CHAPTER 24

TRANSFER PRICING



LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **appreciate** the need for incorporation of transfer pricing provisions in the Income-tax Act, 2025;
- **comprehend** the meaning and significance of arm's length principle and the practical difficulties in application of arm's length principle;
- **appreciate** the meaning and significance of the terms "associated enterprise", "international transaction" and "specified domestic transaction";
- **determine** the arm's length price using different methods prescribed under the income-tax law;
- **appreciate** the meaning of safe harbour as provided in the Income-tax Act, 2025 and the rules for safe harbor incorporated in the income-tax law;
- **appreciate** the benefits of entering into advance pricing agreements;
- **identify** the cases where secondary adjustments have to be made and understand the law relating to the same;
- **pinpoint** the responsibilities of a person entering into an international transaction and specified domestic transaction to keep and maintain prescribed information and documents;

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- **identify** the circumstances when the Assessing Officer can invoke the power to determine the arm's length price;
- **comprehend and appreciate** the country-by-country reporting requirements and related matters incorporated in the income-tax law in compliance with OECD BEPS Action Plan 13;
- **appreciate** the specific anti-avoidance measures incorporated in the Income-tax Act, 2025 in respect of transactions with persons located in notified jurisdictional areas;
- **appreciate** the provisions incorporated in the Income-tax Act, 2025 restricting interest deduction claimed by an entity in respect of borrowings from an associated enterprise in line with OECD BEPS Action Plan 4.

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24.1 INTRODUCTION



In the present era of globalisation, Multinational Enterprises (MNEs) have branches/ subsidiaries/ divisions operating in more than one country. There is a possibility that two or more entities belonging to the same multinational group can influence their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or a negligible profit in the jurisdiction that taxes such profits and a substantial profit in the jurisdiction where the tax liability is minimal. This price, known as the 'transfer price' may be arbitrary and dictated, with no relation to cost and added value and divergent from the market forces. Transfer price is, thus, the price that represents the value of goods or services between independently operating units of an organisation.

The **OECD Transfer Pricing Guidelines** define "Transfer prices" as the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises[1]. Similarly, the **UN Practical Manual on Transfer Pricing** regards transfer pricing as the pricing of cross-border intra-group transactions in goods, services, intangibles and financial arrangements.

This results in base erosion of the high tax jurisdiction by shifting the profits to the low tax jurisdiction, thereby minimising the taxes. This may adversely affect a country's share of due revenue.

From an Indian perspective, the increasing participation of multinational groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. In order to curb such tax avoidance measures, the transfer pricing law was introduced. Transfer pricing is an anti-avoidance law that seeks to ensure that transfer prices are set between related parties so that each country gets to tax its fair share of the profit.

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[1] *Two enterprises are "associated enterprises" if one of the enterprises participates directly or indirectly in the management, control or capital of the other or if both enterprises are under common control.*

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Background Note - Evolution of Transfer Pricing

The history of transfer pricing can be traced back to the early 20th century, when multinational corporations began to emerge and expand their operations globally. The concept of transfer pricing developed as a result of the need to allocate profits and taxes between different units of the same company located in different countries.

The transfer pricing provisions seek to ensure that income arising from **international transactions** and **specified domestic transactions** between associated enterprises is computed having regard to the **Arm's Length Price.**

The concept of transfer pricing is inseparable from the **Arm's Length Principle,** which represents the internationally accepted standard for determining transfer prices. Under this principle, transactions between associated enterprises should be priced in the same manner as transactions between independent enterprises under comparable circumstances. Hence, the arm's length principle ensures that transactions between related parties are conducted as if they were between unrelated parties, i.e., at market value. This principle helps to prevent tax avoidance by ensuring that profits are not artificially shifted between related companies to take advantage of different tax rates in different jurisdictions.

Since international transfer pricing involves more than one tax jurisdiction, any adjustment to the transfer price in one jurisdiction requires a corresponding adjustment in the other jurisdiction. If a corresponding adjustment is not made, double taxation will result.

24.2 MEANING OF "ARM'S LENGTH PRINCIPLE"

The Arm's Length Price (ALP) of a transaction between two associated enterprises is the price that would be paid if the transaction had taken place between two comparable independent and unrelated parties under comparable circumstances.

The Arm's Length Principle, in the context of taxation, is explained in the OECD Model Tax Convention as under:

"Where conditions are made or imposed between two associated 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

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conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

The OECD transfer pricing guidelines provide guidance on the application of the arm's length principle in order to arrive at the proper transfer pricing range between associated enterprises. Market forces determine business relations between independent parties. The arm's length principle seeks to adjust the profits between two associated enterprises by comparing them as if the transaction is carried out between two independent enterprises. It treats each enterprise as a separate, independent entity rather than as an inseparable part of a single unified business.

24.3 SIGNIFICANCE OF THE ARM'S LENGTH PRINCIPLE

There are several reasons as to why OECD member countries and other countries have adopted the arm's length principle.

Parity between MNCs and independent enterprises – A major reason is that the Arm's Length Principle provides broad parity of tax treatment for MNCs and independent enterprises. Since the Arm's Length Principle puts associated and independent enterprises on a more equal footing for tax purposes, it avoids the creation of tax advantages and disadvantages that would otherwise distort the relatively competitive positions of these entities. The Arm's Length Principle thus promotes the growth of international trade and investment by removing these tax considerations from economic decisions.

Determines real taxable profits - The transfer price adopted by a multinational has a direct bearing on the proportional profit it derives in each country in which it operates. If inadequate or excessive consideration is paid for the transfer of goods, services or intangible property between the members of an MNC group, the income calculated for each of those members will be inconsistent with their relative economic contributions. An 'arm's length' price is needed to determine real taxable profits earned in each country. The arm's length doctrine permits the taxing authorities to rectify the accounts of the enterprise so as to reflect correctly the income that the establishment would have earned if it were an independent enterprise.

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Reduction of artificial price distortion - If the arm's length principle is not followed, transfer prices may be manipulated to shift profits from a high-tax jurisdiction to a low-tax jurisdiction or tax haven, resulting in artificial distortion of prices and allocation of profits.

Accurate measurement of economic contribution – The Arm's Length Principle provides accurate measurement of the fair market value of the economic contribution units of an MNC. The focus of the ALP is to ensure that the proper amount of income is attributed to where it is earned. This result in each unit of the MNC earning a return commensurate with its economic contribution and risk assumed.

Avoidance of Double Taxation - Since the arm's length principle is internationally accepted, it facilitates corresponding adjustments by tax administrations and helps reduce the possibility of economic double taxation arising from transfer pricing adjustments.

24.4 PRACTICAL DIFFICULTIES IN APPLICATION OF ARM'S LENGTH PRINCIPLE

There are, however, certain practical difficulties in applying the Arm's Length Principle, which are described hereunder:

Lack of Perfect Comparability – The commercial and financial conditions governing a transaction between independent enterprises are, by and large, never similar to those existing between associated enterprises. As a result, there cannot be a true comparison. The economies of scale and integration of various business activities of the associated enterprise may not be truly appreciated by the arm's length principle.

Unique Intra-group Transactions - Further, associated enterprises may enter into transactions which independent enterprises may not enter into, like, say, licensing of valuable intangible or sharing the benefits of research. The owner of an intangible may be hesitant to enter into licensing arrangements with independent enterprises for fear of the value of the intangible being degraded. In contrast, he may be prepared to offer terms that are less restrictive to associated enterprises because the use of the intangible can be closely monitored. Further, there is no risk to the overall group's profit from a transaction

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of this kind between members of an MNC group. In such situations, where independent enterprises seldom undertake transactions of the type entered into by associated enterprises, the Arm's Length Principle is difficult to apply because there is little or no direct evidence of what conditions would have been established by independent enterprises.

Availability of data and reliability of available data – There may be difficulty in getting adequate and reliable information and data in order to apply the arm's length principle. Information on comparable companies, their profit margins, and the prices they charge under independent and comparable circumstances may be difficult to obtain. Further, the differences in the accounting of the data could result in difficulty as the reliable adjustments may not be possible to make.

Absence of comparable market price for "intangible" transactions - The ALP reaches a comparable uncontrolled market price that is reasonably reliable for standard transactions where the price range is narrow and market price is certain. However, the Arm's Length Principle generally fails to achieve a comparable market price for transactions involving intangibles because they are unique. The unique nature of these transactions creates a very wide price range.

Administrative burden – Due to the subjectivity in the selection of comparables and the methods, the application of arm's length principle results in an administrative burden for the tax administration as well as the taxpayers. Further, extensive documentation and compliance requirements increase the administrative burden on both taxpayers and tax authorities.

Time lag - Although an associated enterprise normally establishes the conditions for a transaction at the time it is undertaken, at some point the enterprise may be required to demonstrate that these are consistent with the arm's length principle. The tax administration may also have to engage in the verification process, perhaps some years after the transactions have taken place. It may result in substantial cost being incurred by the taxpayer and the tax administration. It is also difficult to appreciate the business realities that prevailed at the time when the transactions were entered into. This may lead to bias against the taxpayer.

Despite these practical difficulties, OECD member countries continue to regard the arm's length principle as the most reliable and internationally accepted standard for the allocation of profits among associated enterprises. It has so far provided acceptable solutions to both taxpayers and the tax administrations. The experience gained so far should be used effectively to address practical difficulties and improve administration.

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24.5 TRANSFER PRICING PROVISIONS UNDER THE INCOME TAX ACT

The Finance Act, 2001 introduced Chapter X in the erstwhile Income-tax Act, 1961 (presently also contained in Chapter X – *Special Provisions Relating to Avoidance of Tax* under the Income-tax Act, 2025) with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India to curb the pricing strategies adopted by multinational enterprise groups which may result in Base Erosion and Profit Shifting (BEPS).

Provisions pertaining to transfer pricing are presently contained in sections 161 to 173 of the Income-tax Act, 2025 and Rules 77 to 126 of the Income-tax Rules, 2026. The scope of transfer pricing provisions extends beyond import and export transactions and covers transactions relating to goods, services, tangible and intangible property, financial arrangements, cost contribution arrangements and other transactions having a bearing on the profits, income, losses or assets of the enterprises involved.

I. Computation of income from international transactions and specified domestic transactions having regard to arm's length price [Section 161]

The following conditions must be satisfied in order to attract the special provisions of Chapter X relating to avoidance of tax:

(i) There must be an **international transaction** and/or **specified domestic transaction**;

(ii) In case of international transaction, the transaction should be between two or more associated enterprises either or both of whom are non-residents.

(iii) Such international transaction or specified domestic transaction may be in the nature of:

  (a) purchase, sale or lease of tangible or intangible property; or

  (b) provision of service; or

  (c) lending or borrowing money; or

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(d) any other transaction having a bearing on the profits, income, losses or assets of such enterprise.

(iv) Any income arising from an international transaction or specified domestic transaction shall be determined having regard to the arm's length price. Likewise, any allowance for expense or interest arising from such transactions shall also be determined having regard to the arm's length price.

(v) If in an international transaction or specified domestic transaction, two or more associated enterprises **enter into mutual agreement or arrangement that involves:**

- allocation or apportionment of any cost or expenses 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 to any one or more of such enterprises, the cost or expense allocated or apportioned to or contributed by any such enterprise shall be determined according to arm's length price.

(vi) The above adjustment should either result in an increase of income or decrease of loss returned by the assessee. In other words, the adjustment should not have the effect of reducing the income chargeable to tax or increasing the loss.

The Assessing Officer will have wide powers to determine what is an arm's length price for such transactions and make adjustments for the computation of income. The keywords in section 161 are

(i) associated enterprises,

(ii) international transactions

(iii) specified domestic transaction and

(iv) arm's length price.

Associated enterprise, international transaction and specified domestic transaction are defined in sections 162, 163 and 164, respectively. 'Arm's length price' is defined in section 173(a), while section 165 prescribes the manner of determination of the arm's length price. These terms are discussed in detail in the ensuing paragraphs.

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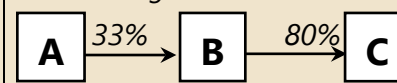
II. Associated Enterprises [Section 162]

The concept of an Associated Enterprise (AE) forms the foundation of the transfer pricing provisions. The provisions of Chapter X apply only where an international transaction or specified domestic transaction is entered into between associated enterprises. Accordingly, **the determination of an AE relationship is the first step in the transfer pricing analysis.**

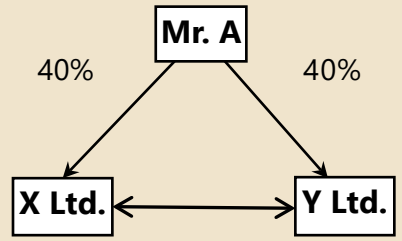
Section 162(1) adopts a unified approach for determining whether two enterprises are associated enterprises. Clause (a) specifies situations involving direct or indirect participation in the management, control or capital of another enterprise, while clauses (b) to (l) prescribe other statutory relationships, each of which independently results in an associated enterprise relationship.

Participation in Management, Control or Capital [Section 162(1)(a)]

An associated enterprise relationship shall be regarded as existing where participation, directly or indirectly, or through one or more intermediaries, in *management, control or capital* is established in another enterprise in any of the following situations:

Section	Condition	Example
Section 162(1)(a)(i)	**Common Participation by same persons** If one or more persons participate, directly or indirectly, or through one or more intermediaries in: • management/ control/capital of the two different enterprises Then, those two enterprises are AEs.	*Mr. A directly has control in A Ltd. and B Ltd. In such a scenario, both A Ltd. & B Ltd. are associated enterprises since there is a common person, i.e., Mr. A, who controls both entities.*
Section 162(1)(a)(ii)	**Enterprise ownership** One enterprise holds shares carrying 26% or more of the voting power, directly or indirectly, in the other enterprise at any time during the tax year.	*A Ltd. holds 33% of Voting Power in B Ltd. and B Ltd. holds 80% Voting Power in C Ltd.*  *In above situation, A Ltd. holds 26% or more voting*

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		power in B Ltd., directly and in C Ltd. indirectly (i.e. through B Ltd.). Therefore, both B Ltd. & C Ltd. are associated enterprises of A Ltd.
Section 162(1)(a)(iii)	**Substantial voting power in two entities by common person or enterprise** Any person or enterprise holds shares carrying 26% or more of the voting power, directly or indirectly, in each of two different enterprises, at any time during the tax year.	*Mr. A holds 40% of voting power in both X Ltd. and Y Ltd. where neither X Ltd. has any holding in Y Ltd. nor Y Ltd. has any holding in X Ltd.*  *In this situation, since Mr. A directly holds 40% of voting power in both X Ltd. and Y Ltd., X Ltd. & Y Ltd. will be associated enterprises.*

Thus, section 162(1)(a) identifies the circumstances in which participation in management, control or capital is considered sufficient to establish an associated enterprise relationship.

Specific Statutory Relationships [Section 162(1)(b) to (l)]		
Apart from the participation-based relationships discussed above, an associated enterprise relationship shall also exist in any of the following situations:		
Section	**Condition**	**Example**
Section 162(1)(b)	**Advancing a substantial sum of money** One enterprise advances a loan to the other enterprise of an amount of	*Book Value of total assets of Y Ltd. is ₹ 100 crores. X Ltd. advances a loan of ₹60 crores to Y Ltd.* *In this case, X Ltd. advances loan of ₹60 crores to Y Ltd, which is 60% of the*

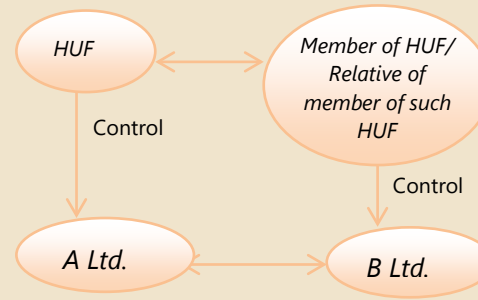
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	51% or more of the book value of the total assets of other enterprise	*book value of the total assets of Y Ltd. Hence, X Ltd. & Y Ltd. are associated enterprises.*
Section 162(1)(c)	**Guaranteeing borrowings** One enterprise guarantees **10% or more of the total borrowings** of the other enterprise.	*P Inc. has a total loan of 1 million dollars from XYZ Bank of America. Out of that, A Ltd., an Indian company, guarantees 20% of total borrowings in case of any default made by P Inc.* *In such case, since A Ltd. guarantees 20% of the total borrowings of P Inc., P Inc. and A Ltd. are associated enterprises.*
Section 162(1)(d)	**Appointment of the majority directors of the other enterprise** One enterprise appoints **more than half of the board of directors** or members of the governing board, or one or more executive directors or executive members of the governing board of other enterprise.	*X Ltd. has 15 directors on its Board. Out of that, Y Ltd. has appointed 8 directors. In such a case, X Ltd. and Y Ltd. are associated enterprises.*
Section 162(1)(e)	**Appointment of the majority directors of two different enterprises by same person(s)** Enterprise whose more than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board are appointed by the same	*Mr. A appointed 9 directors out of 15 directors of X Ltd. and appointed 2 executive directors to the board of Y Ltd.* *In such a case, since a common person, i.e., Mr. A appointed more than half of the directors in X Ltd. and appointed 2 executive directors in Y Ltd., both X Ltd. and Y Ltd. are associated enterprises.*

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	person or persons who has or have done so for the other enterprise	
Section 162(1)(f)	**Dependence on intangibles w.r.t which other enterprise has exclusive rights.** The manufacture or processing of goods or articles or business carried out by one enterprise is **wholly dependent (i.e. 100%)** on the know-how, patents, copyrights, trade-marks, licenses, 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.	
Section 162(1)(g)	**Dependence on raw material supplied by other enterprises** **90% or more** of 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, where the prices and other conditions relating to the supply are influenced by such other enterprise.	
Section 162(1)(h)	**Dependence on sale** 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**.	
Section 162(1)(i)	**Control by a common individual** Where one enterprise is controlled by an individual, and the other enterprise is also controlled by such individual or his relative or jointly by such individual and his relatives.	*Mr. A and Mr. B are relatives. Mr. A has control over X Ltd., and Mr. B has control over Y Ltd. Therefore, both X Ltd. and Y Ltd. will be associated enterprises.*

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Section 162(1)(j)	**Control by HUF or member thereof** Where one enterprise is controlled by a HUF and the other enterprise is controlled by a member of such HUF or by relative of a member of such HUF or jointly by such member and his relative.	 *A Ltd & B Ltd are associated enterprises.*
Section 162(1)(k)	**Interest in a firm, AOPs or BOIs** Where one enterprise is a firm, AOPs or BOIs, and the other enterprise holds 10% or more interest in firm/AOPs/BOIs.	
Section 162(1)(l)	**Mutual interest relationship** One enterprise has a relationship of mutual interest with the other enterprise, as may be prescribed.	

Associated Enterprise in case of Specified Domestic Transactions [Section 162(2)]

For the purposes of specified domestic transactions, the expression "associated enterprise" shall also include –

(a) other units or undertakings or businesses of such assessee in respect of a transaction referred to in section 122 (i.e., deductions to be made in computing total income) or 140(9) (i.e., transfer of goods or services from eligible business to any other business or vice-a versa and such transfer does not correspond to the market value of such goods or services);

(b) any other person referred to in section 140(13) or 205(4) in respect of a transaction referred to therein; and

(c) other units, undertakings, enterprises or business of such assessee, or other person referred to in section 140(13) in respect of transactions referred to in Chapter VIII, to which the provisions of section 140(9) or (13) of this Act or section 80-IA(8)/(10) of the Income-tax act, 1961 are applicable.

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Meaning of Enterprise

The term "enterprise" is defined in section 173(b) to mean a person (including a Permanent Establishment 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 articles or goods, or
- know-how, patents, copy rights, 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
- the provision of services of any kind, or
- carrying out any work in pursuance of a contract, or
- investment, or providing loan or

  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.

Permanent Establishment

"Permanent establishment" is defined in section 173(c) and includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

III. Definition of International Transaction [Section 163]

International Transaction [Section 163(1)]

As per section 163(1), an international transaction means a transaction between two or more associated enterprises, one of which is necessarily a non-resident; and includes:



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	Transactions	Amplification of scope of terms used
(a)	Purchase, sale, transfer, lease or use of tangible property	Tangible property includes - • building, • transportation vehicle, • machinery, equipment, tools, plant, • furniture, • commodity or • any other article, product or thing;
(b)	Purchase, sale, transfer, lease or use of intangible property, including transfer of ownership or the provision of use of certain rights	"Use of certain rights" refer to – • land use, • copyrights, patents, trademarks, licences, franchises, • customer 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, lending or borrowing of money 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,

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		• design, • consultation, • agency, • scientific research, • legal or accounting service.
(e)	Business restructuring or reorganization entered into by an enterprise with an associated enterprise	All such transactions are included in the definition of "international transaction", whether or not it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date.
(f)	mutual agreement or arrangement between two or more associated enterprise	for the 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 to any one or more of such enterprises.
(g)	Any other transaction	having a bearing on profits, income, losses or assets of such enterprises.

The expression "**intangible property"** shall include:

	Type of intangible asset in relation to	**Examples of each type of intangible asset**
(1)	Marketing	• Trademarks • trade names • brand names • logos
(2)	Technology	• Process patents • patent applications • technical documentation such as laboratory notebooks • technical know-how
(3)	Artistic	• literary works and copyrights • musical compositions • copyrights

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		• maps • engravings
(4)	Data processing	• proprietary computer software • software copyrights • automated databases • integrated circuit masks and masters
(5)	Engineering	• industrial design • product patents • trade secrets • engineering drawing and schematics • blueprints • proprietary documentation
(6)	Customer	• customer lists • customer contracts • customer relationship • open purchase orders
(7)	Contract	• favourable supplier • contracts, • licence agreements • franchise agreements • non-compete agreements
(8)	Human capital	• trained and organised work force • employment agreements • union contracts
(9)	Location	• leasehold interest • mineral exploitation rights • easements • air rights • water rights
(10)	Goodwill	• institutional goodwill • professional practice goodwill

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		• personal goodwill of professional • celebrity goodwill • general business going concern value
(11)	methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists or technical data;	
(12)	any other similar item that derives its value from its intellectual content rather than its physical attributes.	

Deemed International Transaction [Section 163(2)]



A transaction entered into by an enterprise with a person other than an associated enterprise ("other person") will be **deemed to be an international transaction between two AEs,** if -

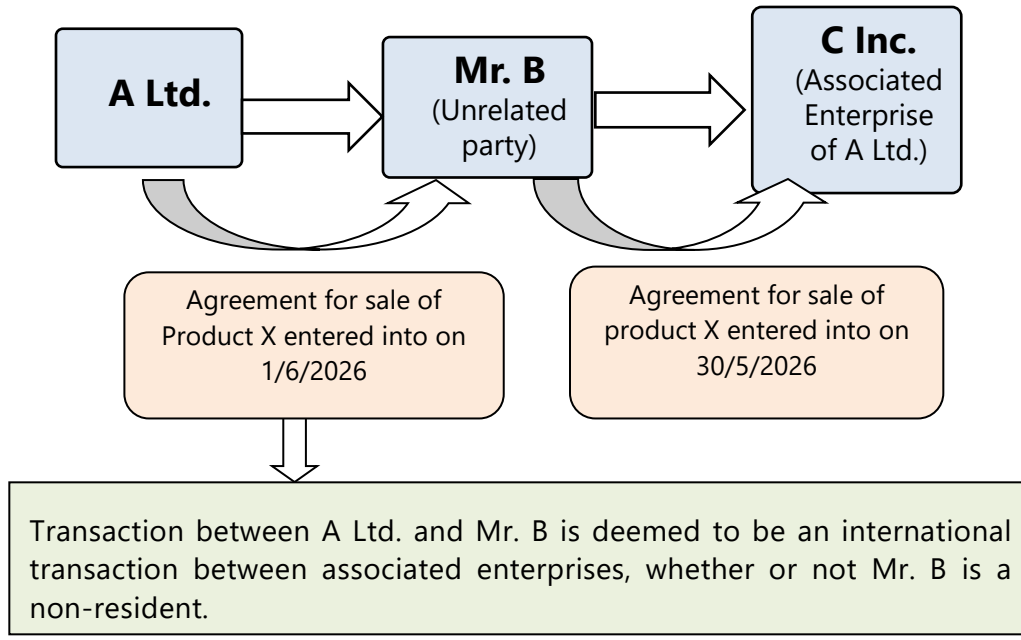
- there exists a prior agreement in relation to the relevant transaction between the other person and the associated enterprise **or**,
- where the terms of the relevant transaction are determined in substance between such other person and the associated enterprise; **and**
- either the enterprise or the associated enterprise or both of them are non-residents,

whether such other person is a non-resident or not.



If A Ltd., an Indian company, has entered into an agreement for sale of product X to Mr. B, an unrelated party, on 1/6/2026 and Mr. B has entered into an agreement for sale of product X with C Inc., a non-resident entity, which holds 27% of the voting power in A Ltd., on 30/5/2026, then, the transaction between A Ltd. and Mr. B shall be deemed to be an international transaction entered into between two associated enterprises, irrespective of whether or not Mr. B is a non-resident.

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Note *– C Inc. is an associated enterprise of A Ltd. since it holds 26% or more of the voting power A Ltd.*

Section 163(2) is an anti-avoidance provision intended to prevent the routing of transactions through unrelated parties to avoid transfer pricing regulations.

Transaction [Section 173(e)]

The word "transaction" has been defined in section 173(e) to include an arrangement, understanding or action in concert -

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

(ii) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings.

Section 173(e) provides an inclusive definition of the term "transaction".

Based on the reading of the section, it is evident that it is not necessary that for a transaction undertaken between two enterprises, there needs to be a formal

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written agreement between them. It is only relevant whether a transaction has been entered into in substance. The section also negates the requirement as to the legal enforceability of the agreement or understanding.



It may be noted that <u>one of the parties to the international transaction should be a non-resident</u>.

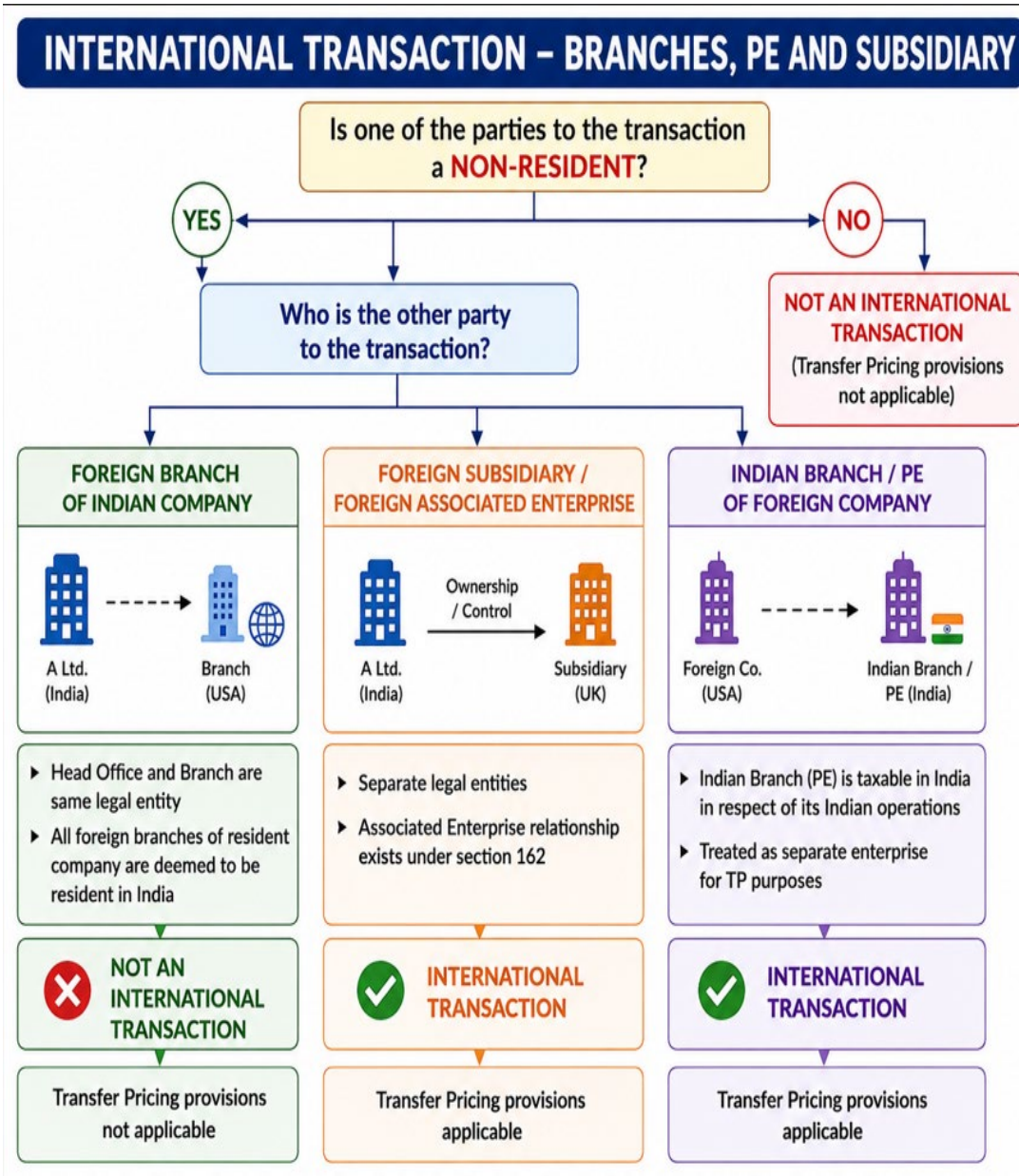
Therefore, transactions between a resident assessee ("A" Ltd.) and its foreign branches or between its two or more foreign branches will not be considered as international transactions.

This is for the reason that when "A" Ltd. is a resident in India, all its foreign branches will be deemed to be resident in India, and transactions between the Head Office and branches or between branches inter se will not be considered as international transactions between residents. Even otherwise, there can be no avoidance of income in the transactions between the Indian Head Office and foreign branches.

On the other hand, if an Indian branch of a foreign company ("B" Ltd.) is having a transaction with the Head Office, the same will be covered by the definition of an international transaction between associated enterprises.

This is because the Indian branch (permanent establishment of "B" Ltd.) will be liable to tax in India in respect of its Indian operations and, therefore, any transaction between the Indian branches of "B" Ltd. with its head office in foreign country or with any of the branches of "B" Ltd. outside India will be considered as an international transaction and it will have to establish that the transaction is at an arm's length price. This will be the position even in respect of transactions between a parent company ("A" Ltd.) and its foreign subsidiary and, therefore, such transactions will have to comply with the provisions of transfer pricing regulations.

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IV. Meaning of Specified Domestic Transaction [Section 164]

Section 164 defines the expression **"specified domestic transaction"** for the purposes of Chapter X. It covers certain domestic transactions between related parties which are required to satisfy the arm's length principle.

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A specified domestic transaction means any of the following transactions, **not being an international transaction**, where the **aggregate value of such transactions** entered into by the assessee during the tax year **exceeds ₹ 20 crore**:

(a) any transaction referred to in section 122;

(b) any transfer of goods or services referred to in section 140(9);

(c) any business transacted between the assessee and other person as referred to in section 140(13);

(d) any transaction, referred to in any other section under Chapter VIII, to which provisions of section 140(9) or (13) of this Act or section 80-IA(8) or (10) of the Income-tax Act, 1961 are applicable;

(e) any business transacted between the persons referred to in section 205(4);

(f) any other transaction as may be prescribed.



Conceptually, specified domestic transactions primarily seek to ensure that profits are not artificially shifted between domestic businesses, units or related parties in order to claim excessive deductions or tax benefits.

V. Determination of Arm's Length Price [Section 165]

Meaning of Arm's Length Price

"Arm's length price" is defined in section 173(a) to mean a price which is **applied or proposed to be applied** in a transaction between persons **other than associated enterprises** in **uncontrolled conditions**.



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Methods of Determination of Arm's Length Price [Section 165(1)]

Section 165 deals with the method for determining arm's length price and the factors that are to be considered for the applicability or non-applicability of a particular method to a given situation.

The factors as well as methods incorporated in this section are not exhaustive, and the CBDT may prescribe further factors and methods.

