

Tax Hotline

June 19, 2006

RAISING THE BAR: ARE YOU STILL GETTING COVERED?

In a recent move that will benefit the multinational companies entering into international transactions (as defined in the Indian transfer pricing regulations) with their Indian affiliates, the Finance Ministry has decided to increase the threshold limit for transfer pricing scrutiny of international transactions from INR 5 crore (approx. USD 1.10 million) to INR 15 crore (approx. USD 3.30 million).

The Indian transfer pricing regime was introduced in 2001 to plug the possible revenue leakages arising from the manipulation of prices of international transactions entered into by Indian entities with their overseas affiliates. In 2003, the Central Board of Direct taxes ("CBDT"), vide its Instruction No. 3 of 2003 (261 ITR (St.) 0051), had laid down that wherever the aggregate value of international transactions crosses the threshold of INR 5 crores, it should be referred to the Transfer Pricing Officer ("TPO") and picked up for "compulsory scrutiny". The transfer pricing audits for the fiscal years 2001-02 and 2002-03 have already been completed by the TPOs and transfer pricing adjustments to the extent of approximately INR 3,200 crores (approx. USD 71.1 million) have been made to the profits of the taxpayers.

The INR 5 crore threshold has been perceived for a while as being too low and has been creating a compliance and administrative burden on both the taxpayers and the Indian tax authorities. Keeping the above in perspective, recently the Finance Ministry has decided to increase the threshold limit for "compulsory scrutiny" of international transactions from the existing INR 5 crore to INR 15 crore. Thus, all cases, where the aggregate value of international transactions exceeds INR 15 crore, will be taken up for compulsory scrutiny by the Indian tax authorities. It is expected that this move would significantly reduce the compliance costs of majority of multinational companies having international transactions with their Indian affiliates.

The above enhancement of threshold has currently been finalized by CBDT for scrutiny of non-corporate taxpayers for the fiscal year 2006-07. However, senior Finance Ministry officials have indicated that the new norms are set to apply for compulsory scrutiny of corporate taxpayers as well. This would be a welcome relief for the sectors such as banking, diamond trade, IT, ITES, auto and pharma, which have been hardest hit by the recently concluded transfer pricing audits, due to the large number of international transactions entered into by the entities operating in these sectors.

In addition to above change, it also remains to be seen whether the Indian tax authorities would consider introducing "safe harbour" provisions for service providers where a specified mark-up over their costs would be deemed to meet the Indian transfer pricing regulations. Such a move could further ease the compliance costs for the Indian tax authorities and the taxpayers.

- Jitender Tanikella & Nishchal Joshipura

Source: *The Economic Times* (dated June 19, 2006) - **"Transfer pricing scrutiny limit to be tripled"**.

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