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TRANSFER PRICING POLICIES AND TAX MANIPULATIONS

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Abstract: *Transfer pricing is the pricing of intra firm trade of Transactional Corporation. Intra firm trade is defined here as transactions involving international shipments of commodities (including capital, finished goods), technology and services between branches or affiliates under the control of one firm. Transfer price is defined as the price paid for goods transferred from one economic unit to another, assuming that the two units involved are situated in different countries, but belong to the same transnational firm.It is a mechanism for distributing revenue between different divisions which jointly develop, manufacture and market products and services. Transfer prices among components of an enterprise may be used to reflect allocation of resources among such components, or for other purposes. Transfer prices are significant for both taxpayers and tax administrations because they determine in large part the income and expenses, and therefore taxable profits, of associated enterprises in different tax jurisdictions.Transfer pricing is not, in itself, illegal or necessarily abusive. What is illegal or abusive is transfer mispricing, also known as transfer pricing manipulation or abusive transfer pricing. Transfer pricing manipulations is fixing transfer price on non-market basis which generally results in saving the total quantum of organization's tax by shifting accounting profits from high tax to low tax jurisdictions. The paper examines the various strategies used by the companies to manipulate the taxes through transfer pricing. The study also examines the various court cases related to transfer pricing.So we conclude that transfer pricing should be treated as normal routine practice and not a tool to evade tax.*

Keywords: *Transfer Price, Parent and Subsidiary Company,Tax manipulation, Tax jurisdictions.*

1. INTRODUCTION

Transfer pricing is the pricing of intra firm trade of Transactional Corporation. Intra firm trade is defined here as transactions involving international shipments of commodities (including capital, finished goods), technology and services between branches or affiliates under the control of one firm. Transfer price is defined as the price paid for goods transferred from one economic unit to another, assuming that the two units involved are situated in different countries, but belong to the same transnational firm. The term "transfer price" applies indiscriminately to all prices for the transfer of goods within the same group of transnational

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companies. So when the parties establish a price for the transaction, they are engaging in transfer pricing. This can be either market based, that is equivalent to what is being charged in the outside market for similar goods, or it can be non-market based (that is cost based and negotiated based). It is a mechanism for distributing revenue between different divisions which jointly develop, manufacture and market products and services. Transfer prices among components of an enterprise may be used to reflect allocation of resources among such components, or for other purposes. Transfer prices are significant for both taxpayers and tax administrations because they determine in large part the income and expenses, and therefore taxable profits, of associated enterprises in different tax jurisdictions. Transfer pricing exists to communicate data which will lead to goal-achieving decisions and also to evaluate performance and motivate managers to make goal-achieving decisions.

1.1. Meaning and Definition of Transfer Pricing

In the present age, a major chunk of the cross-border trade is in the hands of multinational enterprises, which undertake the majority of their transactions within different entities under common control. The prevalence of intra-group transactions has facilitated fixing their internal price at less or more than market value-a practice known as transfer pricing. Transfer pricing manipulations is fixing transfer price on non-market basis which generally results in saving the total quantum of organization's tax by shifting accounting profits from high tax to low tax jurisdictions. Transfer pricing practices are responsive to opportunities for determining values in way that are consequential for enhancing private gains and thereby contributing to relative social impoverishment, by avoiding the payment of public taxes. Transfer pricing is not, in itself, illegal or necessarily abusive. What is illegal or abusive is transfer mispricing, also known as transfer pricing manipulation or abusive transfer pricing. (Transfer mispricing is a form of a more general phenomenon known as trade mispricing, which includes trade between unrelated or apparently unrelated parties).

1.2. Reasons For Using Transfer Pricing

The main reasons which induce the company to use transfer pricing are-

- **Saving on taxes-**The best known inducement to the use of transfer pricing is difference in taxes among the countries. If taxes rates on profit are higher in country B than in country A and the parent transactional corporation from A supplies imports to the subsidiary in B, it would pay the firm to overprice these transactions and transfer profits to A as long as the difference in effective tax rates exceeds the tariff in B on those imports.
- **Remittance of dividend, royalties, interest on loan, technical and management fees etc. -** Transfer pricing is only one of the way by which

a transactional corporations can transfer funds. Other avenues to transfer funds that a transnational corporation may consider are dividends, royalties, interest on loans, technical and management fees, etc. Limits imposed on remittance of dividends etc. can be a contributing factor to the use of transfer pricing.