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

(a) comparable uncontrolled price method;

(b) resale price method;

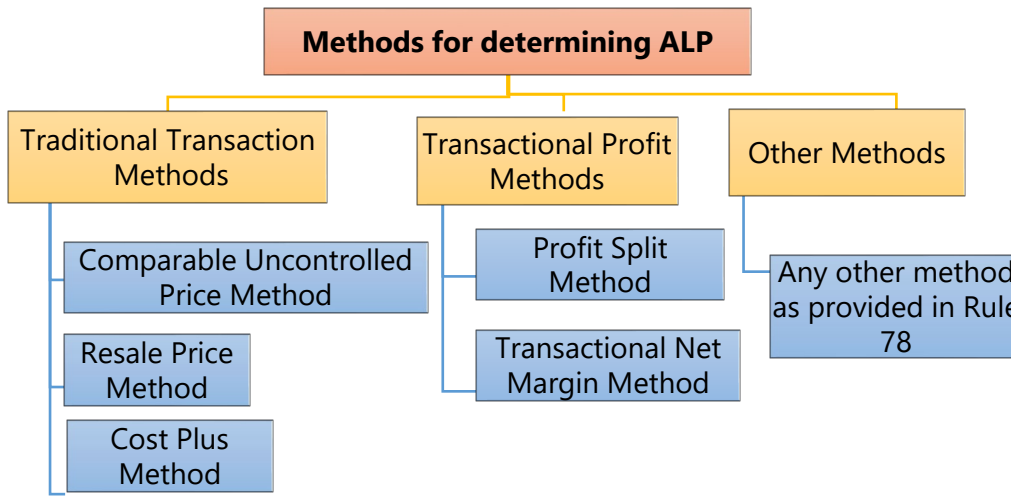
(c) cost plus method;

(d) profit split method;

(e) transactional net margin method;

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

Rule 79 prescribes the manner of determination of arm's length price under the first five methods, whereas **Rule 78** prescribes the "Other Method".



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As per Rule 79(1), the arm's length price in relation to an international transaction or a specified domestic transaction shall be determined by any of the methods specified above, being the most appropriate method, in the following manner:

(a) Comparable Uncontrolled Price (CUP) Method

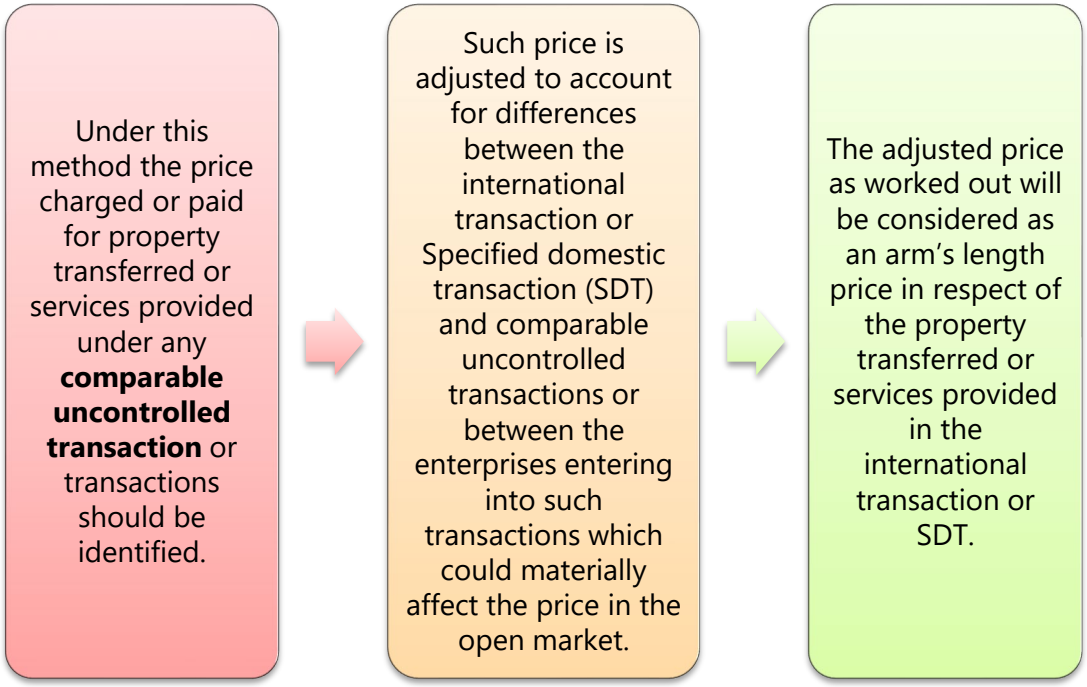


ILLUSTRATION 1

US Ltd., a US company has a subsidiary, IND Ltd. in India. US Ltd. sells computer monitors to IND Ltd. for resale in India. US Ltd. also sells computer monitors to CMI Ltd., another computer reseller. It sells 50,000 computer monitors to IND. Ltd. at ₹ 11,000 per unit. The price fixed for CMI Ltd. is ₹ 10,000 per unit. The warranty in case of sale of monitors by IND Ltd. is handled by IND Ltd. However, for sale of monitors by CMI Ltd., US Ltd. is responsible for the warranty for 3 months. Both US Ltd. and IND Ltd. offer extended warranty at a standard rate of ₹ 1,000 per annum. On these facts, how is the assessment of IND Ltd. going to be affected?

SOLUTION

US Ltd., the foreign company and IND Ltd., the Indian company are associated enterprises since US Ltd. is the holding company of IND Ltd. US Ltd. sells

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computer monitors to IND Ltd. for resale in India. US Ltd. also sells identical computer monitors to CMI Ltd., which is not an associated enterprise. The price charged by US Ltd. for a similar product transferred in comparable uncontrolled transaction is, therefore, identifiable. Therefore, Comparable Uncontrolled Price (CUP) method for determining arm's length price can be applied.

While applying CUP method, the price in comparable uncontrolled transaction needs to be adjusted to account for difference, if any, between the international transaction (i.e. transaction between US Ltd. and IND Ltd.) and uncontrolled transaction (i.e. transaction between US Ltd. and CMI Ltd.) and the price so adjusted shall be the arm's length price for the international transaction.

For sale of monitors by CMI Ltd., US Ltd. is responsible for warranty for 3 months. The price charged by US Ltd. to CMI Ltd. includes the charge for warranty for 3 months. Hence arm's length price for computer monitors being sold by US Ltd. to IND Ltd. would be:

Particulars	No.	₹
Sale price charged by US Ltd. to CMI Ltd.		10,000
Less: Cost of warranty included in the price charged to CMI Ltd. (₹ 1,000 x 3 /12)		250
Arm's length price		9,750
Actual price paid by IND Ltd. to US Ltd.		11,000
Difference per unit		1,250
No. of units supplied by US Ltd. to IND Ltd.	50,000	
Addition required to be made in the computation of total income of IND Ltd. (₹ 1,250 × 50,000)		6,25,00,000

No deduction under Chapter VIII would be allowable in respect of the enhanced income of ₹ 6.25 crores.

Note: *It is assumed that IND Ltd. has not entered into an advance pricing agreement or opted to be subject to Safe Harbour Rules.*

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(b) Resale Price Method (RPM)

The Resale Price Method is generally applicable where goods purchased from an associated enterprise are resold to an unrelated enterprise without substantial value addition.

Identify the Resale Price (RP) at which the item is resold to unrelated party. Reduce such resale price by the amount of normal gross profit margin to an unrelated enterprise from purchase and resale of the same or similar property or services in a comparable uncontrolled transaction(s).

Then, reduce expenses incurred directly in connection with the purchase of property or obtaining of services.

Then adjust price so arrived for functional and other differences, including differences in accounting practices which could materially affect the gross profit margin in the open market.

The adjusted price as stated above will be considered as the ALP in respect of the purchase of the property or obtaining of the services by the enterprise from the AE.

Resale Price (-) Normal Gross Profit Margin (-) Direct Expenses (+/-) functional difference adjustments = **Arm's Length Purchase Price**

ILLUSTRATION 2

Earth (P) Ltd., Calcutta, is engaged in the trading of electronic goods. It purchased goods from its associated enterprise Sun Pte. Ltd., Singapore, and also from an unrelated party, Oceania Ltd., UK. For the T.Y. 2026-27, the gross profit margin was 15% on the sale of goods of Sun Pte Ltd., whereas it was 20% in the case of Oceania Ltd. After-sales warranty of 6 months was provided by Sun Pte Ltd., whereas Oceania Ltd. gave an after-sales warranty of 1 year. The cost of warranty may be

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taken as 2% of the sale price. Sun Pte. Ltd.'s brand value is internationally known, the benefit of the brand value can be taken as 1% of the sale price. During the T.Y. 2026-27, it sold goods of Sun Pte Ltd. for ₹ 20 crores and of Oceania Ltd. for ₹ 15 crores. As regards the transport cost of the goods purchased, there was no difference between the related and unrelated parties. Compute the ALP of the transaction between Earth (P) Ltd. and Sun Pte Ltd., Singapore, by applying the Resale Price Method, considering the facts of the case.

SOLUTION

As per section 163, the transactions entered between Earth (P) Ltd., an Indian company, and Sun Pte. Ltd., Singapore, being associated enterprises, for purchase of electronic goods would be an international transaction.

Since Earth (P) Ltd. purchased similar electronic goods from Oceania Ltd., an unrelated entity, and sold the same to unrelated parties, this transaction can be considered as uncontrolled transaction and the gross profit margin of 20% earned on sale of such goods can be considered for the purpose of determining the arm's length price of the transactions between Earth (P) Ltd. and Sun Pte. Ltd. However, functional adjustments need to be given effect to in arriving at the ALP.

The brand-value and warranty adjustments are comparability adjustments for functional and other differences under Rule 79(1)(b)(iv) and are to be made only to the extent that such differences could materially affect the gross profit margin in the open market.

Computation of ALP of transaction between Earth (P) Ltd. and Sun Pte. Ltd.

Particulars	Amount (In ₹)
Resale price of goods purchased from Sun Pte. Ltd.	20,00,00,000
Less: Profit margin with reference to uncontrolled transaction between Earth (P) Ltd. and Oceania Ltd. (20% on sale)	4,00,00,000
	16,00,00,000
Add: Adjustment for the benefit of the brand value of Sun Pte. Ltd. [Sun Pte. Ltd has its brand value internationally. Therefore, adjustment of the benefit of brand value has to be carried out to arrive at ALP (1% of sale price)]	20,00,000

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Less: Adjustment of cost of warranty [Sun Pte. Ltd. provides warranty for 6 months, whereas an unrelated party has provided a warranty of 12 months. Therefore, adjustment for the cost of such warranty has to be carried out to arrive at an arm's length price (2% of sale price x 6/12)]	(20,00,000)
Arm's length price	16,00,00,000

(c) Cost Plus Method

The Cost Plus Method is generally applied where semi-finished goods, services or contract manufacturing activities are undertaken between associated enterprises.

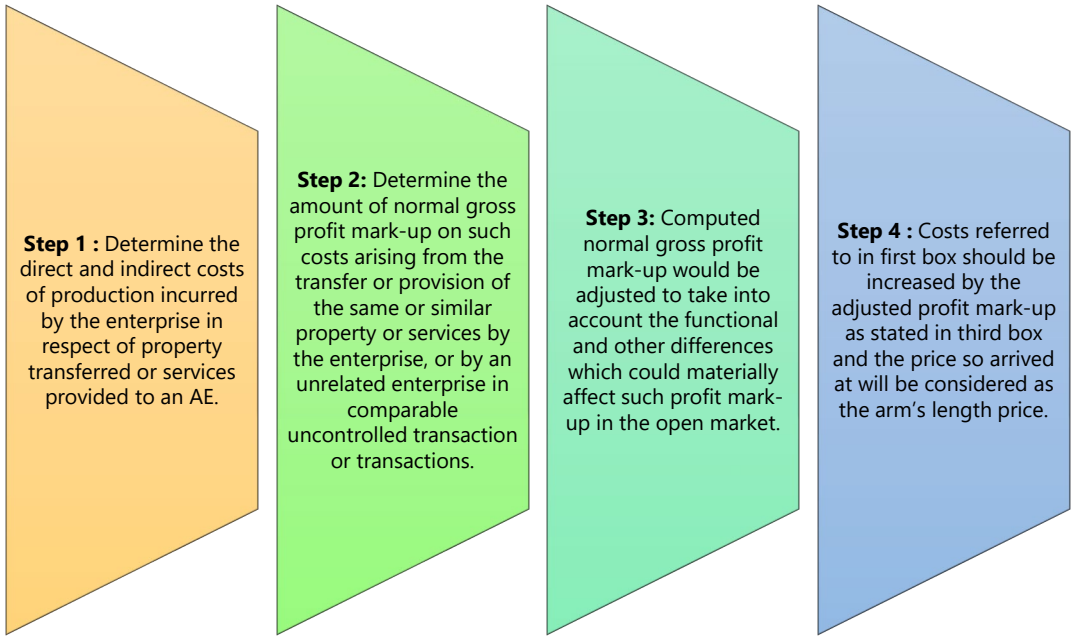


ILLUSTRATION 3

ABC Ltd., Canada holds 35% shares in LMN Ltd., India. LMN Ltd. develops software and provides both onsite and offsite consultancy services for the customers. LMN Ltd. during the year billed ABC Ltd. Canada for 120 man-hours at the rate of ₹ 1,800 per man-hour. The total cost (direct and indirect) for executing this work amounted to ₹ 2,25,000.

However, LMN Ltd. billed XYZ Ltd., India at the rate of ₹ 2,800 per man hour for a similar level of manpower and earned a Gross Profit of 50% on its cost.

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The transactions of LMN Ltd. with ABC Ltd. and XYZ Ltd. are comparable, subject to the following differences:

- *While LMN Ltd. derives technology support from the ABC Ltd., there is no such support from XYZ Ltd. The value of technology support received from ABC Ltd. may be put at 18% of normal gross profits.*
- *As ABC Ltd. gives business in large volumes, LMN Ltd. offered to ABC Ltd., a quantity discount which may be valued at 10% of normal gross profits.*
- *In the case of rendering services to ABC Ltd., LMN Ltd. neither runs any risk nor incurs any marketing costs. On the other hand, in the case of services to XYZ Ltd., LMN Ltd. has to assume all the risks and costs associated with the marketing function which may be estimated at 12% of the normal gross profits.*
- *LMN Ltd. offered one month credit to ABC Ltd. The cost of providing such credit may be valued at 2% of the gross profits. No such credit was given to XYZ Ltd.*

Compute the Arm's Length Price along with income to be increased under the Cost-Plus Method.

SOLUTION

LMN Ltd, an Indian company and ABC Ltd., a Canadian company, are associated enterprises as per section 162(1), since ABC Ltd. holds shares carrying 35% of the voting power (i.e., not less than 26% of voting power) in LMN Ltd. Further, the transaction of developing software and providing consultancy services (both onsite and offsite) fall within the meaning of "international transaction" under section 163. Hence, transfer pricing provisions would be attracted in this case.

Computation of Arm's Length Price as per Cost Plus Method		
Gross Profit mark-up on cost in case of XYZ Ltd. [an unrelated party]		50%
Less: Adjustments for functional and other differences		
- Value of technology support [ABC Ltd. provides technology support, but XYZ Ltd. does not provide such support. Therefore, value of technology support shall be adjusted] [18% of 50%, being gross profit]	9%	
- Quantity discount to ABC Ltd. [Quantity discount is allowed to ABC Ltd. as it gives business in large volumes, but the same is not provided to XYZ Ltd.	5%	

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Therefore, it shall be adjusted] [10% of 50%, being gross profit]		
- Risk and cost associated with marketing [LMN Ltd. has to bear all the risk and costs associated with the marketing function in case of XYZ Ltd., while there is no such risk in case of services to ABC Ltd. Therefore, market risk and cost shall be adjusted] [12% of 50%, being gross profit]	6%	20%
		30%
Add: Cost of credit to ABC Ltd. [LMN Ltd has provided credit of 1 month to ABC Ltd. but not to the unrelated party. Therefore, adjustment for the cost of such credit has to be carried out to arrive at the ALP] [(2% of 50%, being gross profit]		1%
Arm's length gross profit markup to cost		31%
Cost incurred by LMN Ltd. for executing ABC Ltd.'s work		2,25,000
Add: Adjusted gross profit (₹ 2,25,000 x 31%)		69,750
Arm's length billed value		2,94,750
Less: Actual Billed Income from ABC Ltd. (₹ 1800 x 120 man-hours)		2,16,000
The total income of LMN Ltd to be increased by		78,750

(d) Profit Split Method (PSM)

The Profit Split Method (PSM) seeks to determine the arm's length price by identifying and allocating the combined profits arising from international transactions or specified domestic transactions among the associated enterprises participating in such transactions.

Unlike CUP, RPM and CPM, which analyse individual transactions, PSM focuses on the combined profitability generated by associated enterprises and allocates such profits in accordance with the relative value of their contributions.

Applicability: PSM is mainly applicable in the following situations:

(i) Transfer of Unique Intangibles: Where the international transaction or specified domestic transaction involves:

- transfer of unique intangibles; or

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- **unique and valuable contributions** by each of the associated enterprises.

(ii) **Highly Integrated Transactions:** Where there are multiple international transactions or specified domestic transactions which are so interrelated that they cannot be evaluated separately for determining the arm's length price of any one transaction.

Unique and Valuable Contributions (UVC) – New Inclusion under PSM

The Income-tax Rules, 2026, have expanded the scope of the Profit Split Method (PSM) by specifically covering transactions involving "unique and valuable contributions" (UVCs) by associated enterprises. Earlier, PSM was primarily applicable in cases involving the transfer of unique intangibles. Under the new rule, PSM may also apply where associated enterprises make significant value-creating contributions *even without owning legal intangibles*.

A UVC refers to specialised know-how, strategic functions, proprietary processes, high-value R&D capabilities, unique technical expertise, or other economically significant activities that are difficult to benchmark using traditional transfer pricing methods.



Global Pharma Group: An Indian entity conducts advanced R&D and develops drug molecules, while the foreign-associated enterprise commercialises the product globally. Even if the Indian entity does not legally own the patent, such facts may support a finding of a unique and valuable contribution, subject to the actual functions, assets and risks, the availability of reliable comparables and the conditions in Rule 79(1)(d). PSM may accordingly be appropriate depending on the complete facts.



IT/Software Group: An Indian entity develops core software architecture and employs highly skilled engineers, while the US-associated enterprise undertakes global marketing and customer acquisition. Although the Indian entity may not own any intellectual property, such facts may support a finding of a unique and valuable contribution, subject to the actual functions, assets and risks, the availability of reliable comparables and the conditions in Rule 79(1)(d).

Thus, the inclusion shifts the focus from mere legal ownership of intangibles to the creation of actual economic value and aligns the Indian transfer pricing framework with the OECD Transfer Pricing Guidelines.

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(e) Transactional Net Margin Method

In this method, the net profit margin realised by the enterprise from an international transaction entered into with an associated enterprise is computed having regard to costs incurred or sales effected or assets employed or having regard to any other relevant base.

The net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction is computed by applying the same base as computed above.

This profit margin is adjusted to take into account the differences which could materially affect the net profit margin in the open market having regard to international transaction and comparable uncontrolled transactions or having regard to the enterprise entering into such transactions.

If the net profit margin realised by the enterprise as in first box is established to be the same as the net profit margin as in second box, then the same is taken into consideration to arrive at an arm's length price in relation to the international transaction.

ILLUSTRATION 4

Andes Inc., having its business in Malaysia, has advanced a loan of MD 1,60,000 to Andes Ltd, India. The book value of total assets of Andes Ltd was ₹ 125 lakhs. Andes Ltd provides software backup support to Andes Inc. Andes Ltd has spent 50,000 man hours during T.Y. 2026-27 for the services rendered to Andes Inc. The cost for Andes Ltd is MD 75/manhour. Andes Ltd has billed Andes Inc. at MD 90.75/manhour.

Gama Ltd. in India, which has a similar business model, provides software backup support to Olive Inc. in Penang, Malaysia. Olive Inc. is not an associated enterprise of Gama Ltd. Gama Ltd.'s cost and operating profits are as follows:

Particulars	***₹ in lakhs***
Direct costs	*600*
Indirect costs	*200*
Operating profits	*200*

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(1) Calculate the Arm's Length Price for the transaction between Andes Ltd. and Andes Inc. based on the above data of Gama Ltd. using the Transactional Net Margin Method. Assume 1 MD = ₹ 45.

(2) Explain if there is any adjustment to be made to the total income of Andes Ltd.

Note: *MD = Malaysia Dollars*

SOLUTION

Two enterprises are associated enterprises where one enterprise advances a loan constituting not less than 51% of the book value of the total assets of the other enterprise.

In this case, since Andes Inc., a foreign company, has advanced a loan to Andes Ltd., an Indian company, and such loan constitutes 57.6% [(₹ 45 x 1,60,000 x 100/1,25,00,000] of the book value of total assets of Andes Ltd., Andes Inc and Andes Ltd. are associated enterprises. Since the transaction of provision of software backup support by Andes Ltd. to Andes Inc. is an international transaction between associated enterprises, the provisions of transfer pricing would be applicable in this case.

Determination of the Operating Margin of the transaction of the provision of software backup support by Andes Ltd. to Andes Inc

Particulars	₹
Billing per manhour [MD 90.75/hour x ₹ 45]	4,083.75
Cost per man hour [MD 75/hour x ₹ 45]	3,375.00
Operating profit per manhour	708.75
Operating profits to cost (%) [708.75 x 100/3375] = 21%	

Determination of Operating Margin for a Comparable Uncontrolled transaction, i.e., the provision of software backup support. by Gama Ltd. to Olive Inc.

Particulars	₹ in lakhs
Direct Cost	600
Indirect Cost	200
Total cost	800

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Operating profits	200
Operating profits to cost (%) [200 x 100/800] = 25%	

Computation of Arm's Length Price of provision of software backup support provided by Andes Ltd. to Andes Inc. by applying TNMM

Particulars	₹
Cost for Andes Ltd. (per man hour) [MD 75 x ₹ 45/MD]	3,375.00
Add: Arm's length operating profit margin as % of cost (25% of ₹ 3,375)	843.75
Arm's length price (per manhour) in ₹	4,218.75
Arm's length price of total manhours spent by Andes Ltd. for providing software backup support to Andes Inc. [₹ 4,218.75 x 50,000 man hours] = ₹ 21,09,37,500	

Adjustment to be made to the total income of Andes Ltd.

Particulars	₹
Arm's length price of total manhours spent by Andes Ltd. for providing software backup support to Andes Inc.	21,09,37,500
Less: Amount actually billed [90.75 MD x ₹ 45/MD x 50,000 manhours]	20,41,87,500
Arm's length adjustment to be made to the total income of Andes Ltd.	67,50,000

(f) Other Method as may be prescribed by the CBDT [Rule 78]

The Other method allows the use of 'any method', which takes into account

(i) the price which has been charged or paid or

(ii) would have been charged or paid

for the same or similar uncontrolled transactions with or between non-associated enterprises, under similar circumstances.

The various data which may possibly be used for comparability purposes under this method could be third party quotations, valuation reports, tender/bid documents, documents relating to the negotiations, standard rate cards, commercial & economic business models; etc.

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Methods for computing ALP [Section 165]

CUP Method	Resale Price Method (RPM)	Cost Plus Method (CPM)	Profit Split Method (PSM)	Transactional Net Margin Method (TNMM)
This method is applied where there are similar transaction(s) b/w unconnected parties	This method is applied where item obtained from AE is resold to unrelated party	This method is generally applied where semi-finished goods are sold to AEs	This method is applied where there is transfer of unique intangibles or unique & valuable contributions or in highly integrated transactions	Compute Net Profit (NP) margin of the enterprise from International Transaction with AE having regard to cost incurred/sales effected/ assets employed
Identify price in a comparable uncontrolled transaction (CUCT)	Identify the Resale Price (RP) at which the item is resold to unrelated party	Identify direct & indirect cost of production incurred for property transferred or services provided to AE	Determine combined NP of the AEs arising out of International Transaction	Compute the NP margin realised by the enterprise or unrelated enterprise in a CUCT by applying the same base
	Reduce the RP by the normal Gross Profit (GP) margin on CUCT & expenditure incurred (customs duty) w.r.t. purchase	Determine normal GP mark up to such costs by an unrelated enter in CUCT	Evaluate the relative contribution of each enterprise to the earning of combined NP on the basis of FAR	Adjust NP margin realised from CUCT to a/c for differences affecting NP margin in the OM
Adjust the price for material differences in terms of contract, credit, transport etc.	Adjust the price for functional & other differences materially affecting GP margin in open market (OM)	Adjust the normal GP mark-up for functional and other differences materially affecting GP mark-up in OM	Split the combined NP amongst the enterprise in proportion to market returns; & residual profits in proportion to their relative contribution	Compare NP margin relative to costs/sales/assets of the AE with NP margin of uncontrolled party in comparable transactions
Adjusted price is ALP	Adjusted price is ALP	Total Costs ↑d by adjusted mark up = ALP	ALP to be detd. on the basis of profit apportioned by either contribution approach or residual profit approach	Adjusted NP margin taken into A/c to arrive at ALP

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Comparability Factors [Rule 79(2)]

The determination of an arm's length price under any transfer pricing method is based on a **comparison between:**

- the international transaction or specified domestic transaction entered between associated enterprises (controlled transaction); **and**
- a comparable transaction entered between independent enterprises (uncontrolled transaction).

Accordingly, before applying any transfer pricing method, it is necessary to determine whether the uncontrolled transaction selected for comparison is sufficiently comparable with the controlled transaction.

The reliability of the arm's length price determined under any method depends upon the degree of comparability between the controlled transaction and the uncontrolled transaction.

The comparability of the international transaction or specified domestic transaction with an uncontrolled transaction is to be judged with reference to the following factors, i.e. COMPARABILITY FACTORS:

(i) The **specific characteristics** of the property transferred, or services provided in either transaction *[like physical features, nature, expected benefits, etc.]*

(ii) The functions performed, taking into account assets employed or to be employed and the risks assumed **{FAR Analysis}**, by the respective parties to the transactions *[for example, functions like manufacturing, assembly, etc.; assets employed examples like technology, plant, etc., and risks like credit risk, inventory risk, etc.]*

(iii) The **contractual terms** (whether 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 *[for example, allocation of responsibilities, payment terms, credit period, etc.]*

(iv) **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

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competition and whether the markets are wholesale or retail. *[For example, level of competition, geographical location, government regulation, etc.]*

Comparable Uncontrolled Transaction [Rule 79(3)]

Merely identifying an uncontrolled transaction is not sufficient. As per Rule 79(3), an uncontrolled transaction should be considered comparable to the international controlled transaction or specified domestic transaction if there are no material differences (in terms of functions, assets and risks) between the transactions being compared or the enterprises entering into such transactions which would materially affect the prices or costs charged or paid in, or the profit arising from, such transactions in the open market.

It further provides that in cases where there are any such material differences, *reasonably accurate adjustments* should be made to eliminate such material differences in order to compare the controlled and the uncontrolled transactions.

Absolute identity between the controlled and uncontrolled transactions is not required.

The law only requires that:

- material differences should not exist; or
- where material differences exist, reliable adjustments should be possible.

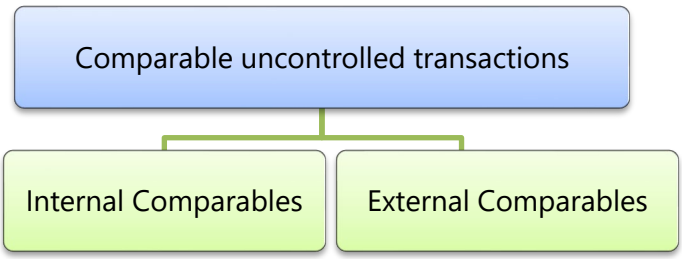
Accordingly, minor differences do not destroy comparability.



Practical Note

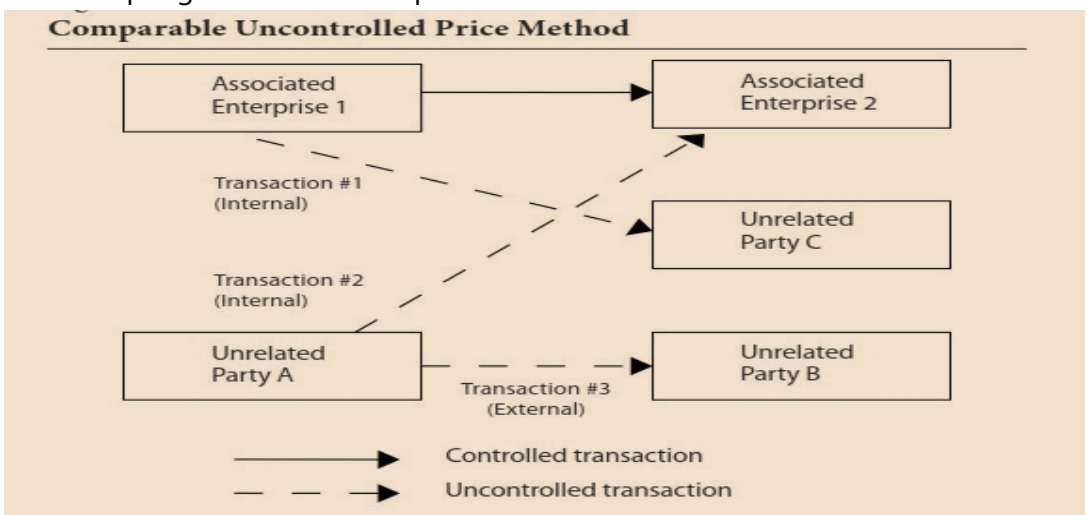
Rule 79(3) prescribes the conditions for determining the comparability of uncontrolled transactions. Based on internationally accepted transfer pricing principles and practical transfer pricing analysis, comparable uncontrolled transactions may be classified into Internal Comparables and External Comparables. Although the Rule does not expressly recognise this classification, reliable internal comparables are generally preferred in transfer pricing analysis due to better product, functional and market comparability and the lower requirement for comparability adjustments. Comparable uncontrolled transactions could be of two types: internal or external.

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(a) Internal comparables: These are the comparable transactions between one of the parties to the controlled transaction (taxpayer or the AE) and an independent third party. These comparables are considered a good measure of comparability as it is likely that the Functions, Assets, Risks analysis (FAR analysis) of the comparable transaction would be similar to that of the controlled transaction due to the involvement of a common entity in the said two transactions. Even though internal comparables may offer a higher degree of comparability, there is a need of rigorous scrutiny like in external comparables, and suitable adjustments should be made, wherever necessary.

(b) External comparables: These are the comparable transactions between two independent parties, neither of which is a party to the controlled transaction. Generally, the level of comparability offered in the external comparables is not as precise as that of internal comparables; however, this rule is not absolute. For instance, it may so happen that an entity offers a certain variation of its product exclusively to its AE and a slightly different variation to unrelated parties. In such a situation, preference should be given to external comparables involving the identical product and identical contractual terms rather than accepting the internal comparable.



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In the above example, transactions between AE1 and AE2 are subject to transfer pricing. AE1 and AE2 are parties to a controlled transaction. Transactions #1 and #2 are internal uncontrolled transactions since it is entered by AEs with unrelated parties.

Transaction #3 is an external uncontrolled transaction since it is entered between unrelated parties.

Process for identification and selection of external comparables

Wherever internal comparables are available, preference should be given to internal comparables in the process of determination of ALP. However, in the absence of the same, recourse has to be taken to search for external comparables. The transfer pricing legislation in India does not prescribe a particular process for selection of such comparables. However, various decisions of the judicial authorities have provided guidance on how to carry out such process based on the data available in public domain. The major steps involved in the search process used under TNMM are discussed hereunder:

Step 1: Selection of database

A database is a domain where information (financial and non-financial) about companies is maintained in an organised manner so as to facilitate easy search for data and also for the application of the relevant filters. Some of the commonly used databases in India are as under:

(a) Capitaline Plus/ Capitaline TP: It contains digital database of over 35,000 companies. It includes information of public, private, co-operative and joint sector companies, listed or otherwise.

(b) Prowess: Prowess is a database of the financial performance of Indian companies. Audited Annual Reports of companies and information submitted to the MCA; and in the case of listed companies, company filings with stock exchanges and prices of securities listed on the major stock exchanges are the sources of the database. The database contains information on all listed companies and a larger set of unlisted companies.

(c) ACE TP Database: ACE TP database contains information, both financial and non-financial of companies and sectors. It also contains information regarding equity and commodity and derivative markets.

There are other available Indian and foreign databases also like Prowess Pro, Amadeus, Royalty Stat, Compustat Global, Osiris, ktmine, Oriana, Bloomberg etc. which can be referred.

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Step 2: Application of quantitative filters

The application of the quantitative filters help in filtering the companies available in the database based on the similarity of the quantitative information between the tested party and the potential comparables. Some of the commonly used quantitative filters are:

(a) **Availability of financial data:** The companies whose financial information for the relevant period (financial year of the controlled transaction or the preceding two years as the case may be) are not available in the public domain should not be considered in the comparability analysis.

