

## Transfer Pricing Audit Report: Scope and Responsibility of An Accountant



*The examination of accounts and records by an accountant under Section 92E is limited to giving her/his opinion on whether “proper information and documents as are prescribed” have been kept by the assessee in relation to the international transaction(s) or Specified Domestic Transaction(s) to be reported in Form No. 3CEB. Author duo in their article discuss the TP (transfer pricing) audit report from various perspectives, especially from that of an accountant’s responsibility. Read on...*

### Introduction

Section 92E mandates every person entering into an international transaction or specified domestic transaction (SDT) during a previous year to obtain and file a report in Form No. 3CEB from an Accountant on or before 30<sup>th</sup> November of the relevant assessment year. The Accountant has to give his opinion in Form No. 3CEB on whether information and documents prescribed under Section 92D read with Rule 10D have been kept by the Assessee in respect of the

international transaction(s) or SDT(s) entered into by the taxpayer.

### Scope of Examination under Section 92E

While the examination under Section 92E is not an audit requiring the opinion of the Accountant on the “true and fair” view of the financial statements of the enterprise, the Accountant is required to opine on whether “proper information and documents as are prescribed” have been kept by the Assessee as prescribed in respect of the international transaction(s) or SDT(s) entered into by him during the previous year.

The documentation requirements in this regard are laid down in the Section 92D read with Rule 10D. Rules have prescribed thirteen different types of information and documents that a person has to keep and maintain in relation to the international transactions undertaken in a given financial year,



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# International Taxation



which can be broadly classified into the following three categories:

- (i) **Enterprise-wise related documents:** These documents describe the enterprise, the relationships with other associated enterprise (AE), the nature of business carried out, etc. This information is, largely, descriptive [Clauses (a) to (c)].
- (ii) **Transaction-specific documents:** These documents explain international transactions in greater detail. These include information with regard to each transaction, such as nature and terms of the contract, description of the functions performed, assets employed and risks assumed by each party to the transaction, economic and market analyses, etc. The information is both descriptive and quantitative in nature [Clauses (d) to (h)].
- (iii) **Arms' length computation-related documents:** These documents describe and detail the methods considered, actual working assumptions, policies, etc., adjustments made to transfer prices and any other relevant information, data, document relied for determination of arm's length price [Clauses (i) to (m)].

The aforesaid list of documents while mandatory, is only *prescriptive* in nature and may vary depending on the nature of transactions. An accountant should exercise her/his professional judgement while assessing whether prescribed documentation as required under the provisions are maintained.

Further, in case of a taxpayer where the aggregate value of international transaction(s) recorded in books of accounts during a previous year does not exceed INR 1 crore, a relief is provided under sub-Rule (2) of Rule 10D from maintaining the specified information and documents. However, the

proviso thereunder necessitates such a taxpayer to substantiate that income arising from international transactions has been computed in accordance with Section 92 on the basis of material in her/his possession.

Accountant's report in Form No. 3CEB consists of three paragraphs dealing with distinct aspects, which *inter-alia* includes accountant's opinion on maintenance of information and documents as prescribed under the Act, expressing an opinion whether particulars declared in the Annexure to Form 3CEB are true and correct.

Accountant is expected to apply professional judgement while determining the extent of examination of the said accounts and records, materiality and the need of test checking the underlying documents. The examination should be restricted to such details and matters that are sufficient to determine whether proper documents have been maintained with respect to the international transaction(s) and SDT(s), and whether the particulars disclosed in the Annexure to Form 3CEB are *true and correct*.

In case where the accountant is dissatisfied that specified records as prescribed have not been maintained properly by a taxpayer, the report under Form 3CEB must be qualified suitably or disclose the same in the report, depending on the facts of the case.

In this context, the ICAI in its *Guidance Note on Report under Section 92E* has prescribed that—the accountant is only required to ensure that the method stated as being used to determine the arm's length price by the taxpayer has actually been used and it is not the accountant's responsibility to ensure that the method so used is the most appropriate method as prescribed by the Act.

