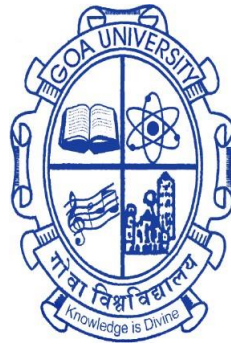


# **Impact of Transfer Pricing Factors and Motives on Transfer Pricing Methods**

A THESIS SUBMITTED IN PARTIAL FULFILLMENT FOR THE DEGREE OF

**DOCTOR OF PHILOSOPHY**

IN GOA BUSINESS SCHOOL  
GOA UNIVERSITY



By

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MARCH 2023

## **DECLARATION**

I, Satyaprakash Suresh Kamath hereby declare that this thesis represents work which has been carried out by me and that it has not been submitted, either in part or full, to any other University or Institution for the award of any research degree.

Place: Taleigao Plateau.

Date: 09-03-2023

Satyaprakash Suresh Kamath

## **CERTIFICATE**

I hereby certify that the work was carried out under my supervision and may be placed for evaluation.

Dr. Purva Hegde Desai  
Professor  
Goa Business School  
Goa University

# Acknowledgement

It is my pleasure to acknowledge all those who supported me in this research.

I am grateful to my guide Dr. Purva Hegde Desai, Professor, Goa Business School, Goa University for selecting me as her student, guiding me with infinite patience, continuously motivating me and ensuring that I reach the goal.

I express my gratitude to Dr. Nilesh Borde and Dr. Harip Khanapuri for continuously guiding me and their insightful thoughts throughout the research process.

I wish to thank Dr. Nandakumar Mekoth, Dr. Nirmala, Dr. Dayanand and all the researchers and staff of Department of Management Studies of Goa Business School for their valuable inputs and support. Thanks to Mr. Amrut Shet for his administrative support.

I am thankful to my professional colleagues CA. Ashish Prabhu Verlekar, for always supporting me and for his brilliant insights; CA. Kiran Kharangate and CS. Shweta Kharangate for their valuable support.

I am thankful to CA. Darryl Frank and CA. Narayana Upadhyaya for giving me opportunities to work in the field of transfer pricing. Special thanks to CA. V. B. Prabhu Verlekar for always motivating me.

I am grateful to the Institute of Chartered Accountants of India and the Institute of Company Secretaries of India which have made me a professional capable of working in the area of transfer pricing and undertaking this research.

This research would not have been possible without the support of my family, especially in tough times. I express my gratitude to my wife Mrs. Gayatri Kamath, for being my source of strength and for her support and encouragement and my daughter Ms. Soumya Kamath, for keeping me cheerful and optimistic.

This thesis was completed by the grace of God and I am ever grateful for the strength and courage I am blessed with.

Satyaprakash Kamath

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# List of Abbreviations

AE	:	Associated Enterprise
ALP	:	Arm's Length Price
AM	:	Assessee Method
AMP	:	Advertising Marketing Promotion
BEPS	:	Base Erosion and Profit Shifting
CPM	:	Cost Plus Method
CUP	:	Comparable Uncontrolled Price
DV	:	Dependent Variable
DRP	:	Dispute Resolution Panel
EF	:	External Factors
FDI	:	Foreign Direct Investment
IF	:	Internal Factors
ITAT	:	Income Tax Appellate Tribunal
MM	:	Management Motives
MNE	:	Multi National Entity / Multi National Enterprise
OECD	:	Organisation for Economic Cooperation and Development
PLI	:	Profit Level Indicator
PSM	:	Profit Split Method
RBV	:	Resource Based View
RM	:	Regulatory Motives
RPM	:	Resale Price Method
RPT	:	Related Party Transactions
SPSS	:	Statistical Package for Social Sciences
TCE	:	Transaction Cost Economics
TNMM	:	Transaction Net Margin Method
TP	:	Transfer Pricing
TPO	:	Transfer Pricing Officer
TT	:	Transaction Type

# **Abstract**

## **Transfer Pricing- Concept and Significance**

Transfer prices are the prices at which transactions are carried out between associated enterprises. It is important for taxpayers as well as tax authorities because transfer pricing affects the quantum of revenue and expenditure, and accordingly the profits liable to tax, of related parties in different countries where the tax jurisdictions differ. (OECD, 2009). Countries face conflicting issues when creating tax regulations for transfer pricing. They need to ensure that there is no erosion of the tax base. However, they should not end up creating regulations presenting uncertainties to multinationals as such issues could discourage foreign direct investment or international trade. Hence, the corporates and authorities need to take cognisance of all factors and motives affecting transfer pricing.

## **Review of Literature and Objectives**

Difference in tax rates and taxation regimes between countries results in tax motivated transfer pricing. If tax rates are alike and tariffs are not levied, there would be no transfer pricing incentive (Gupta, 2012). There could be factors other than tax considerations which could distort the relations between associated enterprises. Reese et al. (1989) stated that transfer prices depend on difference in tax and tariff rates, access to and costs in using intermediate product markets, final product market organisation, global strategy, and the ability to price discriminate between divisions. Lin (2006) stated that the main purposes and functions of applying transfer pricing strategies was increased market competitiveness, flexibility of internal funds transfer, reduction of tax burden and controls by the Government which includes price restrictions and limits in quantitative terms. Lin and Chang (2010) brought out the relationships between the categories of motives, namely internal and external, with low and high transfer pricing strategy. The literature review shows that separate studies for factors and separate studies for motives have been carried out. This has resulted in disparate listing /ranking of factors and motives with respect to

transfer price.

This research sought to discern comprehensively, whether the factors and motives in relation to Indian context have any relationship with the transfer pricing methods employed, after classifying factors as internal and external and the motives as regulatory and management. The research also studied whether the motives mediated between the factors and the methods. The study further endeavoured to clarify whether the methods significantly differ across type of transactions, namely, tangible, and intangible transactions.

### **The objectives of this research are:**

- i. To study the transfer pricing factors, transfer pricing motives and transfer pricing methods of tangible and intangible transactions.
- ii. To study the relationship between transfer pricing factors and choice of transfer pricing method.
- iii. To study the relationship between transfer pricing motives and choice of transfer pricing method.
- iv. To study the relationship between transfer pricing factors and motives taken together and choice of transfer pricing method.
- v. To study whether transfer pricing motives mediate the relationship between the transfer pricing factors and choice of transfer pricing method
- vi. To study whether type of transaction moderates the relationship between the transfer pricing motives and choice of transfer pricing method.

### **Mixed Research Methodology**

The study preferred a mixed approached inclusive of case studies and content analysis supplemented with quantitative research.

