is to be made. This is for the reason that if a similar discount had been allowed in respect of transaction with K Ltd, the gross profit margin from K Ltd., would have been higher and the resultant price would have been lower.

Determination of arm's length price under resale price method

1. Associated enterprises : AE1 Ltd. and AE2 Ltd.
2. Other enterprises : K Ltd. and M Ltd.
3. International transaction : AE1 Ltd. and AE2 Ltd.
4. Bought from AE2 Ltd. and resold to : A Ltd.
5. CUT is purchase from K Ltd. and sales to M Ltd.

Details	₹ / unit
Price paid to AE2 Ltd.(FOB)	2,900
Quantity	100
Purchases cost (actual) (A)	2,90,000
Actual GP Margin on sales to M Ltd.(%)	15
Normal GP Margin on sales to M Ltd.(%)	12
Price charged to A Ltd.	3,000
Less: Normal GP margin	360
Balance	2640
Less: Expenses connected with purchase (freight & customs duty paid)	35
Price before adjustment	2,605
Add:	
Freight incurred in case of purchase from AE2 Ltd.	10
Sub total	10
Less:	
Quantity discount allowed by AE2 Ltd.	15
Sub total	15
Arm's length price	2,600
Adjusted purchase cost (B)	2,60, 000
Income increases by (A-B)	30,000

The following points are to be noticed:

i. The resale price method is to be adopted only when goods purchased from an associated enterprise are resold to unrelated parties.

ii. As provided in Rule 10B(1)(b)(iii), the expenses incurred in connection with the purchase from AE are to be reduced from the cost of sales. In resale price method, the arm's length purchase price is arrived at reducing the normal gross profit margin from the resale price as the first step. If the computation is stopped at this step itself, the derived purchase amount would be inclusive of the such expenses. It is therefore necessary to reduce such expenses in arriving at the arm's length purchase price.

iii. Adjustments have to be made also for accounting practices apart from functional and other differences. Differences in accounting practices may be because:

a. sales and purchases have been accounted for inclusive of taxes or exclusive of taxes;

(b) method of pricing the goods namely, FOB or CIF;

(c) fluctuations in foreign exchange.

iv. In actual practice, the resale in any financial year may be also out of opening stock. Similarly, the goods purchased during the said year may remain in closing stock. Under the resale price method, the arm's length price of purchases from AE during the financial year should be determined. The process of determination under Rule 10B(1)(b) culminates in the cost of sales rather than value of purchase during the year. This 'cost of sales' should be converted into 'value of purchase'. For this purpose, the closing stock of goods purchased from AE should be added and the opening stock of purchases from AE should be deducted.

c. cost plus method, by which,—

i. the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;

ii. the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;

iii. the normal gross profit mark-up referred to in (ii) is adjusted to take into account the functional and other differences, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;

iv. the costs referred to in (i) are increased by the adjusted profit mark-up arrived at under (iii);

v. the sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise;

Taxpoint

- Typical transactions where the cost plus method may be adopted are:

(a) provision of services;

(b) joint facility arrangements;

(c) transfer of semi finished goods;

(d) long term buying and selling arrangements.

- The steps involved in the application of this method are:

i. Determine the direct and indirect cost of production in respect of property transferred or service provided to an associated enterprise.

ii. Identify one or more comparable uncontrolled transactions for same or similar property or service.

iii. Determine normal gross profit mark-up on costs in the comparable uncontrolled transaction. Such costs should be computed according to the same accounting norms. In other words, the components of costs of comparable uncontrolled transaction should be the same as those of international transaction.

iv. Adjust the gross profit mark-up to account for functional and other differences between the international transaction and the comparable uncontrolled transaction. Such adjustments should also be made for enterprise level differences.

v. The direct and indirect cost of production in the international transaction is increased by such adjusted gross profit mark-up.

vi. The resultant figure is the arm's length price.

- CPM determines ALP by adding Gross Profit Margin (mark-up) earned in comparable transaction(s) / by comparable companies to the cost incurred by Tested Party under controlled transaction
- CPM is useful when tested party is supplying made-to-order goods (e.g. engineering goods) to its related party
- While RPM focuses on the control of profit margin at the distribution level, CPM focusses on the control of profit mark-up at the manufacturing level.

➢ The application of the cost plus method can be understood with the following example:

AE1 Ltd., is an Indian company. The shareholding pattern of AE1 Ltd., is as follows:

Shareholder's name	Status	% holding
AE2 Ltd.	Foreign Company	30
AE3 Ltd.	Indian Company	30
Financial Institutions	Indian Company	10
Public		30

AE1 Ltd., develops software for various customers, who include AE2 Ltd. and M Ltd.

AE1 Ltd., during the year billed AE2 Ltd. ₹ 2,00,000. The total cost (direct and indirect) for executing this work was ₹ 1,75,000.

AE1 Ltd., provided similar services to M Ltd., and earned a gross profit (GP) of 50% on costs.

Analysis of transactions

	Transactions with AE2 Ltd.	Transactions with M Ltd.
Technology support	Yes	No - value of technology support incurred by AE1 Ltd., is ₹ 17,500
Discount	Yes – Discount offered is ₹ 8,750	No
Business risks and marketing	Yes – Value of the same is estimated at ₹ 13,125	No

Credit	Yes – Cost of credit is estimated at ₹ 2,625	No

Factors to be considered while determining ALP:

a. In the CPM, one has to start with the gross profit mark up which the enterprise earned in a comparable uncontrolled transaction. In this example, the comparable uncontrolled transaction is between AE1 Ltd., and M Ltd.

b. Such gross profit (GP) mark up needs to be decreased by the following:

- As AE1 Ltd., did not receive the technology support from M Ltd., it has priced its services higher resulting in its earning a higher GP with M Ltd.. The value of technology support of ₹ 17,500 received from AE2 Ltd. is 10% of cost. Therefore, the GP with M Ltd., has to be reduced by 10%.
- AE1 Ltd. did not provide discount to M Ltd., as volume of business from M Ltd., was not as high as that from AE2 Ltd. Had AE1 Ltd., offered similar discount to M Ltd., the GP with M Ltd., would have been lower. The discount of ₹ 8,750 offered to AE2 Ltd. is 5% of cost. Therefore, the GP with M Ltd., has to be decreased by 5%.
- AE1 Ltd., has incurred ₹ 15,000 towards marketing functions in respect of its transactions with M Ltd., which is 7.5% of its cost. However, in its transactions with AE2 Ltd. the said functions are assumed by AE2 Ltd. Had AE1 Ltd., not incurred similar expenses with M Ltd., it would have settled for a lower GP. Therefore, the GP with M Ltd., has to be reduced by 7.5%.
- The cost of credit of ₹ 2,625 provided by AE1 Ltd., to AE2 Ltd. is 1.5% of its cost. However, in its transactions with M Ltd., such credit is not provided. Had AE1 Ltd., provided similar credit to M Ltd., it would have increased its price resulting in a higher GP. Therefore, the GP with M Ltd., has to be increased by 1.5%.

c. The resultant gross profit mark up is the arm's length gross profit mark up.

d. The costs of AE1 Ltd., in its transactions with AE2 Ltd. should be increased by the arm's length gross profit mark up to arrive at the arm's length income.

Determination of arm's length price under costs plus method

1. Associated enterprise : AE1 Ltd. and AE2.
2. Other enterprise : AE1 Ltd. and M Ltd
3. International transaction : AE1 Ltd and AE2 Ltd
4. Comparable uncontrolled transaction : AE1 Ltd. and M Ltd

Determination of arm's length gross profit mark up

Details	
Gross profit mark up in case of M Ltd.	50.00%
Less:	
1. Technology support from AE2 Ltd.	10.00%
2. Quantity discount to AE2 Ltd not to M Ltd.	5.00%
3. Marketing functions performed by AE1 Ltd., in respect of M Ltd.	7.50%
Sub total	22.50%
Add:	

1. Cost of credit to AE2. Ltd.	1.50%
Sub total	1.50%
Arm's length gross profit mark up	29.00%

Determination of arm's length price

Details	
Direct and indirect costs incurred by AE1 Ltd. in respect of transactions with AE2 Ltd.	1,75,000
Arm's length gross profit mark up	29.00%
Arm's length income (A)	2,25,750
Actual price charged to AE2 Ltd. (B)	2,00,000
Income increases by (A-B)	25,750

The following points are to be noticed:

i. In this method, the direct and indirect costs of production are to be determined. The terms 'direct' or 'indirect' costs are however not defined. A reference may therefore be made to the industry practice as well as the pronouncements of the ICAI

ii. In determining the direct and indirect cost, the following factors have to be borne in mind:

(a) if the plant has been under utilised the costs may have to be suitably adjusted;

(b) absorption costing method is normally to be preferred.

iii. This method is to be adopted only in cases of supply of property or services to an associated enterprise. This method is not to be applied when the enterprise is in receipt of property or services from an associated enterprise.

d. profit split method, which may be applicable mainly in international transactions or specified domestic transactions involving transfer of unique intangibles or in multiple international transactions or specified domestic transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which:

i. the combined net profit of the associated enterprises arising from the international transaction or the specified domestic transaction in which they are engaged, is determined;

ii. the relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;

iii. the combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under (ii);

iv. the profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction or the specified domestic transaction.