It may be noted that while the accountant can obtain a representation from management wherever necessary, in respect of matters that may be directly verified by the accountant, mere obtaining of a management representation letter will not be sufficient compliance with the Generally Accepted Auditing Standards.

## Responsibility of Accountant While Examining Documents and Information

- Understand the business of taxpayers and identify associated enterprises/related parties;
- Understand the nature of underlying international transactions and SDTs;

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# International Taxation

- Review accuracy and completeness of information compiled and maintained by taxpayers;
- Reconcile transactions in Form 3CEB with audited accounts (related party disclosure, notes to accounts) and resolve discrepancies, if any;
- Verify details mentioned in the notes to accounts, register of transactions with related parties, etc.;
- Test-check invoices, negotiations, correspondence, ledger accounts, agreements, etc.;
- Ensure all prescribed documents as per Rule 10D are maintained and shared by the taxpayers for verification;
- Compare last year's Form 3CEB with that of the current year to ensure no regular international transactions or SDT are missed out; and
- Obtain representation from management on whatsoever matter which is not verifiable directly.

## Due Date of Filing of Form 3CEB

Due date to file the Form 3CEB by an accountant is on or before 30<sup>th</sup> November of the relevant assessment year.

## Manner of Filing Form 3CEB

With effect from AY 2013-14, the Central Board of Direct Taxes (CBDT) has made it mandatory for taxpayers to file Form 3CEB online on the income-tax portal. However, unlike the manual filing of Form 3CEB, the online utility for filing the Form 3CEB does not provide facility for documenting notes by an accountant, if any, for relevant clauses for the Form 3CEB.

ICAI in its *Guidance Note on Report under Section 92E* has considered such a scenario and provided that—in such a scenario, the accountant may issue a memo under her/his signature to the taxpayer enterprise presenting her/his notes against relevant clauses or Annexure to the Form 3CEB. Subsequently, a physical copy of the Form 3CEB

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along with the signed notes may be filed with the income-tax authorities as a practice to ensure the utmost level of compliance.

The above approach has been harnessed by many taxpayer enterprises while filing the Form 3CEB online on the income-tax portal and is well appreciated and accepted by the income-tax authorities.

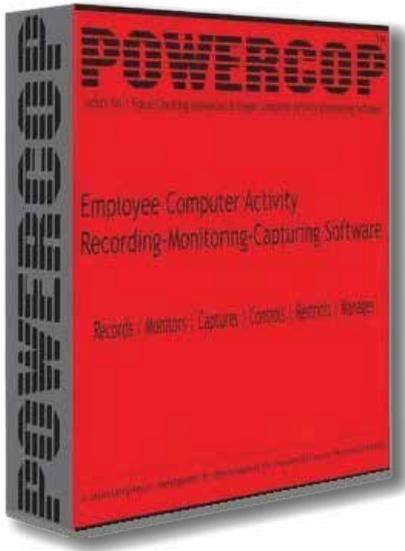
## Reporting of International Transactions in Form 3CEB

Section 92 of the Act, the charging section for transfer-pricing provisions, provides that “any income” arising from an international transaction shall be computed having regard to the arm's length price. There have been long standing debates and arguments on the applicability of transfer-pricing provisions to the international transactions not chargeable to tax in India.

However, in the recent past, a plethora of judgements have been pronounced by various Authorities of Advance Rulings (AARs), High Courts and Tax Tribunals decreeing on the applicability of transfer-pricing provisions to ‘international’ transactions not impacting taxable profits or income of the taxpayers. One such landmark judgement is pronounced by the Bombay High Court in the case of *Vodafone India Services Pvt. Ltd. [2014] (368 ITR 1)*, wherein it was held that the jurisdiction to apply Chapter X of the Act would occasion only when income is earned out of international transaction and such income is chargeable to tax under the Act. Further, in this regard, the CBDT has issued a press release dated 28<sup>th</sup> January 2015, wherein the CBDT has accepted the aforesaid judgement of the Bombay High Court in case of *Vodafone India Services Pvt. Ltd. (supra)* and decided not to file any appeal before the Supreme Court against the said order.