Two case laws relating to transfer pricing disputes from the automobile industry were selected for initial exploratory case analysis. These two cases



served as pilot cases for developing a protocol for analysis of other cases as suggested by Yin (2009). Thus, pattern matching and explanation building by relating the case to factors and motives pre-derived from the literature review was the methodology adopted for case analysis, as suggested by Yin (2009). The orders on transfer pricing disputes issued by the Income Tax Appellate Tribunal (ITAT) were analysed as cases. 43 cases were analysed, with 60 transactions which were the unit of analysis. For deriving generalisations, the quantitative analysis was adopted, with coding of factors and motives derived from cases and logistic regression was done as statistical analysis.

## **Theoretical Contribution**

The present research comprehensively built a model linking both factors and motives to the transfer pricing methods. Thus, the research builds a larger and inclusive perspective to the research agenda on antecedents of transfer pricing.

This research carried forward the research on motives by Lin and Chang (2010) by establishing that motives are mediators between factors and methods. Further management motives mediate between internal factors and choice of methods. Thus, they are the prime influencers, given the internal factors. The findings thus support the resource based view that emphasise the aggregation of resources centrally to arrive at decisions supporting the group of entities as a whole.

The earlier literature had not included “availability of comparables” as a factor affecting the choice of transfer pricing method. The qualitative analysis of the cases has demonstrated that this has often been the prime factor affecting the choice of method. Given the diversity prevalent in different business context, the transactions being identical is a rarity. Hence, the notion of comparability is fundamental. The differences in transactions may be due to product differentiation, differences in contractual terms, differences across economic circumstances and so on. Hence, arriving at a proper analysis of the differences across transactions will be paramount for deciding transfer price.

## **Limitation and Future Research Issues**

We have not considered social factors such as racist policies, civil warfare, religious conflicts, human rights violation (Doğan et al., 2013). Future research may be done taking into account social factors as an additional external factor. Future research may be done with other classifications and test the relationships.

## **Managerial Implications**

The role of tax professionals to help MNEs manage their transfer pricing issues can be classified into four primary areas being (i) planning, (ii) compliance and documentations, (iii) implementation and (iv) assisting in advance pricing agreements, negotiations, arbitration and litigation (Holtzman and Nagel, 2014). The findings of this research will help the tax professionals in all the areas mentioned above.

# Chapter 1

## Introduction

This Chapter presents a brief background of the concept of transfer pricing and its significance from the global point of view as well as from Indian context. Further, framework of the research is presented including objectives and methodology. The Chapter concludes with the organization of the thesis.

### 1.1 Background

#### 1.1.1 Transfer Pricing

Transfer prices are the prices at which transactions are carried out between associated enterprises. It is important for taxpayers as well as tax authorities because transfer pricing affects the quantum of revenue and expenditure, and accordingly the profits liable to tax, of related parties in different countries where the tax jurisdictions differ. (OECD, 2009).

Related party transactions are subject to intensive scrutiny by tax authorities and consequently subject to additional recognition, valuation, and disclosure requirements. This emerges out of the conviction that transfer pricing of related party transactions do not reflect pricing as determined by the market forces. From the point of view of the tax regulator, the relationship between the entities provides an opportunity to the taxpayer to determine the transfer price in a manner that could result in tax savings in the aggregate on account of differential tax regimes for the entities. Accordingly, regulations regarding valuation and pricing of the transactions have been prescribed to control such practices.

However, from the point of view of the management, the pricing of a transaction needs to comply with various regulations and at the same time also satisfy the apprehensions of stakeholders other than the tax regulator. Transfer pricing is also essential to determine the correct profits achieved by each component in a group (Chikara, 2003).

### **1.1.2 Global Scenario**

Transfer pricing is important to multinational entities considering that after globalisation the operations of these entities are spread over different tax jurisdictions and the operations are subject to diverse regulations in different countries. Transfer pricing provides possibilities of adopting practices which could result in private gains by reducing the tax liabilities of multinational entities and hence resulting in relative social impoverishment. (Sikka and Willmott, 2010). It was observed that transfer pricing was considered as the most important issue in taxation by 30% of tax directors of multinational entities all over the world. In North America, 21% of respondents found transfer pricing to be the most important tax issue, whereas in Asia Pacific it was 30% and in Europe, Middle East, India and Africa it was 33%. (Ernst & Young, 2011)

At a theoretical level, both OECD countries and developing and transitioning countries face the same issue when it comes to creating tax regulations for transfer pricing. They need to ensure that there is no erosion of the tax base. However, at the same time, they should not end up creating regulations which result in double taxation or presenting uncertainties to multinationals as such issues could discourage foreign direct investment or international trade. This issue can be resolved by having transfer pricing regulations based on arm's length principle which will ensure protection of tax base as well as avoiding double taxation and uncertainties. If the transfer price is deviating from the arm's length price by not correctly reflecting market forces, it would result in distortion of the tax liability of the entities in the multinational group which in turn would distort the tax revenue of the countries where the entities operate. (OECD, 2009).

Thus, transfer pricing in Multi National Enterprises (MNEs) has socio-economic implications in terms of equitable distribution of wealth, quality of economic statistics as well as implications for business affecting their policies, strategies and operations towards ascertaining the arm's length price; applying it and justifying it. A study in Mauritius has recommended regulatory

framework and Advance Pricing Agreements to dissuade multinationals to engage in transfer pricing abuses (Beebeejaun, 2019). However, a study in Ghana showed that multinational enterprises have more profitability and also pay more dividends, thus evidencing that they do not shift income as per suspicion of the Government (Agana et al., 2018). One of the concerns raised is the poor selection of comparables based on geographical proximity, instead of considering country risk (Steens et al., 2022).

A look at the country wise tax rates for the period from 2015-2020 indicates the presence of differential tax rates and consequently transfer pricing incentives.

Table 1.1: Country wise tax rates

<b>LOCATION</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
Australia	30.00	30.00	30.00	30.00	30.00	30.00
Austria	25.00	25.00	25.00	25.00	25.00	25.00
Belgium	33.99	33.99	33.99	29.00	29.00	29.00
Brazil	34.00	34.00	34.00	34.00	34.00	34.00
Canada	26.50	26.50	26.50	26.50	26.50	26.50
China	25.00	25.00	25.00	25.00	25.00	25.00
France	33.33	33.30	33.33	33.00	31.00	28.00
India	34.61	34.61	34.61	35.00	30.00	30.00
Italy	31.40	31.40	24.00	24.00	24.00	24.00
Japan	33.86	30.86	30.86	30.86	30.62	30.62
Russia	20.00	20.00	20.00	20.00	20.00	20.00
Singapore	17.00	17.00	17.00	17.00	17.00	17.00
United Kingdom	20.00	20.00	19.00	19.00	19.00	19.00
United States	40.00	40.00	40.00	27.00	27.00	27.00

Source: KPMG, Country wise corporate tax rates,

<https://home.kpmg/it/it/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html>

### **1.1.3 Indian Scenario**

With regard to Income Tax laws, India introduced transfer pricing in 2001. International transactions between associated enterprises are covered under Chapter X of the Income-tax Act, 1961 which deals with special provisions relating to avoidance of tax under Section 92 wherein the transactions values are assessed having regard to the arm's length price. Associated enterprises are defined in Section 92A and international transaction is defined in Section 92B.