➢ The combined net profit referred to in (i) may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction or specified domestic transaction in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split

amongst the enterprises in proportion to their relative contribution in the manner specified under (ii) and (iii), and in such a case the aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction or the specified domestic transaction.

Taxpoint

- Typical transactions where the profit-split method may be used are transactions involving:

  a. integrated services provided by more than one enterprise for e.g., in case of financial service sector, where the activities performed by Indian company and foreign AEs in relation of a merger and acquisition transaction are so interrelated that it may not possible to segregate them;

  b. transfer of unique intangibles, for e.g. two associated enterprises contribute their respective intangibles to develop a new product or process and earn income from such product or process.

- There are two approaches to this method, namely, total profits split and residual profit split.

  Total profits split: The steps involved are as follows:

  i. Determine the combined net profit of the associated enterprises arising from the international transactions in which they are engaged. Such profits represent the profits earned from third parties due to the combined efforts of the associated enterprises. It may be noted that the 'combined net profit' referred to in the rule is not the aggregate of entire profits earned by the associated enterprises. Example: AE1 may earn profits from certain transactions wherein there is no contribution by AE2 and vice versa. Such profits do not enter into the determination of combined net profit. Only those profits that are earned as a result of joint efforts of AE1 and AE2 should be taken as combined net profit.

  ii. Evaluate relative contribution made by each entity involved in the transaction on the basis of:

    a. functions performed;

    b. assets employed;

    c. risks assumed;

    d. the reliable external market data indicating how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances. It may be noted that reference to 'external market data' indicates comparable uncontrolled transactions. The use of word 'external' does not preclude use of internal CUT. In the process of choosing CUTs, the function performed, assets used and risks taken (FAR) of the uncontrolled transactions would have been compared with the FAR of the international transactions. When the FAR of the international transaction and CUT are similar, the relative contribution adopted in the CUT should be applied to the international transaction. Any significant differences between the two should be suitably adjusted.

  iii. Thereafter, split the combined net profit in proportion to the relative contribution determined as above.

  iv. The profit so apportioned is taken to arrive at the arm's length price in relation to the international transaction. The profits so apportioned to the AE when added to the costs incurred by it in relation to international transaction would result in arm's length price.

Residual profit split approach

- In this approach, firstly, a basic return is determined for each of the enterprises and profits of each such enterprise is ascertained. This amount is reduced from the combined net profits. Residual profits are allocated on the basis of relative contribution.

- Steps involved in this approach are as follows:

  i. Determine the combined net profit of the associated enterprises arising from the international transactions in which they are engaged.

  ii. At the first stage, depending on functions performed, assets employed and risks assumed, determine the basic return appropriate to the respective activities. Allocate the combined net profit on the basis of above. This step results in a partial allocation of the combined net profit to each enterprise. For this purpose, the allocation is undertaken with reference to margins of comparable uncontrolled entities.

  iii. the balance of the combined net profit is allocated on the basis of the evaluation of the relative contribution.

  iv. the total net profit from such two-tier allocation is taken to arrive at the arm's length price. The profits so apportioned to the AE when added to the costs incurred by it in relation to international transaction would result in arm's length price.

  - PSM is used when transactions are inter-related and is not possible to evaluate separately.
  - PSM first identifies the profit to be split for the AE. The profit so determined is split between the AE on the basis of the functions performed
  - Division of profit maybe done on Contribution analysis basis or Residual analysis basis.
  - Under Contribution analysis, the assessee must use comparable uncontrolled transactions as well as factors such as risks undertaken and assets employed, to determine the division of profit
  - Under Residual analysis during division of profit, step 1 involves division of profits to each party upto the extent of just covering the costs incurred in producing the good. Step 2 involves further proportionate distribution of residual profits in accordance with each party's contribution, after carrying out step 1.

- The application of the profit split-method can be understood with the following example:

  AE1 Ltd., is an Indian company. The shareholding pattern of AE1 Ltd., is as follows;

Shareholder's name	Status	% holding
AE2 Ltd.	Foreign Company	30
AE3 Ltd.	Foreign Company	30
Financial Institutions	Indian Company	10
Public		30

AE1 Ltd., is an investment advisory company, which in association with AE2 Ltd. assists its clients with foreign acquisitions.

AE3 Ltd., which is based in U.S.A., has worldwide presence. AE1 Ltd. is approached by M for identifying potential target companies for acquisitions in the USA. In order to serve M, AE1 Ltd. and AE3 Ltd., have each contributed integrally to identification of potential target and assisting M with the acquisition process. For the above, AE1 Ltd., received consideration of US$ 50,000. The financials are as follows;

	AE1 Ltd.	AE3 Ltd.
Revenue	30,000	20,000

Cost	20,000	8,000
Profit	10,000	12,000

Factors to be considered:

a. The normal basic return is ordinarily calculated as a percentage of the costs incurred or gross revenues or capital employed. In this example, it is assumed as a percentage of the cost.

b. Based on the FAR analysis, the basic return for AE1 Ltd., and AE3 Ltd., are determined to be 15% and 10% respectively. Accordingly, the normal basic return for AE1 Ltd. in India for the aforesaid operation is US$ 3000. The similar returns for AE3 Ltd., US$ 800. The total basic return, thus, is US $ 3,800.

c. On the basis of functions performed, risks assumed and assets employed, the relative contribution may be taken at 70%, 30% for AE1 Ltd. and AE3 Ltd., respectively.

Determination of arm's length price under profit split method:

First Approach: Total Profit Split Method

1. Associated enterprises : AE1 Ltd. and AE3 Ltd.
2. Ultimate delivery of product is : By AE3 Ltd. to M Ltd.
3. International transaction : AE1 Ltd. and AE3 Ltd.

Details	US$
Price charged by AE3 Ltd from M Ltd	50,000
AE3 Ltd share of revenue	20,000
AE1 Ltd share of revenue	30,000
Combined total profits	22,000
Evaluation of relative contribution	
AE1 Ltd : India return – 70%	15,400
AE3 Ltd : US return – 30%	6,600
Total	22,000
Total return for AE1 Ltd	15,400
Total cost of AE1 Ltd	20,000
Income of AE1 Ltd on arm's length price (A)	35,400
Actual revenue (B)	30,000
Increased income (A-B)	5,400

Note: In this example, the basic return is not required to be taken into account.

