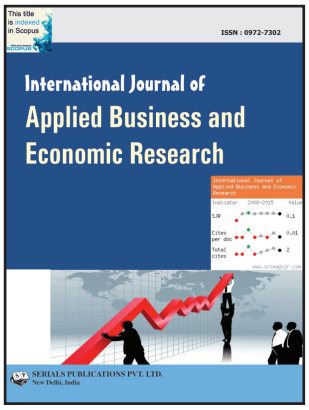

International Journal of Applied Business and Economic Research

ISSN : 0972-7302

available at http: www.serialsjournal.com

Volume 15 • Number 5 • 2017

Transfer Pricing of Hitachi India with Reference to its GDC Segment

Jeyaprabha Bose S[1], Arvind B[2] and Sungkrityayan Khan[3]

[1-2]*SRM University, Chennai, India*

[3]*Corresponding author: SRM University, Chennai, India. Email: sungkrityayankhan@gmail.com*

ABSTRACT

Transfer Pricing is basically a branch of a decentralized association. The association's development is joined by developing complexities in operations scope with limbs spreading past the customary employment shop into a few divisions, branches, and even establishments. Eccles (1985) characterizes transfer price as the esteem (or cost) set on the merchandise, administrations and intangibles that are exchanged inside the organizations, as it moves from one authoritative element (e.g., a division, a unit, a subunit, a division) to another inside a corporate gathering. The strategies for transfer pricing however with numerous varieties are either market or cost based or arranged. This paper was set on including and drawing points of view from developing markets and particularly with respect to Hitachi India not bound by stringent direction of their open partners. Along these lines, the study figured out if it is the objectives or inner environment that comes first in exhorting on transfer pricing technique embraced.

Keywords: Transfer Price; Internal Environment; GDC Segment; multinational corporation.

1. INTRODUCTION

The significance of multinational corporations in world trade accompanied by the surge in international trade has been increasing. Those corporations which operate in more than one country have been encountering various difficulties. One of those difficulties emerges in the determination of transfer pricing or in the selection of transfer pricing methods. Upon further review of related literature, some factors appear to be gaining prominence in the determination of transfer pricing levels.

Those factors are classified as of organizational, environmental and financial structure according to some authors; and of a legal, economic, political and social structure according to some other authors. Such factors should be analyzed by corporations thoroughly. Because these factors can affect the determination

of transfer prices and selection of methods. Transfer pricing is essentially an offshoot of a decentralized organization. The firm's growth is accompanied by growing complexities in operations scope with tentacles spreading beyond the traditional job shop into several divisions, branches, and even franchises. Legally, the firm can exist as a conglomerate of several companies forming a parent and subsidiary relations. Though the proponents of the theory of the firm have consistently argued that internally, a firm can rarely maintain a plausible market structure, the practice has shown that internal trade will go on the lack of a market structure notwithstanding. Trade conducted in such manner does not, however, benefit from a self-setting price mechanism as we know them in perfect competition. Management being cognizance of this fact will set up a price that will guide all the internal transactions as they take place.

Tang (1993), defines a transfer price as that which is appropriate to support intra-firm trade in the context of a multi-national company (MNC). Given this perspective, transfer price is regarded as a vehicle to facilitate intra-firm trade within an MNC. Taken further, it could mean that intra-firm trade or transfer pricing or both are not entirely necessary. Eccles (1985) has been more forthwith defining transfer price as the value (or price) placed on the goods, services and intangibles that are transferred within the firms, as it moves from one organizational entity (e.g., a division, a unit, a subunit, a division) to another within a corporate group. In this perspective, we are allowed to state that transfer pricing does bear recognition even when intra-firm trade occurs within national borders or within seemingly insignificant units within an organization as long as the organization structure allows for such differentiation.

Transfer pricing applies across a varied range of transfer such as finished products, tangible product components for example processors in a computer assembly shop or complete packaged product, for example, a radio selling to a newspaper mention slots for advertisements within the same media house. In some mundane circumstances, units may transfer services which form their core activities, for example, the finance department may charge it services to other departments using a transfer price. Spicer (1988) has referred to three forms of transfers classified according to the degree of customization or idiosyncratic.

Transfer pricing can be used for goods and services transferred between units or profit centers within the same firm, as well as for goods and services transferred between related companies located in different countries (Li, 2005: 59). Transfer pricing, in general, is defined as a term used in order to represent the value of transactions among the subsidiaries operating in different countries (Günaydın, 1999: 166). In other words, transfer pricing is defined as the price charged for transferring a corporation's tangible and intangible assets, goods or services, raw materials, know-how and technology to its subsidiaries or branches (Heimert, 1997: 12; Aranoff, 2000: 3; Davidmann, 1996; Doğan, 2003: 80; Doğan, 2004: 71).