However, the domestic transactions between related parties are regulated by Clause 2(a) of Section 40A of the Income-tax Act, 1961 wherein if expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made, or the legitimate needs of the business or profession of the assessee or the benefit derived by, or accruing to him there from, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction.

Consequently, the domestic transactions are subject to assessment considering the aforesaid three criteria. These transactions were not subject to transfer pricing regulations to determine the arm's length price. Hence, whether the expenditure is excessive or unreasonable is subjective and hence discretionary.

Apart from Income Tax laws, other tax and non-tax regulations also require determination and justification of arm's length price in related party transactions. Accordingly, the permissibility of various transfer pricing methods and applicability of these regulations to entities and their classification is studied.

## **1.2 Transfer Pricing Methods**

Transfer pricing methods as per OECD are classified under two categories:

1. Traditional transaction methods which consist of:
  - a. Comparable uncontrolled price method: In this method, the price in a transaction which is uncontrolled but where the conditions are comparable to that of a transaction which is controlled is considered as an arm's length price.

b. Resale price method: In this method, where a product has been procured from a related entity and is resold to a third party, the resale margin is reduced from the resale price to arrive at the arm's length price of procurement from the related entity.

c. Cost plus method: In this method, the arm's length price is computed by taking into account the cost incurred and adding a profit margin or cost plus mark-up. The margin is determined by considering the functions, assets and risks of the supplier in addition to the market conditions.

2. Transactional profit methods which consist of:

a. Profit split method: In this method, the overall profit in the transaction is split between the related entities. This division is made using a valid economic basis considering that the arrangement was at arm's length basis.

b. Transactional net margin method: In this method, the profit margin is examined based on appropriate profit level indicator (PLI) such as profit as percentage of cost incurred, revenue generated, assets employed.

### **1.3 Statement of problem**

The research has following statement of problem:

1. Comprehensive studies on factors influencing transfer pricing have not been found in the Indian perspective.
2. Studies for factors and studies for motives have been carried out separately resulting in disparate listing /ranking of factors and motives with respect to transfer price.
3. Mere presence of a factor does not affect the transfer price unless there is a motive which could be fulfilled by the factor.

Hence, a study of transfer pricing with respect to both, the factors affecting transfer prices and the motives behind the determination of transfer price, would be expedient for comprehensive knowledge about the antecedents of transfer pricing. It would further enrich the body of knowledge to unearth

whether there exist any relationships between the factors, motives and methods of transfer pricing.

## **1.4 Objectives of study**

The objectives of the study are as follows:

1. To study the transfer pricing factors, transfer pricing motives and transfer pricing methods of tangible and intangible transactions.
2. To study the relationship between transfer pricing factors and choice of transfer pricing method.
3. To study the relationship between transfer pricing motives and choice of transfer pricing method.
4. To study the relationship between transfer pricing factors and motives taken together and choice of transfer pricing method.
5. To study whether transfer pricing motives mediate the relationship between the transfer pricing factors and choice of transfer pricing method
6. To study whether type of transaction moderates the relationship between the transfer pricing motives and choice of transfer pricing method

## **1.5 Significance of the study**

The study has filled the gaps in literature, particularly in context of India, throwing light on the factors and motives that significantly impact the choice of transfer pricing method. It also has highlighted the mediating role of motives in the relationship between the factors and the method. This research focuses on the less researched management motives, i.e., to enhance competitiveness, support associated enterprise, enable performance evaluation, simplify application and to ensure control of assets. These motives are essential for the very survival of the firm. Hence, this research emphasises



and supports management motives, which adds the much-needed dimension to the research on transfer pricing motives.

Similarly, the research brings to the fore, the salience of internal factors such as inter related functions and such as contractual arrangements which significantly affect the choice of transfer pricing method. The research has also unearthed another factor, i.e., availability of comparable, which is a critical factor. This research has highlighted the need for a comprehensive approach, wherein uniformity is introduced in the methods and reporting of related party transactions under the various tax and non-tax regulations.

## **1.6 Overview of methodology**

The design of this research includes qualitative and quantitative methodology to achieve the objectives of the research.

The method of transfer pricing adopted by companies is not available in the public domain. However, orders on transfer pricing disputes issued by the Income Tax Appellate Tribunal (ITAT) could be analysed. The ITAT is the final fact-finding authority for income tax disputes and higher courts take up the matter only if it is a substantial matter of law. These ITAT cases provide an insight into all relevant facts involved in the transfer pricing case. Hence, content analysis of these cases was done to discern the factors and motives.

Total of 60 transactions from 43 Case Laws are analysed to conclude on the research findings. The variables were then coded and statistical analysis was carried out using SPSS.

Normally, when unrelated entities enter a transaction, the determination of the price and conditions for transfer of goods or providing of services are governed by the existing market forces. However, when associated enterprise enter a transaction, the determination of the price and conditions for transfer of goods or providing of services are not impacted by market forces directly though these entities try to determine the same as if it was a transaction between unrelated entities (OECD, 2009). Hence there would be factors other than

market forces which would impact determination of the transfer price of transactions between related parties. The factors affecting transfer pricing have been studied by many researchers from various points of view. Further, motives of choice of transfer pricing methods have also been studied. The current research comprehensively studies antecedents of transfer pricing namely, the factors and motives, also researching the mediating role of motives.

## **1.7 Organisation of the thesis**

The thesis is structured into 5 chapters and the same is outlined as follows:

Chapter 1 provides a background a brief background of transfer pricing, statement of problem, objectives and significance of the study and an overview of methodology

Chapter 2 presents overview of the existing literature on the significance of transfer pricing, methods, factors and motives of transfer pricing, tax administration, factors and their classification, and systems and frameworks and provides the research gaps from the literature review, research objectives, the proposed conceptual model and hypotheses.

Chapter 3 provides the details of the mixed research methodology followed in the study. It is explained for qualitative study stage and quantitative study stage separately in two sections.

Chapter 4 provides the qualitative within case analysis of judgements used in the research further explaining the derivation of variables for quantitative analysis

Chapter 5 presents the findings from quantitative analysis towards testing of hypotheses, revised conceptual model, qualitative analysis, theoretical contributions, managerial implications and future research issues.

# Chapter 2

## Literature review, research questions and hypotheses

Literature review is presented in this Chapter initially bringing out the significance, elucidating all the concepts relevant to this research, revealing the gaps in the literature and objectives, stating the hypotheses and operational definition of constructs. The framework of research and the proposed conceptual model are also stated.