(b) **Industry of the tested party:** The appropriate industry head should be selected. For instance, if the tested party operates in the seed segment, it should be ensured that various industry heads which could include comparable companies should be chosen, i.e. seeds, agriculture etc. Therefore, while applying this filter, the parameters should be fairly broad.

(c) **Turnover filter:** This is perhaps the most commonly used quantitative filter in the search process. This is for the reason that companies which are operating in the same range of turnover would have similar share in the market and thus are more likely to have somewhat similar margins. On the other hand, companies with extremely high or low turnover would not provide an effective base for comparison since their margins would not only reflect the efficiency of their business but also the scale of the operations. The range of the filter is very subjective and varies with the facts of each case.

(d) **Net worth filter:** Net worth of a company can be used to determine the creditworthiness of the company. Negative net worth would indicate that the debts of the company have surpassed its assets. Therefore, a company with consistent negative net worth should be rejected in the comparability analysis since its margins would be adversely affected and it would ordinarily be difficult to quantify and adjust the effect of its negative worth on the margins. Companies with negative net worth are usually rejected in this filter.

(e) **Export filter:** The parameter of 'geographic location of market' has lead to adoption of 'export turnover filter' whereby Transfer Pricing Officers ('TPOs')

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insist that if the taxpayer is an exporter then the comparables should also have export earnings of a certain degree. The export activity levels, by itself, cannot be a valid filter unless it is established that the market to which the exports are made are materially different from the domestic market.

(f) **Employee expense filter:** The employee expense ratio helps to analyse the level of activities and intensity of employee dependence.

(g) **Related party transactions:** As already discussed, a transaction between two related parties cannot be taken as a comparable uncontrolled transaction for the purpose of benchmarking a controlled transaction. This filter finds its application on the same principle, i.e., if a potential comparable has substantial related party transactions, it can be inferred that its margins are contaminated with transactions which are not entirely governed by the market forces and thus such a company should be rejected in the search process.

(h) **Consistently loss making companies:** The companies which are incurring losses on a consistent basis cannot be considered as good comparables as their profitability is adversely impacted by factors which are not specific to the industry but to the entity. However, loss in just one year would not be indicative of any extra ordinary factors surrounding the company and therefore such a company should not be rejected on that count alone.

Step 3: Application of qualitative filters

The entities remaining after the application of the quantitative filters are further narrowed down by applying the qualitative filters. Some of the commonly used qualitative filters are as under:

(a) **Product filter:** Although the industry filter excludes the companies not operating in the same industry but at the same time there are entities producing a variety of products in the same industry and therefore in order to reach a precise measure of comparability, the list of companies should be further shortlisted to exclude the companies not dealing in the same/similar products as that of the tested party. For instance, for a tested party trading in seeds, the industry filter to be applied could be agri-trading. However, this filter might result in companies engaged in various types of agricultural products such as fertilizers, pesticides etc. In order to remedy this, product

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criteria would be applied to only select the companies engaged in trading of seeds in the agriculture industry.

(b) Functional filter: The chosen companies must be further analyzed to select only those companies which are functionally similar to the tested party. The functions could be in the form of manufacturing of goods, rendering of services, trading in goods etc. Thus, the filter to be applied depends on the functions performed by the tested party to find transactions which are functionally similar.

(c) Ownership (Government or private): Generally, entities in the private sector exist for generating profits. Government owned entities on the other hand, function to serve the society and are not necessarily driven by the profit motive. Accordingly, such companies should be included/ excluded based on their comparability analysis like the other private companies.

Data To Be Used for Comparability Analysis [Rule 79(4) and 79(5)]

The data to be used for analysing the comparability of an uncontrolled transaction with an international transaction or a specified domestic transaction shall be data relating to the **current year,** i.e., the financial year in which the international transaction or specified domestic transaction has been entered into [Rule 79(4)]

Exception in Case of RPM, CPM and TNMM [Rule 79(5)]

In case the most appropriate method for the determination of ALP of an international transaction or specified domestic transaction is the **resale price method** or **cost plus method** or **the transactional net margin method**, then, irrespective of anything contained in sub rule (4), the data to be used for analysing the comparability of an uncontrolled transaction with an international transaction or specified domestic transaction shall be –

(i) the data relating to the current year; or

(ii) the data relating to the **first preceding year,** 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 tax year and

(iii) 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

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specified domestic transaction **during the course of any assessment proceeding** for the tax 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 tax year.

Therefore, the ultimate objective of the Rules is to determine the arm's length price using current-year data wherever available.

Most Appropriate Method (MAM) [Section 165(2) read with Rule 80]

After understanding the prescribed methods and comparability principles, the next step is to determine which method should be applied in a particular case.

Section 165(1) merely prescribes the available methods. However, not all methods are suitable for every transaction.

Accordingly, Section 165(2) provides that the arm's length price shall be determined by applying the **Most Appropriate Method (MAM).**

The Most Appropriate Method refers to the method which, having regard to the facts and circumstances of a particular transaction, is best suited for determining the arm's length price and provides the most reliable measure of an arm's length result.

Section 165(2) read with Rule 80 lays down the factors that are to be considered while selecting the Most Appropriate Method.

Under this Rule, the method that is best suited to the facts and circumstances, and which provides the most reliable measure of an arm’s length price in relation to the international transaction or specified domestic transaction, will be considered to be the most appropriate.

For the purpose of selecting the most appropriate method, the following factors should 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;

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(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 the application of a method.

Practical Understanding of MAM

The selection of the Most Appropriate Method (MAM) depends upon the facts and circumstances of each international transaction or specified domestic transaction. The law does not prescribe any hierarchy amongst the prescribed transfer pricing methods and no method is inherently superior to another. The most appropriate method is the method which, having regard to the nature of the transaction, availability of reliable data, degree of comparability and possibility of making reliable adjustments, provides the most reliable measure of the Arm's Length Price.

The practical application of this principle may be understood from the following examples:



Commodity Transaction

An Indian company exports crude oil to its Associated Enterprise. Since reliable market quotations for identical crude oil are available from recognised commodity exchanges, a direct comparison of prices can be undertaken. In such a case, the Comparable Uncontrolled Price (CUP) Method would generally be regarded as the Most Appropriate Method as it provides the most reliable measure of the Arm's Length Price.



Captive Software Service Provider

A captive software development company renders software development services exclusively to its Associated Enterprise. Reliable comparable prices for

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similar services may not be available. However, financial information relating to independent software service providers performing similar functions may be available. In such circumstances, the Transactional Net Margin Method (TNMM) would generally be selected as the Most Appropriate Method since comparison can be made using the net profit margins earned by comparable independent enterprises.



Joint Development of Intellectual Property

Two Associated Enterprises jointly develop valuable intellectual property, and both contribute unique and valuable functions, know-how and intangible assets. Since reliable uncontrolled comparables may not be available and both enterprises contribute significantly to value creation, the Profit Split Method (PSM) would generally be regarded as the Most Appropriate Method for determining the Arm's Length Price.

Determination of Arm's Length Price where More than One Price is Determined [Section 165(3) read with Rule 81]

After selecting the Most Appropriate Method and applying the prescribed computational mechanism, the arm's length analysis may result in:

- a single comparable price; or
- multiple comparable prices.

Accordingly, Section 165(3) prescribes separate rules for the determination of the arm's length price in each case.

CASE 1: ONLY ONE PRICE IS DETERMINED: Section 165(3)(a) provides that where the application of the Most Appropriate Method results in the determination of only one price, the Arm's Length Price shall be such price.

However, where the variation between the Arm's Length Price so determined and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed the percentage **(not exceeding 3%)** notified by the Central Government in this behalf, the transaction price may be accepted as the Arm's Length Price.

CASE 2: MORE THAN ONE PRICE IS DETERMINED: Section 165(3)(b) provides that where the application of the Most Appropriate Method results in the

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determination of more than one price, the Arm's Length Price (ALP) shall be computed in the prescribed manner. Rule 81 lays down the mechanism for determining the ALP in such cases.

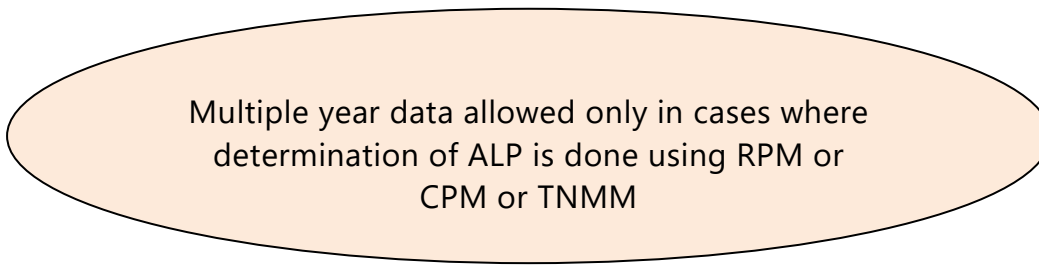
Practical Understanding

Rule 81 becomes relevant only where the application of the Most Appropriate Method results in the determination of more than one arm's length price. In such situations, selecting any one comparable price in isolation may not provide a reliable measure of the Arm's Length Price. Accordingly, Rule 81 provides a statistical framework for determining the Arm's Length Price by constructing a dataset and applying concepts such as weighted average, arm's length range, median, and arithmetic mean.

(a) Construction of Dataset [Rule 81(2)]

Rule 81(2) provides that where in respect of an international transaction or a specified domestic transaction, the application of the most appropriate method referred to in section 165(1) results in determination of more than one price, then, the arm's length price in respect of such international transaction or specified domestic transaction has to be computed based on the **dataset constructed by placing such prices in an ascending order as provided**. The Arm's Length Price shall thereafter be determined on the basis of the dataset so constructed.

(b) Inclusion of Multiple-Year Data in Dataset [Rule 81(3)]



Where the most appropriate method is the resale price method, cost plus method, or transactional net margin method, and where the comparable uncontrolled transaction undertaken by an enterprise, not being the enterprise undertaking such transactions, has been identified using data relating to -

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(a) **the current year**, and the said enterprise has undertaken the same or similar comparable uncontrolled transaction, **in either or both of the two financial years immediately preceding the current year**, then, -

(i) the price in respect of such transaction in such year (or years) shall be determined by applying the most appropriate method in the similar manner as applied in the current year; and

(ii) the weighted average of such prices, as computed under sub-rule (5), shall be included in the dataset under sub-rule (2) instead of price referred to in sub-rule (1);

(b) **the financial year** immediately preceding the current year (if the data relating to current tax year is not available at the time of furnishing return of income for that year), and the said enterprise has undertaken the same or similar comparable uncontrolled transaction **in the financial year immediately preceding the two financial years**, then -

(i) the price in respect of such transaction shall be determined by applying the most appropriate method in the similar manner as it was applied in the **financial year immediately preceding the current year**; and

(ii) the weighted average of such prices, as computed under sub-rule (5), shall be included in the dataset under sub-rule (2) instead of price referred to in sub-rule (1).

Why is Multiple-Year Data Considered?

Sometimes, the profit margin or price of a comparable company fluctuates from year to year. Instead of relying on a single year's data, the rule allows a **weighted average** of multiple years' data to arrive at a more reliable ALP.

Situation 1 – Current year's data is available [Clause (a)]

Suppose you are determining the ALP for F.Y. 2026-27 (current year). You identify a comparable company, say ABC Ltd. ABC Ltd. has undertaken similar uncontrolled transactions in F.Y. 2026-27 (current year), F.Y. 2025-26 and F.Y. 2024-25.

In this case,

- determine the price/margin for 2025-26 using the same transfer pricing method (RPM/CPM/TNMM) as used for 2026-27.
- Determine the price/margin for 2024-25 in the same manner.

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- Compute the weighted average of the prices/margins of all the relevant years.

Use this weighted average instead of only the current year's price while determining the ALP.

Situation 2 – Current year's data is not available [Clause (b)]

Suppose you are filing the return for T.Y. 2026-27, but the financial statements of comparable companies for 2026-27 are not yet available. Therefore, you use data for F.Y. 2025-26. If the comparable company also has data for F.Y. 2024-25, then:

- Determine the price/margin for 2024-25 using the same method applied for 2025-26.
- Compute the weighted average of 2025-26 and 2024-25.

Use this weighted average for determining the ALP.

(c) Exclusion from Dataset [Rule 81(4)]

Where the use of current year data subsequently establishes that -

(a) the enterprise has not undertaken the same or similar uncontrolled transaction during the current year; or

(b) the uncontrolled transaction undertaken during the current year is not a comparable uncontrolled transaction,

then, irrespective of anything else, neither the price nor the weighted average of the prices of the comparable uncontrolled transactions shall be included in the dataset.



A comparable enterprise can remain in the dataset only if it undertakes a comparable uncontrolled transaction in the current year. If it has no such transaction, or the transaction is not comparable, the enterprise is excluded altogether, and neither its current-year price nor its multi-year weighted average can be used for determining the Arm's Length Price.

(d) Computation of Weighted Average [Rule 81(5)]

Rule 81(5) provides that where an enterprise has undertaken comparable uncontrolled transactions in more than one financial year, then for the purposes of constructing the dataset, the weighted average of the prices of such

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transactions would be computed in the following manner, namely:-

	Method	Factors to which weight is assigned
(i)	Resale price method	Quantum of sales considered for arriving at the respective prices
(ii)	Cost plus method	Quantum of costs considered for arriving at the respective prices
(iii)	Transactional net margin method	Quantum of costs incurred, or sales effected or assets employed or to be employed, or as the case may be, any other base which has been considered for arriving at the respective prices.

(e) Range Concept [Rule 81(6)]

The arm's length range provisions apply where -

(a) The most appropriate method is CUP Method, RPM, CPM or TNMM; **and**

(b) The dataset consists of six or more entries.

In such cases, an **arm's length range shall be constructed beginning from the 35th percentile of the dataset and ending at the 65th percentile of the dataset.**

- If the transaction price falls within such range, the transaction price shall be deemed to be the Arm's Length Price.
- If the transaction price falls outside such range, the median of the dataset shall be used for determination of the Arm's Length Price.

Practical Illustration – Understanding the Range Concept

Suppose the following comparable margins are available:

8%, 10%, 12%, 15%, 18%, 20% and 22%.

These observations collectively constitute the **dataset.**

The dataset is arranged in **ascending order**:

8% → 10% → 12% → 15% → 18% → 20% → 22%

Since the dataset contains six or more entries, the arm's length range provisions become applicable.

❑ 35th Percentile Position = 7 × 35% = 2.45. Accordingly, the next higher position (3rd position) is selected.

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35th Percentile = 12%

- 65th Percentile Position = 7 × 65% = 4.55. Accordingly, the next higher position (5th position) is selected.

65th Percentile = 18%

- Therefore: **Arm's Length Range = 12% to 18%**

Now Suppose:

Since, 35th Percentile = 12% & 65th Percentile = 18%, Tested Party (Company in question) Margin = 14%

Since the tested party's margin falls within the arm's length range, the transaction shall be regarded as being at arm's length and no transfer pricing adjustment shall be required.

However, if the tested party's margin is 10%, the transaction falls outside the arm's length range and the median of the dataset shall be used for determination of the Arm's Length Price.

For the above dataset:

8%, 10%, 12%, **15%**, 18%, 20%, 22%

The data in median would be 7 x 50% = 3.5. Accordingly, next higher position (at 4th position) is selected.

Median = 15%

Accordingly, where the tested party's result falls outside the arm's length range, the median shall be used for the determination of the Arm's Length Price.

Note – *Determine the data place by multiplying the number of entries in the dataset by 35%, 65% or 50%, as applicable. Where the resulting data place is a whole number, take the arithmetic mean of the value at that position and the value immediately succeeding it in the dataset.*

(f) Range Concept Not Applicable [Rule 81(7)]

The arm's length range provisions shall not apply where -

(a) The most appropriate method is the Profit Split Method (PSM) or any other method prescribed by the CBDT; ***or***

(b) The dataset contains less than six entries.

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In such cases, the Arm's Length Price shall be the arithmetic mean of all values included in the dataset.

However, where the variation between the Arm's Length Price so determined and the actual transaction price does not exceed the percentage (not exceeding 3%) notified by the Central Government, the transaction price shall be deemed to be the Arm's Length Price.

Meaning of certain terms [Rule 81(8)]

	Term	Meaning
(a)	35th percentile of a dataset (having values arranged in an ascending order)	The lowest value in the dataset such that at least 35% of the values included in the dataset are equal to or less than such value. However, if the number of all values that are equal to or less than the aforesaid value is a whole number, then, the 35th percentile shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.
(b)	65th percentile of a dataset (having values arranged in an ascending order)	The lowest value in the dataset such that at least 65% of the values included in the dataset are equal to or less than such value. However, if the number of all values that are equal to or less than the aforesaid value is a whole number, then, the 65th percentile shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.
(c)	the median of the dataset (having values arranged in an ascending order)	The lowest value in the dataset such that at least 50% of the values included in the dataset are equal to or less than such value. However, if the number of all values that are equal to or less than the aforesaid value is a whole number, then, the median shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.

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Power of Assessing Officer to Determine Arm's Length Price [Section 165(4) and Section 165(5)]

The primary responsibility for determining the arm's length price of an international transaction or specified domestic transaction rests with the assessee. However, the Assessing Officer is empowered to examine the correctness of the arm's length price determined by the assessee and, in specified circumstances, determine the arm's length price in accordance with the provisions of section 165.

Accordingly, section 165(4) provides that during the course of any assessment proceedings, the Assessing Officer may proceed to determine the arm's length price in relation to an international transaction or specified domestic transaction if, **on the basis of material, information or documents in his possession**, he is of the opinion that -

(a) the price charged or paid in the international transaction or specified domestic transaction has **not been determined in accordance with the provisions of section 165(1), (2) and (3)**; or

(b) the assessee has **failed to keep and maintain the prescribed information and documents** relating to the international transaction or specified domestic transaction in accordance with section 171(1) and the rules made thereunder; or

(c) the **information or data** used by the assessee in determining 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 required to be furnished in response to a notice** issued under section 171(2) or section 171(3).

Thus, the Assessing Officer may invoke the provisions of section 165(4) only upon the existence of any of the above circumstances.

However, before determining the arm's length price under section 165(4), section 165(5) mandates that the Assessing Officer shall issue a show-cause notice to the assessee specifying the date and time on which the assessee is required to explain why the arm's length price should not be determined based on the material, information or documents available with the Assessing Officer.

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Consequences of Determination of Arm's Length Price [Section 165(6) to Section 165(8)]

Where the Assessing Officer determines the arm's length price under section 165(4), he may recompute the total income of the assessee having regard to the arm's length price so determined. Consequently, any transfer pricing adjustment resulting from such determination may lead to enhancement of the income chargeable to tax.

For example, if the total income computed by the assessee is ₹ 7 lakh and the total income computed by the Assessing Officer after applying the arm's length principle is ₹ 9 lakh, the total income shall stand recomputed at ₹ 9 lakh.

Section 165(7) further provides that where the total income of the assessee is enhanced pursuant to recomputation under section 165(6), no deduction under Chapter VIII shall be allowed in respect of the amount by which such income is enhanced. The purpose of this provision is to ensure that the additional income arising on account of transfer pricing adjustment does not qualify for profit-linked deductions and thereby dilute the impact of such adjustment.

In the above example, the additional income of ₹ 2 lakh arising due to transfer pricing adjustment would not qualify for deduction under Chapter VIII.

Section 165(8) deals with a situation where the total income of one associated enterprise is recomputed on account of the determination of the arm's length price in respect of a payment made to another associated enterprise on which tax has been deducted or was deductible under the provisions of Chapter XIX-B. In such a case, the income of the recipient associated enterprise shall not be recomputed merely because a transfer pricing adjustment has been made in the hands of the payer associated enterprise.

For instance, where A Ltd. pays royalty to its associated enterprise B Ltd. (a non-resident) at 10% of sales and tax has been deducted at source on such payment, and the Assessing Officer subsequently determines that the arm's length royalty rate should be 8%, the excess royalty of 2% may be disallowed in the hands of A Ltd. However, B Ltd. cannot seek a corresponding reduction in its taxable income merely because such a transfer pricing adjustment has been made in the hands of A Ltd.

Thus, section 165(8) ensures that the determination of arm's length price in the hands of one associated enterprise does not automatically result in recomputation of income in the hands of the other associated enterprise.

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Bright Line Test

To cater to the Indian market an MNC sets up subsidiaries in India. The Indian subsidiaries act as a distributor/provider of goods/services and generally incur certain expenses for promoting the brand or product of the foreign company which are popularly known as Advertisement marketing and sales promotion expenditure (**"AMP expenses"**). The intellectual property rights (**"IPR"**) in products/services and the brands lie with the parent entities. To test whether the transaction is at ALP or not and to determine the excess/non-routine advertising marketing and promotion (AMP) expenditure incurred by the taxpayer for building brand of its associated enterprises in India.

Revenue Authorities sometimes adopt the Bright Line Test (**"BLT"**). The issue under consideration is whether bright line test can be used by the Assessing Officer to determine the excess/non-routine advertising marketing and promotion (AMP) expenditure incurred by the taxpayer for building brand of its associated enterprises in India.

The Delhi High Court in *Bausch & Lomb Eyecare (India) (P.) Ltd. v. Addl. CIT [2016] 381 ITR 227* held that excess advertisement expense incurred is not an international transaction and there is no machinery provision for computation of AMP expense adjustment.

In *Sony Ericsson Mobile Communications India (P) Ltd v. CIT (2015) 374 ITR 118* the Delhi High Court held that bright line test has no statutory mandate, and a broad-brush approach is not mandated or prescribed. It further opined that the exercise to separate "routine" and "non-routine" advertising marketing and promotion or brand building exercise by applying the bright line test of non-comparables should not be sanctioned.

Applying the rationale of the above rulings of the High Court the Revenue Authorities are not justified in adopting the "Bright Line Test" for disallowing or adjusting the advertisement expenditure in computing arm's length price. This matter is however, pending before the Supreme Court.

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VI. Reference to Transfer Pricing Officer [Section 166]

Section 166 provides a mechanism whereby the Assessing Officer may refer the determination of arm's length price of an international transaction or specified domestic transaction to a Transfer Pricing Officer (TPO). It lays down the procedure relating to such reference, determination of arm's length price by the TPO and the consequences thereof -

Reference by Assessing Officer [Section 166(1)]

The option to make a reference to TPO is given to the Assessing Officer.



- Where the assessee has entered into an international transaction or specified domestic transaction in any tax year **and**
- if Assessing Officer considers it necessary or expedient to do so,

he may refer the determination of the arm's length price in relation to the said international transaction or specified domestic transaction to the TPO.

As per section 166(17), a **'Transfer Pricing Officer'** means a Joint Commissioner, Deputy Commissioner or Assistant Commissioner authorised by the CBDT to perform all or any of the functions of an Assessing Officer relating to determination of arm's length price [section 165 and 171].

The Assessing Officer has to take the approval of the Principal Commissioner of Income-tax (PCIT)/Commissioner of Income-tax (CIT) before making such a reference.

Proceedings before the Transfer Pricing Officer

(1) When such a reference is made, TPO would serve a notice to the assessee requiring him to produce on a date specified in the notice, any evidence on which the assessee relied in support of the computation of arm's length price made by him in relation to the international transaction or specified domestic transaction.

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(2) The scope of proceedings before the TPO is not restricted only to the transactions referred by the Assessing Officer. Accordingly, where during the course of proceedings before him it comes to the notice of TPO -

(i) any international transaction or specified domestic transaction not specifically referred by the Assessing Officer; or

(ii) any international transaction or specified domestic transaction not reported by the assessee in the accountant's report furnished under section 172,

the provisions of Chapter X shall apply as if such transaction had also been referred to the TPO under section 166(1). [Section 166(5)].

(3) The TPO has to pass an order in writing determining the arm's length price as per section 165(4) after considering the evidence, documents, etc., produced by the assessee and after considering the material gathered by him. He has to send a copy of his order to the Assessing Officer as well as the assessee. [Section 166(6)].

(4) **Binding Nature of TPO's Order:** The order of the Transfer Pricing Officer determining the arm's length price of an international transaction or specified domestic transaction is binding on the Assessing Officer and the Assessing Officer shall proceed to compute the total income under section 165(6) in conformity with the arm's length price determined by the Transfer Pricing Officer [Section 166(11)].

(5) **Time Limit for Passing Order by TPO:** To provide sufficient time to the Assessing Officer to complete the assessment in a case where reference is made to the Transfer Pricing Officer, section 166(7) provides for determination of arm's length price of international transactions or specified domestic transaction by the Transfer Pricing Officer at least *one month prior* to the month in which the limitation period [section 286 or section 296] for completion of assessment, reassessment, recomputation or fresh assessment expires. Accordingly -

Limitation for Assessment expires on	**The TPO must pass the order by**
March 31st	January 31st
December 31st	October 31st

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(6) In many cases, it becomes necessary to seek information from foreign jurisdictions for the purpose of determining the arm's length price by the TPO. At times, proceedings before the TPO may also be stayed by a court order.

Taking into consideration such cases, it has been provided that where assessment proceedings are stayed by any court or where a reference for exchange of information has been made by the competent authority under an agreement referred to in section 159, the time available to the Transfer Pricing Officer for making an order after excluding the time for which assessment proceedings were stayed or the time taken for receipt of information, as the case may be, is less than 60 days, then, such remaining period shall be extended to 60 days.

Rectification of TPO's Order

Section 166(13) empowers the TPO to rectify any mistake apparent from the record in an order passed under section 166(6). The provisions of section 287 relating to rectification shall apply, as far as may be, to such rectification proceedings.

Where the TPO rectifies his order, a copy of the rectification order shall be forwarded to the Assessing Officer, who shall amend the assessment order so as to bring it in conformity with the rectified order.

Powers of the Transfer Pricing Officer

The TPO can exercise all or any of the powers specified in section 246(1) (a) to (d) or section 252(1)(a) or section 253 for determination of arm's length price once the above reference is made to him. These powers enable the TPO to call for information, examine records and conduct enquiries necessary for the determination of the arm's length price.

Determination of Arm's Length Price for Multiple Years in a Single proceeding

Traditionally, an arm's length price was required to be determined separately for each tax year, even where the nature of the international transaction, functional profile, assets employed and risks assumed remained substantially unchanged over multiple years. This resulted in repetitive transfer pricing proceedings and

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increased compliance burden for taxpayers as well as administrative burden for the tax authorities.

To reduce the compliance burden on the assessee as well as administrative burden on the TPOs, the concept of block transfer pricing assessment has been introduced by the Finance Act, 2025, which allows to apply the ALP determined in relation to an international transaction or specified domestic transaction for any tax year to the similar transaction for the two consecutive tax years immediately following such tax year. The provisions related to block transfer pricing assessment are as follow:

(i) **Option for Multiple Year Determination of ALP**: Section 166(9) provides that the arm's length price determined by the TPO under section 166(6) for any tax year shall apply to **similar** international transactions or specified domestic transactions for the **two consecutive tax years immediately following such tax year**, subject to fulfilment of the following conditions:

(a) the assessee exercises an option or options to the above effect for the said two consecutive tax years;

(b) such option or options are exercised in prescribed form, manner and within prescribed period; and

(c) the TPO shall, within one 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 prescribed conditions.

Thus, where the prescribed conditions are satisfied, the arm's length price determined for one tax year may also be applied to similar transactions undertaken during the immediately succeeding two tax years.

However, these provisions shall not apply to any proceedings for assessment of search cases [Section 166(10)].

(ii) **Effect of Valid Option:** Where the Transfer Pricing Officer declares the option exercised by the assessee as valid, the following consequences shall follow:

(a) **No Separate Reference to TPO** - No reference for the computation of the arm's length price in relation to an international transaction or specified domestic transaction shall be made [Section 166(2)].

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(b) **Existing Reference deemed not to have been made -** Section 166(3) provides that where any reference has already been made in respect of such transaction, whether before or after declaration of validity of the option, such reference shall have effect as if no reference had been made.

(c) **Determination of ALP for Subsequent Years** - Section 166(12) provides that the Transfer Pricing Officer shall examine and determine the arm's length price in relation to the similar transaction for the two consecutive tax years immediately following such tax year in the order passed under section 166(6) itself.

(d) **Re-computation of Income -** On receipt of such order, the Assessing Officer shall recompute the total income of the assessee for the two consecutive tax years immediately following such tax year in accordance with the provisions of section 288(2).

(iii) **Power of CBDT to Issue Guidelines:** Section 166(15) provides that where any difficulty arises in giving effect to the provisions relating to the multiple-year determination of arm's length price, the CBDT may, with the prior approval of the Central Government, issue guidelines for the purpose of removing such difficulty.

Section 166(16) further provides that every such guideline shall be laid before each House of Parliament for a total period of thirty days and shall thereafter take effect subject to any modification or annulment approved by Parliament.

Exercise of Option and Prescribed Conditions [Rule 82]

Rule 82 prescribes the form, manner, time limit and conditions for exercise of the option referred to in section 166(9).

(i) Exercise of Option - The option under section 166(9)(a) may be exercised by an assessee by furnishing **Form No. 46** for the two consecutive tax years immediately following the tax year in respect of which reference has been made under section 166(1). For the purposes of Rule 82 -

- the tax year in respect of which reference has been made under section 166(1) is referred to as the **first tax year**;

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- the immediately succeeding tax year is referred to as the **second tax year**; and
- the next succeeding tax year is referred to as the **third tax year**.

Accordingly, the option is exercised in respect of the second and third tax years.

Form No. 46 for the second and third tax years shall be furnished during the period beginning from the end of the third tax year and ending on 30th June succeeding the third tax year. Further, Form No. 46 shall be accompanied by a certificate from an accountant in **Form No. 47**.

(ii) Order of the Transfer Pricing Officer - Where the international transactions or specified domestic transactions fulfil the prescribed conditions, the Transfer Pricing Officer shall, within one month from the end of the month in which the option is exercised, pass an order in writing declaring whether the option exercised by the assessee is valid or invalid.

(iii) Conditions for Validity of Option - Rule 82(5) provides that the following conditions are required to be satisfied for validity of the option:

(a) Similarity of Transactions - The international transactions or specified domestic transactions in the second and third tax years should be similar to the international transactions or specified domestic transactions in the first tax year.

(b) Conditions for Similarity - The relevant transactions shall be treated to be similar where:

- there is no change in the method adopted for determination of arm's length price;
- the functions performed, taking into account the assets employed and risks assumed, remain materially consistent;
- the business activities, relevant financial, tax and accounting treatment and classification of the assessee, in case of a company, remain materially the same;
- there is no material change in the relevant transaction, and no material change in the functions performed, assets employed and risks assumed, even though there may be a change in the business results, holding structure of the associated enterprise or the associated enterprise itself; and

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- there is no change in the contractual terms governing the transaction which explicitly or implicitly determine the manner in which responsibilities, risks and benefits are shared between the parties.

(c) Compliance Conditions - The assessee should have furnished, for the **first and second tax years** -

- the accountant's report under section 172 on or before the specified date; and
- the return of income on or before the due date under section 263(1).

Further, the assessee should undertake to furnish, for the **third tax year** -

- the accountant's report under section 172 on or before the specified date; and
- the return of income on or before the due date under section 263(1).

(d) Search Cases -The case of the assessee for the first, second and third tax years should not be covered under Chapter XVI-B.

(e) Associated Enterprise not situated in Notified Jurisdiction - None of the associated enterprises relevant to the transactions should be resident in a jurisdiction notified under section 176.

(iv) Objection against Invalidity Order - Where the Transfer Pricing Officer declares the option as invalid, the assessee may file objections before the Commissioner to whom the Transfer Pricing Officer is subordinate within fifteen days from receipt of such order. The Commissioner shall, after providing an opportunity of being heard, pass an appropriate order regarding validity of the option and communicate the same to the assessee and the Transfer Pricing Officer.

(v) Cancellation of Valid Option - Where, during the course of proceedings under section 166, it is found that -

- the information furnished in Form No. 46 is inaccurate or not *bona fide*;
- the accountant furnishes a certificate in Form No. 47 to such effect; or the prescribed conditions are not satisfied,

the order declaring the option as valid shall be cancelled.

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However, before cancelling such order, the Transfer Pricing Officer shall provide a reasonable opportunity of being heard to the assessee and obtain the approval of the Commissioner.

(vi) Consequence of Invalidity or Cancellation - Where the option is declared invalid or the order declaring the option as valid is cancelled, the Transfer Pricing Officer shall proceed to determine the arm's length price for the first tax year in respect of which reference has been made under section 166(1).

VII. Power of Board to make Safe Harbour Rules for determination of arm's length price [Section 167]

Section 167 provides that determination of

- income referred to in section 9(2); or
- arm's length price under section 165 or section 166

shall be subject to Safe Harbour Rules. Section 167(2) empowers the CBDT to prescribe safe harbour rules which are discussed hereunder.