- **Changes in exchange rate**- Transfer pricing may constitute an important element of the monetary and financial management of a transnational corporation. For instance, when devaluation is believed to be imminent, it islikely that a corporation will, to the extent possible, shift profits and cash balances out of country via transfer pricing mechanism.
- **Inducing goal congruent decision-** Producing a product internally may not be the most economical decision for the company. The purchasing division may be able to obtain a similar product for a lower cost than the transfer price, while the supplying division may be able to use the capacity to produce something more profitable. However, there could be strategic reasons to buy internally.
- **Providing relevant information for trade off decision-** Providing relevant information required for making trade off decision is another reason. Transfer pricing tell a purchasing manager how much a product or service will cost. He can used this information in making a variety of decisions, including whether to make or buy a product, whether to invest in a new machinery, whether to launch a product etc.
- **Performance evaluation-** Facilitating performance measurement of the business units involved is another reason for implementing a transfer pricing policy. When designed correctly the policy should be consistent with performance evaluation and motivate subsidiary / divisional managers.

1.3. Transfer Pricing Principle

The transfer price should be similar to the price that would be charged if the product were sold to outside customers or purchased from outside vendors.

1.4. Methods for Computing Arm's Length Price

Arm's length transaction is a transaction in which the buyers and sellers of a product act independently and have no relationship to each other. The concept of an arm's length transaction is to ensure that both parties in the deal are acting in their own self-interest and are not subject to any pressure from the other party.

This can be explained with the help of an example- if two strangers are involved in the sale and purchase of a house; it is likely that the final agreed-upon price will be close to market value (assuming that both parties have equal bargaining power

and equal information about the situation). This is because the seller would want a price that is as high as possible and the buyer would want a price that is as low as possible. But in contrast with the situation above if the parties are not strangers or they are related for example if father and son are involved in sale and purchase then the father may choose to give his son a discount. This transaction will later be considered by the court as a gift rather than a bona fide sale and which could later have tax and other legal consequences. To avoid such a classification, the parties need to show that the transaction was conducted no differently than it would have been for an arbitrary third party. This can be done by appointing a broker who will determine the market value of the property.

So according to the section 92 F, The term "arm's-length price" mean a price that is applied or is proposed to be applied to transactions in uncontrolled conditions between persons other than associated enterprise. The Indian Transfer Pricing Code prescribes that income arising from international transactions between associated enterprises should be computed having regard to the arm's-length price.

The methods to compute the arm's length price are-

1. Comparable uncontrolled price method
2. Resale price method
3. Cost-plus method
4. Profit- split method
5. Transactional net margin method (TNMM)
6. Any other basis approved by the central govt. which has the effect of valuing such transaction at arm's length price.

2. OBJECTIVES OF STUDY

This study basically focuses upon the practical applicability of various transfer pricing manipulations and their consequential impact upon the performance of various strategic business units.

- To analyze the tax manipulations done through transfer pricing by various corporate houses.
- To review the manipulations in transfer pricing through court cases

3. REVIEW OF LITERATURE

Fowler (1978) examined that the profit maximizing price is a function of level of ownership in the subsidiary, the dividend payout ratio of the subsidiary, the effective marginal tax rates in both parent and subsidiary countries, and the tariff on the goods transferred. In general the paper founded that how multinational enterprises appear to set transfer prices to Canadian subsidiaries so as to maximize the overall profits of the enterprise.

Patel (1981) divided the paper into three sections. Firstly the paper highlights the factors which determine transfer pricing by transactional corporations (TNCs) particularly in developing countries. Secondly it deals with the theoretical limits and practical constraints on transfer pricing and discusses the difficulties facing government tax authorities and custom officials to prove the practice of transfer. Thirdly it looks at the empirical evidence on transfer pricing. The paper concluded by giving a suggestion that countries concerned can undertake various unilateral actions in order to mitigate the negative effects of transfer pricing for example training of government officials in the host of issues related to transactional corporations. This would increase their bargaining power and improve their negotiability capacity vis-a-vis transactional corporation.