Second Approach: Residual profit split method

Details	US$
Price charged by AE3 Ltd from M Ltd	50,000
AE3 Ltd share of revenue	20,000
AE1 Ltd share of revenue	30,000

Details	US$
Combined total profits	22,000
1. Basic return	
AE1 Ltd : India return	3,000
AE3 Ltd : US return	800
Total	3,800
2. Residual net profit	18,200
AE1 Ltd: India return – 70%	12,740
AE3 Ltd: US return – 30%	5,460
Total	18,200
Total return for AE1 Ltd (12740 + 3000)	15,740
Total cost of AE1 Ltd.	20,000
Income of AE1 Ltd. on arm's length price (A)	35,740
Actual revenue (B)	30,000
Increased income (A-B)	5,740

The following points are to be noticed:

a. It is the profit from a transaction with the associated enterprise that needs to be ascertained. If there are other transactions, which contribute to the profits, then the profits from transactions with associated enterprise may have to be arrived at on some approximation.

b. The rule itself provides an alternative method to arrive at the arm's length price being the two-tier profit split-method;

c. If in either of the alternatives, a range of figures is available, the arithmetical mean of such figures may be adopted as the arm's length price. It may however not be possible to adopt the arithmetical mean of the two alternatives.

d. Under the two-tier split-method, the basic rate of return may have to be adopted having regard to the profits compared to the net worth of the enterprise. Such rate of return may not be uniform for all the associated enterprises involved in the transaction.

e. This is the only method for which the Rule itself has prescribed the types of transaction to which it may be applicable.

f. Even though the computation proceeds with the profits from a transaction, the purpose is only to arrive at the arm's length price of a transaction. It is only by substituting the arm's length price for the price in the international transaction that an adjustment may be made to the income returned.

e. transactional net margin method, by which,—

i. the net profit margin realised by the enterprise from an international transaction or a specified domestic transaction] entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;

ii. the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

iii. the net profit margin referred to in (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;

iv. the net profit margin realised by the enterprise and referred to in (i) is established to be the same as the net profit margin referred to in (iii);

v. the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction or the specified domestic transaction;

Taxpoint

- Typical transactions where the transactional net margin method may be adopted are:

  (a) provision of services;

  (b) distribution of finished products where resale price method cannot be applied;

  (c) transfer of semi finished goods where cost plus method cannot be applied;

  (d) transactions involving intangibles where profit split method cannot be applied.

- The steps involved in the application of this method are:

  i. Identify the net profit margin realised by the enterprise from an international transaction. Where the assessee also has transactions, segments or businesses where the international transactions with associated enterprises are not relevant, then the net profit margin to be considered for the purposes of this TNMM method should be such net profit margin as is derived only from the transactions, segments or businesses related to the international transaction. The net profit margin may be computed in relation to costs incurred or sales effected or assets employed or any other relevant base.

     For example,

     - In case where the assessee acts as a distributor and the transaction pertains to import, the revenue may be used as base.
     - In case the transaction involves export of services/goods, costs may be taken as base.

  ii. Identify the net profit margin from a comparable uncontrolled transaction or a number of such transactions having regard to the same base; In practice, net profit margin is ascertained at segment level where segment data are available. The unallocated expenses are allocated on a reasonable basis and the segmental net profit is determined. Where segment data are not available, net profit is normally determined at enterprise level. Where internal CUT is available transaction level net profit may be determined.

  iii. In case internal CUT is not available, external CUT is taken. In such case, as discussed above, net profit margin should be taken at enterprise level (segmental or enterprise as a whole) of comparable companies. A search should be carried out to identify comparable companies on the basis of information and data available with the assessee. Where such information and data are not available, search may be carried out with reference to database in public domain.

  iv. The net profit margin so identified is adjusted to take into account the transaction level and enterprise level differences if any. The Methods of Computation of Arm's Length Price differences should be those that could materially affect the net profit margin in the open market;

iv. The adjusted net profit margin is taken into account to arrive at the arm's length price in relation to the international transaction.

➢ The application of the transactional net margin method may be understood with the following example:

AE1 Ltd., is an Indian company

AE1 Ltd., manufactures compact disc (CD) writers and sells the same to AE2 Ltd., which is an associated enterprise of AE1 Ltd.

As AE1 Ltd., does not have similar transaction with a non AE, no internal CUT is available. As AE1 Ltd., does not have information and data to identify a comparable company, it has used the databases in public domain for carrying out the search. The result of the search may be summarised as follows:

		No. of companies
Search on the basis of following keywords:		
(a) Computer		800
(b) Computer hardware		250
(c) Computer peripherals		66
	Sub total	1116
Elimination process :		
Companies with different activities		800
Companies with duplication when multiple database are used		75
Companies with no financials		90
Companies having significant operations like sales or purchases with related party		100
Companies reporting no operations		50
	Sub total	1115
Company/companies selected – Z Ltd.		1

Note: The search criteria and filters adopted above should be taken as illustrative only.

The comparison between AE1 Ltd., and Z Ltd., is carried out as follows:

Financials	AE1 Ltd. (₹ in crores)	Z Ltd. (₹ in crores)
Sales	130	200
Other income	5	10
Total Income	135	210
Operating expenses	85	120
Interest	5	7
Depreciation	10	12
Loss on sale of undertaking	5	0
Expenses relating to non operating income	1	3
Total expenditure	106	142
Net profits	24	58

Financials	AE1 Ltd. (₹ in crores)	Z Ltd. (₹ in crores)
Operating margin		
Sales	130	200
Gross revenue	130	200
Operating expenses	85	120
Interest	5	7
Depreciation	10	12
Total operating cost	100	139
Operating profit	30.00	61.00
Operating margin (before interest and depreciation)	52.94	66.67
Operating margin (after depreciation but before interest)	36.84	51.52

- Rule 10B(e)(iii) requires that transaction level and enterprise level differences should be adjusted if such differences materially affect the amount of net profit margin.

  In this example, following enterprise level differences could be visualised;

a. Working capital – There may be differences in stock holding, debtors and creditors. Appropriate adjustment to eliminate the impact of above difference may be made by taking the prevailing interest rate. For this purpose, useful reference may be made to the guidelines issued by Internal Revenue Service of USA. However, in this example, it is assumed that the difference in the working capital is not significant requiring any adjustment.

b. Cost of capital – There may be difference in the manner of funding such as equity, preference, debenture, inter corporate loans etc. In order that such difference does not impact the net profit, the operating margin on operating cost before interest is taken as profit level indicator.

c. Assets employed – There may be difference in assets employed and the method of providing depreciation. In order that such difference does not impact the net profit, the operating margin on operating cost before depreciation is taken as profit level indicator.

d. Assured or risk bearing business – There may be a difference in the customer/ revenue model of the assessee vis-à-vis the comparables. For example, the comparables identified may be entrepreneurs bearing the market risks of business volume, customer continuity, etc and the assessee's international transaction is in the nature of captive service provider or contract manufacturer with assured volumes and/or assured compensation and/ or assured business period, etc. Such differences may be eliminated by making appropriate adjustment for low-risk or risk free business.

   In the above table, the transaction level differences cannot be noticed. However, some transaction level differences may exist and the same may be adjusted if requisite information is available. Some of the common transaction level differences may be as follows;

   i. Free gifts

   ii. Extended warranty (in addition to the normal one-year)

   iii. Marketing risks

   iv. Pricing - Ex-Shop or FOR-destination.

   v. Quantity discount

Computation of arm's length price under the transactional net margin method

1. Associated enterprise : AE1 Ltd. and AE2 Ltd.
2. International transaction : AE1 Ltd. and AE2 Ltd.
3. Comparable uncontrolled company : Z Ltd.

	%
Net profit margin of Z Ltd. - i.e. operating margin on cost before interest and after depreciation	51.52
Adjustments for transaction level differences	0.00
Arm's length net profit margin	51.52
	(₹ in crores)
Operating costs before interest and after depreciation	95.00
Arm's length sale revenue	143.94
Actual sales	130.00
Income increases by	13.94

The following points are to be noticed:

a. Different bases of determining the net profit margin [i.e. profit level indicators (PLI)] are recognised. The same basis of arriving at the net profit margin is to be adopted year after year, unless circumstances justify an alternate base;

b. Whichever base is selected in determining the net profit margin in an international transaction, the same basis is to be adopted for arriving at the net profit margin in the comparable uncontrolled transaction;

c. It is recommended that operating profit margin may be used instead of net profit margin. Operating profit margin would eliminate the nonoperating items (the items of revenue and costs which do not result from routine business operations such as profit on sale of assets, dividend etc.). Further, the operating profit margins should be computed on the basis of financial statements of the assessee and the comparable company.

d. The accounting treatment of expenses and depreciation is also a critical factor in computing the arm's length price. Unlike the preceding methods, the rule does not explicitly provide for adjustment on account of differing accounting practices. Nevertheless, such differing practices should also be factored in;

e. It is not uncommon to find purchase transaction being an international transaction where TNMM is used. TNMM requires the determination of the net profit margin from an international transaction and purchase transaction as such does not result in net profit. However, as purchase is inextricably linked to earning net profit, TNMM may be used for establishing arm's length purchase value. In such case, comparable operating margin should be appropriately used to work back the arm's length purchase cost. This may be illustrated as follows:

Illustration 1:

1. Actual Profit and loss account of the assessee

	₹ in lakhs		₹ in lakhs
Opening stock-AE purchases	100	Sales of AE purchases	800
Opening stock-Non AE purchases	150	Sales of Non AE purchases	1200