### 2.1 Literature review

#### 2.1.1 Significance of transfer pricing and international transfer pricing

The markets for tangible goods as well as services, intangibles and financial instruments have achieved globalization. Significance of international transfer pricing is growing on account of globalization and important changes in the global business trend. Thus, the impact of growth in trade between nations has resulted in unavoidable external impact on the economy of any country. Further, the integration across nations in supply chain, communication and technology has connected economies.

Transfer pricing impacts the treasury strategy since tax adjustment impacts the cash flows. It also impacts the profits which is the performance indicator in a business thus affecting the business strategy (Luca et al., 2019).

A significant aspect of international trade are the prices at which transactions in goods, services and intangibles are done between entities within the MNEs. This is an important factor for the MNE as well as the Governments of the countries where the entities are located or are operating from, as the transfer price relates to cross-border movement of the goods, services and intangibles.

It assumes significance for the MNEs as the transfer price could be used to

enhance the overall benefits to the MNE and also to evaluate performance of individual entities. At the same time, the Governments would be concerned on use of transfer pricing mechanism to manipulate tax and also the tariff. The interests could be contradictory as over pricing of imports could lead to increase in expenditure resulting in lower direct tax whereas under pricing of imports could result in lower customs duty.

Transfer pricing is of strategic importance as India moves towards a more globalised economy along with focus on liberalisation. The country needs to be attractive to global investors and financial markets to attract Foreign Direct Investment (FDI). In this situation, entities would aim to implement transfer pricing policies which balance the objectives of optimisation of returns and mitigation of risks. The MNEs would ensure transfer pricing leads to optimisation of their goals and values.

From the point of view of the tax regulatory authorities, it is important to have a transfer pricing policy which is not seen as a mechanism to shift profits to lower tax or nil tax jurisdictions with an objective to reduce overall taxes of the MNE. The tax authorities would accept such transfer price that would be adopted by an independent entity in an uncontrolled transaction, or the Arm's Length Price (ALP). In case of deviation from the ALP, the tax authority could then assess the transfer price by benchmarking the transactions based on the facts of the case. The MNEs on the other hand would want to avoid disputes with the tax authorities hence prefer a transfer pricing mechanism perceived as transparent, reasonable and consistent (Kaushik, 1999).

### **2.1.2 Methods in transfer pricing**

Various methods have been developed for computing and assessing transfer prices in international transactions. The basis of these methods is by establishing a benchmark of pricing by independent entities in uncontrolled transactions and then measuring pricing by MNEs against this benchmark. These methods are Comparable uncontrolled price (CUP) method, Resale price method (RPM), Cost-plus method (CPM), Profit split method (PSM),

Transaction Net Margin Method (TNMM). The OECD classifies the CUP method, resale price method, and the cost-plus method as traditional transactional methods. The profit split method and the transaction net margin methods are referred to as transactional profit methods.

There are two decisions to be made with respect to each product transferred when profit centres within an entity buy and sell. Firstly, the source of the product. The entity needs to decide whether it is to be manufactured within the entity or procured externally, which is also known as the sourcing decision. Second, if the entity decides to manufacture the product within the entity, it is required to determine a transfer price (Kaushik, 1999).

The comparable uncontrolled price (CUP) method lays emphasis on the price of the goods or services transferred and the price charged in an uncontrolled transaction between independent parties is the basis for determining the ALP of the transaction under CUP method.

The resale price method (RPM) focuses on the gross margin earned by a distributor. The gross margin represents such amount that a reseller needs to earn in order to cover selling and other operating expenses and make an appropriate profit commensurate with functions performed, assets used, and risks assumed. To determine this, margin earned by independent distributors performing similar functions, contributing similar assets, and bearing similar risks is considered as the basis for determining the appropriate margin in the transaction and the ALP is computed on that basis.

The cost-plus method (CPM) focuses on the gross markup earned by a manufacturer which is based on the markup earned by comparable independent manufacturers performing similar functions. The ALP is computed by adding the markup to the cost incurred based on functions performed, assets used, and risks assumed.

The major difference between the traditional methods is the approach. Though the CUP method is also indirectly focused on considering the functions

performed by each party to the transaction, it is done by focusing directly on the price of the product being transferred. On the other hand, the resale price and cost-plus methods primarily focus on the function being performed.

The profit split method (PSM) firstly considers the combined operating or gross profit to be apportioned between the parties in a controlled transaction. That profit is then split between the parties based on a rational basis which determines the division of profits that would be reflected in an agreement made between independent entities at ALP.

The comparable profit methods include various methods that consider the net profit margin realized from a controlled transaction taking an appropriate indicator. Profit level indicators (PLIs) include the return on assets, operating income to sales, and other suitable financial ratios. This method is referred to as transactional net margin method (TNMM).

Transfer pricing considers the pricing policy of an independent firm as a benchmark for the pricing implemented by a MNE, had it been transacting under similar uncontrolled environment or open market conditions. Practically, the traditional transactional methods adjust the price considered as benchmark to consider the differences in the nature of the goods or services, the functions performed, assets employed and risks assumed by the MNE.

Thus, transfer pricing policy of MNEs should consider identification of comparable independent entity as a benchmark, and then quantify and adjust the differences in the nature of the goods or services, the functions performed, assets employed and risks assumed of the MNEs from those of the independent entity. The MNE should then compare the price adopted for the transaction by the benchmark firm with the pricing adopted. If the prices are consistent, it would be concluded that the price adopted is consistent with the arm's length principle.

Using case study approach, Kumar and Sosnoski (2011) developed a decision framework for Small and Medium Enterprises (SME) for complying with

transfer pricing and selection of the method. However, the scope was restricted to study of only one SME and covered only transaction in tangible components. Transaction Net Margin Method (TNMM) uses multiple factors at domestic and international levels to determine the transfer price of a transaction. Rahmiati and Sandi (2016) conducted an ethnographic study in Indonesia to study how transfer price is determined. They concluded that Cost Plus Method was most tax effective but is complex, requires comparative data and high cost and time whereas Transactional Net Margin Method was better for optimizing tax as data was easier to access and hence requires lower cost and time. Also, Matavulj (2021) compared application of Cost Plus Margin (CPM) Method and Transactional Net Margin Method (TNMM) in an MNE located among Europe's developing countries and observed that CPM should not be always preferred over TNMM.

Friedrich and Tepperova (2021) concluded based on a study that MNEs in digital economy had a potential tendency to indulge in base erosion and profit shifting from the Czech Republic to low tax jurisdiction by mispricing. This was determined using tax evasion rate (TER) indicator and the Transactional Net Margin Method (TNMM). Choi et al. (2022) observed that MNEs may not offer licensing contracts to unrelated parties to avoid creating a benchmark for applying CUP method.