Holmstrom and tirole (1991) advocated a broader view of transfer pricing by arguing that the problem should be analysed in the larger context of organizational choice. A major deficiency of the incentive pricing approach is that it overlooks the reasons why trade is internal in the first place. By considering transfer pricing as an isolated contracting problem, the analysis applies equally well to trade between two firms as to trade between two units of the same firm. The study analysed that the degree of decentralization-with options ranging from complete centralization to non-integration is an integral part of creating an efficient trading relationship and transfer pricing policy. Transfer pricing is just one instrument in the overall organizational design. The literature emphasizes that organizational choice influences incentives whenever contracting is in-complete and new agreements have to be negotiated periodically.

Dutta *et al.* (1999) analyzed that firm with two divisions, each run by a risk-averse manager, contracts with the two managers to operate their divisions and possibly engage in interdivisional trade. The paper examined the role of these two institutional in providing incentives for divisional manger to balance the interest of their own division against good of the firm. The study also analyzed how managerial compensation contacts use divisional and firm's –wide performance measures in conjunction with negotiated transfer price to influence the way division manager balance divisional firm-wide goal. Focus on resolution of the investment hold-up problem through managerial performance evaluation.

Baldenius *et al.* (1999) examined that where supplying division has a monopoly power in the external market, the cost differences are neither necessary nor sufficient for intercompany discounts to be desirable. The imposition of discounts always increases the divisional profits of the buying division, but may also lower the divisional profits of the selling division. The paper derived the conditions for discounts to enhance the firm-wide profit and it also studied the sensitivity of the optimal discount to cost differences between internal and external transaction. The paper concluded that under certain conditions, market- based transfer pricing subject to optimally chosen discounts perform well. If the buying division sells its

final product in the competitive market and if demand and cost parameters are positively correlated, then market- based transfer pricing includes the division to engage in the transaction which are nearly efficient from corporate perspective.

Sojak (2007) examined the transfer pricing policy and performance measurement used in Poland by domestic and multinational enterprises. The article presents basic problems relating to the transfer-pricing policy of companies operating in Poland, where increasing attention is being paid to minimizing taxation liability. The paper concluded that methodology for establishing transfer prices used in Poland is based on the OECD solutions. It also showed that when a transfer-price formula is being selected in Poland, benefits for the whole company are taken into consideration. Benefits are not restricted to individual responsibility centers.

Siwele (2011) examined that the Transfer pricing has been used by the companies as a tax avoidance tools as they shift profit between companies in the same group of companies in an attempt to pay less taxation. This shift of profit is achieved by transacting with connected person at prices that are not at arm's length. The paper a analyzed South African income tax legislation and comparison has been made with the income tax legislation in the United Kingdom regarding transfer pricing as well as to transfer pricing guidelines of OECD.

OECD Secretariat *et al.* (2012) analyzed the number of transfer pricing issues related to stock options. The analysis is limited to transfer pricing issues arising between associated enterprises to the exclusion of Permanent Establishment issues. The study focused on plans in listed companies. Three main situations are identified where transfer pricing issues arise. There is currently limited experience and evidence of what unrelated parties actually do with respect to stock options when determining the value of participants contributions to a Cost Contribution Agreement (CCA). It is only possible to hypothesize what unrelated parties might be expected to do at arm's length. The paper concluded that if stock options are remuneration, independent enterprises dealing at arm's length would not enter into a CCA in which a significant element of employee compensation was omitted from the determination of the participants' contributions.

4. RESEARCH METHODOLOGY

4.1. Scope of the Study

This study aims at summarizing the OECD guidelines applicable to the concept of transfer pricing and to review various situations where by big corporate houses have been penalized by the government for doing the transfer pricing manipulation and their impact upon the performance of those companies.

4.2. Sources of Data

The type of the data which is taken into consideration is secondary data.

4.3. Sampling Technique

Convenience sampling

4.4. Analysis of Tax Manipulations Done Through Transfer Pricing and Court Cases Related to Transfer Pricing

The organization for economic corporation and development (OECD), released the final version of its transfer pricing guidelines. The OECD is a unique forum where the governments of 30 democracies work together to address the economic, social and environmental challenges of globalization. A separate code on transfer pricing under Sections 92 to 92F of the Indian Income Tax Act, 1961 (the act) covers intra group cross-border transactions and is applicable from 1 April 2001. Transfer pricing methods, impose extensive annual transfer pricing documentation requirements, and contain harsh penal provisions for noncompliance. The various requirements, *disclosure, documents required and penalties imposed* under the transfer pricing guidelines.