Purchases from AE	500	Closing stock-AE purchases	120
Purchases from Non AE	1000	Closing stock-Non AE purchases	160
Gross profit	530		
	2280		2280
Expenses	200	Gross profit	530
Net profit	330		
	530		530

2. Comparable operating margin (PLI being operating profit on sale): 35%

3. Profit and loss account - recast to compute arm's length price of purchase

	(₹ in lakhs)		(₹ in lakhs)
Opening stock-AE purchases	100	Sales of AE purchases	800
Purchases from AE (balancing figure)	460	Closing stock-AE purchases	120
Gross profit (brought back)	360		
	920		920
Expenses-allocated (in the ratio of sales)	80	Gross profit (worked back)	360
Net profits	280		
(applying TNMM margin on AE sales)			
	360		360

4. Arm's length value of purchase is ₹ 460 as against actual value of ₹ 500. Therefore, income increases by ₹40.

Illustration 2 :

1. Profit and loss account of the assessee – Actual

	₹ in lakhs		₹ in lakhs
Opening stock of raw material (AE purchases)	100	Sale of finished goods	2500
Opening stock of raw material (Non-AE purchases)	150	Closing stock of raw material (AE purchases)	120
Purchases of raw material from AE	500	Closing stock of raw material (Non-AE purchases)	160
Purchases of raw material from Non-AE	1000	Closing stock of finished goods	500
Manufacturing costs	400		
Admin, selling and finance expenses	200		
Net profit	930		
	3280		3280

2. Comparable operating margin (PLI being operating profit on sale): 45%

3. Profit and loss account - recast:

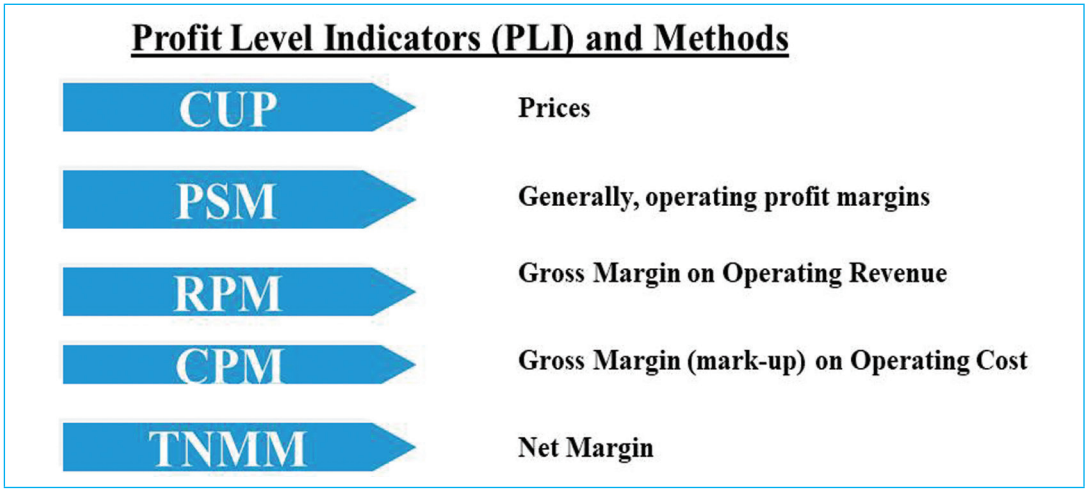
	₹ in lakhs		₹ in lakhs

	₹ in lakhs		₹ in lakhs
Opening stock of raw material	150	Sale of finished goods	2500
(Non-AE purchases)			
Cost of purchase from AE (net of stock)	405	Closing stock of raw material	160
(balancing figure)		(Non-AE purchases)	
Purchases of raw material from Non AE	1000	Closing stock of finished goods	500
Manufacturing costs	400		
Admin, selling and finance expenses	200		
Net profit	1125		
(arrived on basis of TNMM margin)			
	3280		3280
Arm's length Purchase value:			
Cost of purchase from AE (net of stock)			405
Add : Closing stock of Raw Material			120
Add : Closing stock of Raw Material in finished goods (see Note 1 below)			20
Less : Opening stock			100
Arm's length Purchase value			445
Actual purchase			500
Excess price paid			55

Notes:

1. In the above illustration, the raw material cost (of purchases from AE) built into closing stock of finished goods is assumed to be ₹ 20.

2. It is assumed that there is no opening stock of finished goods.



f. any other method as provided in rule 10AB.

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The application of the sixth method may be understood with the following examples:

Illustration 3:

AE1 Ltd. is an Indian Company.

AE1 Ltd. owns certain registered patents which it has developed by undertaking research and development.

It is a subsidiary of AE2 Ltd., a foreign company.

AE1 Ltd. has sold its registered patents to AE2 Ltd., for ₹ 50 crores. The price has been determined based on a valuation report obtained from an independent valuer.

The sale of patents is a unique transaction and AE1 Ltd or AE2 Ltd. has not entered into similar transactions with third parties and hence no internal or external CUP is available.

AE1 Ltd. may select the Other Method as the most appropriate method and use the independent valuation report for comparability purposes.

Illustration 4:

An Indian Company (I Co) buys back its equity shares issued to its foreign associated enterprise (AE Co). I Co obtains a valuation report from an external firm identifying the fair market value of these shares. I Co purchases the shares at the value determined in the valuation report. This value denotes a price that would have been charged if a third party would have bought the same shares. Hence, I Co could use Rule 10AB and rely upon the valuation report to demonstrate this transaction to be arm's length.

Illustration 5:

Another example where this method could be used is in cases of cost allocation arrangements where a taxpayer benefits from certain services provided by a central entity of the group and has to pay a portion of the total cost incurred by the service provider. These costs are generally allocated on the basis of allocation keys like headcount, time spent, revenues etc. and a third party outside the group may not have the capability to provide identical services. Hence, in the absence of comparable prices or transactions, Rule 10AB may be applied and the cost allocation arrangement could be justified appropriately.

- For the purposes of aforesaid rule, the comparability of an international transaction or a specified domestic transaction with an uncontrolled transaction shall be judged with reference to the following:

  a. the specific characteristics of the property transferred or services provided in either transaction;

  b. the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;

  c. the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

  d. conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of

labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

- An uncontrolled transaction shall be comparable to an international transaction or a specified domestic transaction if—

  i. none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or

  ii. reasonably accurate adjustments can be made to eliminate the material effects of such differences.

- The data to be used in analysing the comparability of an uncontrolled transaction with an international transaction or a specified domestic transaction shall be the data relating to the financial year (hereafter in this rule and in rule 10CA referred to as the 'current year') in which the international transaction or the specified domestic transaction has been entered into.

- In a case where the most appropriate method for determination of the arm's length price of an international transaction or a specified domestic transaction, entered into on or after 01-04-2014, is the method specified in sec. 92C(1)(b), (c) or (e), then, the data to be used for analysing the comparability of an uncontrolled transaction with an international transaction or a specified domestic transaction shall be:

  i. the data relating to the current year; or

  ii. the data relating to the financial year immediately preceding the current, if the data relating to the current year is not available at the time of furnishing the return of income by the assessee, for the assessment year relevant to the current year.

  Where the data relating to the current year is subsequently available at the time of determination of arm's length price of an international transaction or a specified domestic transaction during the course of any assessment proceeding for the assessment year relevant to the current year, then, such data shall be used for such determination irrespective of the fact that the data was not available at the time of furnishing the return of income of the relevant assessment year.

Other methods of determination of arm's length price [Rule 10AB]

For the purposes of sec. 92C(1)(f), the other method for determination of the arm's length price in relation to an international transaction or a specified domestic transaction shall be any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.

Most appropriate method [Rule 10C]

The most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction or specified domestic transaction, and which provides the most reliable measure of an arm's length price in relation to the international transaction or specified domestic transaction. In selecting the most appropriate method, the following factors shall be taken into account:

(a) the nature and class of the international transaction or specified domestic transaction;

(b) the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;

(c) the availability, coverage and reliability of data necessary for application of the method;

(d) the degree of comparability existing between the international transaction or specified domestic transaction and the uncontrolled transaction and between the enterprises entering into such transactions;

(e) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction or specified domestic transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;

(f) the nature, extent and reliability of assumptions required to be made in application of a method.