Different transfer pricing methods have been found to interact differently towards achieving the four different goals. For example, according to Li and Ferreira (2007), the transfer pricing method applied will depend on the level of autonomy which firms management seeks to bestow on the sub-units. Cost based prices and methods will be used when low levels of sub-unit autonomy are being sought. As the level increases so do the firm migrates to adjusted external market price and further to negotiated internal market price as a way of assuring high subunit autonomy. This phenomenon is illustrated in Table 5.1 below.

The extent to which these goals are achieved is dependent on organizational factors such as internal management rules and the methods of transfer pricing which top management has elected to adopt. This study was bent on determining such interaction within the framework of an unlisted company. Unlisted companies as by incorporation private limited companies which in a majority of the cases are family owned businesses. We can, therefore, postulate that unlisted companies will desire to pursue corporate goals which do not threaten the very fabric that underpins their success.

Indeed, according to Olson et. al., (2003) to it is generally accepted that these firms aim to achieve a combination of financial and nonfinancial goals that are sometimes variant from conventional firms. This has been attributed to findings that point to significant variations in perceptions of family firm stakeholders regarding even the most fundamental issues as underscored by, Poza et. al., (1997) and Sharma, (1997). This goes to say that unlisted companies that practice transfer pricing may do so in a manner that is entirely different from conventional practice.

2. LITERATURE REVIEW

Establishing transfer prices is complex because a transfer pricing system is usually required to achieve many conflicting objectives. Numerous articles have been written over the past 50 years; therefore, precedence is given to the most recent literature, to the empirical or survey studies, and to the literature that has become established as part of conventional wisdom. Also, the studies conducted by professional companies (e.g., KPMG, Ernst and Young) to investigate the TP issue in a large number of countries, Kenya or regional countries were not included.

Chan, Agnes, and Lan (2006) have based on a sample of 163 transfer pricing audits on foreign investment enterprises in China, the authors examined the impact of managerial autonomy on an international transfer pricing, and whether foreign subsidiaries autonomy in making pricing and sourcing decisions on intra-firm transfers affect their profit shifting through international transfer pricing. The study found that tax audit adjustments for respondents that have autonomy in setting transfer prices or sourcing from outsiders are smaller than those that have their transfer transactions dictated by parent companies. Gault (2006) carried a survey of tax directors in multinational companies across several countries. Findings have shown that the respondents considered transfer pricing as becoming more complex as cross-border transactions increase and that it is the most important tax issue facing their organizations. The survey also found how, as transfer pricing audits become more detailed and tax authorities become more experienced, it becomes more important for tax directors to have adequate defenses. Transfer pricing documentation was found to be more important for 70% of respondents in the survey than it was two years ago. The number of audits has also increased, 65% of parent companies and 59% of subsidiaries stating that they have experienced an examination of their transfer prices since 2001.

In another study, Ki Ho and Lau (2005) examined international transfer pricing (ITP) practices of U.S. multinationals (MNCs) in the People's Republic of China (PRC) and the United Kingdom (UK) on a comparative basis. They examined the U.S. multinationals' practices towards ITP for transactions with their affiliates in these countries and provide empirical evidence on the methods of ITP practices. The sample used in this study consisted of 463 U.S. MNCs that were drawn from the 500 largest corporations in 2000. Empirical evidence suggests that market price and full cost plus are the most commonly used ITP methods. The results of this study also reveal that there are no significant differences in the perceived

frequency of use of various ITP methods by U.S. MNCs for transactions with their affiliates in the PRC and the UK.

Transfer Pricing Model in India

India is rapidly growing using its own model of TP rules and also observing the OECD TP Guidelines. There are so many new concepts, which have come up in treating the Reimbursements, Interest income, deemed international transactions, the sale of shares, loans received/paid, corporate guarantees etc., at Arm's Length Standard. In fact, OECD is also agreed that India is fast developing country on transfer pricing and OECD itself learning the rules/concepts framed by Indian Revenue Authorities. India is successful in implementing the Transfer Pricing laws in the country achieving its targets.

India is following its own model of Transfer Pricing under the Income-tax Act and IT Rules and India is an observer of OECD Model of the convention on Transfer Pricing. India is a non-member in OECD (Organization for Economic Cooperation and Development). Every country is following its own TP model but most of the countries are following OECD model of the convention on Transfer Pricing.