4.4.1. Vodafone

About the Company: Vodafone Group Plc. is a British multinational telecommunications company headquartered in London and with its registered office in Newbury, Berkshire. It is the world's second-largest mobile telecommunications company measured by both subscribers and 2011 revenues and had 439 million subscribers as of December 2011. Vodafone owns and operates networks in over 30 countries and has partner networks in over 40 additional countries. Its Vodafone Global Enterprise division provides telecommunications and IT services to corporate clients in over 65 countries. Vodafone also owns 45% of Verizon Wireless, the largest mobile telecommunications company in the United States measured by subscribers.

Vodafone India formerly **Vodafone Essar** and **Hutchison Essar**, is the third largest mobile network operator in India after Airtel and Reliance Communications by subscriber base. It is based in Mumbai, Maharashtra. It has approximately 147.48 million customers as of December 2012.

Vodafone to challenge tax department in transfer pricing case Facts and contentions: In 1992, the Hong Kong based, Hutchison Group acquired interest in an Indian telecom business through a joint venture (JV) company. Hutchison Telecommunications International (Cayman) Holdings Ltd. (HTIL) held shares of CGP Investments (Holdings) Ltd. (CGP Investments), a holding company, based

in Cayman Island. Through CGP investment and the various Mauritius entities, HTIL held 67% in the Hutch Essar Ltd. (HEL) an Indian JV company. Thus through CGP investments, the hutch group held, directly and indirectly controlling interest in HEL.

In December 2006, HTIL issued a press statement, regarding a possible sale of its equity interests in HEL, which was carrying on telecom operations in India. Vodafone NL, a Dutch entity, made a bid to acquire share capital of CGP Investments and consequently, in February 2007, entered into an agreement for acquisition of the Indian interests of HTIL. Prior to this, Vodafone had entered into a joint venture with Bharti Airtel (Airtel), an Indian company, which was also engaged in providing similar services as that of HEL. Subsequently, an agreement for Sale and Purchase of Share and Loans (SPA) was entered into between HTIL and Vodafone NL under which HTIL agreed to procure and transfer the entire issued share capital of CGP Investments, held by a group company. After the transfer of all rights HTIL announced that Vodafone NL had acquired the controlling interest in HEL. Vodafone NL informed Essar Group (the other stake-holder in HEL) about the acquisition of the entire holding from HTIL. Thereafter, Vodafone NL also applied to the Foreign Investment Promotion Board (FIPB) (Indian foreign investment regulatory authority) and sought approval for direct acquisition of 67% in HEL. Vodafone NL made the payment of consideration to HTIL for acquiring the entire share capital of CGP Investments, as per the instructions of the Hutch Group.

In connection with the transaction, the Tax Authority issued a notice to Vodafone NL enquiring as to why Vodafone NL should not be treated as a, taxpayer-in-default for not withholding taxes on its payments to HTIL. Subsequently, Vodafone NL filed a writ petition before the High court, challenging the validity of the notice.

Ruling: The High court, while dismissing the petition filed, held that the said transaction would be subject to the scrutiny of the Tax Authority for the reason that the dominant purpose of the transaction was to acquire the controlling interest in HEL Further, as the High court was not in possession of the relevant agreements, it was unable to decide the true nature of the transaction and concluded that it was not in a position to deliberate on the taxability of the transaction, including the jurisdictional issue. Pursuant to the order of the High court, Vodafone NL filed a special leave petition (SLP) before the Supreme Court. The Supreme Court, however, dismissed the SLP and held that the jurisdictional issue would have to be examined by the Tax Authority as a preliminary issue pursuant to the Supreme Court observation, the Tax Authority asserted that it had jurisdiction to tax the transaction and considering the fact that Vodafone NL had failed to withhold tax under the provisions of the ITL, it was treated as a „taxpayer default. Aggrieved, Vodafone NL challenged this order before the High court by way of a writ petition.