Meaning of Safe Harbour [Section 167(3)]

Safe Harbour means **circumstances** in which the income-tax authorities shall accept

- the transfer price or
- income, deemed to accrue or arise under section 9(2),

declared by the assessee.

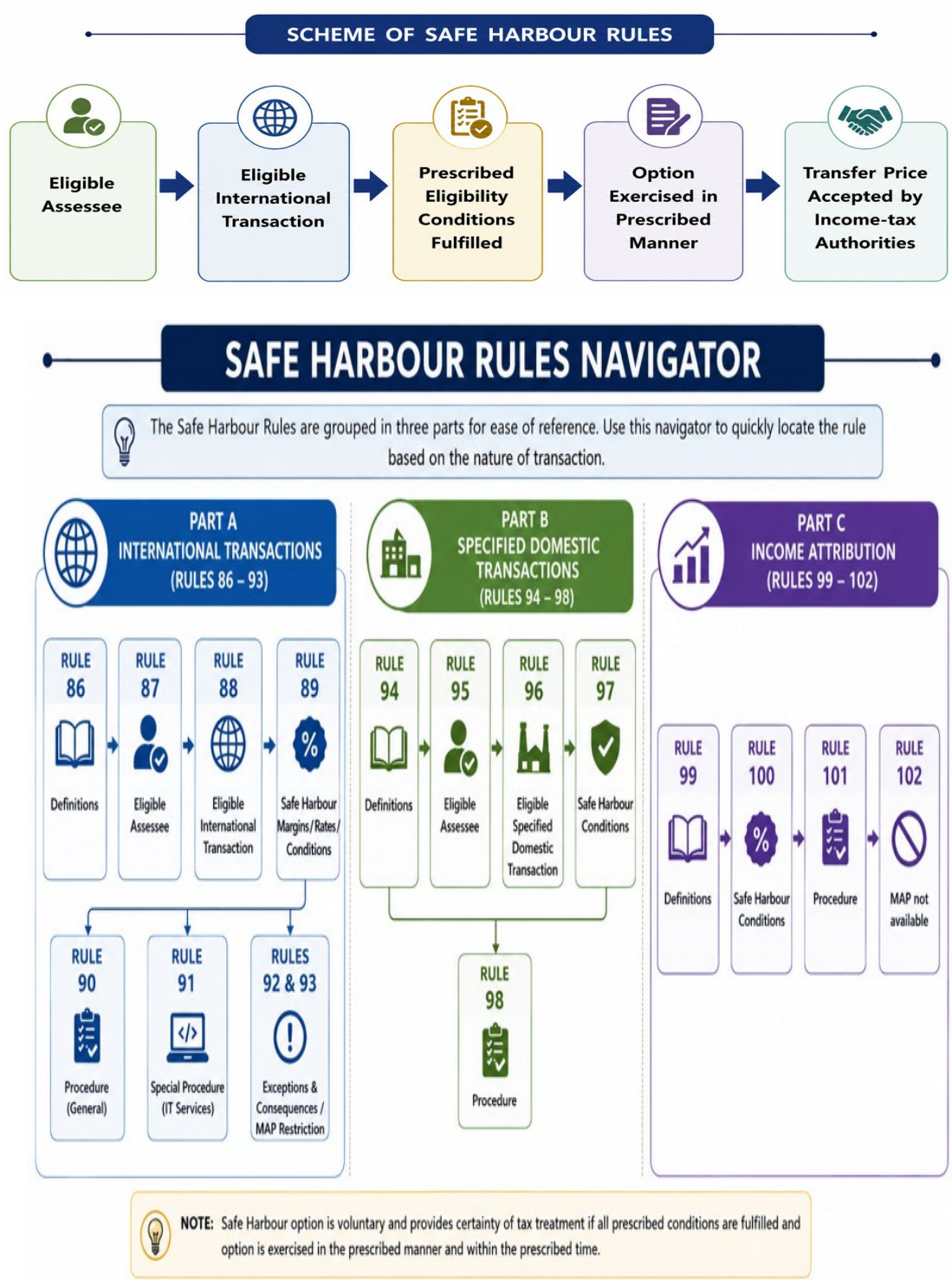
The Safe Harbour Rules provide certainty in determining the arm's length price of specified international transactions. Where an eligible assessee enters an eligible international transaction and satisfies the prescribed Safe Harbour conditions, the transfer price declared by the assessee shall ordinarily be accepted by the income-tax authorities without undertaking a detailed transfer pricing examination.

Thus, the Safe Harbour Rules reduce transfer pricing litigation and provide certainty to taxpayers in respect of eligible international transactions.



Safe Harbour does **not** exempt an assessee from the transfer pricing provisions. It only provides that the transfer price declared by the eligible assessee shall be accepted if all the prescribed conditions are fulfilled.

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PART A - Safe Harbour Rules for International Transactions

As per rule 89(1), the transfer price declared by

- an **eligible assessee**
- in respect of an eligible international transaction
- for a tax year shall be accepted by the income-tax authorities, if -
    - the option exercised by the eligible assessee is not held to be invalid under rule 90 and
    - it is in accordance with the following circumstances specified in column (4) in table below.

As per rule 87, eligible assessee means a person who has exercised a valid option for application of safe harbour rule as per rule 90 and engaged in transactions specified in column (2) in table below.

As per rule 88, an eligible international transaction means an international transaction specified in column (3) in table below between an **eligible assessee** and its **associated enterprise**, one of which is necessarily a **non-resident.**

The Rule specifies the Safe Harbour conditions applicable to each category of eligible international transaction covered under Rule 88. These conditions may be prescribed in the form of:

- Operating Profit Margin;
- Interest Rate;
- Commission or Fee; or
- Other specified circumstances,

depending upon the nature of the eligible international transaction.

Accordingly, where an eligible assessee exercises a valid option for Safe Harbour and satisfies the prescribed conditions under this Rule, the transfer price declared by such assessee shall ordinarily be accepted by the Income-tax Authorities.

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Sl. No.	Eligible Assessee (Rule 87)	Eligible International Transaction (Rule 88)	Circumstances (Rule 89)
(1)	(2)	(3)	(4)
1.	Engaged in providing Information Technology Services consisting of any one or more - (i) Software Development Services; (ii) Information Technology Enabled Services (ITES); (iii) Knowledge Process Outsourcing (KPO) Services; or (iv) Contract Research and Development Services wholly or partly relating to Software Development with insignificant risk[2], to its non-resident associated enterprise (foreign principal).	Provision of Information Technology Services consisting of any one or more - (i) Software Development Services; (ii) Information Technology Enabled Services (ITES); (iii) Knowledge Process Outsourcing (KPO) Services; or (iv) Contract Research and Development Services wholly or partly relating to Software Development.	Operating Profit Margin declared by the eligible assessee in respect of eligible international transaction not less than 15.5% of operating Expense, where the aggregate operating revenue from such transaction during the tax year does not exceed ₹ 2,000 crore.

Meaning of certain terms	
Information Technology Enabled Services (ITES) [Rule 86(h)]	Information Technology Enabled Services (ITES) means the following business process outsourcing services provided mainly with the assistance or use of information technology: • Back-office operations;

[2] *Rule 87(2) provide for the factors for the purpose of identifying an eligible assessee with insignificant risk*

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		• Call centre/contact centre services; • Data processing and data mining; • Insurance claim processing; • Legal databases; • Medical transcription (excluding medical advice); • Translation services; • Payroll services; • Remote maintenance or recovery; • Revenue accounting; • Support centres; • Website services; • Data search, integration and analysis; • Remote education (excluding education content development); and • Clinical database management services (excluding clinical trials). However, ITES does not include research and development services, whether or not in the nature of contract research and development services.
	Knowledge Process Outsourcing (KPO) Services [Rule 86(j)]	Knowledge Process Outsourcing (KPO) services mean the following knowledge-based outsourcing services provided mainly with the assistance or use of information technology requiring advanced analytical and technical skills: • Geographic Information System (GIS); • Human resource services; • Engineering and design services; • Animation or content development and management; • Business analytics; • Financial analytics; and • Market research.

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		However, KPO services do not include research and development services, whether or not in the nature of contract research and development services.
	Software Development Services [Rule 86(r)]	Software development services mean: • Business application software and information system development using known methods and existing software tools; • Ancillary or support services for existing systems; • Converting or translating computer languages; • Adding user functionality to application programmes; • Debugging of systems; • Adaptation of existing software; and • Preparation of user documentation. Does not include: Research and development services, whether or not in the nature of contract research and development services.
	Contract Research and Development Services wholly or partly relating to Software Development [Rule 86(b)]	Contract research and development services wholly or partly relating to software development mean the following: • Research and development producing new theorems and algorithms in the field of theoretical computer science; • Development of information technology at the level of operating systems, programming languages, data management, communications software and software development tools; • Development of internet technology; • Research into methods of designing, developing, deploying or maintaining software;

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<table>
<tr><td></td><td></td><td colspan="2">• Software development resulting in advances in generic methods of capturing, transmitting, storing, retrieving, manipulating or displaying information;
• Experimental development aimed at filling technology knowledge gaps necessary for developing a software programme or system;
• Research and development on software tools or technologies in specialised areas of computing, such as image processing, geographic data presentation, character recognition, artificial intelligence and similar areas; and
• Upgradation of existing products where the source code has been made available by the principal, except where the source code is made available only for carrying out routine functions such as debugging.</td></tr>
<tr><td>2.</td><td>Has made an Intra-group Loan</td><td>Advance of Intra-group Loan denominated in Indian Rupees</td><td>The interest rate declared in relation to the eligible international transaction entered into during the tax year is not less than the one-year Marginal Cost of Funds Lending Rate (MCLR) of the State Bank of India as on 1st April of the relevant tax year, plus the prescribed basis points.
The applicable spread is as follows:
<table>
<tr><td>Credit Rating of Associated Enterprise</td><td>Minimum Interest Rate</td></tr>
<tr><td>AAA to A (or equivalent)</td><td>SBI One-year MCLR + 175 basis points</td></tr>
</table></td></tr>
</table>

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<table>
<tr><td></td><td></td><td></td><td><table>
<tr><td>BBB–, BBB or BBB+ (or equivalent)</td><td>SBI One-year MCLR + 325 basis points</td></tr>
<tr><td>BB to B (or equivalent)</td><td>SBI One-year MCLR + 475 basis points</td></tr>
<tr><td>C to D (or equivalent)</td><td>SBI One-year MCLR + 625 basis points</td></tr>
<tr><td>Credit Rating not available and amount of loan to AE's including loan to all AE's in Indian rupees loans does not exceed ₹ 100 crore in aggregate as on 31st March of the relevant tax year</td><td>SBI One-year MCLR + 425 basis points</td></tr>
</table></td></tr>
<tr><td>3.</td><td>Has made an Intra-group Loan</td><td>Advance of Intra-group Loan denominated in Foreign Currency</td><td>Interest rate declared is not less than the Reference Rate of the relevant foreign currency as on 30th September of the relevant tax year plus the prescribed basis points, depending upon the aggregate amount of loan and the credit rating of the associated enterprise.</td></tr>
</table>

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			Rule 89(2): Table Sl. No. 3 — Foreign-currency intra-group loan matrix: **Aggregate foreign-currency loans to all associated enterprises as at 31st March not exceeding ₹ 250 crore:** **AAA to A– :** Reference Rate + 150 bps; **BBB+ to BBB– :** +300 bps; **BB+ to D, or rating unavailable:** +400 bps. **Aggregate foreign-currency loans to all associated enterprises as at 31st March exceeding ₹ 250 crore:** **AAA to A–:** Reference Rate +150 bps; **BBB+ to BBB– :** +300 bps; **BB+ to B– :** +450 bps; **C+ to D, or rating unavailable:** +600 bps.
Intra-group loan means a loan advanced to an associated enterprise, being a non-resident, where- • the loan is not advanced by a financial company, bank, financial institution or an enterprise engaged in the business of lending or borrowing in the ordinary course of business; and it does not include a credit line or any other loan facility having no fixed repayment term [[Rule 86(i)]			
4.	Has provided a Corporate Guarantee	Provision of Corporate Guarantee where the amount guaranteed, - (i) does not exceed ₹ 100 crores; or	Commission or fee declared in relation to eligible international transaction entered into during the tax year is at a rate not less than 1% per annum of the amount guaranteed.

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		(ii) exceeds ₹ 100 crores, and the credit rating of the associated enterprise, done by an agency registered with the Securities and Exchange Board of India, is of the adequate to highest safety; or	
Corporate Guarantee means an 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. It does not include- • Letter of comfort; • Implicit corporate guarantee; • Performance guarantee; or • Any other guarantee of similar nature. [Rule 86(d)]			
5.	Engaged in providing Contract Research and Development Services wholly or partly relating to Generic Pharmaceutical Drugs, with insignificant risk[3], to a foreign principal	Provision of Contract Research and Development Services, wholly or partly, relating to Generic Pharmaceutical Drugs	Operating Profit Margin declared from eligible international transaction is not less than 24% of Operating Expense, where the aggregate operating revenue from such transaction during the tax year does not exceed ₹ 300 crore.
6.	Engaged in the manufacture and export of Core or Non-core Auto Components, where 90% or more of the total	Manufacture and Export of Core Auto Components	Operating Profit Margin declared is not less than 12% of Operating Expense in relation to eligible international transaction entered during the tax year.

[3] *Rule 87(3) provides for the factors for the purpose of identifying an eligible assessee with insignificant risk.*

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7.	turnover during the relevant tax year consists of Original Equipment Manufacturer (OEM) sales.	Manufacture and Export of Non-core Auto Components	Operating Profit Margin declared is not less than 8.5% of Operating Expense in relation to eligible international transaction entered during the tax year.
Core Auto Components include engine parts, transmission and steering parts, suspension and braking parts, and lithium-ion batteries used in electric or hybrid electric vehicles [Rule 86(c)]. Non-core Auto Components mean all auto components other than core auto components [Rule 86(l)].			
8.	Is in receipt of low Value-adding Intra-group services from one or more members of its group	Receipt of Low Value-adding Intra-group Services	The aggregate amount of low value adding intra-group services during the tax year, including a mark-up not exceeding 5%, does not exceed ₹ 10 crore, and the method of cost pooling, 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 are certified by an accountant.
Low value-adding intra-group services mean services 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, which- • are in the nature of support services; • are not part of the core business of the multinational enterprise group and neither constitute the profit-earning activities nor contribute to its economically significant activities; • are not shareholder services or duplicate services; • neither require the use of unique and valuable intangibles nor lead to the creation of unique and valuable intangibles; • 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 • do not have reliable external comparable services for determining the arm's length price.			

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Does not include:

- Research and development services;
- Manufacturing and production services;
- Information technology (software development) services;
- Knowledge process outsourcing services;
- Business process outsourcing services;
- Purchasing activities relating to raw materials or other materials used in manufacturing or production;
- Sales, marketing and distribution activities;
- Financial transactions;
- Extraction, exploration or processing of natural resources; and
- Insurance and reinsurance services [Rule 86(k)]

9.	Has provided Data Centre Services to a foreign company.	Provision of Data Centre Services	Operating Profit Margin declared is not less than 15% of Operating Expense in relation to eligible international transaction entered during the tax year.

Data centre services mean services provided by a data centre through the use of:

- Physical infrastructure, including land, buildings, mechanical and electrical power equipment, cooling systems and security infrastructure; and
- Information technology infrastructure, including servers, computers, storage systems, operating systems, security solutions, network and associated software platforms, networking equipment and human resources in India. [Rule 86(f)].

Meaning of certain terms

Term	Meaning
Accountant	For Rules 86 to 93, the expression "accountant" is defined in Rule 86(a).
Operating Expense [Rule 86(n)]	The costs incurred by the assessee during the tax year in relation to the international transaction in the normal course of business, including: • Costs relating to Employee Stock Option Plan (ESOP) or similar stock-based compensation provided by the associated enterprise; • Reimbursement of expenses incurred by the associated

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	enterprise on behalf of the assessee, at cost; • Amounts recovered from associated enterprises for expenses incurred by the assessee on their behalf, relating to normal operations, at cost; and • Depreciation and amortisation relating to assets used by the assessee. Does not include: • Interest expense; • Provision for unascertained liabilities; • Pre-operating expenses; • Loss arising from foreign currency fluctuations; • Extraordinary expenses; • Loss on transfer of assets or investments (other than depreciable assets included in operating expenses); • Income-tax expense; and • Other expenses not relating to the normal operations of the assessee.
Operating Revenue [Rule 86(o)]	The revenue earned by the assessee during the tax year in relation to the international transaction in the normal course of business, including costs relating to Employee Stock Option Plan (ESOP) or similar stock-based compensation provided by the associated enterprise. Does not include: • Interest income; • Income arising from foreign currency fluctuations; • Income on transfer of assets or investments (other than depreciable assets included in operating expenses); • Income-tax refunds; • Provisions written back; • Extraordinary income; and • Other income not relating to the normal operations of the assessee.

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Operating Profit Margin [Rule 86(p)]	Operating Profit = Operating Revenue − Operating Expense $\text{Operating Profit Margin}(\%) = \frac{\text{Operating Revenue} - \text{Operating Expense}}{\text{Operating Expense}} \times 100$
Relevant Tax Year [Rule 86(q)]	The tax year for which the option for safe harbour is validly exercised.

(i) Reference Rate" means-

Currency	Reference Rate
US Dollar (USD)	6-month Term Secured Overnight Financing Rate (SOFR), currently administered by the Chicago Mercantile Exchange (CME), as increased by 45 basis points.
Euro (EUR)	6-month Euro Inter Bank Offered Rate (EURIBOR), currently administered by the European Money Markets Institute.
UK Pound Sterling (GBP)	6-month Term Sterling Overnight Index Average (SONIA), currently administered by ICE Benchmark Administration or Refinitiv, as increased by 30 basis points.
Japanese Yen (JPY)	6-month Tokyo Term Risk Free Rate (TORF), currently benchmarked by QUICK Benchmarks Inc., as increased by 10 basis points.
Australian Dollar (AUD)	6-month Bank Bill Swap Rate (BBSW), currently administered by the Australian Securities Exchange.
Singapore Dollar (SGD)	6-month Compounded Singapore Overnight Rate Average (SORA), currently administered by the Monetary Authority of Singapore, as increased by 45 basis points.

Note: *The above Reference Rates are used for determining the minimum interest rate in respect of* ***intra-group loans denominated in foreign currency****.*

(ii) "Credit Rating" means the credit rating assigned to the associated enterprise by a credit rating agency registered with the Securities and Exchange Board of India (SEBI) and accredited by the Reserve Bank of India (RBI), which is applicable for the relevant tax year.

For this purpose-

- Where the associated enterprise has only one credit rating, such rating shall be taken as its credit rating.
- Where the associated enterprise has credit ratings from more than one such credit rating agency, the least of such ratings shall be taken as its credit rating.

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Applicability of Safe Harbour Provisions

The provisions of rule 89 shall apply for a **block period of three tax years**, commencing from the **tax year 2026–2027**, and shall continue to apply for subsequent block periods, unless modified.

Rule 89(4) fixes the block for which the prescribed safe-harbour circumstances and rates apply; Rule 91(1) governs the duration of a valid IT-services option. They address different matters including the applicable block period once elected.

No Comparability Adjustment

Where the transfer price declared by an eligible assessee is accepted, no comparability adjustment and no allowance under section 165(3)(a)(ii) shall be made to such transfer price.

Applicability of Sections 171 and 172

The provisions of sections 171 (maintenance of information and documents) and 172 (transfer audit report from an accountant), in respect of an international transaction, shall apply irrespective of the fact that the assessee has exercised the option for Safe Harbour in respect of such transaction.

Procedure Relating to Transactions other than Provision of Information Technology Services [Rule 90]

Rule 90 prescribes the procedure for exercising the option for Safe Harbour in respect of **eligible international transactions**, other than the **provision of Information Technology Services**. It lays down the procedural requirements that must be complied with by the assessee and the authorities when determining the validity of the option exercised under the Safe Harbour Rules.

(a) Exercise of Option for Safe Harbour

For exercising the option for Safe Harbour, the assessee shall satisfy the following conditions:

Particulars	Requirement
Form to be furnished	Form No. 49
Authority with whom Form is to be furnished	Assessing Officer

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Due date	On or before the due date specified under section 263(1)(c) for furnishing the return of income for the relevant tax year
Return of Income	The return of income for the relevant tax year shall be furnished on or before the date of furnishing Form No. 49

(b) Verification by the Assessing Officer

On receipt of **Form No. 49**, the Assessing Officer shall verify whether-

- the assessee exercising the option is an **eligible assessee**; and
- the transaction in respect of which the option is exercised is an **eligible international transaction**,

before treating the option for Safe Harbour as **validly exercised**.

(c) Reference to the Transfer Pricing Office

Where the Assessing Officer doubts the valid exercise of the option for Safe Harbour, he shall make a reference to the **Transfer Pricing Officer (TPO)** for determination of the eligibility of the assessee or international transaction; or both for the purposes of the Safe Harbour Rules.

(d) Power of the Transfer Pricing Officer

For determining the validity of the option, the Transfer Pricing Officer may, by notice in writing, require the assessee to furnish information or documents; or other evidence, as considered necessary. The assessee shall furnish the same within the time specified in the notice.

(e) Circumstances in which the Option shall be Declared Invalid

The Transfer Pricing Officer shall, by an order in writing, declare the option exercised by the assessee to be **invalid**, after providing the assessee a **reasonable opportunity of being heard**, where-

- the assessee fails to furnish the information, documents or other evidence required by the Transfer Pricing Officer;
- the assessee is found **not to be an eligible assessee**; or

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- the transaction in respect of which the option has been exercised is found **not to be an eligible international transaction**.

A copy of such order shall be served on:

- the assessee; and
- the Assessing Officer.

(f) Objection before the Commissioner

Where the assessee objects to the order of the Transfer Pricing Officer declaring the option to be invalid, the assessee may file objections before the **Commissioner** to whom the Transfer Pricing Officer is subordinate.

Such objection shall be filed **within 15 days** of the receipt of the order of the Transfer Pricing Officer.

(g) Order of the Commissioner

On receipt of the objection, the Commissioner shall:

- provide the assessee a **reasonable opportunity of being heard**;
- pass appropriate orders regarding the validity or otherwise of the option; and
- serve a copy of the order on both the assessee and the Assessing Officer.

(h) Verification of Transfer Price

Where the option exercised by the assessee is held to be **valid**, the Assessing Officer shall verify whether the **transfer price declared** by the assessee is in accordance with the circumstances specified in **Rule 89**.

Where the declared transfer price is **not in accordance with Rule 89**, the Assessing Officer shall adopt the -

- operating profit margin;
- rate of interest; or
- commission,

specified in Rule 89.

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(i) Time Limits

Authority	Action	Time Limit
Assessing Officer	Reference to Transfer Pricing Officer	Within 2 months from the end of the month in which Form No. 49 is received
Transfer Pricing Officer	Order passed by the TPO	Within 2 months from the end of the month in which reference is received from the Assessing Officer
Commissioner	Order passed by the Commissioner	Within 2 months from the end of the month in which the objection is received

(j) Deemed Validity of Option

Where the Assessing Officer, the Transfer Pricing Officer or the Commissioner, as the case may be, fails to make the reference or pass the order within the prescribed time limit, the option exercised by the assessee shall be **deemed to be valid**.

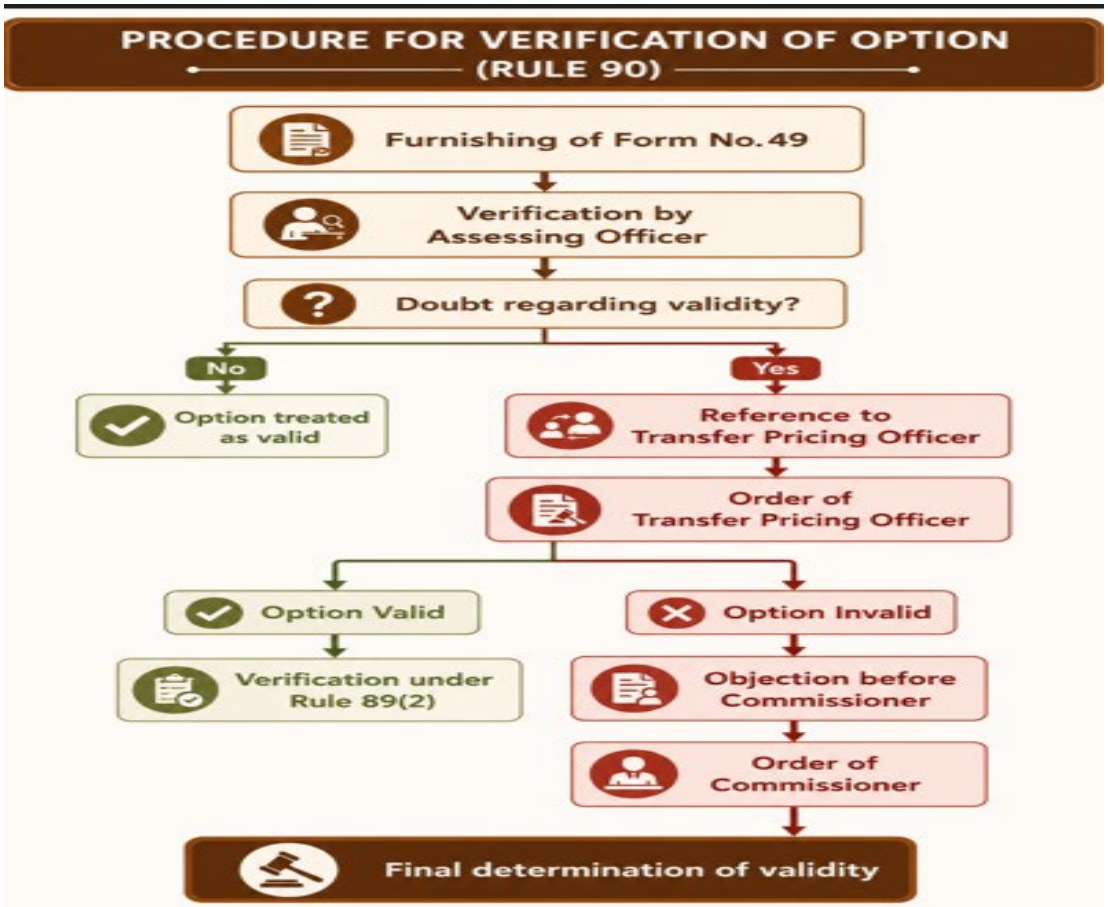
(k) Mode of Furnishing Form No. 49

Form No. 49 shall be furnished **electronically** under **digital signature**; or through **electronic verification code (EVC)**, and shall be verified by the person authorised to verify the return of income under section 265.

(l) Reference under Section 166

Nothing contained in this Rule restricts the Assessing Officer from making a reference under section 166 in respect of an international transaction other than an eligible international transaction.

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Procedure Relating to Transactions of Provision of Information Technology Services (Rule 91)

Rule 91 prescribes a special procedure for exercising the Safe Harbour option in respect of eligible international transactions involving the provision of Information Technology Services.

Unlike the general procedure under Rule 90, this Rule provides for a five consecutive tax year validity of the Safe Harbour option and prescribes an electronic mechanism for furnishing, verification and acceptance of the option.

(a) Validity of Safe Harbour Option

Where the Safe Harbour option is validly exercised in respect of an eligible international transaction involving the **provision of Information Technology Services**, the option shall remain in force for a period of **five consecutive tax years**.

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(b) Threshold of Aggregate Operating Revenue

For the purposes of Safe Harbour under this Rule, the threshold of **₹ 2,000 crore** of aggregate operating revenue shall be tested **only for the first of the five consecutive tax years**.

(c) Exercise of Option

For exercising the Safe Harbour option, the assessee shall furnish **Form No. 49**, complete in all respects, to the **Director General of Income-tax (Systems)** for the first of the five consecutive tax years for which the option is proposed to be exercised.

The Form shall be furnished on or before the due date specified under section 263(1)(c) for furnishing the return of income **for such first tax year.**

(d) Electronic Verification

After furnishing Form No. 49, the following shall be verified electronically:

- whether the assessee is an eligible assessee;
- whether the transaction is an eligible international transaction; and
- whether the exercise of the Safe Harbour option is valid.

(e) Communication of Acceptance or Rejection

After completion of verification, the assessee shall be intimated electronically regarding the acceptance or rejection of the Safe Harbour option within a period of two months from the end of the month in which the option is exercised.

(f) Opportunity to Remove Defects

The Safe Harbour option shall not be rejected unless the assessee is provided an opportunity to remove the defects, if any, in the application filed.

(g) Communication of Reasons for Rejection

Where the Safe Harbour option is rejected electronically, the assessee shall be provided the **reasons for such rejection.**

(h) Furnishing of Return of Income

Where the Safe Harbour option is accepted, the assessee shall furnish the return of income in accordance with the Safe Harbour provisions for each of the five consecutive tax years, on or before the due date specified under section 263(1)(c).

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(i) Withdrawal of Option

The assessee may withdraw the Safe Harbour option by furnishing a **declaration** to that effect. Upon such withdrawal, the option shall cease to remain in force for the relevant tax year.

(j) Time Limit for Withdrawal

The declaration for withdrawal of the Safe Harbour option shall **not be furnished after the expiry of six months from the end of the first tax year**.

(k) Effect of Withdrawal

Where the assessee withdraws the Safe Harbour option-

- the option shall cease to remain in force for the tax year for which it is withdrawn; and
- it shall also cease to remain in force for all **subsequent tax years**.

(l) Restriction on Re-exercising the Option

Where an assessee withdraws the Safe Harbour option, he shall not be eligible to exercise the option again until the expiry of the five consecutive tax years as stated above.

(m) Furnishing of Annual Statement

For each of the **four consecutive tax years** following the first tax year, the assessee shall furnish a statement, on or before the due date specified under section 263(1)(c), containing-

- details of the eligible international transactions;
- quantum of such transactions; and
- profit margins.

(n) Reference under Section 166

Nothing contained in this Rule restricts the Assessing Officer from making a reference under section 166 in respect of an international transaction other than an eligible international transaction.

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(o) Mode of Furnishing Form No. 49

Form No. 49 shall be furnished **electronically**-

- under a digital signature; or
- through an Electronic Verification Code (EVC).

(p) Certification and Verification of Form No. 49

Form No. 49 shall-

- be certified by the Chief Executive Officer (CEO) or the Chairman and Managing Director (CMD) of the assessee; and
- be verified by the person authorised to verify the return of income under section 265.

(q) Power of the Director General of Income-tax (Systems)

The **Director General of Income-tax (Systems)** shall, with the approval of the **Board**, lay down the data structure; standards; format; procedure for furnishing and verification of Forms, statements, orders and declarations; and modifications thereto, if required

Safe Harbour Rules for International Transactions not to Apply in Certain Cases [Rule 92]

The provisions of Rules 86, 87, 88, 89, 90 and 91 shall not apply in respect of an eligible international transaction entered into with an associated enterprise located in-

- a country or territory notified under section 176; or
- a no tax or low tax country or territory.

Thus, even where an assessee and the international transaction otherwise satisfy the prescribed conditions under the Safe Harbour Rules, the benefit of Safe Harbour shall not be available if the associated enterprise is located in any of the above jurisdictions.

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Mutual Agreement Procedure not to Apply where Safe Harbour for International Transactions is Accepted [Rule 93]

Where the transfer price in relation to an eligible international transaction, declared by an eligible assessee, is accepted by the Income-tax Authorities under section 167, the assessee shall not be entitled to invoke the Mutual Agreement Procedure (MAP) under an agreement for avoidance of double taxation entered into with a country or specified territory outside India, as referred to in section 159.

PART B: Safe Harbour Rules for Specified Domestic Transactions

As per rule 97, the transfer price declared by an eligible assessee in respect of an eligible specified domestic transaction for a tax year shall be accepted by the Income-tax Authorities, if-

- the option exercised by the assessee is treated as **validly exercised** under **Rule 98**; and
- it is in accordance with the circumstances specified in Column (3) of the table below.

As per rule 95, an eligible assessee means a person who has exercised a valid option for application of the Safe Harbour Rules in accordance with Rule 97, and

- A Government Company[4] engaged in the business of generation, supply, transmission or distribution of electricity.
- A co-operative society engaged in the business of procuring and marketing milk and milk products.