Traditional Methods to Calculate Transfer Price

Table 5.1
Methods of Calculating Transfer Pricing

Method	*Applicability Circumstances/Trade/Industry*
Comparable Uncontrolled Price	Sale/Purchase of Goods, Commodities Lending/Financing
Resale Price	Trading Business Distribution of Finished Goods
Cost Plus Method	• Providing Services • Processing Work • Transfer Of Semi Finished Goods
Profit Split Method	Transaction Involving Integrated Services provided By more than One Enterprises
Transactional Net Margin Method	Integrated Services Requiring Allocation of Profits at Net Margin Level Than Gross Margin Level

New Method

It includes any method prescribed by central tax authorities and giving guidelines to use the method. ITA does not provide any specific hierarchy of methods. It insists on applying the 'Most Appropriate Method' (MAM). MAM means a Method, which is best suited to facts and circumstances of the transaction and which is the most reliable measure of an arm's length price.

MAM is to be determined considering the nature and class of transaction, functions, assets and risks are undertaken to assess and another party, degree of comparability between underlying transaction and uncontrolled transactions, extent to which reliable and accurate adjustments can be made to account for differences, if any as well as availability, coverage and reliability of data necessary for application of method and nature, extent and reliability of assumptions required to be made in application of method.

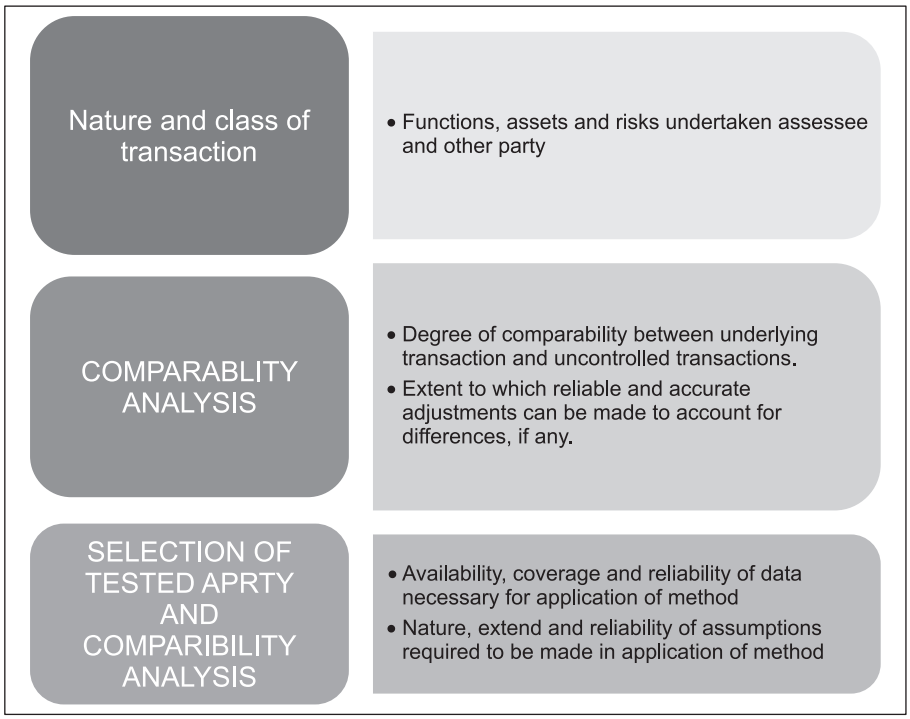

Figure 5.1: Mam Method

Stages of Economic Analysis

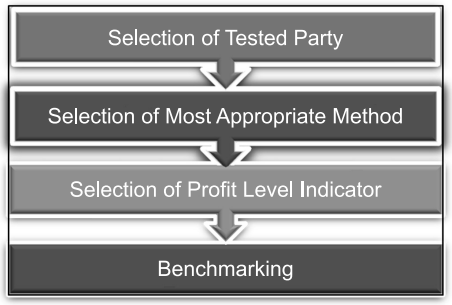

Figure 5.2: Flowchart Depicting the flow involved in Economic Analysis

Selection of Tested Party:

The tested party is generally the participant in the transaction whose transfer price/profitability attributable to the controlled transactions can be verified using the most reliable data, and requiring the fewest and most reliable adjustments; and for which reliable data regarding uncontrolled comparable companies can be located. In most cases, the tested party will be the least complex of the transacting parties and does not own valuable intangible property or unique assets .

Comparibility Analysis

The degree of comparability and extent of reliable and accurate adjustment in case of difference is very crucial in selection as well as the application of MAM. Different methods require the different degree of

comparability E.g. CUP would require very precise comparability whereas, under TNMM, one would look for broader comparable.

Comparability is to be established in terms of

1. Specific characteristics of the property transferred or services provided
2. Functions performed, assets employed or risks assumed by both parties
3. Contractual terms (whether in writing or not) Which may relate to timing, delivery, payment, warranty, currency, etc.