While dismissing the petition, the High court held that the Tax Authority had jurisdiction to tax the transaction aggrieved, Vodafone NL approached the Supreme Court on the issue of taxability of the transaction. The Supreme Court reviewed the case once again and the proceedings took place over a period of 28 days during the months from August to October 2011.

Decision: The Supreme Court, held that the indirect transfer, would not be taxable, according to the Indian tax laws. The sites of the capital asset, being shares, would be situated where the company is incorporated and where the register of members is maintained. The withholding tax provisions under the ITL will not apply when there is anoff shore transaction between two non-residents. Accordingly, such provisions would not have an extra territorial operation. Further, the SC accepted that tax planning within the framework of law is permissible,unless the planning is a sham or a colourable device. In any event, the onus is on the Tax Authority to establish that a transaction is a sham. The source rule provisions under the ITL needs to be strictly construed and, accordingly, in the absence of a look through provision, an indirect transfer would not be taxable in India.

Conclusion/ interpretation: The case highlighted that if the controlling foreign enterprise makes an indirect transfer through abuse of organization form without any reasonable business purpose resulting in tax avoidance or avoidance of withholding tax, then the Tax Authority may disregard the form of arrangement, re characterize the equity transfer according to economic substance, and impose tax on the foreign enterprise. The burden is on the Tax Authority to allege and establish abuse, where there is a tax but in this case after applying various tests by Supreme Court it was concluded that sale of CGP investments shares was a genuine business transaction and not a fraudulent method to avoid capital gain tax.

4.4.2. LG Electronics India Pvt. Ltd

About the Company: LG Electronics is a South Korean multinational electronics company headquartered in Yeouido-dong, Seoul, and a member of the LG Group Chaebol. The company operates its business through five divisions: Mobile Communications, Home Entertainment, Home Appliances, Air Conditioning, and Energy Solutions. It is the world's second-largest television manufacturer and the world's fifth-largest mobile phone maker by unit sales in the second quarter of 2012.

Facts and contentions: LG electronics Inc. (LGK or associated enterprise or AE) is a Korean company engaged in the manufacture, sale and distribution of electronic products and electrical appliances. LG Electronics India Pvt. Ltd (LGI or tax payer) is a wholly-owned subsidiary in India. LGI, in the capacity of the license obtained from LGK that is licensor, a right to use the technical know- how for manufacture, marketing, sale and services of its products, for which a royalty of 1% was agreed.

The licensor allowed the licensee for no charge to use its brand names and trademarks for products manufactures in India.

Ruling: During the course of transfer pricing assessment proceedings, the transfer pricing officer observed that advertisement, marketing and promotion expenses (AMP) were 3.85% of the tax payers' sales. The transfer pricing officer (TPO) computed the similar percentage in the case of Videocon appliances Ltd (0.12%) and whirl pool India ltd (2.66%) with their arithmetic mean at 1.39%. the difference was considered by the transfer pricing officer to be excess AMP incurred by the tax payer on the brand promotion for the A, which should have been compensated by the associated enterprise (AE) to the tax payer. The TPO thus made the adjustment for the difference. The tax payer appealed for the tribunal. A special bench of tribunal was constituted to adjudicate the issue.

The tax payer contended that TPO was not justified in assuming jurisdiction over such international transaction in the absence of any reference made to him by assessing officer (AO). He also contended that there exists no transaction of creation of marketing intangible by brand building for AE, as there was no oral or written understanding between AE and tax payer, and because the AMP expenses were incurred for the tax payers' business purpose.

Decision: The special bench held that decision gets diluted or vacated in the view of the retrospective amendment made by the finance act- that validated the jurisdiction of TPO in examining a transaction even though not expressly referred to him by assessing officer (AO). The special bench also held that an agreement between associated enterprise can be formal or in writing or informal or oral. The critical test would be the conduct of parties to transaction. If the taxpayer has advertised the brand of AE then it can be inferred that there is understanding between the tax payer and AE to its effect. Moreover in this case the AMP expenses incurred were higher so special bench accordingly held that a transaction incurred expenses for the promotion of the brand .of the associated enterprise so the reimbursement by the brand owner is required.