The following table explains the details of the methods of transfer pricing

Table 2.1: Table of methods, applicability and pros and cons

Details	Methodology	Where appropriate	Pros	Cons
CUP	Compares intragroup prices to transaction price between independent willing buyers and sellers	Suitable where comparable data exists	Direct and reliable	Will soon be inapplicable, because comparable transactions are rapidly ceasing to exist

Details	Methodology	Where appropriate	Pros	Cons
RPM	Uses gross margin approach to compare intra-group gross margin to resale margin in the comparable uncontrolled business transactions- Top-down pricing approach	Most useful for distributors and resellers or manufacturing industry	Less demanding as fewer adjustments are required to account for product differences. This is because such differences are usually less material on profit margin than on price	Limited by its one-sided nature
CPM	Uses the gross profit margin approach compares mark-up costs of controlled transactions against those of uncontrolled transactions – bottom-up pricing approach	Is most appropriate in the manufacturing and service industries	Simple and easy to apply. The information is often from internal sources and available	May discourage the manufacturer to control costs
TNNM	Based on net profit indicators. It examines the net profit relative to an appropriate base (such as costs, sales, and assets) that a taxpayer realizes from a controlled transaction	Commonly applied in transactions that involve provision of services between associated enterprises	Is trusted and used by both taxpayers and tax agents because finding comparable with this method is easier	Is a one-sided method and is less reliable than the first 3 methods because of its use of net margins which are sensitive to the cost structures of enterprises



Details	Methodology	Where appropriate	Pros	Cons
PSM	Based on the information available on value added (contribution) of functions to complete the product/service rendered by each enterprise- Splits the profits between related enterprises to match arm's length price joint product approach	More useful where the one-sided methods are inappropriate	Less risk of underestimation as PSM is a two-sided method and is flexible	Maybe difficult to apply particularly because accessing foreign associates' data is a challenge

Source: Mpofu and Wealth (2022)

### 2.1.3 Causes for disputes arising in transfer pricing

There is a possibility that governments may adopt strategy to design transfer pricing regulations in a way that they can compete with other governments to make their jurisdiction more attractive (Raimondos-Møller and Scharfy, 2002). Tax reforms such as BEPS may result in significant impact on MNEs and tax authorities. Hence, the challenge remains for MNEs to evolve to adapt to the changes and the challenge for countries is to act in a way that while collecting tax revenues, their jurisdiction remains attractive for MNE investment (Smith, 2014). The relationship between Foreign Direct Investment (FDI) and tax adjustments from transfer pricing was found based on statistical analysis performed on data in Romania (Tache and Luca, 2021). Thus, the country where the MNE operates has to reconcile the objectives of collection of taxes from revenues, while encouraging the MNEs to be a part of country's commercial eco-system.

Seppälä et al. (2014) observed in a case study of a single product that due to accounting and transfer pricing mechanisms, the most valuable assets of the MNEs could not be located where the operations and supply chain was globalized. MNEs thus have to also face many operational restrictions due to compliances of transfer pricing. MNEs use transfer pricing strategies within the group to shift profits out of the host country and has been enabled on account of increasing international trade, increase in FDI in developing countries, international production and supply chains in more locations and increased value of intangibles (Malesky, 2015). Thus, it is seen that there are several operational decisions impacted due to transfer pricing besides the tax compliances, although tax mechanism remains a primary area in transfer pricing for revenue authorities and the firms alike. Thus, this research includes the agenda of bringing to the fore, the salience of the management motives.

#### **2.1.4 Difference in tax rates**

Difference in tax rates and taxation regimes between countries results in tax motivated transfer pricing. Differential tax jurisdictions arise on account of some countries implementing tax regulations which are liberal as a way of attracting foreign direct investment considering the competition among developing countries for the same (Reese et al., 1989). Clausing (2003) analysed the monthly data on US international trade prices between 1997 and 1999 to investigate the influence of tax minimisation strategies on intra firm trade prices. A strong and statistically significant relationship between a country's tax rate and the prices of intrafirm imports and exports traded with that country was observed.

Shifting of income by transfer pricing from high tax jurisdiction to a lower tax jurisdiction would result in difference in the income reported by the entity as compared to the actual income of the entity arising from the economic activity of the entity. This may be done by multinational entities by using debt financing in higher tax jurisdictions as against equity financing in lower tax jurisdictions. The income could also be shifted by pricing of cross border transactions in goods and services between the entities in the multinational

group (Bartelsman and Beetsma, 2003).

Increasing number of countries are implementing capital control relaxations in view of the competition and hence has resulted in the average tax rate across countries going towards a downward trend (Devereux et al., 2008). Olibe and Rezaee (2008) studied the relationship between cross border transfers within MNEs with returns on investment, the tax rate in the United States and tax rates globally, and concluded that such transactions have the potential to shift income and reduce tax as managers can adjust the transfer price towards the transfer pricing objective.

Gupta (2012) using the Swenson's model stated that the reported transfer prices are a function of comparable arm's-length price, costs and penalties of avoidance and a transfer pricing margin consisting of corporate tax rates in home and foreign country and applicable tariffs in the foreign country. The transfer pricing incentive considered in the model is a composite of tax and tariff components. Accordingly, if tax rates are alike and tariffs are not levied, there would be no transfer pricing incentive. Though, transfer pricing issues faced by MNEs are highly complex and could result in high expenditure, it also allows for managing profits, cashflows and taxes by adopting transfer pricing policies (Holtzman and Nagel, 2014).

Ftouhi and Ghardallou (2020) in a review of literature on international tax planning techniques state that transfer pricing is a significant issue in the field of international transaction as it is considered the biggest issue in taxation of MNEs. MNEs have more intra group transactions with associated enterprises in low tax countries which is consistent with profit shifting. Further, difference in tax rules for transfer pricing also impact the volume of intra group transactions (Rathke et al., 2021). Mashiri et al. (2021) using game theory studied the influence of tax consultants in transfer pricing decisions of MNEs and concluded that they colluded and benefited from such practices.

Overall taxes of an MNE could be reduced by registering entity in a low tax jurisdiction, concentration of profits in entities which ordinarily are not

profitable or in entities used only for sales by using transfer prices deviating from the market price (Chukurna et al., 2021). Otusanya and Adeyeye (2022) using evidence in public domain found that existence of tax havens results in facilitation of capital flight in addition to money laundering and corruption. It was observed that one of the methods of capital flights was deliberate under invoicing exports or over invoicing imports, used to move money across borders by resorting to tax evasion by transfer mispricing. Gill et al. (2022) state that Indian MNCs are planning to minimize tax due on account of aggressive stand by Indian tax authorities and concluded that profit shifting on account of differential tax jurisdictions occurs when the MNCs have presence in at least 5 countries. Further, the study found that Indian MNCs shift profits to no tax countries rather than low tax countries. One of the modes of profit shifting listed is the management of transfer prices. They further state that research on profit shifting by MNCs are focused on developed countries and there is lack of research on developing countries like India.