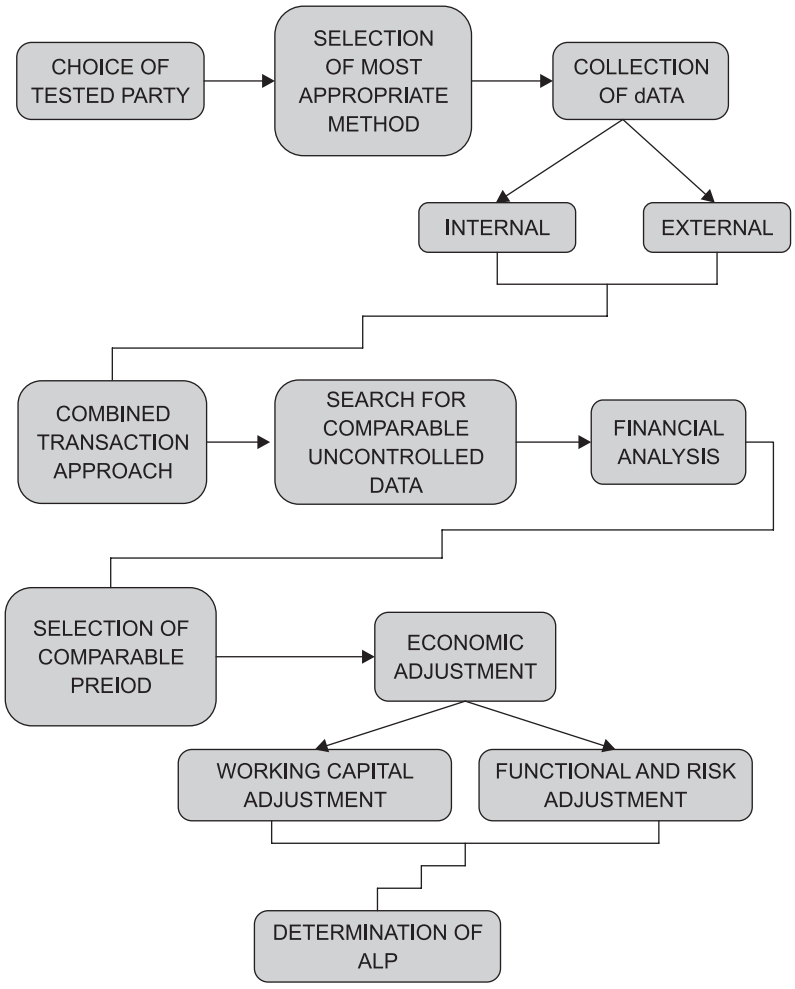

Figure 5.3: Transfer Pricing Flow Diagram

Objective of the Study

The purpose of this transaction of the report is to provide an economic analysis for the following international transaction of HITACHI SOLUTIONS INDIA in the GDC segment from Indian transfer price perspective:

- Provision of IT consultancy services
- Reimbursement of expenses from AE

3. RESEARCH METHODOLOGY

To determine whether any one of the transfer pricing can be applied, availability ,coverage, and reliability of data are necessary for the application of the method. Accordingly, comparable data was identified as follows:

1. **INTERNAL COMPARABLE DATA:** HITACHI SOLUTIONS INDIA undertakes same or similar transactions with third parties. However, the contracted terms and condition and the associated risks are different in the case of the inter-company transaction vis-a-vis third party contracts and reasonably accurate adjustments cannot be made at a transaction price level.
2. **EXTERNAL COMPARABLE DATA:** To identify external comparable data, a search was conducted to identify transaction/companies that could be considered as comparable to HITACHI SOLUTIONS INDIA.

Based on the above analysis, there is no public availability of information on prices charged in the independent transaction of similar or identical in nature that reflects the characteristics of the international transaction undertaken by HITACHI SOLUTIONS INDIA. However, comparable company level data which involved information about companies that are comparable to the tested party's operation, including a description of the functions performed, the risk borne, resources employed and detailed financial data was identified.

Choice of Tested Party

Any transaction involves at least two enterprises. In this case, the first enterprise is HITACHI SOLUTIONS INDIA and the other are its AEs .The most appropriate method for determining the ALP can be determined/ applied with reference to either HITACHI SOLUTIONS INDIA or its AE. The enterprise to which the method is applied is called "TESTED PARTY".

The tested party is usually the participant in the controlled transaction for which profitability can be ascertained most reliably and for which reliable data on comparables can be found. Accordingly, for the international transaction under consideration, HITACHI SOLUTION INDIA has been chosen as the tested party.

