Principles of Transfer Pricing

(PGP Elective)

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No. of Sessions: 10

Slots: XI and XII

Pre-requisites: None

Background

Transfer pricing refers to pricing of transactions entered into between two or more divisions/departments within a company or between two or more companies of the same group (related parties/associated enterprises). It is closer to the business economics. Transfer pricing closely follows business decisions and intentions underlying an inter-division or inter-company transaction. Therefore, it is important to understand the business rationale and relevant facts and circumstances while analysing the transfer prices adopted for such transactions.

In globalised environments, cross-border transactions are increasing in number and complexity and transfer pricing outcomes need to be in line with business value creation. The subject of transfer pricing has become the centre of a new public controversy. The issue is whether the current rules permit multinational entities to pay less than their 'fair share' of the overall tax burden in some of the territories in which they operate. Therefore the consequence is significant increase in transfer pricing disputes and a global focus on base erosion and profit shifting.

India introduced detailed transfer pricing regulations in 2001 and since then India has been no exception to the above development cycle as experienced by other countries; we have been experiencing our own set of issues through the trial and error method of implementing these regulations, both from the tax authority as well as the taxpayer perspective.

Transfer Pricing is thus one of the important agenda items in the board room of multinational Companies and hence critical as part of the MBA curriculum.

Course Objective

Upon completion of the Course, learners will be able to:

- Explain the concept of Transfer Pricing; and
- Understand the importance of Transfer Pricing in current economic scenario of globalisation

Pedagogy

Most of the sessions shall be taught through discussions, based on the assigned readings, supplemented by lectures and case studies. There would be group projects for case studies.

Evaluation

Class participation – 25%
Group Project Work – 40%
End Examination – 35%

Reading

Publications

(1) OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations

(The Organization for Economic Cooperation and Development (OECD) is a unique forum where the governments of 34 democracies with market economies work with each other, as well as with more than 70 non-member economies to promote economic growth, prosperity, and sustainable development.)

(Source: http://www.oecd.org/ctp/transfer-pricing/transfer-pricing guidelines.htm#HowToObtainPublication)

(2) United Nations Practical Manual on Transfer Pricing for Developing Countries

(*The United Nations is an international organization founded in 1945 by 51 countries committed to maintaining international peace and security.* T*he Organization works on a broad range of fundamental issues like sustainable development, environment protection, disaster relief, counter terrorism, etc. and currently provides forum to 193 member states. The United Nations, on October 2, 2012, released eight chapters of its Practical Manual on Transfer Pricing for Developing Countries viz. "UN Transfer Pricing Manual".)*

(3) OECD Discussion drafts on Base Erosion and Profit Shifting ('BEPS')

(Source: http://www.oecd.org/tax/beps-news.htm)

(4) Indian Income-tax Act – (Chapter X)

(5) Indian Income Tax Rules – (Rule 10 A to 10 E)

Websites

http://www.oecd.org
http://www.incometaxindia.gov.in

Paid Sites:
http://www.internationaltaxreview.com
http://www.bna.com

Module	Particulars
	Session 1
1	**Evolving Business Environment**
	Globalisation has enabled Business to go beyond the geographic boundaries to exploit the recourses available. This has resulted into countries wanting to identify and retain a fair share of taxes, for the opportunity provided to the Global business to exploit its resources. Further, the multinational organisations are operating in an environment of unprecedented change. There is a surge in volume and complexity of intercompany transactions. As a result, International Tax and Transfer pricing become an integral part of business in an evolving business environment.
2	**The Arm's Length Principle**
	Interpretation of the arm's length principle - "arm's length price" means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions;
	Associated enterprises – The relationship of "Associated Enterprises" means direct/ indirect participation in the management, control or capital of an enterprise by another enterprise. It also covers situations where the same person (directly or indirectly) participates in the management, control or capital of both the enterprises.
	Reading: *1) Chapter I of OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD TP Guidelines"); 2) Section 92, 92A, 92B, 92C and 92F of Chapter X - Indian Income-tax Act; 3) Chapter 1 and 2 of UN TP Manual*
	Session 2
3	**Functional Analysis**
	Functions, Assets and Risks and its Goal - A functional analysis facilitates characterisation of the transactions between Associated Enterprises after taking into account their functions, assets and risks and assists in establishing a degree of comparability with similar transactions in uncontrolled conditions