However, due to the introduction of stringent disclosure requirements and penal provisions with respect to non-filing of Form 3CEB and non-reporting the transactions in it, taxpayers are compelled to report such transactions in the report, on a conservative basis.

Recently, the Mumbai Tribunal in case of *BNT Global Private Limited (ITA No. 4111/Mum/2016)* held that not reporting the international transaction of ‘issue of shares to AE’ is a violation of Section 92E and consequently, a levy of penalty under Section 271BA is consequential and unavoidable. The Mumbai Tribunal placed the reliance on coordinate



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# International Taxation

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**Recently, Mumbai Tribunal in case of *BNT Global Private Limited (ITA No. 4111/Mum/2016)* held that not reporting the international transaction of 'issue of shares to AE' is a violation of Section 92E and consequently a levy of penalty under Section 271BA is consequential and unavoidable.**

— [REDACTED] —

bench ruling in case of *IL&FS Maritime Infrastructure Company* wherein it was held that share investment transactions fall within the purview of Section 92 and accordingly, filing of Form 3CEB is required.

In the above scenario, taxpayers can resort to the below-given approaches to avoid the penal consequences and protracted litigation, depending on a case-to-case basis:

- Report such transactions in the Form 3CEB along with an appropriate disclosure in the notes to Form 3CEB stating that it has been disclosed on a without prejudice basis and it is outside the purview of Section 92. It is also advisable to record the rationale behind the contention of the taxpayer;
- Alternatively, one can also disclose such transactions only by way of notes to the Form 3CEB and by providing appropriate explanation to it.

Drawing an analogy from the aforementioned rulings, “international transactions” not impacting taxable profits or income of the taxpayer should be reported in the Form 3CEB in order to prevent the levy of penalty under the Act.

## **Use of “Other Method” Prescribed under Rule 10AB**

“Other Method” was introduced in TP laws with effect from AY 2012-13, whereby “the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts” can be considered for the determination of arms’ length price.

The intention behind introducing such “other method” is to provide more flexibility in applying an appropriate method for benchmarking unique transactions not covered by the existing five benchmarking methods. “Other Method” can be applied *inter alia* while relying on the following

documents/information for benchmarking a transaction:

- Third party quotations,
- Valuation reports,
- Tender/Bid documents,
- Documents relating to the negotiations,
- Standard rate cards,
- Commercial and economic business models, etc.

Introduction of “Other Method” is considered a welcome move by the taxpayers struggling to determine arms’ length price for the transactions not fitting the first five methods of benchmarking. Complex business transactions such as purchase and sale of unlisted equity shares/ debentures, payment for availing of intra-group services, transactions using revenue split as business model, receipt/ payment of brokerage commissions, etc., can now be benchmarked using “Other Method” as most appropriate method.

## **Deemed Associated Enterprise**

Finance Act, 2002 introduced the concept of “Deemed Associated Enterprise” into the transfer-pricing provisions vide amending the Section 92A of the Act. By virtue of this amendment, a transaction undertaken between two unrelated parties (one enterprise being a non-resident), which satisfies criteria mentioned under Section 92A(2), shall be considered to be an international transaction under the transfer-pricing provisions. Section 92A(2) lays down 13 circumstances under which two unrelated enterprises shall be deemed to be *associated enterprises*. In case, where the accountant is not able to verify such transactions directly, she/he must obtain a representation from the taxpayers that they have disclosed all transactions entered during the previous year which are covered under the aforementioned deeming provision.