As per rule 96, an eligible specified domestic transaction means a specified domestic transaction undertaken by an eligible assessee, comprising any of the following transactions specified in column (2) in the below table:

Sl. No.	Eligible Specified Domestic Transaction	Circumstances
(1)	(2)	(3)
1.	Supply of electricity, transmission of	The tariff in respect of supply, transmission, wheeling of electricity is determined or the

[4] *Defined under section 2(45) of the Companies Act, 2013*

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	electricity or wheeling of electricity	methodology for determination of such tariff, is approved by the Appropriate Commission[5] in accordance with the provisions of the Electricity Act, 2003.
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 fat content and Solid Not Fat (SNF) content, and: (a) such rate is irrespective of - the quantity of milk procured, - percentage of shares held by the members in the co-operative society; - voting power held by the members in the society and (b) such rates are routinely declared by the co-operative society in a transparent manner and are available in the public domain.

No Comparability Adjustment

Where the transfer price declared by an eligible assessee is accepted under sub-rule (1), **no comparability adjustment** and **no allowance under section 165(3)(a)(ii)** shall be made to such transfer price.

Applicability of Sections 171 and 172

The provisions of sections 171 and 172 shall apply in respect of a specified domestic transaction irrespective of the fact that the assessee has exercised the Safe Harbour option.

Procedure Governing Safe Harbour Rules for Specified Domestic Transactions [Rule 98]

Rule 98 prescribes the procedure for exercising the Safe Harbour option in respect of *eligible specified domestic transactions*. It lays down the procedural requirements to be complied with by the assessee and the Income-tax Authorities for determining the validity of the option exercised under the Safe Harbour Rules.

[5] *Defined under section 2(4) of the Electricity Act, 2003*

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Rule 98 applies exclusively to specified domestic transactions. However, the procedural framework under this Rule broadly follows the mechanism prescribed in Rule 90 for eligible international transactions.

(a) Exercise of Option for Safe Harbour

For exercising the option for Safe Harbour, the assessee shall comply with the following requirements:

Particulars	Requirement
Form to be furnished	Form No. 49
Authority with whom Form is to be furnished	Assessing Officer
Due date	On or before the due date specified under section 263(1)(c) for furnishing the return of income for the relevant tax year
Return of Income	The return of income for the relevant tax year shall be furnished on or before the date of furnishing Form No. 49

(b) Verification by the Assessing Officer

On receipt of **Form No. 49**, the Assessing Officer shall verify whether—

- the assessee exercising the option is an **eligible assessee**; and
- the transaction in respect of which the option is exercised is an **eligible specified domestic transaction**,

before treating the option for Safe Harbour as **validly exercised**.

(c) Calling for Information or Documents

Where the Assessing Officer doubts the valid exercise of the Safe Harbour option, he may, by notice in writing, require the assessee to furnish such-

- information;
- documents; or
- other evidence,

as he may consider necessary.

The assessee shall furnish the same within the time specified in such notice.

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(d) Circumstances in which the Option shall be Declared Invalid

The Assessing Officer shall, by an order in writing, declare the option exercised by the assessee to be **invalid**, after providing the assessee a **reasonable opportunity of being heard**, where-

- the assessee fails to furnish the information, documents or other evidence required by the Assessing Officer;
- the assessee is found **not to be an eligible assessee**;
- the specified domestic transaction in respect of which the option has been exercised is found **not to be an eligible specified domestic transaction**; or
- the **tariff is not in accordance with the circumstances specified under Rule 97**.

A copy of such order shall be served on the assessee.

(e) Objection before the Principal Commissioner or Commissioner

Where the assessee objects to the order of the Assessing Officer declaring the option to be invalid, the assessee may file objections before the **Principal Commissioner or Commissioner**, as the case may be, to whom the Assessing Officer is subordinate.

Such objection shall be filed **within 15 days** of the receipt of the order of the Assessing Officer.

(f) Order of the Principal Commissioner or Commissioner

On receipt of the objection, the **Principal Commissioner or Commissioner**, as the case may be, shall—

- provide the assessee a reasonable opportunity of being heard;
- pass appropriate orders regarding the validity or otherwise of the option; and
- serve a copy of the order on both the assessee and the Assessing Officer.

(g) Time Limits

Authority	Action	Time Limit
Assessing Officer	Order passed by AO	Within 3 months from the end of the month in which Form No. 49 is received

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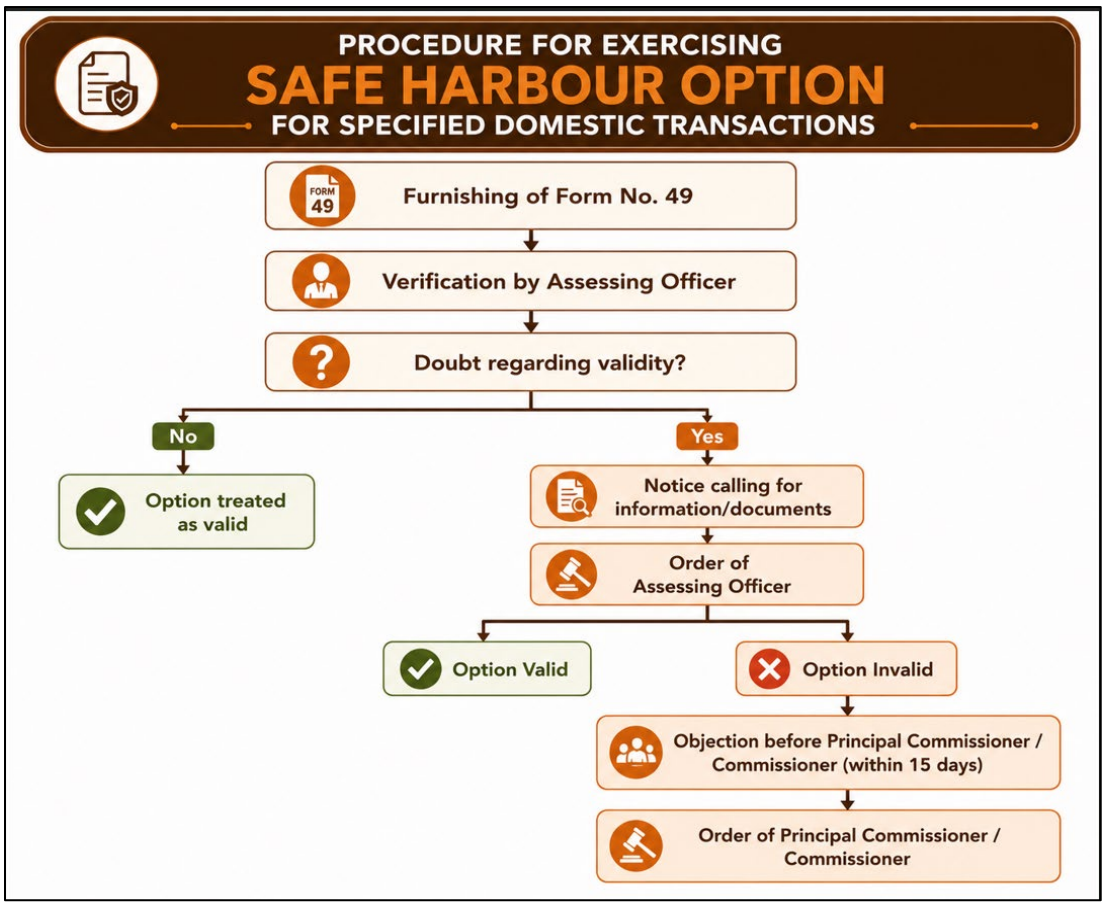
Principal Commissioner/ Commissioner	Order passed by the PC/C	Within 2 months from the end of the month in which the objection is received

(h) Deemed Validity of Option

Where the Assessing Officer or the **Principal Commissioner / Commissioner**, as the case may be, fails to pass the order within the prescribed time limit, the option exercised by the assessee shall be **deemed to be valid**.

(i) Reference under Section 166

Nothing contained in this Rule restricts the Assessing Officer from making a reference under section 166 in respect of a specified domestic transaction other than an eligible specified domestic transaction.



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PART C: Safe Harbour Rules for Income Attribution in case of Income from Business and Profession (Rules 99 to 102)

Rules **99 to 102** prescribe the Safe Harbour framework for determining the income attributable to certain foreign companies carrying on specified business activities in India.

As per rule 100(1), the Income-tax Authorities shall accept the option for Safe Harbour exercised by an eligible assessee in any **relevant tax year** under **Rule 101**, where-

- the income declared by such assessee from an **eligible business** is in accordance with the circumstances specified under sub-rule (2); and
- the Safe Harbour option is **not declared invalid** under Rule 101(3).

Eligible assessee means -

(i) a foreign company engaged in the business of diamond mining which has exercised an option for application of Safe Harbour Rules in accordance with Rule 100; or

(ii) a foreign company which stores components in a warehouse in a custom bonded area for providing them to a contract manufacturer to be used for manufacturing of specified electronic goods.

Eligible business means

(i) a business of selling raw diamonds in any notified special zone as referred to in section 9(9)(c)(ii)(C); or

(ii) the business activity of storage of components in a warehouse in a custom bonded area for sale to a contract manufacturer to be used for manufacturing of specified electronic goods.

Rule 100(2) prescribes the following circumstances in which the **income declared by an eligible assessee** from an **eligible business** shall be accepted by the Income-tax Authorities under the Safe Harbour Rules.

Sl. No.	Eligible Business	Circumstances
1.	Selling of raw diamonds	The profits and gains of the eligible business chargeable to tax under the head "Profits and

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		Gains of Business or Profession" shall be 4% or more of the gross receipts from such business.

Raw diamonds means diamonds that are:

- uncut or unpolished;
- unassorted;
- unworked or simply sawn, cleaved or bruted;
- not conflict diamonds as defined by the Kimberley Process;
- accompanied by Kimberley Process Certificate issued by the Kimberley Process authority in the exporting country; and
- falling under Tariff Heading 7102 of the First Schedule to the Customs Tariff Act, 1975.

Gross Receipts means the aggregate of-

(A) the amount paid or payable to the eligible assessee or to any person on his behalf on account of sale of raw diamonds by such eligible assessee; and

(B) the amount received or deemed to be received by the eligible assessee or by any person on his behalf on account of sale of raw diamonds by such eligible assessee.

2.	Business activity of storage of components in a warehouse in a custom bonded area for sale to a contract manufacturer	The profits and gains of the eligible business chargeable to tax under the head "Profits and Gains of Business or Profession" shall be 2% or more of the gross receipts from such business.

Gross Receipts means the aggregate of :

(A) the amount paid or payable to the eligible assessee or to any person on his behalf on account of sale of components in a warehouse in a custom bonded area to the contract manufacturer to be used for manufacturing of specified electronic goods; and

(B) the amount received or deemed to be received by the eligible assessee or by any person on his behalf on account of sale of components in a warehouse in a custom bonded area to the contract manufacturer to be used for manufacturing of specified electronic goods.

Meaning of Certain Terms

Terms	Meaning
Contract Manufacturer	An Indian company which produces specified electronic goods on behalf of any foreign company in a custom bonded area.

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Custom Bonded Area	A warehouse as referred to in section 65 of the Customs Act, 1962.
Relevant Tax Year	The tax year in which the option for Safe Harbour is exercised.
Specified Electronic Goods	(i) mobile phones; or (ii) laptops, all-in-one personal computers and tablets; or (iii) servers and ultra small form factor (USSF); or (iv) sub-assemblies to the finished goods mentioned in clauses (i) to (iii); or (v) hearables and wearables and accessories related to the finished goods mentioned in clauses (i) to (iii).

Consequences where option not declared invalid

Where the eligible assessee has exercised the Safe Harbour option under Rule 101 in respect of the eligible business and such option is **not declared invalid**, then-.

Clause	Consequence
(a)	Any deduction allowable under **sections 28 to 34, 44 to 49, 51, 52, Schedule IX and Schedule X** shall be deemed to have been already given full effect to and **no further deduction** under those provisions shall be allowed.
(b)	The **Written Down Value (WDV)** of any asset of such business shall be deemed to have been calculated as if depreciation for such tax year had been claimed and actually allowed.
(c)	**No set-off** of unabsorbed depreciation under **section 33(11)** or carried forward loss under **section 112(1)** shall be allowed.
(d)	**No set-off** of loss from other business under **section 108(1)** or under any other head under **section 109** shall be allowed against the income chargeable under the head **"Profits and Gains of Business or Profession"** in respect of such business.

Applicability of Transfer Pricing Provisions

The provisions of sections 171 and 172 shall continue to apply in respect of an international transaction or specified domestic transaction, where the eligible assessee enters into such transaction while carrying on the eligible business.

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Procedure Governing Safe Harbour Rules for Income Attribution in case of Income from Business and Profession [Rule 101]

(a) **Exercise of Option:** For exercising the Safe Harbour option, the assessee shall furnish **Form No. 49**, complete in all respects, to the **Assessing Officer** before furnishing the return of income under **section 263** for the relevant tax year.

(b) **Where Safe Harbour Option is not Exercised:** Where the assessee does **not** exercise the Safe Harbour option under Rule 100(1), the income from the eligible business shall be determined in accordance with the provisions of the Act **without having regard to Rule 100(2)**.

(c) **Circumstances in which the Option may be Declared Invalid:** The Assessing Officer may, by an order in writing, declare the Safe Harbour option to be **invalid**, where the assessee has:

- availed the Safe Harbour by furnishing **incorrect facts**; or
- **concealed facts** relating to his business.

(d) **Opportunity of Being Heard:** Before declaring the Safe Harbour option invalid, the Assessing Officer shall provide the assessee a **reasonable opportunity of being heard**.

(e) **Service of Order:** The Assessing Officer shall serve a copy of the order Declaring the option invalid on the assessee and the other provisions of the Act shall apply accordingly.

(f) **Mode of Furnishing Form No. 49:** Form No. 49 shall be furnished electronically:

- under a digital signature; or
- through an Electronic Verification Code (EVC),

and shall be verified by the person authorised to verify the return of income under section 265.

Mutual Agreement Procedure not to Apply where Safe Harbour for Income Attribution is Exercised [Rule 102]

The assessee shall **not be entitled to invoke the Mutual Agreement Procedure (MAP)** under an agreement for avoidance of double taxation referred to in

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section 159, in relation to an **eligible business**, where -

- the assessee has exercised the Safe Harbour option under **Rule 101** in respect of such business; and
- such option has **not been declared invalid** under the said Rule.

VIII. Advance Pricing Agreements [Sections 168]

Section 168 contains provisions relating to Advance Pricing Agreements (APAs). An APA is an agreement entered into between the CBDT and a taxpayer for determination of the arm's length price, or the manner in which the arm's length price is to be determined, in relation to an international transaction. The provision also enables the determination of income attributable to operations carried out in India by or on behalf of a non-resident. The APA mechanism seeks to provide certainty in transfer pricing matters and reduce transfer pricing disputes.

(1) An Advance Pricing Agreement (APA) 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. They offer greater assurance regarding transfer pricing methods and provide certainty and a unified approach.



(2) Keeping in mind the benefits offered by the APAs, sections 168 and 169 of Chapter X of the Act provide a framework and effect for the formulation of APAs between the taxpayer and the income-tax authorities.

(A) Scope of APA

Section 168(1) provides that the CBDT, with the approval of the Central Government, may enter into an Advance Pricing Agreement with any person determining -

(a) arm's length price or specifying the manner in which arm's length price shall be determined, in relation to such international transaction to be entered into by that person

(b) income referred to in section 9(2), 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.

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Accordingly, an APA may determine either -

- the arm's length price of an international transaction;
- the manner in which such arm's length price is to be determined;
- the income attributable to operations carried out in India by or on behalf of a non-resident; or
- the manner in which such income is to be determined.

Note: The APA provisions contained in section 168 apply in relation to international transactions and income attributable to operations carried out in India by or on behalf of a non-resident. The provisions do not extend to specified domestic transactions.

Types of APA

Type	Meaning
Unilateral APA	Agreement *[which is neither a bilateral nor a multilateral]* between CBDT and the applicant.
Bilateral APA	APA based on an agreement between the Competent Authorities of India and the other country under the applicable tax treaty.
Multilateral APA	APA based on an agreement between the Competent Authorities of India and two or more countries under the applicable tax treaties.

(B) Manner of determination under APA

The manner of determination of arm's length price or the income referred above may include methods referred to in section 165(1) or any other method provided by rules made under the Act with necessary adjustments or variations.

(C) Provisions of APA to override sections 165 or 166

In case an APA has been entered, the arm's length price in relation to that transaction or the income referred to in section 9(2) shall be determined in accordance with that APA irrespective of anything contained in section 165 (determination of ALP) or section 166 (reference to TPO).

(D) Validity of APA

The APA shall be valid for such period as specified in the agreement, which shall in no case exceed five consecutive tax years.

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(E) Binding nature of APA

The APA so entered into shall be binding on:

(a) the person in whose case, and in respect of the transaction in relation to which, the APA has been entered into; and

(b) the Principal Commissioner or Commissioner and the income-tax authorities subordinate to him, in respect of the said person and the said transaction.

(F) Circumstances in which APA shall not be binding

The APA shall not be binding if there is any change in law or facts having bearing on such APA.

(G) Conditions to declare APA as *void ab initio*

In case the Board finds that the APA so entered into has been obtained by the person by way of fraud or misrepresentation of facts, the Board is empowered to pass an order declaring any such APA to be *void ab initio*, with the approval of Central Government.

(H) Consequences of declaration of an APA as *void ab initio*

As a result of declaration of an APA as *void ab initio*:

(a) all the provisions of the Act shall apply to such person as if such APA had never been entered into.

(b) The period beginning with the date of such APA and ending on the date of order declaring the APA as *void ab initio*, shall be excluded for the purpose of computation of any period of limitation under this Act. This is irrespective of anything contained in any other provision of the Act.

(c) In case the period of limitation after exclusion of the above-mentioned period is less than 60 days, such remaining period of limitation shall be extended to 60 days.

Accordingly, the income-tax authorities shall always have a minimum period of 60 days available for taking consequential action after the declaration of the APA as void ab initio.

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(I) Pendency of Proceedings in case of APA Application

If an application is made by a person for entering into an APA under section 168(1), the proceedings in the case of such person shall be deemed to be pending for the purposes of this Act till -

(a) the Advance Pricing Agreement is entered into; or

(b) such proceedings are closed in the prescribed manner.

(J) Prescribed scheme for APA

The Board is empowered to prescribe a scheme specifying the manner, form, procedure and any other matter generally in respect of the APA.

Accordingly, the detailed procedural framework governing Advance Pricing Agreements has been prescribed under Rules 103 to 120. Some of the important provisions of the scheme are briefed hereunder –

(1) Meaning of Terms used in APA Rules [Rule 103]

Expression	Meaning
Agreement	An Advance Pricing Agreement entered into between the CBDT and the applicant, with the approval of the Central Government under section 168(1).
Applicant	A person who has made an application for entering into an Advance Pricing Agreement.
Competent Authority of India	An officer authorised by the Central Government for the purpose of discharging the functions relating to DTAA as referred under section 159.
Covered Transaction	The international transaction or transactions in respect of which the APA has been entered into.
Critical Assumptions	Factors and assumptions which are so critical and significant that, if changed, the parties to the APA shall no longer continue to be bound by the agreement.
Rollback Year	Any tax year falling within the period not exceeding four tax years preceding the first of the tax years covered by the APA.

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(2) Persons eligible to apply [Rule 104]

Any person who has undertaken an international transaction or is contemplating to undertake an international transaction shall be eligible to enter into an agreement under these rules.

Accordingly, the option of entering into an APA is available not only in respect of an international transaction already undertaken but also in respect of an international transaction proposed to be undertaken in future.

(3) Pre-filing Consultation [Rule 105]

Before making an application for entering into an APA, an eligible person may opt for a pre-filing consultation.

The pre-filing consultation enables the applicant and the tax administration to have a preliminary discussion on the proposed APA before commencement of the formal APA process.

(a) An eligible person may make an application in **Form No. 50** to the **Principal Chief Commissioner of Income-tax (International Taxation)** for a pre-filing consultation. On receipt of the application, the APA Team shall hold a pre-filing consultation with the eligible person.

(b) 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 the broad terms of the agreement.

(c) The pre-filing consultation is only consultative in nature. Accordingly –

  (i) shall not bind either the CBDT or the eligible person to enter into an Advance Pricing Agreement or to initiate the APA process;

  (ii) shall not be deemed to mean that the eligible person has applied for entering into an agreement.

NOTE:

(1) The provisions of Rule 105 relating to pre-filing consultation shall not apply in the case of renewal of an Advance Pricing Agreement.

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(2) In case of a **bilateral** or **multilateral** Advance Pricing Agreement, the **Competent Authority of India** or his representative shall also be associated in pre-filing consultation.

(4) Application for advance pricing agreement [Rule 106]

(a) The application for entering into an APA shall be made in **Form No. 51** and shall be accompanied by a **fee of ₹ 20 lakh.** Further, the application shall be accompanied by the proof of payment of the prescribed fee.

(b) The application shall be furnished to the Principal Chief Commissioner of Income-tax (International Taxation) in the case of a unilateral agreement, and to the competent authority of India in the case of a bilateral or multilateral agreement.

(c) The application may be filed by the eligible person at any time -

(i) **before the first day of the first tax 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 all other international transactions.

Accordingly, Rule 106 permits an APA application to be made both in respect of continuing international transactions and international transactions proposed to be undertaken in future, subject to the prescribed conditions.

ILLUSTRATION 5

XYZ (P) Ltd. has been supplying goods to its Associate Enterprise (AE) in foreign country. It has applied for Advance Pricing Agreement ('APA') in respect of the transactions with its AE. Application for APA was filed on 15th March, 2026 and the APA was signed on 2nd June, 2026. Discuss from which tax year APA would be applicable.

SOLUTION

XYZ (P) Ltd. has filed an APA application in respect of transactions with its AE that are of a continuing nature, arising from dealings already occurring. Since the application was filed on 15th March, 2026, i.e., before 1.4.2026, APA would be applicable from tax year 2026-27.

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(5) Withdrawal of application for agreement [Rule 107]

The applicant may withdraw the application for agreement at any time **before the finalisation of the terms of the agreement** by furnishing an intimation to the Principal Chief Commissioner of Income-tax (International Taxation) in case of unilateral agreement and to the competent authority of India in case of bilateral or multilateral agreement.

However, application fees paid shall not be refunded on withdrawal of application by the applicant.

(6) Terms of the agreement [Rule 110]

Once the processing of the application is completed, the Advance Pricing Agreement (APA) entered into between the CBDT and the applicant shall, inter alia, contain the terms governing the determination of the arm's length price and the obligations of the parties thereto.

(a) 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) the manner in which the arm's length price is to be determined;
- (v) definition of any relevant term to be used in item (ii) or (iii) or (iv);
- (vi) **critical** assumptions on which agreement is based;
- (vii) rollback provision referred to in Rule 111;
- (viii) the conditions, if any, other than provided in the Act or these rules.

(b) 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.

(c) The binding effect of agreement shall cease only if any party has given due notice to the concerned other party or parties.

(d) Where there is a change in any of the critical assumptions or there is a failure to comply with the conditions of the APA -

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- the **assessee** shall intimate such change in writing to the **Principal Chief Commissioner of Income-tax (International Taxation)** as soon as it is practicable to do so; and
- the **CBDT** shall similarly intimate the assessee in writing as soon as such change or failure comes to its knowledge.

(e) 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.

(7) Furnishing of Annual Compliance Report [Rule 113]

(a) The assessee shall furnish an Annual Compliance Report to the Principal Chief Commissioner of Income-tax (International Taxation) for each tax year covered in the agreement.

(b) The annual compliance report shall be in Form No. 52.

(c) The assessee shall file the annual compliance report for each year covered in the agreement, within thirty days of the due date of filing the income-tax return for that year, or within ninety days of entering into an APA, whichever is later.

(d) On receipt of the Annual Compliance Report, the Principal Chief Commissioner of Income-tax (International Taxation) shall forward one copy each to -

- the **Competent Authority of India**;
- the **Commissioner of Income-tax** having jurisdiction over the assessee; and
- the **Transfer Pricing Officer** having jurisdiction over the assessee.

(8) Compliance Audit of the agreement [Rule 114]

Mere furnishing of an Annual Compliance Report by the assessee does not conclude the compliance process. To verify whether the assessee has complied with the terms of the APA, Rule 114 provides for a Compliance Audit.

(a) The Transfer Pricing Officer (TPO) in respect of the arm's length price and having the jurisdiction over the assessee shall carry out the **compliance**

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audit of the agreement for each of the tax year covered in the agreement. For this purpose, 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.

(b) The compliance audit report shall be furnished by the TPO within six months from the end of the month in which the Annual Compliance Report is received by the Transfer Pricing Officer.

(c) The report shall be submitted -

- to the Principal Chief Commissioner of Income-tax (International Taxation), in the case of a unilateral APA; and
- to the Competent Authority of India, in the case of a bilateral or multilateral APA.

Where the Compliance Audit Report records a failure on the part of the assessee to comply with the terms of the APA and cancellation of the agreement is considered necessary, the **Principal Chief Commissioner of Income-tax (International Taxation)** shall forward the report to the **CBDT**.

(d) Where an Advance Pricing Agreement has been entered into under Rule 109, the Transfer Pricing Officer shall not undertake the regular transfer pricing audit of the covered transactions.

However, where the APA is **cancelled** under Rule 116, the regular transfer pricing audit may be undertaken in accordance with the provisions of the Act and the Rules.

(9) Revision of an agreement [Rule 115]

An APA, once entered into, is intended to provide certainty in relation to the covered international transactions. However, where circumstances subsequently undergo a material change, Rule 115 permits revision of the agreement in specified cases.

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(a) An agreement, after being entered, may be revised by the Board either *suo moto* or on request of the assessee or the competent authority in India or the Principal Chief Commissioner of Income-tax (International Taxation), 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 a revision of agreement, in case of a bilateral or multilateral agreement.

(b) 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.

(c) 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.

(d) Where the assessee does not agree to the proposed revision, the APA may be **cancelled** in accordance with **Rule 116**. Further, where the revision has been sought by the assessee and the **CBDT** does not agree to such request, it shall reject the request **in writing**, stating the reasons for such rejection.

(e) For arriving at the revised agreement, the procedure prescribed under **Rule 109** for processing an APA application may, so far as applicable, be followed.

(10) Cancellation of an agreement [Rule 116]

(a) An agreement shall be cancelled by the Board for any of the following reasons:

(i) the compliance audit 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;

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(iii) the annual compliance report furnished by the assessee contains material errors; or

(iv) the assessee is not in agreement with the revision proposed in the agreement or the agreement is to be cancelled under rule 115(4) or 117(7)

(b) The Board shall give an opportunity of being heard to the assessee before proceeding to cancel an application.

(c) 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.

(d) The order of cancellation shall also specify the effective date of cancellation of the agreement, where applicable.

(e) 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.

(f) The order cancelling the APA shall be intimated to the Assessing Officer and the Transfer Pricing Officer having jurisdiction over the assessee.

(11) Renewing an agreement [Rule 119]

An assessee may seek renewal of an APA by making a fresh application in Form No. 54. The application for renewal shall be processed in accordance with the same procedure as applicable to a new APA application under Rules 104 to 120. However, **a pre-filing consultation under Rule 105 is not required for the** renewal of an APA. [Rule 119]

(12) Miscellaneous Provisions for APA [Rule 120]

Mere filing of an application for an agreement under these rules **shall not prevent the operation of Chapter X** of the Act for the determination of arms' length price under that Chapter till the agreement is actually entered into [Rule 120(1)].

In the case of a bilateral or multilateral APA, the negotiations between the Competent Authority of India and the Competent Authority of the other country

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or countries shall be carried out in accordance with the provisions of the applicable tax treaty.

(K) Provision for Rollback in APA Scheme [Section 168(9)]

(a) An Advance Pricing Agreement (APA) ordinarily applies prospectively for the period specified therein. However, with a view to extending the benefit of the agreed transfer pricing methodology to earlier years and reducing transfer pricing disputes relating to past years, section 168(9) permits the incorporation of **rollback provisions** in an APA.

(b) Accordingly, the APA may, subject to such prescribed conditions, procedure and manner, provide for determining the

- ALP or for specifying the manner in which ALP is to be determined in relation to an international transaction entered into by the person
- income referred to in section 9(2), 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,

for any period not exceeding four tax years preceding the first of the tax year for which the APA applies in respect of the international transaction to be undertaken.

The rollback provisions relating to determination of the arm's length price are contained in **Rules 111, 112 and 117**.

Rule	Particulars	Conditions, Procedure & Manner of determination of ALP
111	Roll back of the agreement	The said rule provides the following: **1.** Rule 111(1): A rollback provision enables the transfer pricing methodology agreed under an APA to be applied to the same international transaction undertaken during the rollback years. Accordingly, the APA may provide for: • determination of the arm's length price; or • specification of the manner in which the arm's length price shall be determined,

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		in relation to the international transaction undertaken during the rollback years. **2. Rule 111(2): Conditions for applying for rollback provisions:** The agreement shall contain a rollback provision in respect of an international transaction subject to the following, namely:- (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 within the time specified under section 263(1)(c); (iii) the accountant's report in respect of such international transaction has been furnished within the prescribed time; (iv) the applicant has requested rollback for all the rollback years in which the covered international transaction has been undertaken; and (v) the applicant has made an application seeking rollback in Form 51 along with payment of an additional fee of ₹ 5 lakh at the time of filing the application under Rule 106; ***Important Note:*** *The applicant is required to seek a rollback for all eligible rollback years in which the covered international transaction has been undertaken. However, if the transaction was not undertaken in a particular rollback year, or the prescribed conditions were not fulfilled for that year, rollback may still be available for the remaining eligible rollback years.*

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		3. Rule 111(3): Non-applicability of Rollback provision: 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 already been decided by the Appellate Tribunal before signing of the APA; 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. Rule 111(4): Manner for determining arm length price to be the same for rollback years and other tax years:** 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 tax year to which the agreement applies, not being a rollback year. **5. Rule 111(5): Filing application for rollback provision:** The applicant may furnish along with the application for advance pricing agreement, the request for rollback provision in Form No. 51 with proof of payment of an additional fee of ₹ 5 lakh.
112	Amendments to application (applies	An applicant may request an amendment of an APA application at any time before finalisation

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	to both application-with roll back provisions or without roll back provisions)	of the terms of the agreement. The amendment request shall be made in writing. Such an amendment may be permitted by- • the Principal Chief Commissioner of Income-tax (International Taxation), in the case of a unilateral APA; or • the Competent Authority of India, in the case of a bilateral or multilateral APA, provided that the amendment does not alter the nature of the application originally filed.
117	Procedure for giving effect to rollback provision of an Agreement	Where an Advance Pricing Agreement contains rollback provisions, effect shall be given to such provisions in accordance with Rule 117: (i) Rule 117(2): The applicant shall furnish a modified return of income referred to in section 169 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. (ii) Rule 117(3): The modified returns for all the rollback years shall be furnished along with the modified return relating to the first tax year covered by the APA. (iii) Rule 117(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. (iv) Rule 117(5): Similarly, where an appeal has been filed by the Assessing Officer or the Commissioner before the Appellate

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		Tribunal or the High Court on an issue covered by the rollback provision, such appeal shall be withdrawn, to the extent of the subject matter covered by the APA, within three months from the date of filing of the modified return by the applicant. (v) Rule 117(6): The applicant, the Assessing Officer or the Commissioner, as the case may be, shall inform the Dispute Resolution Panel, the Commissioner (Appeals), the Appellate Tribunal or the High Court, as applicable, about the APA containing the rollback provision and furnish a copy thereof as soon as practicable. (vi) Rule 117(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 the applicant, the agreement shall be cancelled.

Circular No. 10/2015 dated 10.6.2015



The CBDT has issued *Circular No. 10/2015 dated 10.6.2015* adopting a Question-and-Answer format to clarify certain issues arising out of the said Rules. The questions raised and answers to such questions as per the said Circular are given hereunder:

Question 1

Under rule 111(2)(b), there is a condition that the return of income for the relevant roll back year has been or is furnished by the applicant before the due date specified in Section 263(1)(*c*). *It is not clear as to whether applicants who have filed returns under section 263(4) or 263(5) of the Act would be eligible for rollback.*

Answer

The return of income under section 263(5) can be filed only when a return under section 263(1)(a) has already been filed. Therefore, the return of income filed under section 263(5) of the Act, replaces the original return of income filed under section 263(1)(a). Hence, if there is a return that is filed under section 263(5) to

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revise the original return filed before the due date specified in Section 263(1)(*c*), the applicant would be entitled to a rollback on this revised return of income.

However, rollback provisions will not be available in the case of a return of income filed under section 263(4), as it is a return not filed before the due date.

Note – *A belated return filed under section 263(4) can also be revised under section 263(5). In such a case, the revised return would replace the belated return. Therefore, an applicant would not be entitled to rollback provisions on a revised return that replaces a belated return.*

Question 2

Rule 111(2)(a) mandates that the rollback provision shall apply in respect of an international transaction that is the same as the international transaction to which the agreement (other than the rollback provision) applies. It is not clear what is the meaning of the word "same". Further, it is not clear whether this restriction also applies to the Functions, Assets, Risks (FAR) analysis.