Module	Particulars
	Tested Party – The tested party is the participant in the controlled transaction whose profit attributable to the controlled transaction can be verified using the most reliable data and requiring the fewest and most reliable adjustments. In most cases, the tested party is the least complex of the controlled taxpayers.
	Entity characterisation (e.g. characterisation as "entrepreneur" or a "contract manufacturer") – Based on the Functions, Assets and Risks analysis characterisation of the transacting entities are determined to identify the tested party amongst them
	Reading: *1) D.1.2.2 of Chapter I - OECD TP Guidelines; 2) Rule 10D of Indian Income-tax Rules; 3)Chapter 5 of UN TP Manual*
	Session 3&4
4	**Transfer Pricing Methods**
	Description of methods
	Most Appropriate Method - The 'Most Appropriate Method' is that method which, under the facts and circumstances of the transaction under review, provides the most reliable measure of an arm's length result.
	Reading: *1) Chapter II of OECD TP Guidelines; 2) Section 92C of Indian Income-tax Act and Rule 10B of Indian Income-tax Rules; and 3) Chapter 6 of UN TP Manual)*
5	**Comparability analyses in practice**
	The role of comparables; rationale and limits. Situations where no comparables or only imperfect comparables are found
	Typical process proposed by the OECD Transfer Pricing Guidelines
	Transaction analysis (for e.g. purchase of goods)
	Aggregation of transactions - In order to assess, whether the international transactions entered are at arm's length, a transfer pricing method may be applied to each of the said transactions separately or to all such transactions as a single group of transactions (for e.g. import of good and royalty payment for use of technology and trademarks)
	Availability of comparables in Public domain (databases)
	Comparability adjustments
	Arm's length range;
	Price setting vs. Price testing

Module	Particulars
	Reading: *1) Chapter III of OECD TP Guidelines; 2) Section 92C of Indian Income-tax Act 3) Rule 10B, 10C and 10D of Indian Income-tax Rules; and 4) Chapter 5 UN TP Manual*
	Session 5
6	**Managing Intellectual Property**
	Intellectual Property It is important to build the Intellectual Property in form of brand/technology etc. and it is equally important to maintain and reap benefits for the same. - Legal Ownership vs. Beneficial Ownership. - Concept of Marketing Intangibles - Quantum of advertisement and marketing spends of multinationals and their associates that do not own any intangibles have given rise to various questions. etc.
	Reading: *Chapter VI of OECD TP Guidelines*
	Session 6
7	**Efficiencies – Business Restructuring and Cost sharing arrangements**
	Business restructuring Business restructuring has become an important board room discussion in view of evolving economies and dynamic business practices. A business restructuring can occur for various commercial reasons, which may be in response to competitive pressures, business opportunities, market conditions, cost pressures etc. This has material impact on the business operations of the group and the intra-group pricing arrangements. Business restructuring can be used as a tool to bring business synergies and optimize taxes.
	Cost sharing arrangements Groups having presence across border enter into cost sharing arrangements amongst the group companies to bring in economies of scale and operational efficiencies. Transfer pricing assists in managing these arrangements to ensure that the participating group companies receive the intended benefit and support to ensure that the same are observed in the right spirit by the revenue department of those jurisdictions.
	Reading: *Chapter VIII and IX of OECD TP Guidelines*

Module	Particulars
	Session 7
8	**Business Models and Case Studies**
	Discussion on certain business models from select industries like Financial services, Pharmaceuticals, FMCG etc. from Transfer Pricing perspective and case studies to get insight on various business concepts and practical issues
9	**Locational Saving and Bargaining Power**
	Movement of operations/ activity from high cost jurisdiction to low cost jurisdiction have given rise to the debate between jurisdictions as to which jurisdiction should enjoy the additional profits from the movement.
	Reading: *1) Chapter IX of OECDTP guidelines; 2) Chapter 5 and Chapter 10 of UN TP Manual*
	Seesion 8
10	**OECD on Base Erosion and Profit Shifting**
	With the debate over base erosion and profit shifting having reached the highest levels of governments, and with growing attention from the media and the public on perceived international tax avoidance techniques of high-profile multinationals, the OECD has taken up the matter of Base Erosion and Profit Shifting ("BEPS"). An Action Plan on BEPS was published in July 2013 was negotiated and drafted with active participation of its member states, contains 15 action points.
	Reading: *BEPS action plan by OECD and various discussion drafts released by OECD*
	Session 9 and 10
11	**Case Study - Presentations**