Applicability of Prescribed Methods

The methods prescribed under the ACT are applicable in the following scenarios:

1. CUP methods evaluate the "price" charged in a controlled transaction with reference to their "price" charged in the comparable uncontrolled transaction, which could be identified either through internal or external comparables.
2. RPM is applicable in the resale situation, where the property or services purchased from an AE are sold to unrelated enterprises. RPM is applied on either a transactional or a comparable – company basis, and it applies to distributors/marketers.
3. CPM is generally applied in relation to the supply of products or provisions of services. CPM is most useful where semi-finished goods are sold between related parties, where related parties

have concluded joint facility agreements or long term buy and supply arrangements or where the controlled transaction is the provision of services.

4. PSM may be applicable mainly in an international transaction involving the transfer of unique intangibles or in multiple international transactions, which are so interrelated that they cannot be evaluated separately for the purpose of determining the ALP of any one transaction. PSM is, therefore, appropriate for an integrated transaction with more than one enterprise.

5. TNMM is generally appropriate for the provision of services/sales of goods where CPM or RPM cannot be adequately applied.

6. Any method that takes into account price that 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 circumstance considering all the facts, shall be regarded as one of the recognized methods for determining the ALP.

Applicability of these methods to an international transaction under consideration is as follows:

Nature and class of international transaction	*CUP*	*RPM*	*CPM*	*PSM*	*TNMM*	*Other method*
Provision of IT Consultancy Services	√	×	√	×	√	√
Reimbursement of expenses from AEs	√	×	×	×	√	√

Combined Transaction Approach

Generally, to arrive at the most precise approximation of ALP, the arm's length principle should ideally be applied on transaction-by-transaction basis (separate transaction approach). Further, application of the TNMM would require comparison of the net margins earned by the enterprise from a controlled transaction.

However, frequently, there are situations where separate transactions are so closely linked or continuous that they cannot be evaluated adequately on an individual basis. In such a situation, rather than assigning the arm's length of the transaction individually, this transaction should be evaluated taken together using the most appropriate arm's length method (combined transaction approach). In this regard rule 10AB of the rules also permit the use of combined transaction approach by defining transaction to include a number of closely linked transactions.

The table below describes the manner in which the various transactions are closely linked to principle activity of HITACHI SOLUTION INDIA being provision of IT consultancy services:

As mentioned earlier in respect of the above-mentioned transaction, the principal activity of HITACHI SOLUTION INDIA is the provision of IT consultancy services. The international transactions listed above from an integral part of HITACHI SOLUTIONS INDIA's business. Further, reliable data on transactional net margins of HITACHI SOLUTIONS INDIA from each of its international transaction and comparable data both are not available . In case the net margin based analysis is undertaken, the same can be analyzed only by using a combined transaction approach and by comparing margin earned by HITACHI SOLUTION INDIA with margins earned by other comparable companies in the same industry . Hence, this transaction were analyzed together using combined transaction approach ,wherein if the margin earned by HITACHI SOLUTIONS INDIA could be considered to be at arm's length as a consequence ,it could also be concluded that the value of the international transaction with AE's is also at arm's length.

Table 5.2
Table Showing Various Transactions Related to The Principal Activity of Hitachi

Transactions	*Reason for inclusion*
Provision of IT consultancy Services	Hitachi Solutions India is primarily engaged in provision of IT consultancy services and it forms the core business activity.
Reimbursement of expenses	Hitachi Solutions India incurs certain expenses in the nature of travel and accommodation during the course of the provision of IT consultancy services, the GDC segment caters only to the AEs, the expenses have been recovered on a cost plus markup basis and have been aggregated to determine the arm's length price.
Trade receivables	Hitachi Solutions India has outstanding receivable and payables arising from the above mentioned international transactions.
Trade payables	Since these transactions are closely linked and form an integral part of Hitachi Solutions India's business operations the same has been integrated while determining the ALP.

Search for Comparable Uncontrolled Data

Based on the provisions of rule 10B of the rules, comparable for the international transaction would have to be companies which are engaged in same or similar activities as HITACHI SOLUTION INDIA, and are comparable in terms of functions performed, the risk assumed and assets utilized. Further, such companies should themselves be independent and should not have a significant controlled transaction, which could affect the arm's length nature of their operating margins.

Accordingly, companies engaged in the provision of IT services can be considered as comparable to HITACHI SOLUTIONS INDIA's business activities. To identify companies that could be considered as comparable to HITACHI SOLUTION INDIA for analyzing the above – mentioned transaction, we have referred to three widely recognized commercial information databases for obtaining publicly available financial information:

1. Prowess updated (a database compiled and managed by The Centre for Monitoring Indian Economy)
2. CapitaLine Plus (Capital Line) (a database compiled and managed by Capital Market Publisher)
3. ACE TP V2 (ACE) (a database compiled and managed by Accord Fintech Private Limited)
4. Indian transfer pricing regulations prescribe that the data be used for analysing comparability of an uncontrolled transaction with an international transaction shall be:
5. The data relating to the current year or
6. The data relating to the financial year immediately preceding the current 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 current year.