Answer

The international transaction for which a rollback provision is to be allowed should be the same as the one proposed to be undertaken in the future years and in respect of which the agreement has been reached. There cannot be a situation where rollback is finalised for a transaction which is not covered in the agreement for future years. The term same international transaction implies that the transaction in the rollback year has to be of same nature and undertaken with the same associated enterprise(s), as proposed to be undertaken in the future years and in respect of which agreement has been reached. In the context of FAR analysis, the restriction would operate to ensure that rollback provisions would apply only if the FAR analysis of the rollback year does not differ materially from the FAR validated for the purpose of reaching an agreement in respect of international transactions to be undertaken in the future years for which the agreement applies.

The word "materially" is generally defined in the Advance Pricing Agreements being entered into by CBDT. According to this definition, the word "materially" will be interpreted consistently with its ordinary definition and in a manner that a material change of facts and circumstances would be understood as a change

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which could reasonably have resulted in an agreement with significantly different terms and conditions.

Question 3

Rule 111(2) (d) requires that the application for the rollback provision, in respect of an international transaction, has to be made by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant. Clarification is required as to whether rollback has to be requested for all four years or the applicant can choose the years out of the block of four years.

Answer

The applicant does not have the option to choose the years for which it wants to apply for rollback. The applicant has to either apply for all four years or not apply at all. However, if the covered international transaction(s) did not exist in a rollback year or there is some disqualification in a rollback year, then the applicant can apply for rollback for less than four years. Accordingly, if the covered international transaction(s) were not in existence during any of the rollback years, the applicant can apply for rollback for the remaining years. Similarly, if in any of the rollback years for the covered international transaction(s), the applicant fails the test of the rollback conditions contained in various provisions, then it would be denied the benefit of rollback for that rollback year. However, for other rollback years, it can still apply for rollback.

Question 4

Rule 111(3) states that the rollback provision shall not be provided in respect of an international transaction for a rollback year if the determination of arm's length price of the said international transaction for the said year has been the 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. Further, Rule 117(4) provides that 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 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.

There is a need to clarify the phrase "Tribunal has passed an order disposing of such appeal" and on the mismatch, if any, between Rule 111(3) and Rule 117(4).

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Answer

The reason for not allowing rollback for the international transaction for which the Appellate Tribunal has passed an order disposing of an appeal is that the ITAT is the final fact-finding authority and hence, on factual issues, the matter has already reached finality in that year. However, if the ITAT has not decided the matter and has only set aside the order for fresh consideration of the matter by the lower authorities with full discretion at their disposal, the matter shall not be treated as one having reached finality and hence, the benefit of rollback can still be given.

There is no mismatch between Rule 111(3) and Rule 117(4).

Question 5

Rule 111(3)(b) provides that rollback provision shall not be provided in respect of an international transaction for a rollback year if 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. It may be clarified whether the rollback provisions in such situations can be applied in a manner so as to ensure that the returned income or loss is accepted as the final income or loss after applying the rollback provisions.

Answer

It is clarified that in case the terms of rollback provisions contain specific agreement between the Board and the applicant that the agreed determination of ALP or the agreed manner of determination of ALP is subject to the condition that the ALP would get modified to the extent that it does not result in reducing the total income or increasing the total loss, as the case may be, of the applicant as declared in the return of income of the said year, the rollback provisions could be applied. For example, if the declared income is ₹ 100, the income as adjusted by the TPO is ₹ 120, and the application of the rollback provisions results in reducing the income to ₹ 90, then the rollback for that year would be determined in a manner that the declared income ₹ 100 would be treated as the final income for that year.

Question 6

Rule 117(7) states that in case an effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies,

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on account of failure on the part of the applicant, the agreement shall be cancelled. It is to be clarified as to whether the entire agreement is to be cancelled or only that year for which the rollback fails.

Answer

The procedure for giving effect to a rollback provision is laid down in Rule 117. Sub-rules (2), (3), (4) and (6) of the Rule specify the actions to be taken by the applicant so that effect may be given to the rollback provision. If the applicant does not carry out such actions for any of the rollback years, the entire agreement shall be cancelled.

This is because the rollback provision has been introduced for the benefit of the applicant and is applicable at its option. Accordingly, if the rollback provision cannot be given effect to for any of the rollback years on account of the applicant not taking the actions specified in sub-rules (2), (3), (4) or (6), the entire agreement gets vitiated and will have to be cancelled.

Question 7

If there is a Mutual Agreement Procedure (MAP) application already pending for a rollback year, what would be the stand of the APA authorities? Further, what would be the view of the APA Authorities, if MAP has already been concluded for a rollback year?

Answer

If MAP has been already concluded for any of the international transactions in any of the rollback year under APA, rollback provisions would not be allowed for those international transactions for that year but could be allowed for other years or for other international transactions for that year, subject to the fulfilment of specified conditions in Rules 111 and 117. However, if MAP request is pending for any of the rollback year under APA, upon the option exercised by the applicant, either the MAP or the application for rollback shall be proceeded with for such year.

Question 8

Rule 111(1) provides that the agreement may provide for determining ALP or the manner of determination of ALP. However, Rule 111(4) only specifies that the manner

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of determination of ALP should be the same as in the APA term. Does that mean the ALP could be different?

Answer

Yes, the ALP could be different for different years. However, the manner of determination of ALP (including choice of Method, comparability analysis and Tested Party) would be same.

Question 9

Will there be a compliance audit for rollback? Would critical assumptions have to be validated during a compliance audit?

Answer

Since rollback provisions are for past years, ALP for the rollback years would be agreed after full examination of all the facts, including validation of critical assumptions. Hence, compliance audit for the rollback years would primarily be to check if the agreed price or methodology has been applied in the modified return.

Question 10

Whether the applicant has an option to withdraw its rollback application? Can the applicant accept the rollback results without accepting the APA for the future years?

Answer

The applicant has an option to withdraw its rollback application even while maintaining the APA application for the future years. However, it is not possible to accept the rollback results without accepting the APA for the future years. It may also be noted that the fee specified in Rule 111(5) shall not be refunded even where a rollback application is withdrawn.

Question 11

For already concluded APAs, where the modified return has already been filed for the first year of the APA term, how will the time-limit for filing modified return for rollback years be determined?

Answer

The time to file modified return for rollback years will start from the date of signing the revised APA incorporating the rollback provisions.

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Question 12

In case of the merger of companies, where one or more of those companies are APA applicants, how would the rollback provisions be allowed and to which company or companies would it be allowed?

Answer

The agreement is between the Board and a person. The principle to be followed in case of merger is that the person (company) who makes the APA application would only be entitled to enter into the agreement and be entitled for the rollback provisions in respect of international transactions undertaken by it in rollback years. Other persons (companies) who have merged with this person (company) would not be eligible for the rollback provisions.

To illustrate, if A, B and C merge to form C and C is the APA applicant, then the agreement can only be entered into with C and only C would be eligible for the rollback provisions. A and B would not be eligible for the rollback provisions. To illustrate further, if A and B merge to form a new company C and C is the APA applicant, then nobody would be eligible for rollback provisions.

Question 13

In case of a demerger of an APA applicant or signatory into two or more companies (persons), who would be eligible for the rollback provisions?

Answer

The same principle as mentioned in the previous answer, i.e., the person (company) who makes an APA application or enters into an APA would only be entitled for the rollback provisions, would continue to apply. To illustrate, if A has applied for or entered into an APA and, subsequently, demerges into A and B, then only A will be eligible for rollback for international transactions covered under the APA. As B was not in existence in rollback years, availing or grant of rollback to B does not arise.

IX. Effect of Advance Pricing Agreement [Section 169]

Section 169 lays down the procedure for giving effect to an Advance Pricing Agreement (APA). Where the income of a person is modified as a consequence of an APA, this section provides for furnishing of a return or modified return and the

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consequential assessment or reassessment of the relevant tax years covered by the agreement.

Section 169 provides for the **following procedure for giving effect to an APA**-

(i) irrespective of anything contrary contained in the provision contained in section 263, where an income is modified as a result of APA entered into with any person, then such person shall or any other person being an AE, may

- furnish **a return or a modified return** in accordance with and limited to the agreement
- **within 3 months from the end of the month** in which the agreement was entered into.

The benefit of such return or modified return shall be available only for the tax years covered by the APA.

(ii) Such modified return shall be in accordance with and limited to the provisions of such APA i.e., modifications can only be made on account of such APA in the return to be filed.

(iii) Except as provided in this section, all other provisions of this Act shall apply accordingly as if the modified return is a return furnished under section 263.

(iv) Where a modified return is furnished under section 169(1), and the assessment or reassessment proceedings for a tax year covered by the APA had already been initiated before the filing of such modified return, the Assessing Officer shall give effect to the APA in the following manner:

(a) Assessment or reassessment proceedings already completed

Where the assessment or reassessment proceedings have been completed before the filing of the modified return, the Assessing Officer shall pass an order modifying the total income of the relevant tax year in conformity with the APA.

Such order shall be passed **within one year from the end of the financial year** in which the modified return is furnished, irrespective of anything contained in sections 275, 286 or 296.

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(b) Assessment or reassessment proceedings pending

Where the assessment or reassessment proceedings are pending on the date of furnishing the modified return, the Assessing Officer shall complete such proceedings in conformity with the APA after taking into consideration the modified return so furnished.

In such a case, the period of limitation prescribed under sections 275, 286 or 296 for completion of the pending assessment or reassessment proceedings shall stand **extended by twelve months**.

(v) The assessment or reassessment proceedings for a tax 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 under section 270(8) till the expiry of the limitation period provided under the said section.

X. Secondary Adjustment [Section 170]

(1) Meaning of Primary Adjustment and Secondary Adjustment

"**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.

"Secondary adjustment" means an adjustment in the books of accounts 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.

Accordingly, section 170 provides for secondary adjustment in specified cases to ensure that the actual allocation of profits between the assessee and its associated enterprise is consistent with the arm's length price.

(2) Forms of Secondary Adjustment:

As per the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD transfer pricing guidelines), secondary adjustment

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may take the form of constructive dividends, constructive equity contributions, or constructive loans.

(3) Alignment of economic benefit of the transaction with the arm's length position

The provisions of secondary adjustment are internationally recognised and are already part of the transfer pricing rules of many leading economies in the world. Whilst the approaches to secondary adjustments by individual countries vary, they represent an internationally recognised method to align the economic benefit of the transaction with the arm's length position.

(4) Cases where secondary adjustment has to be made

In order to align the transfer pricing provisions in line with OECD transfer pricing guidelines and international best practices, section 170 provides that an assessee shall be required to make a secondary adjustment where the **primary adjustment to the transfer price is ₹ 1 crore or more** and such primary adjustment:

(a) has been made *suo motu* by the assessee in his return of income; or

(b) made by the Assessing Officer and has been accepted by the assessee; or

(c) is determined by an advance pricing agreement entered into by the assessee under section 168; or

(d) is made as per the safe harbour rules framed under section 167; or

(e) is arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into under section 159 for avoidance of double taxation.

(5) Consequences of Secondary Adjustment:

Where -

- a primary adjustment results in an increase in the total income or reduction in the loss of the assessee; and
- the excess money arising on account of such adjustment is not repatriated to India within the prescribed time,

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such ***excess money*** shall be ***deemed to be an advance*** made by the assessee to its associated enterprise. The excess money may be repatriated from any associated enterprise of the assessee which is not resident in India. Interest on such deemed advance shall be computed in the prescribed manner.

"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 taken place. Such excess money represents the amount which continues to remain with the associated enterprise and is required to be repatriated to India within the prescribed time.



(6) Time limit for repatriation of excess money or part thereof

Rule 83 prescribes the time limit for repatriation of excess money or part thereof i.e., on or before **90 days** from the relevant date given in column (C) in the cases mentioned in column (B) of the table below.

Sl. No.	Circumstances	Relevant Date
A	B	C
1.	Primary adjustments to transfer price have been made *suo motu* by the assessee in his return of income	Due date of furnishing of return under section 263(1)
2.	Primary adjustments to transfer price as determined in the order of Assessing Officer or the appellate authority and has been accepted by the assessee	Date of the order of Assessing Officer or the appellate authority, as the case may be
3.	Primary adjustment to transfer price is determined by an APA entered into by the assessee under section 168 in respect of a tax year on or	Due date of furnishing of return under section 263(1)

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	before the due date of furnishing of return for the relevant tax year	
4.	Primary adjustment to transfer price is determined by an APA entered into by the assessee under section 168 in respect of a tax year after the due date of furnishing of return for the relevant tax year	End of the month in which the APA has been entered into
5.	Option is exercised by the assessee as per the safe harbour rules under section 167	Due date of furnishing of return under section 263(1)
6.	Primary adjustment to transfer price is determined by the resolution arrived at under mutual agreement procedure under a Double Taxation Avoidance Agreement entered into under section 159 (1) or section 159(2)	Date of order giving effect under rule 121(10) to such resolution.

(7) Interest on Non-repatriation of Excess Money [Rule 83(2) to (4)]

Rule 83(2) prescribes the rate at which the per annum interest income shall be computed in case of failure to repatriate the excess money or part thereof within the above time limit. The interest would be computed at the rates mentioned in column (3) in respect of the cases mentioned in column (2) of the table below:

	Case	Rate
(1)	(2)	(3)
(i)	Where the international transaction is denominated in Indian rupee	At the one-year marginal cost of fund lending rate (MCLR) of SBI as on 1st April of the relevant tax year + 325 basis points
(ii)	Where the international transaction is denominated in foreign currency	Reference rate of the relevant foreign currency under Rule 89(3) as on 30th September of the relevant tax year + 300 basis points

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Note *– 1) If the excess money is not repatriated within the prescribed period of 90 days under Rule 83(1), interest shall be computed at the prescribed rate on such excess money from the date immediately following the expiry of the said period.*

The exchange rate for conversion of the value of international transactions denominated in foreign currency into Indian rupees shall be the telegraphic transfer buying rate of such currency on the last day of the tax year in which the transaction was undertaken, and the "telegraphic transfer buying rate" shall have the same meaning as assigned to it in rule 207.

(8) Option to pay additional income-tax, if the excess money not repatriated

In a case where the excess money or part thereof has not been repatriated within the prescribed time as mentioned above, the assessee has the **option** to pay additional income-tax @ **20.9664%** (i.e., tax@18% plus surcharge@12% plus cess@4%) on such excess money or part thereof, as the case may be.

Where additional income-tax is so paid by the assessee, he will **not** be required to make a secondary adjustment and compute interest from the date of payment of such tax. This implies that he would, in any case, be required to compute interest upto the date of payment of such additional tax.

The additional income-tax so paid by the assessee shall be treated as the **final payment of tax i**n respect of excess money or part thereof not repatriated and **no further credit** would be allowed to the assessee or to any other person in respect of the amount of additional income-tax so paid.

Further, **no deduction** in respect of the amount on which such additional income-tax has been paid, would be allowed under any other provision of the Act.

ILLUSTRATION 6

On 1.4.2026, PQR Ltd., an Indian company, advanced a loan of ₹ 6 crores to XYZ Inc., a company resident in Singapore. As on the date of the loan, the book value of total assets in the books of XYZ Inc. was ₹ 10 crores. During T.Y. 2026-27, PQR Ltd. also entered into an agreement with XYZ Inc. to provide 20,000 medical equipment at a cost of ₹ 7,400 per unit. The Assessing Officer treats them as associated enterprises and wants to recompute the income of PQR Ltd. at arm's length price. You are required to answer the following questions in this respect:

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(1) Would PQR Ltd. and XYZ Inc. be treated as associate enterprises for the purpose of transfer pricing adopted by the Assessing Officer? If yes, why?

(2) Calculate the arm's length price of PQR Ltd., which sells the same equipment at the rate of ₹ 9,000 per unit to Y Ltd. and at the rate of ₹ 9,500 per unit to X LLP (both of them are unrelated parties in respect of PQR Ltd.). PQR Ltd. is not a wholesale dealer.

(3) What are the options available to PQR Ltd. in respect of such increase in transfer price by income tax authorities, if PQR Ltd. accepts such transfer price?

SOLUTION

(1) Two enterprises are associated enterprises as per section 162(1)(b) if one enterprise advances a loan to the other enterprise and the amount of such loan constitutes not less than 51% of the book value of the total assets of the other enterprise. Since PQR Ltd., an Indian company, advanced a loan of ₹ 6 crores to XYZ Inc., a Singapore company, which is 60% of the book value of the total assets of XYZ Inc. (i.e., 60% of ₹ 10 crores), PQR Ltd. and XYZ Inc. are associated enterprises.

(2) PQR Ltd. sells equipment at the rate of ₹ 9,000 per unit to Y Ltd. and at ₹ 9,500 per unit to X LLP, both being unrelated parties. Since the transactions can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price, Comparable Uncontrolled Price (CUP) method would be the most appropriate method.

Since two prices are determined by the most appropriate method, and the data set comprises of only two entries, the arm's length price shall be the arithmetical mean of both the values included in the dataset.

Accordingly, arm's length price would be ₹ 9,250 [(₹ 9,000 + ₹ 9,500)/2]. Since the deviation between the arm's length price and actual sale price of the equipment to XYZ Inc. i.e., ₹ 7,400 per unit, is 25%, which far exceeds the maximum percentage deviation which can be notified by the Central Government[6], the arm's length price would be ₹ 9,250 per unit and the total income would increase by ₹ 3.7 crores [i.e. ₹ 1,850 (₹ 9,250 – ₹ 7,400) x 20,000 units]

[6] *Which cannot exceed 3% in any case*

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(3) On account of the primary adjustment of ₹ 3.7 crores (₹ 1,850 × 20,000 units) made by the Assessing Officer and accepted by PQR Ltd., secondary adjustment has to be made under section 170 because the primary adjustment is ₹ 1 crore or more.

Accordingly, the excess money, i.e., ₹ 3.7 crores available with XYZ Inc. must be repatriated to India within 90 days of the date of the order of the Assessing Officer.

In case of non-repatriation, ₹ 3.7 crores would be deemed as an advance made by the PQR Ltd. to its associated enterprise, XYZ Inc. Interest would be calculated on such advance at the one-year marginal cost of fund lending rate of SBI as on 1st April of the relevant tax year + 3.25%, since the international transaction is denominated in Indian rupee.

Alternatively, PQR Ltd. can opt to pay additional income-tax @20.9664% (tax @18% *plus* surcharge @12% *plus* cess@4%) on ₹ 3.7 crores, which amounts to ₹ 77,57,568.

XI. Maintenance, Keeping and Furnishing of Information and Documents [Section 171]

A taxpayer undertaking international transaction or specified domestic transaction with the associated enterprise has to compute the income, expense or allocation of cost arising from such international transaction or specified domestic transaction having regard to the arm's length price. To substantiate the arm's length price, the taxpayer is required to maintain the three-tier documentation:

- **Local File**, containing information relating to international transactions or specified domestic transactions [Section 171 read with Rule 84];
- **Master File**, containing information relating to the international group [Section 171 read with Rule 123]; and
- **Country-by-Country Report**, required to be furnished by specified constituent entities of an international group [Section 511].

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(1) Persons required to maintain and furnish information and documents

Section 171 imposes responsibility on every person

(i) who **enters into an international transaction or specified domestic transaction** to keep and maintain such information and documents in respect thereof as may be prescribed;

(ii) being a **constituent entity of an international group**, to keep and maintain the prescribed information and document **in respect of an international group**.

The constituent entity is required to keep and maintain the information and document irrespective of the fact **whether or not any international transaction is undertaken during the tax year** by such constituent entity and furnish the same to the prescribed authority in the prescribed manner and within the prescribed time.

(2) Documentation relating to International Transactions and Specified Domestic Transactions [Rule 84]



Rule 84 prescribes the information and documents required to be maintained by every person entering into an international transaction or specified domestic transaction. Broadly, such documentation includes:

(a) Enterprise and Group Information

(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 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 have been entered into by the assessee, and ownership linkages among them;

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(iii) A broad description of the business of the assessee and the industry in which the assessee operates, and the business of the associated enterprises with whom the assessee has transacted;

(b) Details of International Transactions / Specified Domestic Transactions

(iv) The **nature and terms** (including prices) of international 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;

(v) A description of the functions performed, risks assumed and assets employed or to be employed **(FAR analysis)** by the assessee and by the associated enterprises involved in the international transactions or the specified domestic transaction;

(c) Arm's Length Price Documentation

(vi) 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 the specified domestic transaction entered into by the assessee;

(vii) A r**ecord of uncontrolled transactions** taken into account for analysing their comparability with the international 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 the specified domestic transaction;

(viii) A record of the **analysis performed to evaluate comparability** of uncontrolled transactions with the relevant international transaction or the specified domestic transaction;

(ix) a description of the **methods considered** for determining the arm's length price in relation to each international transaction or specified domestic transaction or class of transactions, 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;

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(x) 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 to apply the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions;

(d) Other Relevant Information

(xi) The **assumptions, policies and price negotiations**, if any, which have critically affected the determination of the arm's length price;

(xii) Details of the **adjustments**, if any, made to transfer prices to align them with arm's length prices determined under the Income-tax Rules and consequent adjustment made to the total income **for tax purposes**;

(xiii) Any **other information**, data or documents, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

(3) Relaxation from Maintenance of Detailed Documentation for International Transaction [Rule 84(2) & (3)]

The detailed documentation prescribed under Rule 84(1) shall not apply in respect of international transactions where the aggregate value of such international transactions, as recorded in the books of account during the tax year, does not exceed ₹ 1 **crore.**

However, the assessee shall substantiate, based on the material available, that the income arising from such international transactions has been computed in accordance with section 161. This will mean that, even if the aggregate value of the international transactions is less than ₹ 1 crore, the assessee will have to maintain adequate records and evidence to show that the international transactions with associated enterprises are based on the arm's length principle.

(4) Documentation for Eligible Specified Domestic Transactions [Rule 84(4)]

In the case of eligible assessee entering into eligible specified domestic transactions referred in rule 96, the detailed documentation requirements under Rule 84(1) shall not apply.

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Instead, the eligible assessee shall maintain the information and documents specifically prescribed under Rule 84(4), having regard to the nature of such specified domestic transactions.

Rule	Eligible Assessee	Information and documents to be kept and maintained
84(4)(a)	A government company engaged in the business of generation, supply, transmission or distribution of electricity	(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.
84(4)(b)	A co-operative society engaged in the business of procuring	(i) a description of the ownership structure of the assessee co-operative society with details of shares or other ownership interest

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	and marketing milk and milk products	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.

(5) Information to be supported by authentic documents [Rule 84(5) & (6)]

The information to be maintained by the assessee, is to be supported by authentic documents. These documents may include the following:

(i) Official publications, reports, studies and data bases from the Government of the country of residence of the associated enterprise, or of any other country;

(ii) Reports of market research studies carried out and technical publications brought out by institutions of national or international repute;

(iii) Price publications including stock exchange and commodity market quotations;

(iv) Published accounts and financial statements relating to the business affairs of the associated enterprises;

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(v) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions;

(vi) Letters and other correspondence documenting any terms negotiated between the assessee and the associated enterprise;

(vii) Documents normally issued in connection with various transactions under the accounting practices followed.

It is also provided that the information and documents to be maintained should be contemporaneous and should exist latest by one month before the due date for furnishing the return of income under section 263(1)(c) for the relevant tax year.

(6) Period of Maintenance [Rule 84(7) & (8)]

Where an international transaction or specified domestic transaction continues to have effect beyond one tax year, fresh documentation is not required to be maintained for each year *unless there is a significant change in* -

- the nature or terms of the transaction;
- the underlying assumptions; or
- any other factor affecting the transfer price.

The prescribed information and documents shall be kept and maintained for a period of **nine years from the end of the relevant tax year**.

(7) Power of Assessing Officer or Commissioner (Appeals) to Call for Information and Documents

The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceedings under the Income-tax Act, require any person who has entered into an international transaction or specified domestic transaction to furnish any such prescribed information or documents within a period of **10 days** from the date of receipt of a notice issued in this regard. The requisition period may, on request, be extended further for a period not exceeding thirty days by the Assessing Officer or the Commissioner (Appeals).

*[**Note:** Rule 123 - Documentation by Constituent Entity of an International Group (Master File) are discussed along with section 511 in detail further in this chapter]*

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XII. Audit Report [Section 172]

Every person who has entered into an international transaction or specified domestic transaction during a tax year shall obtain a report from an accountant and furnish such report **on or before the specified date** in the prescribed form, duly signed and verified by the accountant in the prescribed manner and setting forth such particulars as may be prescribed.

For this purpose, "specified date" means the date one month before the due date for furnishing the return under section 263(1) for the relevant tax year.

Rule 85(2) separately requires Form No. 48 to be furnished at least one month before the due date under section 263(1)(c). Under section 263(1)(c) table, a person to whom section 172 applies the due date of 30 November of the financial year succeeding the relevant tax year.

Report from Accountant [Rule 85]

The report required under section 172 shall -

- be furnished in **Form No. 48**;
- be verified in the manner specified therein; and
- be furnished **at least one month prior to the due date** for furnishing the return of income under section 263(1)(c).

The accountant is required to state that he has examined the accounts and records of the assessee relating to the international transactions or specified domestic transactions entered into by the assessee during the relevant tax year. He also has to give his opinion on whether the prescribed information and documents relating to the above transactions have been kept by the assessee. Further, he has to state that the particulars stated in the Annexure to his report are true and correct.

XIII. Penalties

Stringent penalties are provided in various sections for non-compliance with the requirements provided under the transfer pricing provisions. These are as under:

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(1) Penalty for failure to report any international transaction or any transaction deemed to be an international transaction or any specified domestic transaction

(A) Immunity from penalty in respect of Transfer Pricing Adjustment [Section 439(8)(d)]

Under section 439, penalty @50% of tax payable on under-reported income is leviable. An addition made in conformity with the arm's length price determined by the Transfer Pricing Officer shall **not** be regarded as under-reported income where the assessee -

- has maintained the prescribed information and documents under section 171;
- has reported the international transaction under Chapter X; and
- has disclosed all the material facts relating to such transaction.

Accordingly, where all the above conditions are satisfied, no penalty for under-reporting of income shall be leviable in respect of such transfer pricing adjustment.

Note: The above immunity is available only in respect of **international transactions**. Section 439(8)(d) does not extend such immunity to additions made in respect of **specified domestic transactions**.

(B) Failure to Report Transfer Pricing Transactions [Section 439(11)(f)]

Further, **failure to report** any international transaction or any transaction deemed to be an international transaction or specified domestic transaction to which the provisions of Chapter X applies would constitute **'misreporting of income'** under section 439(11)(f), in respect of which **penalty @200%** would be attracted.

(2) Penalty for failure to keep and maintain information and documentation [Section 442]

Section 442 provides for a penalty in respect of failure to comply with the transfer pricing documentation requirements prescribed under section 171.

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(A) Failure relating to Transfer Pricing Documentation [Section 442(1)]

The Assessing Officer or the Commissioner (Appeals) may impose a penalty equal to **2% of the value of each international transaction or specified domestic transaction** entered into by a person, if he -

- fails to keep and maintain the prescribed information and documents under section 171(1);
- fails to report an international transaction or specified domestic transaction which is required to be reported; or
- maintains or furnishes incorrect information or documents.

(B) Failure to Furnish Information and Documents relating to an International Group [Section 442(2)]

The prescribed income-tax authority referred to in section 171(4) may impose a penalty of **₹ 5,00,000** where a constituent entity of an international group fails to furnish the information and documents required under section 171.

(3) Penalty for failure to furnish information or document under section 171 [Section 457]

Section 457 provides that 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 Assessing Officer or Commissioner (Appeals), within 10 days from the date of receipt of notice or extended period not exceeding 30 days, as the case may be then such person shall be liable to a penalty equal to 2% of the value of such transaction imposed by AO or TPO or CIT(A) in respect of which the failure occurred.

(4) Fee for failure to furnish report under section 172 [Section 428(d)]

Where a person fails to furnish the report from an accountant as required under section 172, he shall be liable to pay the following fee:

- ₹ 50,000, for delay upto one month for which such failure continues; and
- ₹ 1,00,000, thereafter.

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Penalty/fee for failure to comply with TP provisions: A Summary		
Section	**Nature of default**	**Penalty/fess**
439(11)	Failure to report any international transaction or deemed international transaction or specified domestic transaction to which the provision of Chapter X applies would constitute 'misreporting of income'	200% of the tax payable on under-reported income
442(1)	(1) Failure to keep and maintain any such document and information as required by section 171(1); (2) Failure to report such international transaction or specified domestic transaction which is required to be reported; or (3) Maintaining or furnishing any incorrect information or document.	2% of the value of each such international transaction or specified domestic transaction
442(2)	Failure to furnish the information and documents required under section 171(4) by a constituent entity of an international group	₹ 5,00,000
457	Failure to furnish information or document as required by the Assessing Officer or CIT(A) u/s 171(2) within 10 days from the date of receipt of notice or extended period not exceeding 30 days, as the case may be.	2% of the value of the international transaction or specified domestic transaction for each failure
428(d)	Failure to furnish the report from an accountant as required under section 172	Fee: ₹ 50,000 for delay upto one month for which such failure continues; and ₹ 1,00,000, thereafter.

Notes:

- *The penalty under section 442(2) is independent of, and not in substitution of, the penalty under section 457.*
- *If the assessee proves that there was reasonable cause for the failure, no penalty shall be leviable under sections 442 and 457, in accordance with the general relief provisions relating to reasonable cause [The relief does not apply to the penalty under section 439 and fee leviable under section 428(d)].*

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24.6 FURNISHING OF REPORT IN RESPECT OF INTERNATIONAL GROUP IN LINE WITH BEPS ACTION PLAN – COUNTRY BY COUNTRY REPORT AND MASTER FILE

Transfer pricing documentation plays a significant role in demonstrating that international transactions between associated enterprises are carried out in accordance with the arm's length principle. Section 171 requires the maintenance of prescribed information and documents relating to international transactions and specified domestic transactions.

Requirements as per OECD report on Action 13 of BEPS Action Plan

In order to enhance transparency in transfer pricing and facilitate effective assessment of transfer pricing risks, the OECD/G20 **BEPS Action Plan 13** report provides for:

(a) detailed transfer pricing documentation; and

(b) a template for country-by-country reporting of income, earnings, taxes paid and certain measure of economic activity.

This measure is recommended to ensure that the MNEs are reporting the profits in the jurisdiction where the economic activities are performed.

Three-tier structure mandated by BEPS

The BEPS report recommends that countries adopt a standardised approach to transfer pricing documentation; it mandates the following three-tier structure: -

	Document	Information
(1)	Local file	Detailed information relating to the international transactions of the constituent entity
(2)	Master File	Standardised information relevant for all multinational enterprises (MNE) group members as a whole
(3)	Country-by-country report (CbCR)	Information relating to the global allocation of the MNE's income and taxes paid; and indicators of the location of economic activity within the MNE group.

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Advantages of the three-tier structure [as per BEPS Report]

(a) Taxpayers will be required to articulate consistent transfer pricing positions;

(b) Tax administrations would get useful information to assess transfer pricing risks;

(c) Tax administrations would be able to make determinations about where their resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries.

Country-by-country Report: Reporting Requirements of MNEs

The Country-by-Country (CbC) report has to be submitted by the parent entity of an international group to the prescribed authority in its country of residence. This report is to be based on consolidated financial statements of the group.

(a) MNEs have to report annually and for each tax jurisdiction in which they do business:

  (1) the amount of revenue;

  (2) profit before income tax; and

  (3) income tax paid and accrued.

(b) MNEs have to report their total employment, capital, accumulated earnings and tangible assets in each tax jurisdiction.

(c) MNEs have to identify each entity within the group doing business in a particular tax jurisdiction and provide an indication of the business activities each entity engages in.

Master File: Objective & Features

(a) The master file would provide an overview of the MNE groups business, including:

  (1) the nature of its global business operations,

  (2) its overall transfer pricing policies, and

  (3) its global allocation of income and economic activity

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in order to assist tax administrations in evaluating the presence of significant transfer pricing risk.

(b) The master file is intended to provide a high-level overview in order to place the MNE group's transfer pricing practices in their global economic, legal, financial and tax context.

(c) The master file shall contain information which may not be restricted to transaction undertaken by a particular entity situated in a particular country.

(d) Thus, information in master file would be more comprehensive than the existing regular transfer pricing documentation.

(e) The master file shall be furnished by each entity to the tax authority of the country in which it operates.