4.4.3. Coca-Cola Company

About the Company: The Coca-Cola Company is an American multinational beverage corporation and manufacturer, retailer and marketer of non-alcoholic beverage concentrates and syrups, which is headquartered in Atlanta, Georgia. The Company is best known for its flagship product Coca-Cola, invented in 1886 by pharmacist John Stith Pemberton in Columbus, Georgia.

Coca-Cola currently offers more than 500 brands in over 200 countries or territories and serves over 17 billion servings each day. The company operates a franchised distribution system dating from 1889 where The Coca-Cola Company only produces syrup concentrate which is then sold to various bottlers throughout the world who hold an exclusive territory.

High Court Rules against Coca-Cola in Transfer Pricing Case Facts and contentions: Coca cola the soft drink company had an agreement to offer advisory services to Britco at the rate of cost plus 5%. According to Coca-Cola's the transfer pricing rules cannot be applied in the absence of prima facie evidence of profit transfer outside India. They were meant to check profit erosion outside India and therefore could not be applied in cases where there is no prima facie evidence of profit transfer outside the country.

Ruling/ decision: The Punjab & Haryana High Court ruled against Coca-Cola India's contention that the proof of profit transfer outside India is a precondition for applying transfer pricing rules. Coca-Cola approached the high court after it was served a notice on transfer pricing.

According to Coca-Cola, the transfer pricing provisions have been incorporated in the Income-tax Act by the Finance Act 2001 and the applicability of these provisions has been limited to situations involving profit diversion outside India. There is no material evidence to show that profits have been diverted outside India.

The high court did not accept this view. It held that existence of a cross border transaction and computation of the resultant income at arm's length price are sufficient grounds for applying transfer pricing rules. The court also said that it is the prerogative of the income-tax department to issue such a notice and expressed its inability to intervene in the matter.

4.4.4. Sony Corporation

About the Company: Sony Corporation commonly referred to as Sony is Japanese multinational conglomerate headquartered in Konan Minato in Tokyo, Japan. Its diversified business is primarily focused on the electronics, game, entertainment and financial services sectors.] The company is one of the leading manufacturers of electronic products for the consumer and professional markets. Sony is ranked 87th on the 2012 list of Fortune Global 500.

Sony India is a wholly owned subsidiary of Sony Corporation, Japan ("Sony Japan"). Sony India is engaged in assembly and distribution of color televisions and audio products and also the distribution of high-end electronic goods recordable media tapes, play stations, projectors and spare parts required for these goods imported from its foreign associated enterprises (**"**AEs**"**). Sony India also renders advisory services and software development services to its AEs. The revenues of Sony India are generated mainly from assembly and sale of color televisions and trading of other electronic goods.

Facts and Contentions: The Indian Transfer Pricing Regulations require Sony India to conduct all transactions with its AEs at an Arm's Length Price (**"ALP"**).

Sony India claimed that all its international transactions were undertaken at ALP and for this purpose relied upon Transactional Net Margin Method (**"TNMM"**). For the purpose of calculating the ALP, Sony India had chosen the foreign AEs from whom the components were imported as tested parties and computed the profits of AEs with Indian comparable chosen from Indian data base. The same method was chosen for the distribution activities relating to high-end electronic products, projector tapes etc. where Sony India was taken as the tested party.

Rulings: However, the Transfer Pricing Officer (**"TPO"**) did not agree that foreign AEs could be taken as tested parties for determining the ALP and accordingly asked Sony India to submit fresh transfer pricing report taking Sony India as a tested party and Indian entities as comparable. The TPO made certain transfer pricing adjustments to the income of Sony India which were adopted by the Assessing Officer.

Sony India approached the Commissioner of Income Tax against the transfer pricing adjustment made by the Assessing Officer and the TPO. The Commissioner of Income Tax partially upheld the assessment made by the Assessing Officer and thereafter, Sony India approached the Tribunal in this regard.

Decision: The Tribunal heard the parties at length and thereafter pronounced a detailed order dealing with the various issues at hand. The Tribunal made references to the International jurisprudence with respect to transfer pricing where the Indian law and jurisprudence is lacking. The decision of the tribunal are-

(1) Under Rule 10B (2) (c) the comparability of an international transaction with an uncontrolled transaction has to be judged with reference to the contractual terms. Accordingly, the actual transaction, as entered into between the parties, has to be considered and the authorities have no right to re-write the transaction unless it is held that it is sham or bogus or entered into by the parties in bad faith to avoid and evade taxes.