Accordingly, information and data (including financial data) of the comparable companies has been considered for analyzing comparability. If the search in more than one data, a data set constructed based on multiple years weighted average data would need to be considered for computing arm's length price. While

performing the analysis, factors taken into consideration for judging comparability were characteristics of products sold, functions performed and risk assumed. While the contractual terms under which HITACHI SOLUTIONS INDIA operated were known, the contractual terms of third parties were not available in the public domain and hence this did not become a factor for judging comparability of the transactions .Further, the comparables were also Indian companies, akin to HITACHI SOLUTIONS INDIA and working under similar economic condition .

On merging the result of the three databases (.i.e. Prowess, CapitaLine and ACE TP) and after eliminating common companies a total of 3901 companies were identified for evaluation as comparable service providers. As the initial search criterion used was fairly broad, they narrowed down the list of selected companies by undertaking a review of nature of service rendered by each company in their list. Business descriptions, reports of Board of Directors, Management Discussion and Analysis, Auditors Report, Accounting Policies and Notes to Accounts available in Prowess, CapitaLine, and ACE TP were examined to determine comparability .The review resulted in the rejection of 3,888 companies that fell under one or more of the following categories:

1. Companies for which financial data relevant financial years was not available to undertake analysis
2. Companies that had ceased business operations or were currently inactive
3. Companies that had been declared sick or had persistent net worth
4. Companies that have turnover less than 1 crore
5. Companies undertaking significantly different functions compared to HITACHI SOLUTIONS INDIA
6. Companies that do not have significant (less than 25 percent) foreign exchange earnings
7. Companies that had substantial (in excess 25 percent) transactions with related parties
8. Companies that experience persistent operating losses
9. Companies that are exceptional years of operation
10. Companies that are duplicated in the database with different names or merged to form another company

Finally, 13 companies were identified as comparables.

4. FINANCIAL ANALYSIS

Selection of PLI

TNMM apportions the total operating profit arising from the transaction o some appropriate basis like sales cost, assets, etc. There is no further guidance on the selection of denominator under Indian TP provision, in this regard, OEDC guidelines as follows:

The dominator should be focused on the relevant indicators of the value of the functions performed by the tested party in the transaction under review, taking account of its assets used and risk assumed. Typically, and subjects to a review of the facts and circumstances of the case, sales or distribution operating

expenses may be an appropriate base for distribution activities, full cost or operating expenses may be an appropriate base for a service or manufacturing activity and operating assets may be an appropriate base for capital – intensive base activities such as certain manufacturing activities or utilities. Other bases can also be appropriate depending on the circumstances of the case.

The denominator should be reasonably independent of controlled transaction: otherwise, there would be no objective starting point. For instances, when analyzing a transaction consisting in the purchase of goods by a distributor from associated enterprise for resale to independent customers, one could not weight the net profit indicator against the cost of goods sold because these costs are the controlled cost for which consistency with the arm's length principle is being tested.

Similarly, for a controlled transaction consisting in the provision of services to an associated enterprise, one could not weight the net profit indicator against the revenue from the sales of service because these are the controlled sales for which consistency with the arm's length principle is being tested. Where the denominator is materially affected by controlled transaction costs that are not the object of the testing (such as head office charges, rental fees or royalties paid to an associated enterprise), caution should be exercised to ensure that said controlled transaction costs do not materially distort the analysis and in particular that they are in accordance with arm's length principle.

Keeping the above guidance in view, the ratio used for the TNMM analysis is as follows:

$$\frac{\text{OPERATING PROFIT}}{\text{OPERATING COST}}$$

Where in:

Operating Profit = Operating Revenue – Operating Cost

Operating Revenue = Revenue from operating activities excluding other financial and non-routine income [i.e. interest/dividends received]

Operating Cost = Total Cost includes losses on foreign exchange fluctuations and excludes extraordinary expenses/non-recurring expenses [.i.e. profit/(loss) on sales of fixed asset, amortization of preliminary expenses, any interest payment, etc.] and tax.

Therefore in respect of a comparable company, as provided in the amended rules, wherein multiple year data has been used the weighted average of the price has been used, used with weights being assigned to the quantum of operating cost computed as above.

Selection of Comparable Period

The Indian transfer pricing regulations provide that in respect of comparable companies in cases where:

1. The comparable uncontrolled transaction has been identified on the basis of data relating to the current year and the comparable uncontrolled transaction is present in preceding two years or
2. The comparable uncontrolled transaction has been identified on the basis of the data relating to the financial year immediately preceding the current year and comparable uncontrolled transaction is also present in the year.