### **2.1.5 Tax administration**

Haufler and Schjelderup (2000) observed that one of the tax reforms by countries was reduction of tax rates on account of increase in the tax base and that that one effect of corporate tax is differential treatment for financing modes. It was suggested that corporate tax could be based on cash flow tax being expensing of investments or where all forms of financing had same treatment.

Ali (2016) using sectoral based data from 1999 to 2005 observed that from perspective of advanced economies, US owned MNEs had higher returns compared to foreign owned investment in the US as well as US based industries. On the other hand, Sebele-Mpofu et al. (2021) observed that transfer pricing in developing countries in the African continent resulted in significant revenue losses due to mispricing of technical and management fees, mis-invoicing and use of tax havens and recommended adoption of transfer pricing regulations among other measures related to tax policy and authorities to overcome these challenges. Aggressive transfer pricing is used by MNEs in

developing countries for avoidance and evasion of tax (Mpofu and Wealth, 2022). Padhi and Bal (2015) studied transfer pricing conflicts with tax authorities and observed use of creative and innovative transfer pricing policies by MNEs in Indian scenario and discretionary power used by tax authorities.

Cazacu (2015) linked transfer pricing with tax havens by concluding that transfer pricing determines whether the price is higher or lower and accordingly allows shifting of profits to lower tax jurisdictions, being tax havens, and listed methods such as conversion of debt into equity, interest rates, and pricing of services, dividends and royalty as methods of profit transfer. Jalan and Vaidyanathan (2017) in their study on tax havens found that base erosion and profit shifting exists and is mainly on account of operation of tax havens and have listed transfer pricing as a significant factor for operation of tax havens and resulting tax evasion. Sari et al. (2017) in their study of Indonesian entities observed that tax avoidance and cash dividend payments were indirectly related. However, Dharmapala (2008) observed that tax havens have better governance from political and legal point of view and lower corruption and that though tax havens provide opportunity for planning tax, it would also depend on the tax rules in the home country of MNEs. It is further proposed that tax havens could increase efficiency and reduce tax competition.

According to Hong et al. (2014), when the transfer price of related party transaction deviates from the Arm's Length Price, it results in trade mispricing or abnormal pricing which may not be visible and detection is expensive. Hong et al. (2014) taking banana trade of US with Latin American and Caribbean countries examined trade mispricing by using free market price instead of interquartile price range and found that the banana exporting countries may lose tax revenue and result in capital flight from those countries. Christian and Zdanowicz (2016) examined the impact of abnormal pricing on the state corporate tax and observed that if states invested in compliance enforcement activities in respect of imports and exports, it could result in higher corporate tax revenues.

Audit of related party transactions is difficult as identification of the

transactions is difficult, reliance is placed on management for the details of such transactions and internal controls have difficulty tracking the same (Gordon et al., 2007). Related party transactions result in increase in audit risk (Rasheed et al., 2021). Muhammadi et al. (2016) studied the audit of transfer prices of intangible assets in Indonesia and listed the various issues in the audit. They concluded that the tax auditors adopted in-depth analysis using legal documents and comparison with the facts in the transaction to arrive at the substance over form principle.

Suryana and Gouw (2021) observed in a study of MNEs in Indonesia that bonus mechanism affects transfer pricing on account of tax expenses. Whereas, Sari et al. (2022) concluded based on study of MNEs in Indonesia that intangible assets and bonus structures do not influence transfer pricing on account of tax expenses but debt covenants can influence transfer pricing.

Transfer pricing methods are not disclosed by Companies in the financial statements or annual reports. Sikka (2018) has argued that public filing of tax returns by large companies will discourage tax avoidance, increase transparency, accountability and increase competition. Wu and Zhang (2022) suggest that measures such as comment letters from regulatory authority over securities in China could have an impact of discouraging tax avoidance.

As countries have powers to make independent decisions regarding the tax regulations, the MNEs must learn the various taxation regimes but also provides opportunity for adopting strategies to shift income and reduce their overall taxes (Gérard, 2007). Beyer (2018) in his study of income tax with non-discrimination rules of General Agreement on Tariffs and Trade (GATT) suggests that if the transfer pricing rules are discriminatory, it could be challenged at the dispute settlement proceedings of the World Trade Organisation (WTO). Grinenko et al. (2021) conducted a study of tax disputes in two countries and concluded that in Ukraine the disputes were focused on technical errors whereas, in the United States of America the disputes were focused on the transactions. Ignat and Feleagă (2019) while studying the arm's length principle as per IAS 24 concluded that justification of the transfer price

of the transaction is subjective and affected by the regulations in that country. Mugarura (2018) analysed tax avoidance and proposed that harmonization of law can help individual countries to deal with tax avoidance. Another mechanism to avoid tax disputes on account of double taxation is opting for Advance Pricing Agreements (APA) which along with measures such as dispute resolutions and safe harbours would impact taxation of MNEs (Verma and Singh, 2014).

Amidu et al. (2019) studied transfer pricing practices of MNEs in Ghana and concluded that most of the MNEs included in the sample used transfer pricing for tax avoidance. Further, non-financial firms were found to use more Transfer Pricing practices for tax avoidance. El-Helaly (2018) identified three risks arising from related party transactions (i) expropriation of wealth of minority shareholders (ii) reduction in earnings quality and (iii) reduction in performance and valuation and also found that corporate governance could reduce the negative effects of such transactions. Beebeejaun (2019) using case law and legal analysis in Mauritius concluded that formal transfer pricing legal framework and strict transfer pricing rules are required to enable detection and discourage MNEs from manipulation of transfer prices and recommends use of Advance Pricing Agreements. Sebele-Mpofu et al. (2022) suggested that political commitment, legislative improvement and increase in capacity of administration is required to reduce abuse of transfer pricing. Goerdts and Eggert (2022) observed that applying multiple measures simultaneously as hybrid rules are effective.

Sebele-Mpofu et al. (2021) observed use of service fees as the foremost transfer pricing strategies in MNEs in Zimbabwe for mispricing. Sari et al. (2020) examined profit shifting practices in developing countries in Asia using data from various subsidiaries in MNEs and found that such practices take place in transfer pricing of purchases and fees for management services. The study also concludes that use of Specific Anti Avoidance Rules (SAAR) reduces such practices in sale transactions. Rathke et al. (2021) found that specific rules for transfer pricing overriding OECD Transfer Pricing

Guidelines could control profit shifting. Further, the difference in transfer pricing rules in Brazil and OECD guidelines enabled MNEs to take advantage and shift profits from Brazil.

Accounting research and research in tax have been done in isolation. The studies need to be integrated to develop understanding and ability to explain transfer pricing. The pricing of related party transactions for accounting and tax needs to be integrated. Hummel et al. (2019) tested a structural equation model to determine whether transfer pricing system which is tax compliant can be integrated into management control system. This was done to achieve dual objective of internal control and compliance with tax. The current research also tests a composite model comprising of management and regulatory motives.