Comparison of Methods of computing Arm's Length Price

Methods	Product Comparability	Functional Comparability	Approach	Remarks
CUP	Very High	Medium	Prices are benchmarked	Very difficult to apply as very high degree of comparability required
RPM	High	Medium	GPM (on sales) benchmarked	Difficult to apply as high degree of comparability required
CPM	High	High	GPM (on costs) benchmarked	Difficult to apply as high degree of comparability required
PSM	Medium	Very High	Profit Margins	Complex Method, sparingly used
TNMM	Medium	Very High	Net Profit Margins	Most commonly used Method

Some Important Ratios

Cost Cover Ratio

The cost coverage ratio measures the ability of a company to cover its operating expenses through operating revenue. Given the limitation of financial information publicly available, the operating expenses of a selected comparable company are the sum of its operating revenue less EBIT.

Return on Assets Ratio

The return on assets ratio measures the amount of EBIT per rupee of asset invested. This is a profitability ratio measuring each company's operational efficiency, that is, how efficiently the assets have been deployed by the company.

Berry Ratio

Berry ratio is the ratio of gross profit to operating expenses. It measures the return on operating expenses. As the functions performed by the tax-payers are often reflected in the operating expenses, this ratio determines the relationship of the income earned in relation to the functions performed. This ratio helps in overcoming the difficulties in applying the RPM, which does not explain the creation of gross profit. This ratio is used in conducting an arm's length analysis of service-oriented industry such as limited risk distributor, advertising, marketing and engineering services. The Berry ratio may be used to test whether service providers have earned enough mark-up on their operating expenses. In essence, the Berry ratio implicity assumes that there is a relationship between the level of operating expenses and the level of gross profits earned by routine distributors and service providers.

Annexure 2

Information and documents to be kept and maintained under section 92D [Rule 10D]

1. Every person who has entered into an international transaction or a specified domestic transaction shall keep

and maintain the following information and documents:

a. a description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises;

b. a profile of the multinational group of which the assessee enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions or specified domestic transactions, as the case may be, have been entered into by the assessee, and ownership linkages among them;

c. a broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the associated enterprises with whom the assessee has transacted;

d. the nature and terms (including prices) of international transactions or specified domestic transactions entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;

e. a description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involved in the international transaction or specified domestic transactions;

f. a record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately, which may have a bearing on the international transactions or specified domestic transactions entered into by the assessee;

g. a record of uncontrolled transactions taken into account for analysing their comparability with the international transactions or specified domestic transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions or specified domestic transactions, as the case may be;

h. a record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction or specified domestic transactions;

i. a description of the methods considered for determining the arm's length price in relation to each international transaction or specified domestic transactions or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case;

j. a record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction or specified domestic transactions and the comparable uncontrolled transactions, or between the enterprises entering into such transactions;

k. the assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price;

l. details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under these rules and consequent adjustment made to the total income for tax purposes;

m. any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

2. Threshold limit in case of international transaction: Nothing contained in sub-rule (1), in so far as it relates to an international transaction, shall apply in a case where the aggregate value, as recorded in the books of account, of international transactions entered into by the assessee does not exceed ₹ 1 crore

However, the assessee shall be required to substantiate, on the basis of material available with him, that income arising from international transactions entered into by him has been computed in accordance with sec. 92.

3. Eligible assessee, on which safe harbour rule applies in respect of specified domestic transaction: Nothing contained in sub-rule (1), in so far as it relates to an eligible specified domestic transaction referred to in rule 10THB, shall apply in a case of an eligible assessee mentioned in rule 10THA and:

   a. the eligible assessee, referred to in rule 10THA(i) [i.e., Government company engaged in the business of generation, supply, transmission or distribution of electricity], shall keep and maintain the following information and documents:

      i. a description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises;

      ii. a broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the associated enterprises with whom the assessee has transacted;

      iii. the nature and terms (including prices) of specified domestic transactions entered into with each associated enterprise and the quantum and value of each such transaction or class of such transaction;

      iv. a record of proceedings, if any, before the regulatory commission and orders of such commission relating to the specified domestic transaction;

      v. a record of the actual working carried out for determining the transfer price of the specified domestic transaction;

      vi. the assumptions, policies and price negotiations, if any, which have critically affected the determination of the transfer price; and

      vii. any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the transfer price;

   b. the eligible assessee, referred to in rule 10THA(ii) [i.e., co-operative society engaged in the business of procuring and marketing milk and milk products], shall keep and maintain the following information and documents:

      i. a description of the ownership structure of the assessee co-operative society with details of shares or other ownership interest held therein by the members;

      ii. description of members including their addresses and period of membership;

      iii. the nature and terms (including prices) of specified domestic transactions entered into with each member and the quantum and value of each such transaction or class of such transaction;

      iv. a record of the actual working carried out for determining the transfer price of the specified domestic transaction;

      v. the assumptions, policies and price negotiations, if any, which have critically affected the determination of the transfer price;

      vi. the documentation regarding price being routinely declared in transparent manner and being available in public domain; and

      vii. any other information, data or document which may be relevant for determination of the transfer price.

4. The information specified in aforesaid rules shall be supported by authentic documents, which may include the

following:

a. official publications, reports, studies and data bases from the Government of the country of residence of the associated enterprise, or of any other country;

b. reports of market research studies carried out and technical publications brought out by institutions of national or international repute;

c. price publications including stock exchange and commodity market quotations;

d. published accounts and financial statements relating to the business affairs of the associated enterprises;

e. agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions [56e][or the specified domestic transactions, as the case may be];

f. letters and other correspondence documenting any terms negotiated between the assessee and the associated enterprise;

g. documents normally issued in connection with various transactions under the accounting practices followed.

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- The information and documents specified under aforesaid rules, should, as far as possible, be contemporaneous and should exist latest by the specified date [i.e., due date u/s 139(1)].
- Where an international transaction or specified domestic transaction continues to have effect over more than one previous years, fresh documentation need not be maintained separately in respect of each previous year, unless there is any significant change in the nature or terms of the international transaction or specified domestic transaction, in the assumptions made, or in any other factor which could influence the transfer price, and in the case of such significant change, fresh documentation shall be maintained bringing out the impact of the change on the pricing of the international transaction or specified domestic transaction.
- Aforesaid information and documents shall be kept and maintained for a period of 8 years from the end of the relevant assessment year.

Illustration 6:

Brain Inc. London has 35% equity in Salem Ltd. The company Salem Ltd. is engaged in development of software and maintenance of customers across the globe, which includes Brain Inc.

During the year 2025-26, Salem Ltd. spent 2000 men hours for developing and maintaining a software for Brain Inc. and billed at ₹ 1,000 per hour. The cost incurred for executing maintenance work to Brain Inc. for Salem Ltd. amount to ₹ 15,00,000. Similar such work was done for unrelated party Try Ltd. in which the profit was at 50%.

Brain Inc. gives technical support to Salem Ltd. which can be valued at 8% of gross profit. There is no such functional relationship with try Ltd.

Salem Ltd. gives credit period of 90 days the cost of which is 3% of the normal billing rate which is not given to other parties.

Compute ALP under cost plus method in the hands of Salem Ltd. and the impact of the same on the total income.

Solution:

A. Computation of Arms Length Gross Profit Mark-up

Particulars	%
Normal Gross Profit Mark up	50.00
Less: Adjustment for differences	
Technical support from Brain Inc [8% of Normal GP = 8% of 50%]	(4.00)
	46.00
Add: Cost of Credit to Brain Inc 3% of Normal Bill [3% ×GP 50%]	1.50
Arm's Length Gross Profit mark-up	47.50

B. Computation of Increase in Total Income of Brain Inc

Particulars	Amount
Cost of services	15,00,000
Arm's length Billed Value [Cost / [(100 – Arm's Length mark up)] [₹ 15,00,000 / (100% - 47.50%)]	28,57,143
Less: Billed amount [2,000 hours x ₹ 1,000 per hour]	20,00,000
Therefore, Increase in Total Income	8,57,143

Illustration 7:

A Co. Ltd. of Chennai and Sky Inc. of Singapore are associate enterprises. A Co. Ltd. imported 1000 television sets at ₹ 16,000 per set without any warranty period. A Co. Ltd. also imports similar TV sets from unrelated party Sign Inc. of Japan. It is imported at ₹ 15,000 per set with warranty time of 2 years. The cost of warranty in respect of goods imported from Sky Inc. for a period of 2 years would cost ₹ 2,000.