The weighted average of the prices of the above mentioned years shall be considered in determining the ALP. For this purpose, the weighted average of the prices shall be computed with weights being assigned to the quantum of the base of the PLI used to arrive the respective prices.

Findings

Based on the above analysis, a summary of adjusted operating margins (computed as defined above) of the comparable companies is tabulated below:

S. No.	*Name of the Company*	*Weighted Average of Operating Profits on Operating Cost (%)*
1	Sagar Soft India Limited	–1.28%
2	TVS Infotech Limited	3.25%
3	Akshay Software Technologies Limited	4.68%
4	Sasken Communication Technologies Limited (Segmental)	7.56%
5	Cigniti Technologies Ltd.	11.00%
6	Kals Information Systems Ltd	11.49%
7	CG-VAK Software & Exports Limited	12.61%
8	Helios & Matheson Information Technology Limited	19.62%
9	R Systems International Limited (Segmental)	19.99%
10	SQS India BFSI Limited (formerly Thinksoft Global Services Ltd) (Consolidated)	21.24%
11	Larsen & Toubro Infotech Limited	24.88%
12	R S Software (India) Limited	25.30%
13	InfoBeans Technologies Limited	41.85%

Working Capital Adjustment

The rules provide that the transaction can be considered as comparable if a reasonably accurate adjustment can be made to eliminate difference that is likely to materially affect the price or cost or profit between a controlled and uncontrolled transaction. The extent to which the companies extend and receive credit in the form of accounts payable and receivable affects their sales and cost of sales . Hence in case if there is any significant difference in working capital between the tested parties. i.e. HITACHI SOLUTIONS INDIA and Comparable companies, an appropriate adjustment may be required for such difference so that closely linked international transaction of accounts receivable/trade credit is properly considered in determining Arm's Length Price .

Accordingly, to improve the reliability of results, they adjust the comparable companies reported financial data for these differences. Such adjustments include adjustments for accounts receivables, inventory, and accounts payable. The adjustments ensure that the absolute levels of relevant balance sheet items are normalized by measuring them against cost.

The adjustment resulting from the different levels of working capital i.e. accounts receivable, inventory and accounts payable between HITACHI SOLUTIONS INDIA i.e. the tested party and the comparable company was calculated as below.

First, determining the networking capital of tested party and the comparable companies by reducing the average payables from the sum of average receivables and average inventory. Then, determining

the difference between the working capital as the percentage of operating cost of tested party and the working capital as a percentage of operating cost of each comparable company. This difference represents the excess or shortage of working capital held by the tested party relative to the comparable companies. Next, multiplying the above difference by an interesting rate benchmarked in order to arrive at a figure representing the adjustment, the SBI base rate considered for arriving at the benchmark rates. Lastly, adding the working capital adjustment (in percentage terms) to the comparable company's net profit margin to arrive at the working capital adjustment net profit margin of the comparable company. This can then be used to compute the working capital adjustment operating profit in absolute terms and subsequently the weighted average of working capital net margin.

The formula used to calculate the adjusted operating margin is presented below:

1. Adjusted comparable margin = Working capital adjustment + operating profit margin
2. Working capital adjustment = Difference in working capital × *i*
3. Where *i* is the *y-o-y* prime lending rate
4. Difference in working capital = working capital as a percentage of operating cost (tested party) – working capital as a percentage of operating cost (comparables)

Functional and Risk Adjustment

The comparables selected for analysis could also include companies that may perform additional functions in addition to the comparable activity. Further, independent companies may undertake additional risk vis-à-vis HITACHI SOLUTIONS INDIA. The effect of these functional and risk differences on profit margins, need to be factored while determining the ALP. However, no adjustment have been made to account for such functional and risk differences between the tested party (HITACHI SOLUTIONS INDIA) and the comparable companies and HITACHI SOLUTIONS INDIA will make an adjustment for such differences (including differences in the risk assumed) if warranted.

Findings

Based on the amended rules for determination of ALP in transfer pricing analysis, given that the number of comparables identified is more than 6, the arm's length range shall be the beginning from the 35th percentile of the data set and ending on the 65th percentile of the data set as computed below:

S. No.	*Name of the Company*	*Weighted Average of Adjusted Operating Profits on Operating Cost (%)*
1	Sagar Soft India Limited	-1.11%
2	TVS Infotech Limited	2.75%
3	Kals Information Systems Ltd	3.17%
4	Akshay Software Technologies Limited	5.16%
5	Sasken Communication Technologies Limited (Segmental)	7.02%
6	Cigniti Technologies Ltd.	7.99%
7	CG-VAK Software & Exports Limited	11.33%

S. No.	*Name of the Company*	*Weighted Average of Adjusted Operating Profits on Operating Cost (%)*
8	Helios & Matheson Information Technology Limited	15.47%
9	R Systems International Limited (Segmental)	19.22%
10	SQS India BFSI Limited (formerly Thinksoft Global Services Ltd) (Consolidated)	19.42%
11	Larsen & Toubro Infotech Limited	23.33%
12	R S Software (India) Limited	25.25%
13	InfoBeans Technologies Limited	41.39%
Data	*Place*	*Range*
5	35th percentile	7.02%
7	Median	11.33%
9	65th percentile	19.22%

As per the information provided by HITACHI SOLUTIONS INDIA, the company earns an opening margin of 21.51 percent on operating cost in the GDC segment.