### **2.1.6 Other factors**

Brem and Tucha (2006) proposed that for determining ALP, simplified application may not be sustained due to lack of availability of comparable information and specific information on functions, risks and assets of third parties in databases and accordingly the transfer pricing in the future would have to resort to information derived from within the MNE.

There could be factors other than tax considerations which could distort the conditions of commercial and financial relations which are established between associated enterprises. For example, the multinational entities could face conflicting governmental pressures in their own country or in a foreign country where it has operations relating to customs valuations, foreign exchange controls, anti-dumping duties, or price controls. Further, the transfer price could be distorted due to liquidity requirements of entities within a multinational group. There is also possibility of pressure to show profits in the case of entity which has public holding in the holding company itself especially if the company does not report consolidated financial statements. (OECD, 2009)

Reese et al. (1989) ranked the survey results from studies by Kim and Miller (1979), Burns (1980), Tang (1980) and Yunker (1983) identifying influences



on Transfer Pricing Policies of Multinational Entities included restriction on repatriation of profits, foreign exchange controls, direct and indirect taxes in the host country and affiliate country, profits, government relations, evaluation of performance, simplified application. According to Reese et al. (1989), transfer prices are shown to depend on difference in tax and tariff rates, access to and costs in using intermediate product markets, final product market organisation, global strategy, and the ability to price discriminate between divisions. The study primarily examined either US or Canadian multinational enterprises. Lin and Chang (2010) have quoted Lin (2006) that the main purposes and functions of applying transfer pricing strategies by Multi National Enterprises was increased market competitiveness, flexibility of internal funds transfer, reduction of tax burden and controls by the Government which includes price restrictions and limits in quantitative terms.

Fernandes et al. (2015) developed a model of supply chain network where the transfer pricing methods were considered as decision variables and the profits were dependent variables for maximization to study impact of transfer pricing decision on the supply chain network. Martins (2017) using legal research method studied the financial reporting using International Financial Reporting Standards in Portugal and the impact on Transfer Pricing and concluded that the profit margins derived from the new accounting environment are of low quality when they are used as Profit Level Indicator. Due to this there is increase in uncertainty and consequently resources required by tax authorities as well as taxpayer.

Bohoslavsky (2018) observed that controlling tax abuse which includes transfer of funds abroad in violation of domestic tax laws is important to improve human rights obligations. Transfer pricing depends on situation and different approaches are required depending on the situation unless there are comparatives in the nature of substitutes with market price available. Cost based models are static and improvements are required for specific situations (Smolarski et al., 2019). In a study of intensity of transfer pricing by French listed MNEs, Merle et al. (2019) observed positive association of the size of

the firm and leverage and negative association of intangible assets and tax rates with the intensity.

Park (2018) observed higher levels of tax avoidance in increased volumes of related party transactions and that such transactions were used for tax avoidance by business groups in Korea. Gordon et al. (2004) observed that higher amounts of related party transactions were associated with weaker corporate governance. Alhadab et al. (2020) based on data from MNEs in Jordan studied relation between related party transactions and earnings management and concluded that the related party transactions were not used for earnings management. The study found that higher concentration of ownership resulted in reduced related party transactions and earnings management.

### **2.1.7 Classification of factors**

Ho (2009), in *International Transfer Pricing by Multinationals in the People's Republic of China (PRC)* has grouped the various factors, stated as "Environmental Variables of International Transfer Pricing for Intra-Group Transactions Between Multinationals and Their PRC Affiliates," as External Economic Environment, Political Issue, Socio-behavioural Concern, Internal Economic Environment and Regulatory Compliance.

The study was based only on international business aspects of Asian based and Anglo based multinational entities with their affiliates in PRC and concluded that compliance with local tax laws and regulations in host countries has the highest ranking.

Besides classification of motives into internal and external, various researchers have classified the factors also, in different ways. Doğan, et al. (2013) in their *Case Study of United Kingdom of Factors Influencing the Selection of Methods and Determination of Transfer Pricing in Multinational Companies* grouped the factors into legal factors, political and social factors, external economic factors and internal economic factors. The legal factors included

various regulatory factors like tax related and reporting standards, the political and social factors mainly comprised government policies, conflicts, and stability. The external economic factors included various controls, restrictions, and inflation whereas internal economic factors included competitiveness and performance.

The current study sought to build a composite model of antecedents of choice of transfer pricing method. Hence, the study divided the factors into external factors which would be beyond the control of management vis a vis internal factors which would be under management control.

### **2.1.8 Derivation of factors from literature review**

Table 2.2: Factors derived from literature review

<b>Sr. No.</b>	<b>Description</b>	<b>Source</b>
<b>1.</b>	Profit Repatriation Restrictions	Kim and Miller (1979)
<b>2.</b>	Exchange Controls	Kim and Miller (1979)
<b>3.</b>	Joint Ventures	Kim and Miller (1979)
<b>4.</b>	Tariffs and Customs Duties	Kim and Miller (1979)
<b>5.</b>	Foreign Income Tax	Kim and Miller (1979)
<b>6.</b>	Host Country Competition	Burns (1980)
<b>7.</b>	Host Country Market Conditions	Burns (1980)
<b>8.</b>	Securing Reasonable Affiliate Profits	Burns (1980)
<b>9.</b>	Federal Income Taxes in Home Country	Burns (1980)
<b>10.</b>	Host Country Taxes	Burns (1980)
<b>11.</b>	Overall Firm Profit	Tang (1980)
<b>12.</b>	Host Country Customs Duties and Regulations	Tang (1980)

<b>Sr. No.</b>	<b>Description</b>	<b>Source</b>
13.	Host Country Competition	Tang (1980)
14.	Profit Repatriation Restrictions	Tang (1980)
15.	Host Country Government Relations	Tang (1980)
16.	Transfer Pricing Incentive	Swenson (2001), Gupta, (2012)
17.	Tariffs and Customs Duties	Swenson (2001), Gupta, (2012)
18.	Penalties	Swenson (2001), Gupta, (2012)
19.	Location of Holding Company	Sikka and Wilmott (2010)
20.	Tax rates and tax laws in the country in which the parent corporation operates	Dogan et al. (2013)
21.	Tax-customs laws and rates in the country in which the subsidiary operates	Dogan et al. (2013)
22.	Government interventions (price and quantity restrictions)	Dogan et al. (2013)
23.	Shares of the local partnerships	Dogan et al. (2013)
24.	Principles of tax authorities	Dogan et al. (2013)
25.	Financial reporting standards	Dogan et al. (2013)
26.	Anti-dumping and anti-trust laws in the country in which the corporation operates	Dogan et al. (2013)
27.	Confiscation and dispossession risks in the country in which the corporations operate	Dogan et al. (2013)
28.	The corporations' ability to have well connections with the government of the country in which	Dogan et al. (2013)