(2) The Tribunal also discussed the controversy with respect to the selection of comparable for the purpose of the transfer pricing analysis. It made an observation to the effect that an entity can be taken as a comparable for the purpose of economic analysis if its related party transactions do not exceed 10 to 15% of its total revenue and that within this limit, transactions could not be held to be significant to influence the profitability of the comparable

(3) For purposes of determining what parties should be considered for purposes of comparison under Rule 10B (3), what is to be judged is the impact of the related party transaction vis-à-vis sales and not just profit since profit of an enterprise is influenced by large number of other factors.

(4) While comparing controlled and uncontrolled transactions or enterprises, one has to look for the differences and whether such differences are likely to affect

the price, cost charged or paid or profit arising from the transaction in the open market. It has further to be examined whether a reasonable accurate adjustment can be made to eliminate the material effect of the differences between the transactions or entities. If a reasonable accurate adjustment for the difference to eliminate material effect of the differences cannot possibly be made, then such comparables (uncontrolled) have to be rejected.

(5) The Tribunal allowed the inclusion of certain items in operating income such as the reimbursement of advertisement expenses received from one of the AEs. The Tribunal opined that the argument of Sony India that it would not have incurred such huge expenses on advertisement but for agreement of reimbursement was acceptable. On the basis of the facts at hand, the Tribunal held that such reimbursements should be a part of the normal operating profits of Sony India.

(6) As regards the export of colour TV sets to Sony Japan, Sony India has made a claim that these TVs were assembled and exported to Sony Japan for the purpose of utilizing idle capacity of assembling facilities and therefore, to enable the company to improve recovery of its fixed assembly cost. The Tribunal held that under-utilization of capacity could not justify export of Colour TVs at a price less than the price to any unrelated party. The Tribunal further observed that it was essential to show that similar prices were being charged for similar products in identical circumstances.

5. FINDINGS AND SUGGESTIONS

1. The study reveals that there are so many factors in transfer pricing through which tax manipulations can be done easily.
2. This study is based upon the tax issue and manipulation done by the big corporate houses in the transfer pricing methods adopted by the company for valuing the goods and services sold to overseas associated enterprise was not correct.
3. The study also shows various techniques that is shifting of profit from high tax country to low tax country, creation of tax heaven subsidiaries -used by the multinational companies to evade taxes and increased their overall profits.
4. Many multinational companies' uses branch adjustments to evade taxes. This can be explained with the help of an example- suppose if the profit of the parent company is Rs 100 and that of subsidiary is Rs 20 and taxes are levied on the profits above Rs 40 so the parent company transfers Rs 20 to subsidiary through transfer pricing and reduce their payment of taxes. So these kind of branch adjustments should be avoided.
5. The difference in tax rates needs to be minimized, so that the inducement for transfer of business profits is minimized consequently.

6. Government should check in a consistent way whether the companies engaging in transfer pricing are adhering to the transfer pricing guidelines that is requirement of arm's length price etc. and if not then they should be penalized.

6. CONCLUSION

As importance of the transfer pricing is increasing, it is generally considered as a major international taxation issue faced by MNCs today. The tools is particular attractive because it is largely invisible to the public and is difficult and expensive for regulatory authority to detect. Transfer pricing is important to corporations because its affect calculation of divisional, segmental, product and global profits. The reported price matter to stock markets because they effect earning, dividend, share price and return on capital. They matter to co. executive because there financial rewards are frequently linked to corporate earnings. Transfer pricing matter to the state because they affect the taxes that it can levy upon corporate profit to finance public goal to secure its legitimacy

Transfer pricing, like science and technology, is a neutral phenomenon. It is its use or abuse which makes it an innocuous commercial practice or a cognizable offence. Transfer pricing is not an immoral or illegal act. It can be purely for business considerations without any intentional or unintentional endeavor to defraud government or any concerned party. Therefore transfer pricing is generally conceived as a permissible practice like other administrative or commercial practices of business entities. So transfer pricing should be treated as normal routine practice and not a tool to evade tax.

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