Implementation of international consensus in India

India is one of the active members of BEPS initiative and part of international consensus. The Income-tax Act, 2025 has incorporated these recommendations by prescribing separate documentation and reporting requirements for multinational enterprise groups. The compliance framework under the Act is summarised below:

Documentation / Report	Governing Provision
Local File	Section 171 read with Rule 84
Master File	Section 171 read with Rule 123
Country-by-Country Report (CbCR)	Section 511

The provisions relating to maintenance of the Local File have already been discussed under Section 171 read with Rule 84. The discussion in this part focuses on the Master File and the Country-by-Country Report, which together constitute the group-level documentation framework recommended under the BEPS Action Plan.

Maintenance and furnishing of Master file

The Master File forms the second tier of the transfer pricing documentation framework recommended under BEPS Action Plan 13. Unlike the Local File, which contains entity-specific information, the Master File provides a high-level

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overview of the multinational enterprise group, its global business operations, transfer pricing policies and allocation of income.

Consequent provisions in the Income-tax Act, 2025

	Section	Provision
(1)	171(1)(b)	Every person, being a constituent entity of an international group, has to keep and maintain the prescribed information and documents in respect of the international group. The constituent entity has to keep and maintain such prescribed information and documents irrespective of the fact whether or not any international transaction is undertaken by such constituent entity.
(2)	171(4)	The information and document shall also be furnished to the prescribed authority u/s 511(1) within such period as may be prescribed and the manner of furnishing may also be provided for in the rules
(3)	442(2)	For non-furnishing of the information and document to the prescribed authority, a penalty of ₹ 5 lakh shall be leviable.
(4)	470	Reasonable cause defence against levy of penalty shall be available to the entity.

Maintenance and furnishing of information and documents by certain person under section 171 [Rule 123]

Rule	Particulars
123(1)	**Persons required to keep and maintain the information and documents:** Rule 123 applies where a constituent entity of an international group satisfies the following conditions – (a) if the consolidated group revenue of the international group, of which such person is a constituent entity, as reflected in the consolidated financial statement of the international group for the accounting year, exceeds ₹ 500 crore; and (b) the aggregate value of international transactions undertaken by such constituent entity – (i) during the accounting year, as per the books of accounts, exceeds ₹ 50 crore, or

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	(ii) in respect of purchase, sale, transfer, lease or use of intangible property during the accounting year, as per the books of accounts, exceeds ₹ 10 crore Note – The rate of exchange for the calculation of the value in rupees of the consolidated group revenue in foreign currency shall be the telegraphic transfer buying rate (TTBR) of such currency on the last day of the accounting year. [Rule 123(6)] Part A of Form No. 56 (Master File), however, shall be furnished by every person, being a constituent entity of an international group, whether or not the above conditions are satisfied [Rule 123(3)].
	Information and documents required to be kept and maintained: The constituent entity shall keep and maintain the following information and documents of the international group, namely:- (a) a list of all entities of the international group along with their addresses; (b) a chart depicting the legal status of the constituent entity and ownership structure of the entire international group; (c) a description of the business of international group during the accounting year including,- (I) the nature of the business or businesses; (II) the important drivers of profits of such business or businesses; (III) a description of the supply chain for the five largest products or services of the international group in terms of revenue and any other products including services amounting to more than five per cent. of consolidated group revenue; (IV) a list and brief description of important service arrangements made among members of the international group, other than those for research and development services; (V) a description of the capabilities of the main service providers within the international group; (VI) details about the transfer pricing policies for allocating service costs and determining prices to be paid for intra-group services; (VII) a list and description of the major geographical markets for the products and services offered by the international group; (VIII) a description of the functions performed, assets employed and risks assumed by the constituent entities of the international group that contribute at least ten per cent. of the revenues or assets or profits of such group; and

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	(IX) a description of the important business restructuring transactions, acquisitions and divestments; (d) a description of the overall strategy of the international group for the development, ownership and exploitation of intangible property, including location of principal research and development facilities and their management; (e) a list of all entities of the international group engaged in development and management of intangible property along with their addresses; (f) a list of all the important intangible property or groups of intangible property owned by the international group along with the names and addresses of the group entities that legally own such intangible property; (g) a list and brief description of important agreements among members of the international group related to intangible property, including cost contribution arrangements, principal research service agreements and license agreements; (h) a detailed description of the transfer pricing policies of the international group related to research and development and intangible property; (i) a description of important transfers of interest in intangible property, if any, among entities of the international group, including the name and address of the selling and buying entities and the compensation paid for such transfers; (j) a detailed description of the financing arrangements of the international group, including the names and addresses of the top ten unrelated lenders; (k) a list of group entities that provide central financing functions, including their place of operation and of effective management; (l) a detailed description of the transfer pricing policies of the international group related to financing arrangements among group entities; (m) a copy of the annual consolidated financial statement of the international group; and (n) a list and brief description of the existing unilateral advance pricing agreements and other tax rulings in respect of the international group for allocation of income among countries.

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123(2)	**Due date for furnishing report:** The prescribed information and documents shall be furnished in Form No. 56 to the Joint Director referred to in Rule 124(1), on or before the due date for furnishing the return of income under section 263(1)(c).
123(4)	**Furnishing of report in case of more than one constituent entity:** Where more than one constituent entity of the same international group is required to furnish the Master File in India, the international group may designate any one constituent entity to furnish Form No. 56 on behalf of all such constituent entities. In such a case, the prescribed authority shall be informed of such designation in Form No. 57 at least 30 days before the due date for furnishing Form No. 56.
123(5)	**Period for which such information and document to be kept or maintained:** The information and documents (Master File) shall be kept and maintained for a period of nine years from the end of the relevant tax year.

Country-by-Country Reporting (CbCR) Framework [Section 511 read with Rule 124]

Country-by-Country Reporting (CbCR) constitutes the third tier of the transfer pricing documentation framework recommended under BEPS Action Plan 13. It provides tax administrations with jurisdiction-wise information relating to the global allocation of income, taxes and economic activities of multinational enterprise groups, thereby facilitating transfer pricing risk assessment.

Section 511, read with Rule 124, prescribes the Country-by-Country Reporting requirements applicable to the constituent entities of an international group. The reporting obligation varies depending upon the nature of the reporting entity and the residential status of the parent entity.

(a) Notification by Resident Constituent Entity [Section 511(1) read with Rule 124(2)]: Every constituent entity resident in India, being a constituent of an international group, whose parent entity is **not resident in India**, shall notify the prescribed income-tax authority-

- whether it is the **Alternate Reporting Entity (ARE)** of the international group; or
- where it is not the Alternate Reporting Entity, the details of the **parent entity** or the **alternate reporting entity**, as the case may be, together with the country or territory of which such entity is resident.

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Such notification shall be furnished—

- to the **Joint Director** designated by the **Director General of Income-tax (Systems)**;
- in **Form No. 58**; and
- **at least two months before the due date** for furnishing the Country-by-Country Report.

Thus, every resident constituent entity, whose parent entity is not resident in India, is required to notify the prescribed income-tax authority of the entity responsible for furnishing the Country-by-Country Report.

(b) Furnishing of Country-by-Country Report by Parent Entity or Alternate Reporting Entity [Section 511(2) read with Rule 124(3)]

Every **parent entity** or **alternate reporting entity**, resident in India, shall furnish a Country-by-Country Report in respect of the international group for every reporting accounting year.

The report shall:

- be furnished in **Form No. 59**;
- be furnished to the prescribed income-tax authority, namely, the **Joint Director** designated by the **Director General of Income-tax (Systems)**; and
- be furnished **within twelve months from the end of the relevant reporting accounting year**.

(c) Contents of Country-by-Country Report [Section 511(3)]: The Country-by-Country Report shall, inter alia, contain the following information in respect of the international group:

Particulars	Information to be reported
Financial information	Aggregate information in respect of the amount of revenue, profit or loss before income-tax, amount of income-tax paid, amount of income-tax accrued, stated capital, accumulated earnings, number of employees and tangible assets not being cash or cash equivalents, with regard to each country or territory in which the group operates

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Constituent entities	Details of each constituent entity together with the country or territory of incorporation or organisation and the country or territory where it is resident
Business activities	Nature and details of the main business activity or activities of each constituent entity;
Other information	Such other information as may be prescribed

(d) Furnishing of Country-by-Country Report by Constituent Entity in Specified Cases [Section 511(4) read with Rule 124(4) & (5)]: A constituent entity resident in India, other than the parent entity or alternate reporting entity, shall furnish the Country-by-Country Report where the parent entity is resident in a country or territory-

- which does not require furnishing of a Country-by-Country Report;
- with which India does not have an agreement providing for the exchange of such report; or

where there has been a systemic failure i.e., such country is not exchanging information with India even though there is an agreement and this fact has been intimated to the entity by the prescribed authority.

In such cases, the report shall be furnished -

- within twelve months from the end of the reporting accounting year; or
- within six months from the end of the month in which the systemic failure is intimated to the constituent entity, where the reporting obligation arises due to such systemic failure.

(e) No obligation to furnish CbC report in certain cases [[Section 511(6)]: If an international group, having parent entity which is not resident in India, had designated an alternate entity for filing its report with the tax jurisdiction in which the alternate entity is resident **and** such alternate entity has furnished such report on or before the date specified by that country or territory, then, the entities of such group operating in India would not be obliged to furnish report if -

- the report is required to be furnished under the law for the time being in force in the said country or territory

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- the report can be obtained under the agreement of exchange of such reports by Indian tax authorities
- No systemic failure in respect of the said country or territory has been conveyed to any constituent entity of the group that is resident in India
- the said country or territory has been informed in writing by the constituent entity that it is the alternative reporting entity on behalf of the international group
- the same has been informed to the prescribed authority by the entity in accordance with section 511(1).

Accordingly, where an effective mechanism exists for automatic exchange of Country-by-Country Reports, duplicate reporting in India is avoided.

(f) Power to Call for Information and Documents [Section 511(7)]: The Joint Director, designated by the PDGIT (Systems) may call for such document and information from the entity furnishing the report as it may specify in notice in writing for the purpose of verifying the accuracy.

The entity shall be required to make submission within 30 days of receipt of notice or further period if extended by the prescribed authority, but extension shall not be beyond a further period of 30 days.

(g) Threshold limit for applicability of CbCR [Section 511(8) read with Rule 124(7) & (8)]: The reporting provision shall apply in respect of an international group for an accounting year, if the total consolidated group revenue as reflected in the consolidated financial statement (CFS) for the accounting year preceding such accounting year is above a threshold to be prescribed ***i.e., ₹ 6,400 crore***. [Rule 124(7)]

Where the total consolidated group revenue of the international group, as reflected in the consolidated financial statement, is in foreign currency, the rate of exchange for the calculation of the value in rupees of such total consolidated group revenue shall be the telegraphic transfer buying rate (TTBR) of such currency on the last day of the accounting year preceding the relevant accounting year [Rule 124(8)].

(h) Revision or Correction of Country-by-Country Report [Rule 124(9)]: Any revision or correction in the Country-by-Country Report furnished in **Form**

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No. 59 shall be made by furnishing an intimation to the **Director General of Income-tax (Systems).**

Compliance Summary

Particulars	Form	Time Limit
Notification by resident constituent entity	Form No. 58	At least 2 months before the due date for furnishing CbCR
Country-by-Country Report by Parent Entity/ Alternate Reporting Entity	Form No. 59	Within 12 months from the end of the reporting accounting year
Country-by-Country Report by Constituent Entity (specified cases)	Form No. 59	Within 12 months from the end of the reporting accounting year or within 6 months from the end of the month in which systemic failure is intimated, as the case may be
Intimation of the designated constituent entity	Form No. 60	Rule 124(6) prescribes Form No. 60 for the information conveyed under section 511(5); neither section 511(5) nor Rule 124(6) prescribes a separate time limit.
Revision / Correction of Country-by-Country Report	Intimation to DGIT (Systems)	As and when required

Meaning of certain terms [Section 511(10)]

<table>
<tr><th></th><th>Term</th><th>Meaning</th></tr>
<tr><td>(a)</td><td>Accounting year</td><td>
<table>
<tr><th>Case</th><th>Accounting year</th></tr>
<tr><td>In a case where the parent entity is resident in India; or</td><td>A tax year</td></tr>
<tr><td>In any other case</td><td>An annual accounting period, with respect to which the parent entity of the international group prepares</td></tr>
</table>
</td></tr>
</table>

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			its financial statements under any law in force or the applicable accounting standards of the country or territory of which such entity is resident.
(b)	Agreement	A combination of all of the following agreements, namely– (i) an agreement referred to in section 159(1) or (2); or (ii) an agreement for exchange of the CbC report referred to in section 511(2) as may be notified by the Central Government.	
(c)	Alternate reporting entity	Any constituent entity of the international group that has been designated by such group, in the place of the parent entity, to furnish the CbC report in the country or territory in which the said constituent entity is resident on behalf of such group.	
(d)	Constituent entity	(i) any separate entity of an international group that is included in the consolidated financial statement of the said group for financial reporting purposes, or may be so included for the said purpose, if the equity share of any entity of the international group were to be listed on a stock exchange; (ii) any such entity that is excluded from the consolidated financial statement of the international group solely on the basis of size or materiality; or (iii) any permanent establishment of any separate business entity of the international group included in sub clause (i) or (ii), if such business unit prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting or internal management control purposes	
(e)	Group	This includes a parent entity and all the entities in respect of which, for the reason of ownership or control, a consolidated financial statement for financial reporting purposes, - (i) is required to be prepared under any law for the time being in force or the accounting standards of the country or territory of which the parent entity is resident; or (ii) would have been required to be prepared had the equity shares of any of the enterprises were listed on a stock	

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		exchange in the country or territory of which the parent entity is resident.
(f)	Consolidated financial statement	The financial statement of an international group in which the assets, liabilities, income, expenses and cash flows of the parent entity and the constituent entities are presented as those of a single economic entity.
(g)	International group	Any group that includes, - (i) two or more enterprises which are resident of different countries or territories; or (ii) an enterprise, being a resident of one country or territory, which carries on any business through a permanent establishment in other countries or territories;
(h)	Parent entity	A constituent entity, of an international group holding, directly or indirectly, an interest in one or more of the other constituent entities of the international group, such that, - (i) it is required to prepare a consolidated financial statement under any law for the time being in force or the accounting standards of the country or territory of which the entity is resident; or (ii) it would have been required to prepare a consolidated financial statement had the equity shares of any of the enterprises were listed on a stock exchange, and, there is no other constituent entity of such group which, due to ownership of any interest, directly or indirectly, in the first mentioned constituent entity, is required to prepare a consolidated financial statement, under the circumstances referred to in sub clause (i) or sub clause (ii), that includes the separate financial statement of the first mentioned constituent entity.
(i)	Permanent establishment	Meaning assigned to it in section 173(c) i.e., includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.
(j)	Reporting accounting year	The accounting year in respect of which the financial and operational results are required to be reflected in the report provided in 511(2), (4) and (5)

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(k)	Reporting entity	The constituent entity including the parent entity or the alternate reporting entity, that is required to furnish a report referred to in section 511(2).
(l)	Systemic failure	Systemic failure, with respect to a country or territory, means that the country or territory has an agreement with India providing for exchange of report of the nature referred to in section 511(2), but— (i) in violation of the said agreement, it has suspended automatic exchange; or (ii) has persistently failed to automatically provide to India the report in its possession in respect of any international group having a constituent entity resident in India

Penalty for Failure to Furnish Country-by-Country Report [Section 459(1)

Where a reporting entity required to furnish the Country-by-Country Report under section 511 fails to furnish such report for a reporting accounting year, the prescribed authority may impose the following penalty:

	Period of delay/ default	Penalty
(a)	Not more than a month	₹ 5,000 for every day for which the failure continues, if the period of failure does not exceed one month.
(b)	beyond one month	₹ 15,000 for every day for which the failure continues beyond the period of one month.

Penalty for failure to produce information and documents within prescribed time [Section 459(2)]

Where a reporting entity fails to produce the information or documents required by the prescribed authority within the period prescribed under section 511(7), the prescribed authority may levy penalty of ₹ 5,000 per day of continuing failure, from the day immediately following the day on which the period for furnishing the information and document expires.

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Penalty for continuing default after service of penalty order [Section 459(3)]

If the failure referred to in sub-section (1) or (2) continues after an order imposing a penalty under the said sub-section, has been served on the entity, then, irrespective of the provisions of the said sub-sections, the prescribed authority may impose penalty of ₹ 50,000 for every day for which such failure continues beginning from the date of service of such order.

Penalty for submission of inaccurate information in the CbCR [Section 459(4)]

If the reporting entity has provided any inaccurate information in the report, the prescribed authority may impose penalty of **₹ 5,00,000** if,-

(a) the entity has knowledge of the inaccuracy at the time of furnishing the report but does not inform the prescribed authority; or

(b) the entity discovers the inaccuracy after the report is furnished and fails to inform the prescribed authority and furnish correct report within 15 days of such discovery: or

(c) the entity furnishes inaccurate information or document in response to notice of the prescribed authority under section 511(7).

Non-levy of penalty if reasonable cause for failure is proved [Section 470]

Section 470 provides for non-levy of penalty under various sections if the assessee proves that there was reasonable cause for such failure. Section 459 i.e., penalty for failure to furnish report or furnishing inaccurate report under section 511 has been included within the scope of section 470. Therefore, the entity can offer reasonable cause defence for non-levy of penalties mentioned above.

24.7 AVOIDANCE OF INCOME TAX BY TRANSACTIONS RESULTING IN TRANSFER OF INCOME TO NON-RESIDENTS [SECTION 174]

A resident and an ordinarily resident is subject to tax in India in respect of his global income, whereas in the case of a non-resident, income accruing or arising

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outside India would not be taxable in his hands in India if it is not deemed to accrue or arise in India and is not received in India.

Thus, in order to reduce his tax liability, a resident Indian may transfer the ownership of his foreign asset to a non-resident, while continuing to enjoy the benefits of income derived therefrom. Section 174 hits at such transactions which are effected with a view to avoiding income-tax liability.

Conditions for applicability of Section 174

In order to attract the provisions of this section, the following conditions must be satisfied:

(a) There should be a transfer of assets , either before or after the commencement of the Act.

(b) The said transfer may be made **either alone or in conjunction with associated operations**.

(c) The transfer of assets is effected in such a manner that the **income** from transferred assets becomes **payable to a non-resident.**

(d) As a consequence of the transfer, the **transferor,** either alone or in conjunction with associated operations, has acquired any right, by virtue of which he **gets the power to enjoy** the income from transferred assets, whether immediately or in future.

(e) Such **income of the non-resident transferee** would have been chargeable to tax in India, had it been the income of the resident transferor.

(f) The Assessing Officer is satisfied that avoidance of liability to tax in India is the purpose of the transfer.

Consequences

- Where the above conditions are satisfied, the income payable to the non-resident shall, irrespective of whether it is otherwise chargeable to tax under any other provision of the Act, be **deemed to be the income of the transferor and shall be chargeable to tax in his hands**.
- Further, where the transferor **receives or becomes entitled to receive any capital sum**, whether before or after the transfer, and such payment is

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connected with the transfer or any associated operation, the income which has become payable to the non-resident shall likewise be deemed to be the income of the transferor.

This section will not, however, apply to cases where it is shown to the satisfaction of the Assessing Officer that –

(i) neither the transfer nor any associated operation had for its purpose or for one of its purposes the avoidance of liability to taxation or

(ii) the transfer and all associated operations were *bona fide* commercial transactions and were not designed for the purpose of avoiding tax liability.

Subsequent receipt of income

Where any income has already been deemed to be the income of the transferor under section 174 and has been taxed accordingly, its subsequent receipt by him, whether as income or otherwise, shall **not be taxed again**.

Deeming Provisions

For the purposes of this section:

- references to assets representing any assets, income or accumulations of income include shares in, or obligations of, any other person to whom such assets, income or accumulations have been transferred.
- Any body corporate incorporated outside India shall be treated as if it were a non-resident.
- A person is deemed to have the power to enjoy the income of a non-resident if:

  (i) the income, in fact, so dealt with by any person as to be calculated at some point of time to enure for the benefit of the transferor, whether in the form of the income or otherwise;

  (ii) the receipt or accrual of the income operates to increase value of any assets held by the transferor or for his direct or indirect benefit;

  (iii) the transferor receives or is entitled to receive at any time any benefit out of the income or out of any moneys available for the purpose by reason of the effect or successive effects of the associated operations on that income and the assets which represent that income;

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(iv) the transferor is in a position to obtain for himself the beneficial enjoyment of the income by exercising any power of appointment or power of revocation or otherwise, whether with or without the consent of any other person, or

(v) the transferor is able to control, directly or indirectly, the application of the income in any manner whatsoever.

However, in determining whether a person has the power to enjoy the income, due regard shall be had to the substantial result and effect of the transfer and any associated operations; all benefits which may at any time accrue to such person as a result of the transfer and any associated operations must be taken into consideration irrespective of the nature or form of the benefits.

Meaning of Certain Terms

	Terms	Meaning
(i)	Associated operation	The 'associated operation," in relation to a transfer, means an operation of any kind effected by any person in relation to: (i) any of the assets transferred; (ii) any assets representing, whether directly or indirectly, any of the assets transferred; (iii) any income arising from such assets; (iv) any assets representing, whether directly or indirectly, the accumulation of income arising from such assets.
(ii)	Assets	It includes property or rights of any kind.
(iii)	Transfer	In relation to rights, includes creation of those rights.
(iv)	Benefit	It includes a payment of any kind.
(v)	Capital sum	It means - (i) any sum paid or payable by way of a loan or repayment of a loan; and (ii) any other sum paid or payable otherwise than as income, being a sum, which is not paid or payable for full consideration in money or money's worth.
(vi)	Non-resident	It means a person who is not a resident and for the purposes of section 161, 174 and 312, includes a person who is not ordinarily resident as per section 6(13) [Section 2(72)].

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24.8 INTRODUCTION OF SPECIFIC ANTI AVOIDANCE MEASURES IN RESPECT OF TRANSACTIONS WITH PERSONS LOCATED IN NOTIFIED JURISDICTIONAL AREA [SECTION 176]

The objective of anti-avoidance measures is to discourage assessees from entering into transactions with persons located in countries or territories which do not have effective information exchange mechanism with India. The following are the anti-avoidance measures introduced -

(i) The Central Government is empowered to notify any country or territory outside India as a **NJA (Notified Jurisdictional Area) in relation to transactions entered into by any assessee**, having regard to the lack of effective exchange of information with such country or territory.

(ii) Irrespective of anything to the contrary contained in the Act, 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, -

(a) all the parties to the transaction shall be deemed to be associated enterprises within the meaning of section 162;

(b) any transaction of the nature described in section 163(1) and (2) shall be deemed to be an international transaction within the meaning of section 163,

and the provisions of sections 161, 162, 163, 165 [except the benefit of variation specified in sections 165(3)(a)(ii)], 166, 167, 171, 172 and 173 shall apply accordingly.

(iii) Person located in a NJA shall include:

- a person who is a resident of the NJA;
- a person, not being an individual, which is established in the NJA; and
- a permanent establishment of any other person in the NJA.

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(iv) Irrespective of anything to the contrary contained in the Act, no deduction shall be allowed in respect of

- any payment made to a financial institution located in a Notified Jurisdictional Area unless the assessee furnishes an authorisation, in the prescribed form, authorising the Board or any other income-tax authority acting on its behalf to obtain the relevant information from such financial institution and
- any other expenditure or allowance, including depreciation, arising from the transaction with a person located in a NJA would be allowed unless the assessee maintains the relevant documents and furnishes the prescribed information[7].

(v) Irrespective of anything to the contrary contained in the Act, if in any tax year, the assessee has received or credited any sum from a person located in a Notified Jurisdictional Area and -

- the assessee does not provide any explanation about the source of such sum in the hands of that person or in the hands of the beneficial owner; or
- the explanation provided by the assessee is not satisfactory in the opinion of the Assessing Officer,

such sum shall be deemed to be the income of the assessee for that tax year.

(vi) Irrespective of anything to the contrary contained in the Act, if any person located in NJA is entitled to receive any sum or income or amount on which tax is deductible under TDS provisions of the Act, the tax shall be deducted at source at the highest of the following rates –

(1) at the rate or rates in force; or

(2) at the rate specified in the relevant provision of the Income-tax Act, 2025; or

(3) at the rate of 30%.

[7] *Rule 125 prescribes the information and documents to be furnished*

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ILLUSTRATION 7

A Ltd., an Indian company, provides technical services to XYZ Inc., a foreign company located in a NJA for a consideration of ₹ 40 lakhs in October 2026. It charges ₹ 42 lakhs for similar services rendered to PQR Inc., which is not located in an NJA. PQR Inc. is not an associated enterprise of A Ltd.

Discuss the tax implications under section 176 read with section 165 in respect of the above transaction of provision of technical services by A Ltd. to XYZ Inc.

SOLUTION

Since XYZ Inc. is located in an NJA, the transaction of provision of technical services by the Indian company, A Ltd., would be deemed to be an international transaction and XYZ Inc. and A Ltd. would be associated enterprises. Therefore, the provisions of transfer pricing would be attracted in this case.

The price of ₹ 42 lakhs charged for similar services from PQR Inc, being an independent entity located in a non-NJA country, can be taken into consideration for determining the arm's length price (ALP) under Comparable Uncontrolled Price (CUP) Method.

Since the ALP is more than the transfer price, the ALP of ₹ 42 lakhs would be considered as the income arising from the international transaction between A Ltd. and XYZ Inc.

It may be noted that the benefit of permissible variation between the ALP and transfer price is not available in respect of a transaction entered into with an entity in NJA. Accordingly, the income of A Ltd. shall be increased by ₹ 2 lakhs.

ILLUSTRATION 8

Mr. X, a non-resident individual, is due to receive interest of ₹ 5 lakhs during March 2027 from a notified infrastructure debt fund eligible for exemption as per Schedule VII (Table Sl. No. 46). He incurred expenditure amounting to ₹ 10,000 for earning such income. Assuming that Mr. X is a resident of a NJA, discuss the tax implications under section 176, read with sections 207 and 393.

SOLUTION

The interest income received by Mr. X, a non-resident, from a notified infrastructure debt fund would be subject to a concessional tax rate of 5% under section 207 on the gross amount of such interest income. Therefore, the tax

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liability of Mr. X in respect of such income would be ₹ 26,000 (being 5% of ₹ 5 lakhs *plus* health and education cess@4%).

Under section 393(2) (Table Sl. No. 5), tax is deductible @5% (*plus* health and education cess@4%) on interest paid by such fund to a non-resident. However, since X is a resident of a NJA, tax would be deductible@30% (*plus* health and education cess@4%) as per section 176, and not @5% specified under section 393.

TDS at highest prescribed rate for payments to a person located in a notified jurisdictional area would be attached by virtue of section 176(5). It provides that irrespective of anything to the contrary contained in the Act, if any person located in a NJA is entitled to receive any sum or income or amount on which tax is deductible under Chapter X IX-B, the tax shall be deducted at the highest of the following rates -

(a) at the rate or rates in force;

(b) at the rate specified in the relevant provision of the Act;

(c) at the rate of 30%.

Mr. X may, however, claim a refund of the excess tax deducted, while furnishing his return of income.

24.9 LIMITATION OF INTEREST DEDUCTION IN CERTAIN CASES [SECTION 177]

Debt and equity are the instruments through which a company is generally financed or capitalised. The way a company is capitalised has a major impact on the amount of taxable profit, as the tax laws of countries generally provide for a deduction in respect of interest paid or payable while arriving at the taxable profit.

However, 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 income. For this reason, debt is considered a more tax efficient method of finance than equity.

Multinational groups are often able to structure their financing arrangements to maximize tax benefits through intra-group financing. In this manner, the MNEs are able to claim the excessive deduction of interest in the high tax jurisdiction

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and shift the profits to the low tax jurisdiction resulting in base erosion and profit shifting (BEPS).

Tax Rules to prevent shifting of profits through excessive interest payments

In order to address this issue, tax rules are in place in many countries to fix a ceiling limit on the amount of interest deductible in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, with the objective of protecting a country's tax base.

Relevant Action Plan of BEPS

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** and recommended certain measures in its final report.

Provision in the Income-tax Act in line with BEPS Action Plan 4

Section 177 provides for limitation of deduction in respect of excess interest paid or payable by an Indian company or the permanent establishment of a foreign company in India in specified cases. The provision is broadly based on the recommendations contained in the OECD BEPS Action Plan 4.

Applicability

The provisions of section 177 apply where all the following conditions are satisfied:

- the borrower is an Indian company or a permanent establishment of a foreign company in India;
- the expenditure is by way of interest or similar payment in respect of any debt issued by a non-resident associated enterprise;
- the aggregate expenditure by way of such interest or similar payment **exceeds ₹ 1 crore** during the tax year.

Where these conditions are satisfied, the deduction in respect of **excess interest** shall be restricted in accordance with the provisions of section 177.

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Note: The restriction applies only to **excess interest**, and not to the entire amount of interest expenditure.

Excess interest shall mean an amount of

- total interest paid or payable* in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the tax year or
- interest paid or payable to associated enterprise for that tax year

whichever is less.

**"Total interest paid or payable" to be interpreted as interest paid or payable to non-resident associated enterprise as per the intent expressed in section 177(1) and also the Explanatory Memorandum to the Finance Bill, 2017.*

Debt Deemed to be Issued by an Associated Enterprise

Where a lender not being an associated enterprise has issued a debt and an associated enterprise either

- provided an implicit or explicit guarantee to such lender in respect of such debt or
- deposited a corresponding and matching funds with such lender,

then, such debt shall be deemed to have been issued by an associated enterprise.

Accordingly, the limitation on deduction of excess interest shall apply even though the immediate lender is not an associated enterprise.

Meaning of debt [Section 177(7)(a)]

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".

Carry forward of excess interest

Interest expenditure not wholly deducted against income under the head" Profits and gains from business or profession" for any tax year would be

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- carried forward to the following tax year or years and
- allowed as deduction against profits and gains, if any, of any business or profession carried on by it and assessable for such tax year, to the extent of maximum allowable interest expenditure for that tax year.

Amount of interest disallowed may be carried forward for **eight tax years** immediately succeeding the tax year for which the disallowance was first computed.

Cases where Section 177 does not Apply

The provisions of this section shall not apply to -

- interest paid in respect of a debt issued by a lender which is a permanent establishment in India of a non-resident engaged in the business of banking
- an Indian company or permanent establishment of a foreign company which is engaged in the business of banking or insurance or
- a Finance Company located in any IFSC
- such class of non-banking financial companies as may be notified by the Central Government

Meaning of Finance Company [Section 177(7)(b)]

"Finance Company" means a finance company as defined in regulation 2(1)(e) of the IFSC Authority (Finance Company) Regulations, 2021 made under the IFSCA Act, 2019 and which satisfies such conditions and carries on such activities as may be prescribed.

As per Regulation 2(1)(e) of the IFSC Authority (Finance Company) Regulations, 2021 means a financial institution separately incorporated to deal in one or more of the permissible activities provided -

(i) It does not accept public deposit from resident and non-resident, as defined in these regulations; and

(ii) It is not registered with the Authority as a Banking Unit;

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As per Rule 126, the finance company located in IFSC shall only carry out one or more of the following activities:

(i) lending in the form of loans, commitments and guarantees, credit enhancement, securitisation, financial lease;

(ii) factoring and forfaiting of receivables; or

(iii) functions of Global or Regional Corporate Treasury Centre such as borrowings, lending, hedging of currency or commodity risk or investments, cash management, structured credit, intra group financing, financial budgeting and similar other such treasury services and activities.

The interest being paid by such Finance Company, being the borrower, in respect of any debt issued by a non-resident, shall be in foreign currency.

Meaning of non-banking financial company [Section 2(71)]

A non-banking financial company" means -

(i) a financial institution which is a company;

(ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;

(iii) such other non-banking institution or class of such institutions, as may be notified by the Bank with the previous approval of the Central Government.



Johnson Matthey Public Limited Company vs. CIT (International Taxation) (2024) 465 ITR 649 (Delhi)

Issue: Whether the amount received as "Guarantee Fees" by a foreign company from its Indian subsidiaries fall within the definition of "interest" for the purpose of section 177?

Facts of the Case: The assessee was a tax resident of the United Kingdom and engaged in manufacturing specialty chemicals. It entered into global corporate guarantee for the purpose of securing loans taken by its Indian subsidiaries from foreign banks. It received guarantee charges for extending such guarantee.

Relevant Provision: As per section 2(59), "interest" means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or

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other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized. Article 12(5) of India-UK DTAA defines "interest" to mean 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 but, subject to the provisions of paragraph 9 of this Article, shall not include any item which is treated as a distribution under the provisions of Article 11(Dividends) of this Convention.