Compute arm's length price and the amount of increase in total income of A Co. Ltd. as per CUP method.

Solution:

A. Computation of Arms Length Price

Particulars	Amount
Cost of TV Set acquired from Sign Inc	15,000
Less: Cost of Warranty	2,000
Arm's Length Gross Profit mark-up	13,000

B. Computation of Increase in Total Income

Particulars	Amount
Cost of TV Set acquired from Sky Inc [₹ 16,000 * 1,000]	1,60,00,000
Less: Arm's length Value [₹ 13,000 * 1,000]	1,30,00,000

Therefore, Increase in Total Income	30,00,000

Illustration 8:

J Inc. of Korea and CD Ltd, an Indian Company are associated enterprises. CD Ltd manufactures Cell Phones and sells them to J.K.& F Inc., a Company based in Nepal. During the year CD Ltd. supplied 2,50,000 Cellular Phones to J Inc. Korea at a price of ₹ 3,000 per unit and 35,000 units to JK & F Inc. at a price of ₹ 5,800 per unit. The transactions of CD Ltd with JK & F Inc. are comparable subject to the following considerations:

Sales to J Inc. are on FOB basis, sales to JK & F Inc. are CIF basis. The freight and insurance paid by J Inc. for each unit @ ₹ 700. Sales to JK & F Inc. are under a free warranty for Two Years whereas sales to J Inc. are without any such warranty. The estimated cost of executing such warranty is ₹ 500. Since J Inc.'s order was huge in volume, quantity discount of ₹ 200 per unit was offered to it.

Compute the Arm's Length Price and the subsequent amount of increase in the Total Income of CD Ltd, if any.

Solution:

Computation of Arm's Length Price of Products sold to J Inc. Korea by CD Ltd

Particulars	₹	₹
Price per Unit in a Comparable Uncontrolled Transaction		5,800
Less: Adjustment for Differences -		
(a) Freight and Insurance Charges	700	
(b) Estimated Warranty Costs	500	
(c) Discount for Voluminous Purchase	200	(1,400)
Arms's Length Price for Cellular Phone sold to J Inc. Korea		4,400

Computation of Increase in Total Income of CD Ltd

Particulars	₹
Arm's Length Price per Unit	4,400
Less: Price at which actually sold to J Inc. Korea	(3,000)
Increase in Price per Unit	1,400
No. of Units sold to J Inc. Korea	2,50,000
Increase in Total Income of CD Ltd (2,50,000 × ₹ 1,400)	₹ 35 Crores

Illustration 9: Comparable sales of same product

DSM, a manufacturer, sells the same product to both controlled and uncontrolled distributor. The circumstances surrounding the controlled and uncontrolled transactions are substantially the same, except that the controlled sales price is a delivered price to the buyer and the uncontrolled sales are made F.O.B. DSM's factory. Differences in the contractual terms of transportation and insurance generally have a definite and reasonably ascertainable effect on price, and adjustments are made to the results of the uncontrolled transaction to account for such differences. In this case the transactions are comparable and internal CUP can be applied by comparing the prices of both, the controlled and uncontrolled transactions, albeit after subtracting the costs of transportation and insurance of the controlled transaction.

Illustration 10: Effect of geographic differences

FM, a foreign specialty radio manufacturer, also exports its radios to a controlled U.S. distributor, AM, which serves the United States. FM also exports its radios to uncontrolled distributors to serve in South America. The product in the controlled and uncontrolled transactions is the same, and all other circumstances surrounding the controlled and uncontrolled transactions are substantially the same, other than the geographic differences. The geographic differences e.g. differences in purchasing power, levels of economic development, etc, in two different geographies, are likely to have a material effect on price, for which accurate adjustments cannot be made and hence the transactions are not comparable. Thus, CUP method cannot be applied.

Illustration 11: External Commercial Borrowing

Pharma Ltd, an Indian company has borrowed funds from its parent company at LIBOR plus 150 basis points. The LIBOR prevalent at the time of borrowing is 4% for US$, thus its cost of borrowings is 5.50%. The borrowings allowed under the External Commercial Borrowings guidelines issued under FEMA, for example, say is LIBOR plus 250 basis points, then it can be said that Pharma's borrowing at 5.50% is less than 6.50% and thus at arm's length. In this connection, one may rely on Rule 10B (2) (d) which specifies that the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the laws and government orders in force.

Illustration 12:

Megabyte Inc. of France and R Ltd. of India are associated enterprises. R Ltd. imports 3,000 compressors for Air Conditioners from Megabyte Inc. at ₹ 7,500 per unit and these are sold to Pleasure Cooling Solutions Ltd at a price of ₹ 11,000 per unit. R Ltd. had also imported similar products from Cold Inc. Poland and sold outside at a Gross Profit of 20% on Sales. Megabyte Inc. offered a quantity discount of ₹1,500 per unit. Cold Inc. could offer only ₹500 per unit as Quantity Discount. The freight and customs duty paid for imports from Cold Inc. Poland had cost R Ltd. ₹ 1,200 per piece. In respect of purchase from Terabyte Inc., R Ltd. had to pay ₹ 200 only as freight charges. Determine the Arm's Length Price and the amount of increase in Total Income of R Ltd.

Solution:

Computation of Arm's Length Price

Particulars	Amount
Resale Price of Goods Purchased from Megabyte Inc.	11,000
Less: Adjustment for Differences –	
a) Normal Gross Profit Margin at 20% of Sale Price [20% × ₹ 11,000]	2,200
b) Incremental Quantity Discount by Megabyte Inc. [₹ 1,500 – ₹ 500]	1,000
c) Difference in Purchase related expenses [₹ 1,200 – ₹ 200]	1,000
Arms Length Price	6,800

Computation of Increase in Total Income of R Ltd

Particulars	Amount
Price at which actually bought from Megabyte Inc. of France	7,500
Less: Arms Length Price per unit under Resale Price Method	6,800
Decrease in Purchase Price per unit	700
No. of units purchased from Megabyte Inc.	3,000 units
Increase in Total Income (3,000 units × ₹ 700)	₹ 21,00,000

Illustration 13:

NBR Medical Equipments Inc. (NBR) of Canada has received an order from a leading UK based Hospital for development of a hi-tech medical equipment which will integrate the best of software and latest medical examination tool to meet varied requirements. The order was for 3,00,000 Euros. To execute the order, NBR joined hands with its subsidiary Precision Components Inc. (PCI) of USA and Bioinformatics India Ltd (BIL), an Indian Company. PCI holds 30% of BIL. NBR paid to PCI and BIL Euro 90,000 and Euro 1,00,000 respectively and kept the balance for itself. In the entire transaction, a profit of Euro 1,00,000 is earned. Bioinformatics India Ltd incurred a Total Cost of Euro 80,000 in execution of its work in the above contract. The relative contribution of NBR, PCI and BIL may be taken at 30%, 30% and 40% respectively. Compute the Arm's Length Price and the incremental Total Income of Bioinformatics India Ltd, if any due to adopting Arms Length Price determined here under.

A	Share of each of the Associates in the Value of the Order	3,00,000
	Share of BIL [Given]	1,00,000
	Share of PCI [Given]	90,000
	Share of NBR [Amount Retained = 3,00,000 – 1,00,000 - 90,000]	1,10,000
B	Share of each of the Associates in the Profit of the Order	
	Combined Total Profits	1,00,000
	Share of BIL [Contribution of 40% x Total Profit € 1,00,000]	40,000
	Share of PCI [Contribution of 30% x Total Profit € 1,00,000]	30,000
	Share of NBR [Contribution of 30% x Total Profit € 1,00,000]	30,000
C	Computation of Incremental Total Income of BIL	
	Total Cost to BIL Ltd	80,000
	Add: Share in the Profit to BIL (from B above)	40,000
	Revenue of BIL on the basis of Arm's Length Price	1,20,000
	Less: Revenue Actually received by BIL	1,00,000
	Increase in Total Income of BIL	20,000

Illustration 14:

lndco, an Indian company, has developed and manufactures a robot to be used for multiple industrial applications. The robot is considered to be an innovative technological advance. Chco, a Chinese subsidiary of Indco, has developed and manufactures a software programme which incorporates the new programme in the robot and makes it more effective. The success of the robot is attributable to both companies for the design of the robot and the software programme.

Indco manufactures and supplies Chco with the robot for installing of the new software programme for assembly and manufacture of the robot. Chco manufactures the robot and sells to an arm's length distributor.