Inference

Since Hitachi Solutions India's operating margin of 21.51 percent on operating cost is higher than the median of margins of the comparable companies of 11.33 percent, the international transaction between HITACHI SOLUTIONS INDIA and its AE in the GDC segment can be considered to be at arm's length from an Indian transfer pricing perceptive.

5. CONCLUSION

The rapid growth in transfer pricing resources on the Internet and in print is the testimony to the importance of transfer pricing for multinational enterprises. Information specialists need to master not only the terminology and know where to find these resources, they also need better knowledge of the relevant statistical databases in order to assist their clients with transfer pricing analyses. As the MNC's expand globally, this also means following changing national regulations around the world. Keeping abreast of the latest, and most important transfer pricing resources is a daunting task.

References

Aranoff, G. (2000), Transfer Pricing With Technology Choice and Demand Fluctuations in a Simple Manufacturing Model, Quarterly Journal of Business and Economics, 39(2), 2-5.

Chan, K.H., W.Y. Agnes and P. Lia Lan (2006), Managerial Autonomy and Tax Compliance: An Empirical Study on International Transfer Pricing, Journal of the American Taxation Association 28 (2), 1-22.

Davidmann, M. (1996), Community Economics, Multinational Operations: Transfer Pricing.

Doğan, Z. (2003), Japon ve Amerikan Çok Uluslu İşletmelerinde Transfer Fiyatlama Yönteminin Seçimine Etki Eden Faktörler, Muhasebe ve Finansman Dergisi, 19, 66-73.

Doğan, Z. (2003), Transfer Fiyatlama Politikalarının Belirlenmesinde Faaliyet Esasına Dayalı Maliyetleme Yönteminin Önemi, Muhasebe ve Finansman Dergisi, 29, 79-90.

Doğan, Z. (2004), Çok Uluslu İşletmelerde Transfer Fiyatlama Uygulama Nedenleri ve Verilerin Analizi, Muhasebe ve Finansman Dergisi, 22, Nisan, 71-76.

Doğan, Z., Çürük T. (2003), A Research on The Determination of Transfer Pricing Methods Used by Multinational Companies and Factors Influence The Selection of Methods Used, Journal of Faculty of Business, 4(2), 27-37.

Eccles, R.G., (1985), The transfer pricing problem: A theory for practice. Lexington, MA: Lexington Books.

Gault, L. (2006), Transfer pricing is priority tax issue for tax executives globally, International Tax Review 17 (1), 2-3, p. 6.

Günaydin, İ. (1999), Uluslararası Transfer Fiyatlamanın Vergisel Amaçları, Vergi Dünyası, 216, Ağustos, 165-171.

Ki Ho, D. and T. Y. Lou (2005), An Exploratory Study of Transfer Pricing Practices by Multinationals with International Affiliates, International Tax Journal 31 (4), 37-54, p. 6.

Li, D. and Ferreira M. P. (2007), Internal and external factors on firms' transfer pricing Decisions: insights from organization studies, Center of Research in International Business & Strategy, Working paper No 7/2007.

Li, J (2005), International transfer pricing practices in New Zealand. Business Review, University of Auckland.

Olson, P.D., Zuiker, V.S., Danes, S.M., Stafford, K., Heck, R.K.Z. and Duncan, K.A. (2003), Impact of family and business on family business sustainability, Journal of Business Venturing, 18(5), 639-66.

Poza, E.J., Alfred, T. and Maheshwari, A. (1997), 'Stakeholder perceptions of culture and management practices in family firms – a preliminary report', Family Business Review, 10(2), 135-55.

Sharma, P., Chrisman, J.J. and Chua, J.H. (1997), Strategic management of the family business: past research and future challenges, Family Business Review, 10(1), 1-35.

Spicer, B.H. (1988), Towards an Organisational Theory of the Transfer Pricing Process. Accounting, Organizations and Society, Vol. 13, No. 3, p. 303-22.

Tang, R.Y.W. (1993), Transfer Pricing in the 1990's: Tax and Management Perspectives. Quorum Books: Westport.