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UNION BUDGET 2024-25

Key expectation from Transfer Pricing ('TP') perspective amidst the economic vision of the new government

The Annual Budget 2024 will be presented in the Monsoon Session of Parliament. The Annual Budget 2024 is expected to build upon the principles of "Reform, Perform, and Transform." It is most likely that the finance minister would declare India's commitment to 'Pillar 2', aiming to implement a global minimum effective corporate tax rate of 15%. The initiative of the Organization for Economic Cooperation and Development (OECD), supported by the G20¹ targets the multinational enterprise groups with annual consolidated revenues of at least 750 million euros.

1. the Group of Twenty (G20) is the premier forum for international economic cooperation. <https://www.g20.in/en/about-g20/about-g20.html>

In the realm of taxation, TP plays a crucial role in structuring intra-group transactions. Since the inception of TP provisions in India, the law has steadily evolved. However, recent years have seen limited developments in TP law. Given India's commitment to the OECD's Base Erosion and Profit Shifting (BEPS) initiative, changes in domestic TP laws to align with BEPS recommendations are pivotal. Key expectations from the budget on the TP front are highlighted below:

Revamping the Safe Harbour Rules ('SHR') provisions

SHR provisions apply to eligible taxpayers entering into eligible international transactions. Currently, SHR provisions are applicable to taxpayers with international transactions up to INR 200 crores for provision of software development and Information Technology enabled Services. This prescribed threshold limits the ability of larger taxpayers to benefit from the SHR mechanism.

Since the introduction of these provisions in 2013, the prescribed margins have only been revised once, in 2017. Since then, the government has extended the applicability for financial years without modifying the prescribed margins. CBDT in December 2023 made couple of amendments with respect to definition of operating expenses and operating revenue and the scope of intra-group loan transactions to cover inter-company loans given to any non-resident AE rather than restricting it only to loans given to non-resident wholly owned subsidiaries.

Budget 2024 may consider revisiting the SHR regime by expanding the scope to cover more transactions, increasing the monetary threshold and lowering the prescribed margins to make it more competitive.

Alignment of TP Compliance Requirements with Filing of Tax Returns for Non-Residents

Non-residents are relieved from filing their annual Return of Income (ROI) if their taxable income in India is derived from dividends, royalties, or fees for technical services, and taxes have been withheld in accordance with the provisions of the Income-tax Act, 1961 (the Act) (and not per the applicable tax treaty). However, TP compliance requirements for filing the Accountant's Report in Form 3CEB, as per Section 92E of the Act, must be adhered to by all taxpayers in India (including non-residents) for international transactions with AEs, regardless of whether taxes have been withheld as per the Act or the applicable treaty.

Therefore, it is crucial to align the TP compliance requirements with the provisions of Section 115A of the Act. This alignment would encourage more non-residents to have their taxes withheld under the provisions of the Act and get relief from various compliances.

Use of Inter-Quartile Range for Comparability Analysis

Indian TP provisions currently use the 35th to 65th percentile to determine the arm's length range for comparable companies when there are 6 or more comparable. To align with global practices and expand the range, the Indian TP provisions may consider adopting the inter-quartile range (25th to 75th percentile).

Monetary thresholds for TP compliance requirements

Filing of Accountant's Report in Form 3CEB ('AR')

Currently, the filing of AR is mandatorily required to be undertaken by all the taxpayers in India irrespective of any materiality threshold of the quantum of the international transactions with the AEs. Application of monetary threshold in this regard would assist in reducing the compliance burden for small taxpayers and newly started enterprises in India having insignificant quantum of international transactions.

TP Documentation

Since the introduction of the TP provisions in India, the prescribed threshold of INR 10 million for maintaining TP documentation has remained unchanged. Due to this relatively low threshold, most taxpayers in India are required to adhere to TP documentation requirements.

Furthermore, various capital international transactions with Associated Enterprises (AEs), which have no direct impact on the profit and loss of the taxpayer (such as the issue of equity shares, loans taken or repaid, and advances taken or repaid), are currently included in determining the quantum for the materiality threshold of TP documentation requirements. These transactions also affect the filing of the detailed Master File in Form 3CEAA (Part A and Part B).

Provisions relating to deemed international transactions

Indian TP provisions have a unique concept of "deemed international transaction" under the provisions of Section 92B(2) of the Act wherein transactions entered into between independent parties but influenced by any of the overseas AEs are covered under the ambit of deemed international transaction. Currently, there is no threshold prescribed for reporting such transactions in Form No. 3CEB.

Many a times multinational enterprises (MNEs) enter into contracts at group level for benefits in the nature of cost control, efficiency, higher productivity etc. Such transactions though forming only miniscule part of the expenses of the Indian taxpayers but may still come under the purview of deemed international transaction thereby warranting reporting requirements and determination of arm's length price ('ALP') of such transactions. The Government of India may consider introducing thresholds for reporting requirements relating to the provisions of deemed international transactions to reduce compliance burden and reporting requirements.

Secondary adjustment

Secondary adjustment arises when the taxpayer agrees to a transfer price, which is different from what is recorded in the books of accounts. The provisions require Indian taxpayers to repatriate the difference in transfer price as per tax and as per books of accounts (excess money) from the overseas AE within 90 days. Section 92CE of the Act prescribes that secondary adjustment shall be applicable wherein the quantum of primary adjustment exceeds INR 1 crore in any previous year. Considering the increase in the quantum of the international transactions amongst group companies, the government may consider increasing the threshold of application of secondary adjustment.

Conclusion

While with the recent efforts of the government of India, the global investors have been benefited in the area of 'ease of doing business' in India, however, there is still a need to accelerate this evolution and adopt more matured set of TP regulations in India which would pave the way for India's development.

OECD has been publishing the guidance on a timely basis as part of the ongoing OECD/G20 project on addressing the tax challenges of the digitalization of the economy. OECD issued a report 19 February 2024 on implementation of Amount B followed up with additional guidance on 17 June 2024 to simplify and standardize the principles relating to Amount B. India has already expressed reservations about the practical application in implementing Amount B and potential impact on the tax base. It would be worthwhile to see if there is any specific reference for this in the upcoming Union Budget.

The Indian budget is expected to incorporate measures aligning with the international consensus on Pillar 2. This alignment will ensure that India remains in step with global tax norms and avoids potential disputes with other jurisdictions.

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