In light of the innovative nature of the robot and software, the group was unable to find comparables with similar intangible assets. Because they were unable to establish a reliable degree of comparability, the group was unable to apply the traditional transaction methods or the TNMM.

However, reliable data are available on robot and software manufacturers without innovative intangible property, and they earn a return of 10% on their manufacturing costs.

The total profits attributable to manufacture of robots are calculated as follows:

Particulars	Amount	Amount
Sales to the arm's length distributor		1,000
Less:		
Indco's manufacturing costs	200	
Chco's manufacturing costs	300	
Total manufacturing costs for the group		500
Gross Margin		500
Less:		
Indco's development costs	100	
Chco's development costs	50	
Indco's operating costs	50	
Chco's operating costs	100	300
Net profit		200
Indco's return to manufacturing (200 × 10%)	20	
Chco's return to manufacturing (300 × 10%)	30	50
Residual profit attributable to development		150

The split of the residual profit has been considered on the basis of the development cost considering the significance of technology in the manufacturing process.

Based on proportionate development costs

Particulars	Amount
Indco's share of residual profit [100/(100+50)] × 150	100
Chco's share of residual profit [50/(100+50)] × 150	50

Indco's transfer price is calculated as follows:

Particulars	Amount
Manufacturing costs	200
Development costs	100
Operating costs	50
Routine 10% return on manufacturing costs	20
Share of residual profit	100
Transfer price	**470**

Illustration 15:

Fox Solutions Inc. a US Company, sells Laser Printer Cartridge Drums to its Indian Subsidiary Quality Printing Ltd at S 20 per drum. Doc Solutions Inc. has other takers in India for its Cartridge Drums, for whom the price is $ 30 per drum. During the year, Fox Solutions had supplied 12,000 Cartridge Drums to Quality Printing Ltd.

Determine the Arm's Length Price and taxable income of Quality Printing Ltd if its income after considering the above is ₹ 45,00,000. Compliance with TDS provisions may be assumed and Rate per USD is ₹ 45. Also determine income of Doc Solutions Inc.

Solution:

Computation of Total Income of Quality Printing Ltd.

Particulars	Amount	Amount
Total Income before adjusting for differences due to Arm's Length Price	1,08,00,000	
Add: Difference on Account of adopting Arm's Length Price [12,000 × $20 × ₹ 45]	1,62,00,000	
Less: Amount under Arm's Length Price [12,000 × $ 30 × ₹ 45]	(54,00,000)	45,00,000
Incremental Cost on adopting ALP u/s 92(3), Taxable Income cannot be reduced on applying ALP. Therefore, difference on account of ALP is ignored.		
Total Income of Quality Printing Ltd.		45,00,000

Computation of Total Income of Fox Solutions Inc.

The provisions relating to taxing income of Fox Solutions Inc., on applying Arm's Length Price for transactions entered into by a Foreign Company is given in Circular 23 dated 23.7.1969, which is as follows:

i Transactions Not Taxable in India: Transactions will not be subject tax in India if transactions are on principal-to-principal basis and are entered into at ALP, and the subsidiary also carries on business on its own.

ii Transactions Taxable in India if the Indian Subsidiary does not carry on any business on its own. The following are the other considerations in this regard:

a. Adopting ALP does not affect the computation of taxable income of Fox Solutions Inc. if tax has been deducted at source or if tax is deductible.

b. Where ALP is adopted for taxing income of the Parent Company, income of the recipient Company (i.e. Quality Printing Ltd) will not be recomputed.

Illustration 16:

Khazana Ltd is an Indian Company engaged in the business of developing and manufacturing Industrial components. Its Canadian Subsidiary Techpro Inc. supplies technical information and offers technical support to Khazana for manufacturing goods, for a consideration of Euro 1,00,000 per year. Income of Khazana Ltd is ₹ 90 Lakhs. Determine the Taxable Income of Khazana Ltd if Techpro charges Euro 1,30,000 per year to other entities in India. What will be the answer if Techpro charges Euro 60,000 per year to other entities. (Rate per Euro may be taken at ₹ 50.)

Solution:

Computation of Total Income of Khazana Ltd

Particulars	Amount	Amount
When price charged for Comparable Uncontrolled Transaction	€ 1,00,000	€ 50,000
Price actually paid by Khazana Ltd [€1,00,000 × ₹ 50]	50,00,000	50,00,000
Less: Price charged in Rupees (under ALP)		
[€1,30,000 × ₹ 50]	65,00,000	
[€60,000 × ₹ 50]		30,00,000
Incremental Profit on adopting ALP (A)	(15,00,000)	20,00,000
Total Income before adjusting for differences due to Arm's Length Price	90,00,000	90,00,000
Add: Difference on account of adopting Arms Length Price [if (A) is positive]	NIL	20,00,000
Total Income of Khazana Ltd.	90,00,000	1,10,00,000

Note: u/s 92(3), Taxable Income cannot be reduced on applying ALP. Therefore, difference on account of ALP which reduces the Taxable Income is ignored.

Illustration 17:

Videsh Ltd., a US company has a subsidiary, Hind Ltd. in India. Videsh Ltd. sells mobile phones to Hind Ltd. for resale in India. Videsh Ltd. also sells mobile phones to Bharat Ltd. another mobile phone reseller. It sold 48,000 mobile phones to Hind Ltd. at ₹ 12,000 per unit. The price fixed for Bharat Ltd. is ₹ 11,000 per unit. The warranty in case of sale of mobile phones by Hind Ltd. is handled by itself, whereas, for sale of mobile phones by Bhart Ltd., Videsh Ltd. is responsible for warranty for 6 months. Both Videsh Ltd. and Hind Ltd. extended warranty at a standard rate of ₹ 500 per annum.

On the above facts, how is the assessment of Hind Ltd. going to be affected?

Solution:

Computation of Arms Length Price

Particulars	Amount
Cost of Mobile Phone sold to Bharat Ltd.	11,000
Less: Cost of Warranty	250
Arm's Length Price	10,750

Computation of Increase in Total Income

Particulars	Amount (₹) (in lacs)
Cost of mobile phone acquired from Videsh Ltd. [₹ 12,000 * 48,000]	5,760
Less: Arm's length Value [₹ 10,750 × 48,000]	5,160
Therefore, Increase in Total Income	600

Illustration 18:

ABC India Limited ('the Company') is engaged in the business of import and sales of computers, laptops & printers. The company is a 100% subsidiary ABC Inc., USA. The company purchases laptops from ABC Inc., USA at negotiated rates and sells to independent customers in India under its own terms and conditions.

The company also trades in computers and printers which it procures from independent vendors in USA and sell to its own customers in India under its own terms and condition.

Below is the profit and loss account of the company.

Particulars	₹	Particulars	₹
Opening stock		Sales	
- Computers	500	- Computers	8,000
- Printers	200	- Printers	2,000
- Laptops	800	- Laptops	11,000
Purchases (Imports)		Closing Stock	
- Computers	5,000	- Computers	800
- Printers	1,300	- Printers	250
- Laptops	6,000	- Laptops	1,200
Gross profit c/f	9,450		
	23,250		23,250
		Gross profit c/f	9,450

Particulars	₹	Particulars	₹
Salary	2,000		
Rent	1,000		
Fright Outward	250		
Travel and Conveyance	300		
PBITD	5,900		
	9,450		9,450

Other relevant information:

1. Credit period of 2 months is allowed for customers of computers and printers and hence 2% extra margin towards interest cost is factored in sale price.
2. Purchase of materials accounted at landed costs. It is estimated that around 20% of the purchase cost reported in P&L is towards customs duty and clearing charges.
3. Delivery of computers and printers made at company's cost. For laptop, the customers collect the goods for company premises.
4. For laptop purchases, the company has incurred ocean freight (around ₹300) whereas for computer and printers the terms of import are CIF, Chennai.

Question and Solution

1. Identify the Associated Enterprise in the scenario?

Ans: ABC Inc., USA by virtue of ownership criteria.

2. Identify the International transaction?

Ans: Purchase of the laptop during the year of ₹4,800 (₹6,000 less 20%)

3. Which is the comparable uncontrolled transaction here?

Ans: Sale of computers and printers (since they are similar product to laptops), procured from, as well as sold to independent parties.