## **Deemed International Transaction**

In order to bring a well-thought-out transaction under the purview of transfer-pricing provisions, which are primarily intended to circumvent the

— [REDACTED] —

**Complex business transactions such as purchase and sale of unlisted equity shares/ debentures, payment for availing of intra-group services, transactions using revenue split as business model, receipt/ payment of brokerage commissions, etc., can now be benchmarked using “Other Method” as most appropriate method.**

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**TP provisions prescribe that every person who has entered into international transaction or SDT shall obtain an accountant's report in Form 3CEB. This provision shall also extend in case of permanent establishments (including a branch) of overseas entities. Various rulings have decreed in favour of Revenue that a permanent establishment of a foreign company has to be treated as a separate entity for the purpose of transfer pricing.**

transfer pricing laws, Section 92B was amended to cover cases where an independent third party was interposed by two AEs to remain out of the scope of transfer pricing provisions. Sub-Section (2) of Section 92B covers the transactions where a prior agreement between a third party and the AE exists or where the terms of relevant transaction with the third party are determined in substance by the AE. It is worthwhile to note that with effect from FY 2014-15, transactions of the taxpayer with an Indian company are also covered within the ambit of "Deemed International Transaction".

The primary responsibility of identification and analysing such transactions rests with the taxpayers. In this context, taxpayers are required to report in Form 3CEB and maintain the relevant documents prescribed under the Rules with regard to the "Deemed International Transaction" entered by the taxpayers during the previous year.

### **Filing of Form 3CEB in Case of Permanent Establishment of An Overseas Entity**

TP provisions prescribe that every person who has entered into international transaction or SDT shall obtain an accountant's report in Form 3CEB. This provision shall also extend in case of permanent establishments (including a branch) of overseas entities. Various rulings have decreed in favour of Revenue that a permanent establishment of a foreign company has to be treated as a separate entity for the purpose of transfer pricing. Therefore, every transaction between a permanent establishment (in form of Indian branches of overseas group entities) and its head office should be reported in Form 3CEB of the relevant entities.

However, the data which is not relevant in case of such permanent establishments may not be maintained and the Accountant should apply his professional judgement while giving her/his opinion in Form 3CEB.

### **Penalties Associated with Non-Filing of Report under Section 92E/Furnishing Inaccurate Details**

Non-filing of Form 3CEB may give rise to following penal consequences:

- Penalty under Section 271AA at the rate of 2% of the value of each international transaction for non-reporting of transaction/ furnishing incorrect information; and
- Penalty under Section 270A(1) for under-reporting or misreporting of income:
  - o A sum equal to 50% of the amount of tax payable on under-reported income; and
  - o A sum equal to 200% of the amount of tax payable on under-reported income where under-reported income is in consequence of any misreporting.
- Penalty under Section 271BA amounting to INR 1,00,000 for non-filing of Form 3CEB.

Further, in order to fix the accountability on an accountant issuing the Form 3CEB and ensure the utmost standards of due-diligence are adhered to before making such certification, Section 271J has been introduced *vide* The Finance Act, 2017, providing that if an accountant or a merchant banker or a registered valuer, furnishes incorrect information in a report or certificate under any provisions of the Act or the rules made thereunder, the Assessing Officer or the Commissioner (Appeals) may direct her/him to pay a sum of INR 10,000 for each such report or certificate by way of penalty.

### **Conclusion**

In the world of MNEs entering complex business transactions within group entities, there has been a steep rise in the number of MNE taxpayers filing Form 3CEB over the past years and reporting complex cross border transactions.

While the responsibility entrusted on an accountant under Section 92E is limited to the examination of accounts and records and giving her/his opinion on whether "proper information and documents as are prescribed" have been kept by the taxpayer in relation to the international transaction(s) or SDTs to be reported in Form 3CEB, it is the professional duty of a chartered accountant to ensure that she/he uses her/his professional skill and expertise and applies such tests as the circumstances of the case may require before issuing the report and maintain working papers to substantiate her/his stand. ■