Analysis and Decision: The High Court concur with the views of the Tribunal that the word "interest" as defined in Article 12(5) of the Treaty and section 2(59) of the Act, shall be understood contextually. Article 12(5) of the DTAA and section 2(59) of the Act extend the scope of such payments. However, payment or re-payment pursuant to any loan to be qualified as "interest", necessarily have to be within the context of loan and shall relate to the parties to the privity of contract. In this context only, the expressions "claims of any kind", "service fee or other charge" have to be understood. The word "interest" does not take into its fold any payments made to stranger to the privity of loan transactions, though such payments have to be made incidentally in relation to such loan.

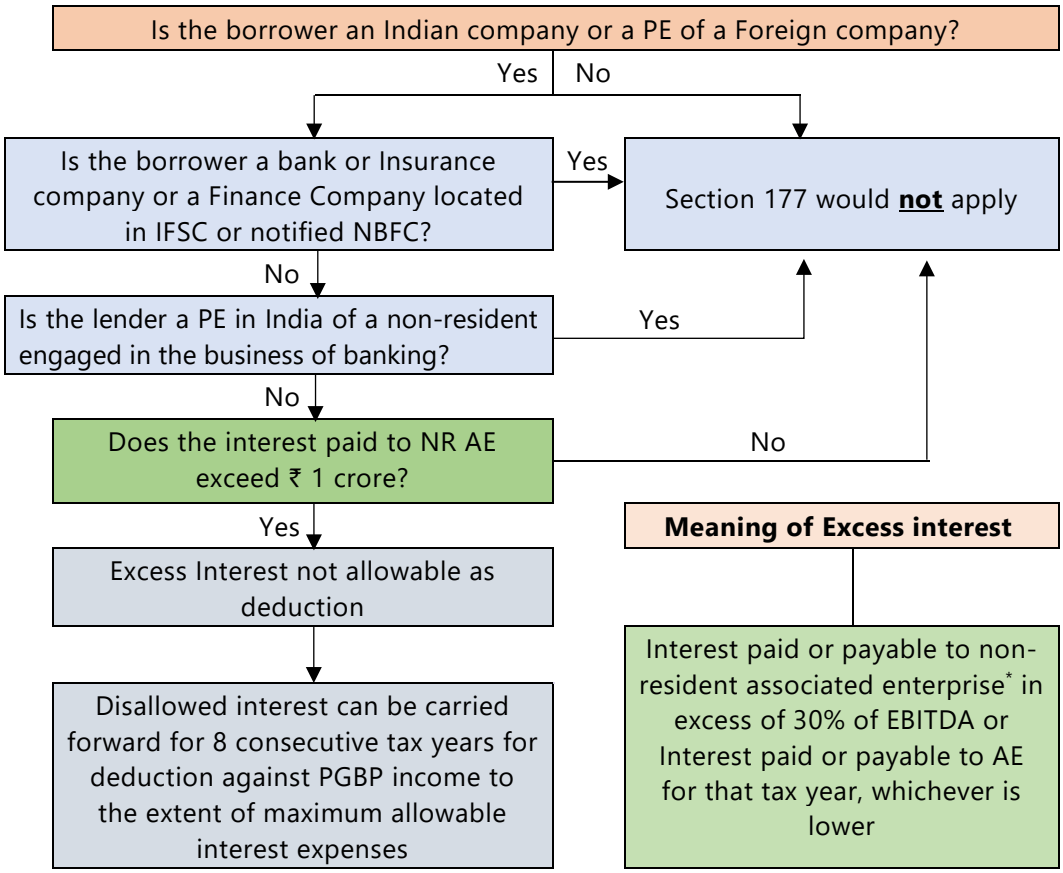
Undoubtedly, assessee is a stranger to the privity of loan transactions in as much as the contract of loan is different from the contract of guarantee, as such in our considered opinion, the expression of "debt claims of any kind" or "the service fee or other charge in respect of moneys borrowed or debt incurred" does not stand extended to the payment of guarantee commission received by the assessee in India.

The expression "interest" is defined to mean amounts payable in respect of any monies borrowed or debts incurred. Undisputedly the appellant had not borrowed any monies. The debt, if any, which could be said to have been incurred was clearly not one owed to the Indian subsidiaries. The income that it received from its Indian subsidiaries was solely in consideration of any liability that could possibly befall in case its Indian subsidiaries were to default in their repayment obligations.

Accordingly, the High Court held that the guarantee fee would neither fall within the ambit of Article 12 of India-UK DTAA nor section 2(59) of the Act.

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Limitation of interest deduction (Section 177): A Summary



**"Total interest paid or payable" may be interpreted as interest paid or payable to non-resident associated enterprise as per the intent expressed in section 177(1) and also the Explanatory Memorandum to the Finance Bill, 2017.*

ILLUSTRATION 9

ND Ltd., an Indian Company, has borrowed ₹ 90 crores on 01-04-2026 from M/s. TM Inc, a company incorporated in London, at an interest rate of 10% p.a. The said loan is repayable over a period of 5 years. Further, this loan is guaranteed by M/s TY Inc. incorporated in UK. M/s TD Inc., a non-resident company, holds shares carrying 40% of the voting power in both M/s ND Ltd. and M/s TY Inc.

Net profit of M/s. ND Ltd. for T.Y. 2026-27 was ₹ 11 crores after debiting the above interest, depreciation of ₹ 5 crores and income-tax of ₹ 4 crores.

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Calculate the amount of interest to be allowed to be claimed under the head "Profits and gains of business or profession" in the computation of M/s ND Ltd. giving appropriate reasons. Also explain allowability of such disallowed interest, if any.

SOLUTION

If an Indian company, being the borrower, incurs any expenditure by way of interest in respect of any debt issued by its non-resident associated enterprise (AE) and such interest exceeds ₹ 1 crore, then, the interest paid or payable by such Indian company in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is lower, shall **not** be allowed as deduction as per section 177.

Further, 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 and limitation of interest deduction would be applicable.

In the present case, M/s TD Inc. holds 40% of the voting power i.e., not less than 26% of the voting power in both M/s ND Ltd. and M/s TY Inc. Accordingly, M/s ND Ltd. and M/s TY Inc. qualify as associated enterprises under section 162(1)(a)(iii).

Since loan of ₹ 90 crores taken by ND Ltd., an Indian company from M/s TM Inc, is guaranteed by M/s TY Inc, an associated enterprise of ND Ltd., such debt shall be deemed to have been issued by an associated enterprise and interest payable to M/s TM Inc shall be considered for the purpose of limitation of interest deduction u/s 177.

Computation of interest to be allowed as per section 177 under the head profits and gains of business or profession of ND Ltd.

Particulars		₹ (in crores)
Net profit		11.00
Add: Interest already debited (₹ 90 crores x 10%)		9.00
Depreciation		5.00
Income-tax		4.00

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EBITDA		**29.00**
Interest paid or payable by ND Ltd.		9.00
Lower of the following would be disallowed		
- Total interest paid or payable in excess of 30% of EBITDA (₹ 9,00,00,000 – ₹ 8,70,00,000) = ₹ 30 lakhs	0.30	
- Interest paid or payable to non-resident AE	9.00	
Interest to be disallowed as deduction		0.30
Interest allowable as deduction under the head "Profits and gains from business or profession (₹ 9,00,00,000 – ₹ 30,00,000)		8.70

Disallowed interest of ₹ 30 lakh shall be carried forward for eight tax years immediately succeeding the tax year in which the disallowance is first computed.

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TEST YOUR KNOWLEDGE

Questions

1. *Examine the consequences that would follow if the Assessing Officer made adjustment following order passed by the TPO to arm's length price in international transactions of the assessee resulting in increase in taxable income. What are the remedies available to the assessee to dispute such adjustment?*

2. *Mr. Hari holds 30% of voting power in ABC Inc, a company incorporated under the laws of Country A. For the purpose of expansion of business, the said company enters into an agreement with XYZ Ltd., a company incorporated under the Indian laws. As per one of the clauses of the agreement, ABC Inc has the power to appoint 6 directors of XYZ Ltd., which has 12 directors on board; none of the six directors appointed by ABC Inc. is an executive director. Further, XYZ Ltd. is engaged in manufacture/processing, and the raw materials and consumables required for such manufacture/ processing during T.Y. 2026-27 are estimated to be ₹ 500 crores, out of which purchases of ₹ 48 crores have been sourced locally and the balance shall be supplied by ABC Inc. The price for the entire purchase has been fixed in the agreement and the conditions for supply are determined by ABC Inc.*

   Advise Mr. Hari as to whether ABC Inc and XYZ Ltd are Associated Enterprises, on the basis of the provisions of the Income-tax Act, 2025.

3. *I. Limited, an Indian Company supplied billets to its holding company, U. Limited, UK during the tax year 2026-27. I. Limited also supplied the same product to another UK-based company, V. Limited, an unrelated entity. The transactions with U. Limited are priced at Euro 500 per MT (FOB), whereas the transactions with V. Limited are priced at Euro 700 per MT (CIF). Insurance and Freight amounts to Euro 200 per MT. Compute the arm's length price for the transaction with U. Limited.*

4. *X Ltd., operating in India, is the dealer for the goods manufactured by Yen Ltd. of Japan. Yen Ltd. owns 55% of the shares of X Ltd., and of the company's 7 directors, 4 were appointed by them. The Assessing Officer, after verification*

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of international transactions of ₹ 300 lakhs of X Ltd. for the relevant tax year and by noticing that the company had failed to maintain the requisite records, had not reported the relevant international transaction, and had failed to furnish the accountant's report under section 172 by the specified date, adjusted its income by making an addition of ₹ 30,00,000 to the declared income and also issued a show cause notice to levy various penalties. X Ltd seeks your expert opinion.

5. *Anush Motors Ltd., an Indian company declared income of ₹ 300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2027:*

   (i) 10,000 cars sold to Rida Ltd., US company, which holds shares carrying 30% of the voting power in Anush Motors Ltd. at a price which is less by $ 200 for each car than the price charged from Shingto Ltd., an unrelated enterprise.

   (ii) Royalty of $ 1,20,00,000 was paid to Kyoto Ltd., a US company, for use of technical know-how in the manufacturing of car. However, Kyoto Ltd. had provided the same know-how to another Indian company for $ 90,00,000. Kyoto Ltd. is the sole owner of technology used by Anush Motors Ltd. in its manufacturing process and the manufacture of cars by Anush Motors Ltd is wholly dependent on the use of know-how owned by Kyoto Ltd.

   (iii) Loan of Euro 1000 crores carrying interest @10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31.3.2027. The total book value of assets of Anush Motors Ltd. on the date was ₹ 90,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @9% p.a. Total interest paid for the year was EURO 100 crores.

   Explain in brief the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for T.Y. 2026-27 keeping in mind that the value of 1$ and of 1 EURO was ₹ 83 and ₹ 94, respectively, throughout the year.

   For the purpose of this question, section 177 is to be ignored.

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6. *What is the legislative objective of bringing into existence the provisions relating to transfer pricing in relation to international transactions? Examine.*

7. *XE Ltd. is an Indian Company in which Zilla Inc., a US company, has 28% shareholding and voting power. Following transactions were entered into between these two companies during the tax year 2026-27.*

   (i) XE Ltd. sold 1,00,000 pieces of T-shirts at $ 2 per T-Shirt to Zilla Inc. The identical T-Shirts were sold to unrelated party namely Kennedy Inc., at $ 3 per T-Shirt.

   (ii) XE Ltd. borrowed $ 2,00,000 from a foreign lender based on the guarantee of Zilla Inc. For this, XE Ltd. paid $ 10,000 as guarantee fee to Zilla Inc. To an unrelated party for the same amount of loan, Zilla Inc. collected $ 7000 as guarantee fee.

   (iii) XE Ltd. paid $15,000 to Zilla Inc. for getting various potential customers details to improve its business. Zilla Inc. provided the same service to unrelated parties for $ 10,000.

   Assume the rate of exchange as 1 $ = ₹64

   XE Ltd. is located in a Special Economic (SEZ) and its income before transfer pricing adjustments for the year ended 31st March, 2027 was ₹ 1,200 lakhs.

   Compute the adjustments to be made to the total income of XE Ltd. Further, state whether XE Ltd. is eligible to claim deduction under section 144 in respect of the income enhanced on account of such transfer pricing adjustments.

8. *Examine, with reasons, whether the two enterprises referred to in the following independent situations qualify as **associated enterprises** under the transfer pricing provisions of the Income-tax Act, 2025:*

   (i) PQR Inc, a US company having its place of effective management also in the USA, has advanced a loan equivalent to ₹ 170 crores to Mahanadi Ltd., an Indian company on 10-4-2026. The total book value of assets of Mahanadi Ltd. is ₹ 300 crores. The market value of the assets, however, is ₹ 320 crores.

   (ii) Queenland plc., a French company having its place of effective management also in France, has the power to appoint 3 of the directors

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of Godavari Ltd, an Indian company, whose total number of directors in the Board is 8. None of the three directors appointed by Queenland plc. is an executive director.

(iii) Total value of raw materials and consumables of Saraswati Ltd., an Indian company, is ₹ 900 crores. Of this, supplies to the tune of ₹ 830 crores are by Zoel GmbH, a German company having its place of effective management in Germany, at prices and terms decided by the German company.

9. *NP Ltd., an Indian Company, has borrowed ₹ 80 crores on 01-04-2026 from M/s. TL Inc, a company incorporated in London, at an interest rate of 10% p.a. The said loan is repayable over a period of 5 years. Further, loan is guaranteed by M/s ST Inc. incorporated in UK. M/s. Tweed Inc, a non-resident, holds shares carrying 40% of voting power both in M/s NP Ltd. and M/s ST Inc.*

Net profit of M/s. NP Ltd. for tax year 2026-27 was ₹ 7 crores after debiting the above interest, depreciation of ₹ 6 crores and income-tax of ₹ 4 crores. Calculate the amount of interest to be disallowed under the head "Profits and gains of business or profession" in the computation of M/s NP Ltd., giving appropriate reasons.

10. *MNO Ltd., having its registered office in Mumbai, is engaged in multiple businesses. It has borrowed ₹ 200 crores from State Bank of India (SBI) for which 100% guarantee was given by the parent company, ABC Inc. of Country A. The total borrowings of MNO Ltd. are ₹ 1,000 crores.*

MNO Ltd. purchases mobile phones from ABC Inc. The mobile phones are branded for which royalty at ₹ 100 per mobile phone sold is paid to ABC Inc. Similar mobile phones are also sold to other customers in India by ABC Inc., but no royalty is charged from them. The credit period offered to MNO Ltd. is 2 months, whereas for other customers, the credit period is 1 month.

During the year, 10 lakh mobile phones were bought for an aggregate sum of ₹ 2,600 crores from ABC Inc., inclusive of the separately payable royalty of ₹ 100 per mobile phone. The purchase could be assumed as uniform throughout the tax year 2026-27. The cost of capital may be adopted as 10% per annum. ABC Inc. would have billed ₹ 2,400 crores (excluding interest

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component for the delay beyond 1 month) for supply of identical quantity of similar mobile phones to other customers. It may be assumed that the entire purchase has been sold out by 31st March, 2027.

Determine the arm's length price (ALP) of the transaction relating to purchase of mobile phones by MNO Ltd. from ABC Inc. and the consequent adjustment, if any, to the total income of MNO Ltd. for the tax year 2026-27.

11. *Beta Ltd., an Indian company, has two units in India, a manufacturing unit in Hyderabad and a trading unit in Surat. Beta Ltd., has entered into various international transactions with its associated enterprises from both the units. The assessment of Beta Ltd., an Indian company, for tax year 2026-27 is pending before the Assessing Officer who referred the matter to Transfer Pricing Officer (TPO) for determination of arm's length price (ALP) in respect of its manufacturing unit at Hyderabad. The TPO, however, expanded the scope of his work by calling for details in respect of the trading unit of Beta Ltd. located at Surat.*

Examine the procedure to be followed by the Assessing Officer before making reference to TPO. Can the TPO enlarge his scope of work by calling for details of trading activity at Surat, when the Assessing Officer has made reference only in respect of the manufacturing unit at Hyderabad? Examine.

Answers

1. In case the Assessing Officer makes adjustment to arm's length price in an international transaction which results in increase in taxable income of the assessee, the following consequences shall follow: -

(1) No deduction under Chapter VIII shall be allowed from the income so increased.

(2) No corresponding adjustment would be made to the total income of the other associated enterprise (in respect of payment made by the assessee from which tax has been deducted or is deductible at source) on account of increase in the total income of the assessee on the basis of the arm's length price so recomputed.

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The remedies available to the assessee to dispute such an adjustment are:-

(1) In case the assessee is an eligible assessee under section 275, he can file his objections to the variation made in the income within 30 days of the receipt of draft order by him to the Dispute Resolution Panel and Assessing Officer. Appeal against the order of the Assessing Officer in pursuance of the directions of the Dispute Resolution Panel can be made to the Appellate Tribunal.

(2) In any other case, he can file an appeal under section 357 to the Commissioner (Appeals) against the order of the Assessing Officer within 30 days from the date of service of notice of demand.

(3) The assessee can opt to file an application for revision of order of the Assessing Officer under section 378 within one year from the date on which the order in question is communicated or the date on which he otherwise came to know of it, whichever is earlier, provided the time limit for appeal to the Commissioner (Appeals) or the Appellate Tribunal has expired or the assessee has waived the right of such an appeal. The eligibility conditions stipulated in section 378 should be fulfilled.

2. Section 162(1) of the Income-tax Act, 2025 provides the circumstances in which an associated enterprise relationship exists between two enterprises.

In the present case, the relationship between ABC Inc. and XYZ Ltd. has to be examined under the relevant clauses of section 162(1).

(i) Appointment of Directors [Section 162(1)(d)]: An associated enterprise relationship exists where **more than half** of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise are appointed by the other enterprise.

In the present case:

- Total number of directors on the Board of XYZ Ltd. = 12
- Directors appointed by ABC Inc. = 6

Since ABC Inc. has the power to appoint only half of the directors and not more than half, the condition specified under section 162(1)(d) is

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not satisfied. Further, none of the six directors appointed by ABC Inc. is an executive director. Therefore, an associated enterprise relationship cannot be established on this basis.

(ii) Supply of Raw Materials [Section 162(1)(g)]: Section **162(1)(g)** provides that an associated enterprise relationship exists where:

- **90% or more** of the raw materials or consumables required for the manufacture or processing of goods are supplied by the other enterprise (or by persons specified by it); and
- the **prices and other conditions** relating to such supply are influenced by that enterprise.

In the present case:

- Raw materials and consumables required by XYZ Ltd. for manufacture/processing = ₹ 500 crores
- Purchases from local sources = ₹ 48 crores
- Purchases from ABC Inc. = ₹ 452 crores

Thus,

$$\frac{₹\ 452\ \text{crores}}{₹\ 500\ \text{crores}} \times 100 = 90.4\%$$

Accordingly, 90.4% of the purchases are supplied by ABC Inc. Further, the agreement provides that:

- the purchase price is fixed by ABC Inc.; and
- the conditions of supply are also determined by ABC Inc.

Therefore, both the conditions prescribed under section 162(1)(g) are satisfied.

Conclusion: Although the condition relating to appointment of directors under section 162(1)(d) is not satisfied, the conditions specified under section 162(1)(g) are fulfilled.

Accordingly, ABC Inc. and XYZ Ltd. are associated enterprises as per section 162(1)(g).

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3. In this case, I. Limited, the Indian company, supplied billets to its foreign holding company, U. Limited. Since the foreign company, U. Limited, is the holding company of I. Limited, I. Limited and U. Limited are the associated enterprises within the meaning of section 162.

As I. Limited supplies similar product to an unrelated entity, V. Limited, UK, the transactions between I. Limited and V. Limited can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between I. Limited and U. Limited Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

However, the transactions are not on identical delivery terms. Transactions with U. Limited are on FOB basis, whereas transactions with V. Limited are on CIF basis. This difference has to be adjusted before comparing the prices.

	Amount (in Euro)
Price per MT of billets to V. Limited (CIF)	700
Less: Cost of insurance and freight per M.T.	200
Adjusted Price per M.T. (FOB)	500

Since the adjusted price for V. Limited, UK and the price fixed for U. Limited are the same, the arm's length price is Euro 500 per MT. Since the sale price to related party (i.e., U. Limited) and unrelated party (i.e., V. Limited) is the same, the transaction with related party U. Limited has also been carried out at arm's length price.

4. The facts of the case indicate that X Ltd. and Yen Ltd. of Japan are associated enterprises since Yen Ltd. holds 55% shares of X Ltd. and has appointed more than half of the board of directors of X Ltd. Since Yen Ltd. is a non-resident, any transaction between X Ltd. and Yen Ltd. would fall within the meaning of "international transaction" under section 163. Therefore, the income arising from such transactions have to be computed having regard to the arm's length price.

The action of the Assessing Officer in making addition to the declared income and issuing show cause notice for levy of various penalties is ***correct*** since X Ltd. had committed defaults, as listed hereunder, in respect of which penalty, as briefed hereunder, is imposable -

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The immunity in section 439(8)(d) is not available to X Ltd. That immunity applies only where, *inter alia*, the prescribed information and documents have been maintained, the international transaction has been reported, and all material facts relating to it have been disclosed. X Ltd. has satisfied none of these conditions.

(i) Failure to report any international transaction or any transaction, deemed to be an international transaction or any specified domestic transaction, to which the provisions of Chapter X applies, would attract penalty @ 200% of the amount of tax payable since it is a case of misreporting of income referred under section 439(11) read with section 439(10).

(ii) Failure to maintain the requisite records as required under section 171, and failure to report the international transaction, attract section 442(1)(a) and section 442(1)(b) respectively. The Assessing Officer or the Commissioner (Appeals) may impose a penalty of 2% of the value of each international transaction. The attraction of more than one limb of section 442(1) in respect of the same transaction does not multiply that rate.

This penalty is distinct from the consequence in (i) above: the same failure attracts 200% of the tax payable on the mis-reported income under section 439(11)(f) read with section 439(10) and 2% of the value of each transaction under section 442(1)(b).

(iii) Under section 428(d), failure to furnish the accountant's report required under section 172 attracts a fee of ₹ 50,000 for a delay upto one month for which such failure continues and ₹ 1,00,000 thereafter.

The Assessing Officer shall give an opportunity of being heard to the assessee with a show cause notice as to why the arm's length price should not be determined on the basis of material or information or document in the possession of the Assessing Officer.

Note: *It is assumed that X Ltd. has not entered into an APA and has also not opted to be subject to Safe Harbour Rules.*

5. Any income arising from an international transaction between two or more associated enterprises shall be computed having regard to the arm's length

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price in accordance with the provisions of Chapter X of the Income-tax Act, 2025.

Section **162** defines an **"associated enterprise"** and sub-section (1) specifies the circumstances in which an associated enterprise relationship exists. Applying the provisions of section 162(1) to the given facts, it is evident that **Anush Motors Ltd.** is associated with:

(i) Rida Ltd. as per section 162(1)(a)(ii), because this company holds shares carrying not less than 26% of the voting power in Anush Motors Ltd.;

(ii) Kyoto Ltd. as per section 162(1)(f), since this company is the sole owner of the technology used by Anush Motors Ltd. in its manufacturing process;

(iii) Dorf Ltd. as per section 162(1)(b), since this company has financed an amount which is not less than 51% of the book value of total assets of Anush Motors Ltd.

Accordingly, the international transactions entered into by Anush Motors Ltd. with the above associated enterprises are required to be computed at the arm's length price and the income chargeable to tax shall be computed accordingly.

Particulars		₹ (in crores)
Income of Anush Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter X		300.00
Add:	Difference on account of adjustment in the value of international transactions:	
(i)	Difference in price of car @ $ 200 each for 10,000 cars ($ 200 x 10,000 x ₹ 83)	16.60
(ii)	Difference for excess payment of royalty of $ 30,00,000 ($ 30,00,000 x ₹ 83) [See Note below]	24.90
(iii)	Difference for excess interest paid on loan of EURO 1000 crores (₹ 94*1000*1/100)	940.00
Total Income		1,281.50

***Note**: It is presumed that Anush Motors Ltd. has not entered into an Advance Pricing Agreement or opted to be subject to Safe Harbour Rules.*

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6. The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions prompted the Government to set up an Expert Group to examine the issues relating to transfer pricing.

There is a possibility that two or more entities belonging to the same multinational group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction which is tax haven or where the tax liability is minimum. This may adversely affect a country's share of due revenue. The increasing participation of multinational groups in economic activities in India 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, which may lead to erosion of tax revenue. Accordingly, the transfer pricing provisions contained in Chapter X of the Income-tax Act, 2025 provide a statutory framework for determining the arm's length price of international transactions between associated enterprises so as to ensure that income arising from such transactions is computed on a fair and reasonable basis. The objective of these provisions is to prevent tax avoidance through profit shifting and to safeguard the revenue of the country by ensuring that taxable profits attributable to India are appropriately determined.

7. Any income arising from an international transaction between two or more associated enterprises shall be computed having regard to the arm's length price in accordance with the provisions of Chapter X of the Income-tax Act, 2025.

Section **162(1)(a)(ii)** provides that an associated enterprise relationship exists where one enterprise holds **not less than 26% of the voting power** in the other enterprise. Since Zilla Inc. holds 28% of the voting power in XE Ltd., the two companies are associated enterprises.

As per Section 163, the transactions entered into between these two companies for sale of product, lending or guarantee and provision of

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services relating to market research are included within the meaning of "international transaction".

Accordingly, transfer pricing provisions would be attracted and the income arising from such international transactions have to be computed having regard to the arm's length price. In this case, from the information given, the arm's length price has to be determined taking the comparable uncontrolled price method to be the most appropriate method.

Particulars	₹ in lakhs
Amount by which total income of XE Ltd. is enhanced on account of adjustment in the value of international transactions:	
(i) Difference in price of T-Shirt @ $ 1 each for 1,00,000 pieces sold to Zilla Inc. ($ 1 x 1,00,000 x ₹ 64)	64.00
(ii) Difference for excess payment of guarantee fee to Zilla Inc. for loan borrowed from foreign lender [($10,000 – $7,000) × ₹ 64]	1.92
(iii) Difference for excess payment for services to Zilla Inc. [($15,000 – $10,000) × ₹ 64]	3.20
	69.12
Income after Transfer Pricing Adjustments	1269.12
Section 165(7) prohibits any deduction under Chapter VIII in respect of the income by which total income is enhanced under section 165(6). Section 144 forms part of Chapter VIII. Consequently, no deduction under section 144 is allowable in respect of the transfer-pricing enhancement of ₹ 69.12 lakh.	

8. (i) As per section 162(1)(b) of the Income-tax Act, 2025, an enterprise is regarded as an associated enterprise of another enterprise if it has advanced a loan to the other enterprise and such loan constitutes not less than 51% of the book value of the total assets of the other enterprise.

PQR Inc, a foreign company, has advanced loan of ₹ 170 crores to Mahanadi Ltd., an Indian company, which amounts to 56.67% (170/300*100) of book value of assets of Mahanadi Ltd. Since the loan constitutes 56.67% of the book value of the total assets, which

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exceeds the prescribed threshold of 51%, PQR Inc. and Mahanadi Ltd. qualify as associated enterprises under section 162(1)(b).

(ii) As per section 162(1)(d), two enterprises qualify as associated enterprises if **more than half of the board of directors or members of the governing board**, or one or more executive directors/executive members, are appointed by the other enterprise. Queenland plc, a foreign company has the power to appoint 37.50% (3 out of 8) of the directors of an Indian company, Godavari Ltd.

Since more than half of the Board is not appointed by Queenland plc. and none of the three directors appointed by Queenland plc. is an executive director, Queenland plc. and Godavari Ltd. do not qualify as associated enterprises under section 162(1)(d).

(iii) As per section 162(1)(g), two enterprises qualify as associated enterprises where -

- **90% or more** of the raw materials and consumables required for manufacture or processing are supplied by the other enterprise (or persons specified by it); and
- the **prices and other conditions** relating to such supplies are influenced by the supplying enterprise.

Since Zoel GmbH, a German company, supplies 92.22% of the raw materials and consumables required by Saraswati Ltd., an Indian company, which is more than the specified threshold of 90%; and the prices and terms of supply are decided by the German company, the two companies qualify as associated enterprises under section 162(1)(g).

9. If an Indian company or the permanent establishment of a foreign company in India, being the borrower, incurs any expenditure by way of interest in respect of any debt issued by its non-resident associated enterprise (AE) and such interest exceeds ₹ 1 crore during the tax year, then, the interest paid or payable by such Indian company in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is lower, shall not be allowed as deduction as per section 177.

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Further, where the lender is not an associated enterprise has issued debt, then such debt shall be deemed to have been issued by an associated enterprise if 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.

In the present case, since M/s Tweed Inc holds 40% of voting power i.e., not less than 26% of voting power in both NP Ltd and M/s ST Inc, NP Ltd. and M/s ST Inc are associated enterprises.

Since loan of ₹ 80 crores taken by NP Ltd., an Indian company from M/s TL Inc, is guaranteed by M/s ST Inc, an associated enterprise of NP Ltd., such debt shall be deemed to have been issued by an associated enterprise and interest payable to M/s TL Inc shall be considered for the purpose of limitation of interest deduction under section 177.

Computation of interest to be disallowed as per section 177 in the computation of income under the head profits and gains of business or profession of NP Ltd.

Particulars		₹
Net profit		7,00,00,000
Add: Interest already debited (₹ 80 crores x 10%)		8,00,00,000
Depreciation		6,00,00,000
Income tax		4,00,00,000
EBITDA		**25,00,00,000**
Interest paid or payable by NP Ltd.		8,00,00,000
Lower of the following would be disallowed		
- Total interest paid or payable in excess of 30% of EBITDA (₹ 8,00,00,000 – ₹ 7,50,00,000)	₹ 50,00,000	
- Interest paid or payable to non-resident AE	₹ 8,00,00,000	
Interest to be disallowed as deduction		50,00,000

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10. MNO Ltd., an Indian company, and ABC Inc., a Country A based company, are associated enterprises as per section 162, since ABC Inc. is a parent company of MNO Ltd. Further, the purchase of mobile phones by MNO Ltd. from ABC Inc., a non-resident associated enterprise, constitutes an international transaction under section 163. Accordingly, the arm's length price of the transaction is required to be determined in accordance with section 165.

ABC Inc. is selling mobile phones to unrelated customers, which would be the comparable uncontrolled transaction in this case. The purchase price for unrelated customers has to be adjusted by taking into consideration the functional differences existing between the transactions of ABC Inc. with associated enterprise (MNO Ltd.) and other unrelated parties.

Accordingly, the arm's length price for purchase of mobile phones has to be computed for working out the impact on assessable value as per CUP method.

Computation of Arm's Length Price

Particulars	₹ in crores
Purchase price of mobile phones by unrelated parties from ABC Inc.	2,400
Adjustments for functional differences	
Add: Royalty payable by MNO Ltd. [₹ 100 per mobile phone x 10,00,000]	10
Cost of capital for 1 month credit which is not given to unrelated party [10% x ₹ 2,400 crore x 1/12]	20
Arm's Length Price of 10,00,000 mobile phones (A)	2430
Purchase price of mobile phone by MNO Ltd. from ABC Inc., its parent company (associated enterprise) (B)	2600
Amount to be added to its total income (B) – (A)	170

Accordingly, the purchase consideration paid by MNO Ltd. exceeds the arm's length price by ₹170 crores. Therefore, the total income of MNO Ltd. shall be enhanced by ₹170 crores in accordance with the transfer pricing provisions.

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11. As per section 166(1), where the Assessing Officer considers it necessary or expedient so to do, he may refer the computation of the arm's length price in relation to the international transaction or specified domestic transaction entered by any person, being an assessee, to the Transfer Pricing Officer (TPO).

However, the Assessing Officer has to take the prior approval of the Principal Commissioner of Income-tax (PCIT)/Commissioner of Income-tax (CIT) before making such a reference.

Further, section 166(5) provides that where, during the course of the proceedings before the TPO, any other international transaction or specified domestic transaction, other than the transaction referred under section 166(1), or any international transaction or specified domestic transaction not reported under section 172, comes to the notice of the TPO, the provisions of Chapter X shall apply as if such transaction had also been referred to the TPO under section 166(1).

The Assessing Officer has made reference for determination of ALP in respect of the manufacturing unit at Hyderabad which shall be taken as the proceedings before him (TPO).

Section 166(5) permits the TPO to determine the arm’s length price of another international transaction or specified domestic transaction that comes to his notice during the proceedings, even though that transaction was not the one originally referred. Accordingly, the TPO may call for details of the Surat trading activity only with respect to international transactions or specified domestic transactions comes to his notice within section 166(5); the provision does not confer unrestricted jurisdiction over every activity of the Surat unit.

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