4. What is the normal gross profit margin on the comparable transactions?

Ans:

	₹
Gross profit as per trading account [8,000 + 2,000 + 800 + 250 – 500 – 200 – 5,000 – 1,300]	4,050
Less: Interest elements factored in sale price [2% of [8,000 + 2,000]	200
Less: Fright outward costs	250
Normal gross profit	3,600
Normal gross profit percentage [3,600 / 10,000 × 100]	36%

At this stage, the difference in the terms of sales transactions of computers and printers vis-a-vis the sale transactions of laptops are considered. The difference in terms of purchase will be adjusted in subsequent stage.

5. What is the price of laptop being purchased from the AE, is resold to unrelated enterprise?

Ans: ₹11,000

6. What is the resultant cost of sales after deducting 'Normal Gross Profit Margin'

Ans: ₹7,040 (i.e. ₹11,000 less 36% Normal Gross Profit Margin)

7. What are the expenses incurred in connection with purchase?

Ans: ₹1,200 (since it is mentioned that around 20% of the purchase cost reported in P&L is toward freight, customs duty and clearance charges)

8. What are the functional difference, including accounting practices, between the international transaction and the comparable uncontrolled transaction, which could materially affect the amount of gross profit margin?

Ans: ₹300 on account of ocean freight

9. What is the cost of sale after adjustment made as per 7 & 8 above?

Ans: ₹5,540 (i.e. ₹7,040 less ₹1,200 less ₹300)

10. How is the arm's length purchase price determined?

Ans:	Price as arrived at 9 above	₹5,540
	Add: Amount in closing stock (80% of ₹1200)	₹ 960
		₹6,500
	Less: Amount in opening stock (80% of ₹800)	₹640
	Arm's length price of purchase	₹5,860

11. Is the purchase price at arm's length?

Ans: Yes. Since the purchase price is ₹4,800 is less than arm's length price determined at ₹5,860.

Illustration 19:

Compute arm's length price from following information

Particulars	Related Party	Unrelated Party
Price paid (inclusive of taxes)	INR 25,000	INR 23,500
Delivery terms	CIF	FOB
Quantity	100 pcs	110 pcs
Availability of Input Tax Credit	No	Yes
Quantity	100 pcs	110 pcs
Freight cost	-	INR 1,200
Insurance cost	-	INR 700
Input Tax Credit	-	INR 2,000

Solution:

Computation of ALP

Particulars	Amount
Price paid to unrelated party (inclusive of taxes)	INR 23,500
Adjustments of differences -	
Delivery terms – Freight cost	INR 1,200
Delivery terms – Insurance cost	INR 700
Quantity	-
Input tax credit available	(INR 2000)
Arm's Length Price	INR 23,400

Illustration 20:

Compute arm's length price from the following information

Particulars	Related Party	Unrelated Party
Price paid (inclusive of taxes)	INR 25,000	INR 23,500
Delivery terms	CIF	FOB
Quantity	100 pcs	110 pcs
Availability of Input Tax Credit	No	Yes
Quantity	100 pcs	110 pcs
Freight cost	-	INR 1,200
Insurance cost	-	INR 700
Input Tax Credit	-	INR 2,000
Credit period	90 days	Upon dispatch
Interest rate on working capital	12% p.a.	-

Solution:

Computation of ALP

Particulars	Amount
Price paid (inclusive of taxes)	INR 23,500
Adjustments of differences	
Delivery terms – Freight cost	INR 1,200
Delivery terms – Insurance cost	INR 700
Input Tax Credit available	(INR 2000)
Credit period (Interest on INR 23,500 for 3 months @ 12% p.a.)	INR 705
Arm's length price	INR 24,105

Illustration 21:

Compute ALP through following information:

- A Ltd. is a distributor of IT products.
- A Ltd. purchases these products from its related party, P Ltd.
- A Ltd. also trades in laptops manufactured by X Ltd.
- P Ltd as well as X Ltd would supply the warranty replacements free of cost to A Ltd.
- Other details are as under:

Particulars	P Ltd (AE)	X Ltd
Purchase price of A Ltd.	INR 15,000	INR 22,000
Sale price of A Ltd	INR 18,000	INR 26,000
Other expenses incurred by A Ltd	INR 500	INR 700

Solution:

Computation of gross profit margin on unrelated transaction

Particulars	Amount (INR)
Sale price of laptop in India	26,000
Expenses incurred by A Ltd	700
Net Sale proceeds of laptop in India [A]	25,300
Purchase price [B]	22,000
Gross profit [A - B]	3,300
GP on sale (%)	12.69%

Computation of arm's length price

Particulars	Amount
Sales price of desktop in India	18,000
Less: Expenses incurred by A ltd	500
Less: Arm's length resale margin @ 12.69 % of sale	2,284
Arm's length purchase price	15,216
Purchase price paid to AE	15,000

Thus, no adjustment is required.

Illustration 22:

A sold a machine to B (associated enterprise) and in turn B sold the same machinery to C (an independent party) at sale margin of 30% for ₹ 4,00,000 but B has incurred ₹ 4,000 in sending the machine to C. From the above data, determine arm's length price.

Solution:

Computation of Arm's Length Price

Particulars	Details	Amount
Sales price to B		4, 00,000
Less: Gross Margin	4,00,000 × 30%	1, 20,000
Balance		2, 80,000
Less: Expenses incurred by B		4,000
Arm's length price		2,76,000

Emerging Transfer Pricing challenges in India

Transfer Pricing Regulations in India

The Indian TP regulations are based on arm's length principle. The regulations came into effect from 1 April, 2001. The regulations provide that any income arising from an international transaction between associated enterprises shall be computed having regard to the arm's length price (ALP). The concept of associated enterprises has been defined in detail in the regulations. The regulations do not provide any hierarchy of the Arm's Length Methods and support concept of "most appropriate method" which provide the most reliable measure of an arm's length result under a particular set of facts and circumstances. The regulation prescribes mandatory annual filing requirements as well as maintenance of contemporaneous documentation by the taxpayer in case international transactions between associated enterprises cross a threshold and contains stringent penalty implications in case of non-compliance. The primary onus of proving arm's length price of the transaction lies with the taxpayer. Indian transfer pricing administration prefer Indian comparables in most of the cases and also accept foreign comparables in cases where foreign associated enterprises is less or least complex entity and requisite information are available about tested party and comparables. In order to provide uniformity in application of transfer pricing law there is a specialized Directorate of transfer pricing to administer transfer pricing rule under supervision of Director General of Income tax (International Taxation). Transfer Pricing officers (TPO) are vested with powers of inspection, discovery, enforcing attendance, examining a person under oath, on-the-spot enquiry/verification and compelling the production of books of account and other relevant documents during the course of a transfer pricing audit. A dispute resolution panel (in short DRP) is available to taxpayer to resolve disputes relating to transfer pricing before disputes of final order by Assessing Officer, (which incorporates the order of TPO).

Key Current and Emerging TP Audit Issues in India

Indian transfer pricing administration over the past 10 years has witnessed several challenges in administration of transfer pricing law. Following are some of the emerging transfer pricing issues and difficulties in implementation of arm's length principle:

1. Challenges in the comparability analysis

India believes that comparability analysis is key to determine arm's length price of international transaction. However, increased market volatility and increased complexity in international transaction have thrown open serious challenges to comparability analysis and determination of arm's length price. Some of these challenges and responses of Indian transfer pricing administration in dealing with these challenges are as under:

a. Use of contemporaneous data: Commodity price volatility, debt, recession and worries have brought volatility to world market. The volatility impede a stable business environment and result in fluctuation in margins of MNEs and their subsidiaries. In this context, use of contemporaneous comparables provides a more accurate arm's length price in a particular year.

b. Application of data rules: The Indian transfer pricing regulation stipulates that data to be used in analyzing the comparability of uncontrolled transaction with an international transaction should be the data relating to the financial year in which international transactions have been entered into. However, the rule also provides exception and permits use of data for the preceding two years if and only if, it is proved that such data reveals a fact which could have an influence on the determination of arm's length price. Therefore, the exception comes into the play only when a proof that earlier year data could have an influence on determination of arm's length price is brought on the record.

c. Rationale: The mandatory requirement under the law to use contemporaneous document has a solid economic sense in the way that contemporaneous transaction reflect similar economic condition. Therefore, use of current year data is more relevant and appropriate for ensuring a higher degree of comparability of uncontrolled transaction for arriving at arm's length price in respect of international transaction. In India,