<b>Sr. No.</b>	<b>Description</b>	<b>Source</b>
	they operate	
<b>29.</b>	Racist policies in the country in which the corporations operate	Dogan et al. (2013)
<b>30.</b>	Civil warfare in the country in which the corporations operate	Dogan et al. (2013)
<b>31.</b>	Religious conflicts in the country in which the corporations operate	Dogan et al. (2013)
<b>32.</b>	Political instability in the country in which the corporations operate	Dogan et al. (2013)
<b>33.</b>	Human rights violations in the country in which the corporations operate	Dogan et al. (2013)
<b>34.</b>	Exchange rate controls and exchange rate fluctuations	Dogan et al. (2013)
<b>35.</b>	Restrictions on profit and cash transfers	Dogan et al. (2013)
<b>36.</b>	Price controls	Dogan et al. (2013)
<b>37.</b>	Import restrictions and quotas	Dogan et al. (2013)
<b>38.</b>	Inflation rates in the countries in which the corporations operate	Dogan et al. (2013)
<b>39.</b>	Market shares of corporations	Dogan et al. (2013)
<b>40.</b>	Market structure of the countries in which the corporations operate	Dogan et al. (2013)
<b>41.</b>	Competitiveness of the corporations	Dogan et al. (2013)
<b>42.</b>	Performance and evaluation criteria for the corporations	Dogan et al. (2013)
<b>43.</b>	Influence of top management of the group's parent company	Ho (2009)
<b>44.</b>	Corporate income local tax rates and incentives in host countries	Ho (2009)

<b>Sr. No.</b>	<b>Description</b>	<b>Source</b>
45.	Local turnover tax rates and incentives in host countries	Ho (2009)
46.	Local customs duty rates and regulations in host countries	Ho (2009)
47.	Compliance with local financial reporting requirements in host countries	Ho (2009)
48.	Participation of local management from affiliates in host countries	Ho (2009)
49.	Interest of local partners of foreign affiliates	Ho (2009)
50.	Risk of expropriation in host countries	Ho (2009)
51.	Change of government in host countries	Ho (2009)
52.	Religious conflicts in host countries	Ho (2009)
53.	Compliance with local tax laws and regulations in host countries	Ho (2009)
54.	Human rights violations in host government	Ho (2009)
55.	Existence of foreign exchange controls	Ho (2009)
56.	Rates of inflation in host countries	Ho (2009)
57.	Increased market share of foreign affiliates	Ho (2009)
58.	Strengthened competitive position of foreign company	Ho (2009)
59.	Compliance with home country tax laws and regulations	Ho (2009)
60.	Compliance with home country financial reporting	Ho (2009)

### **2.1.9 Internal and external motives globally**

Lin and Chang (2010) studied the internal and external motivations for transfer pricing manipulation by Multi National Enterprises and the pricing strategy under different motives. Dunning (1993) and Tang (2002) listed several incentives and environmental factors affecting international transfer pricing manipulation which were considered in the study. Thereafter, the motives are grouped as external and internal motives. Lin and Chang (2010) summarised the above literature relating to transfer pricing manipulation and after selecting the factors brought out the relationships between the categories of motives, namely internal and external, with low and high transfer pricing strategy. The motives comprised (a) External Motives which included reducing global tax, indirect taxes and tariffs, risk of foreign exchange fluctuations and political risk; increasing of profits and capital assets; avoiding controls at local level and ensuring repatriation of funds and (b) Internal Motives which included assisting joint ventures and supporting subsidiaries apart from making the entity competitive.

The Analytical Network Process was employed to calculate weights and the model was constructed. The study concluded that the main purpose of transfer pricing manipulation by MNEs is to maximise economic profits and enhance competitiveness.

The study however was restricted to Taiwanese MNEs who were having investments in China. Accordingly, the low pricing of exports was essential for competitive pricing considering low cost of raw materials and labour in China. This indicates that the results of the study are likely to differ across different nations since the factors and impact thereof are specific in the context of those nations and circumstances therein.

Hence, our research sought to discern whether the factors and motives in relation to Indian context have any relationship with the transfer pricing methods employed. Further, we have included motive to ensure control over tangible and intangible assets, motive to enable performance evaluation and

motive to simplify application as additional motives over the research done by Lin and Chang (2010).

### 2.1.10 Derivation of motives from literature review

Table 2.3: Motives derived from literature review

<b>Sr. No.</b>	<b>Description</b>	<b>Source</b>
1.	Increase Overall Firm Profit	Yunker (1983)
2.	Simplicity and Ease of Application	Yunker (1983)
3.	Facilitate Performance Evaluation	Yunker (1983)
4.	Increase Overall Corporate Sales	Yunker (1983)
5.	To minimize the overall global tax for MNES	Lin and Chang (2010)
6.	To minimize tariffs and import/export duties	Lin and Chang (2010)
7.	To maximize export profits	Lin and Chang (2010)
8.	To reduce foreign exchange risks	Lin and Chang (2010)
9.	To ensure the repatriation of profits or capital	Lin and Chang (2010)
10.	To increase enterprise capital assets	Lin and Chang (2010)
11.	To avoid local control of capital expenditures	Lin and Chang (2010)
12.	To reduce political risks in the country receiving investment	Lin and Chang (2010)
13.	To assist the joint venture in obtaining the maximum economic profits	Lin and Chang (2010)
14.	To assist the joint venture in obtaining support for price adjustments	Lin and Chang (2010)
15.	To assist the joint venture in avoiding	Lin and Chang (2010)



<b>Sr. No.</b>	<b>Description</b>	<b>Source</b>
	anti-monopoly controls	
<b>16.</b>	To assist the joint venture in avoiding anti-dumping controls	Lin and Chang (2010)
<b>17.</b>	To assist the joint venture in reducing book value to avoid demands of higher salaries	Lin and Chang (2010)
<b>18.</b>	To support starting subsidiaries	Lin and Chang (2010)
<b>19.</b>	To strengthen competitiveness in the country receiving investment	Lin and Chang (2010)

### **2.1.11 Transfer pricing systems and frameworks**

International transfer pricing systems aim to implement pricing for internally produced and consumed goods, services and intangibles. Transfer pricing systems have become a challenge, due to decentralization of decision making and creation of profit centres in MNEs with multiple products. Multiple environmental factors including tax and tariff regulations add to this challenge. Further, from the managerial point of view, inaccurate transfer prices may result in inefficient allocation of resources. For instance, if a transfer price is implemented at low level, entities that purchase would appear more profitable and command a disproportionately higher allocation of limited resources. From the perspective of tax compliance, MNEs are required to consider the component entities as independent profit centres for transfer pricing (Cools and Slagmulder, 2009). Rossing (2013) observed that when an MNE faces transfer pricing risks, the strategy adopted impacts the management control systems.

An internal pricing system is required because individual entities operating in a decentralized MNE could take advantage as externally determined market prices are not available for the goods and services which are traded within the MNE. The importance of autonomy arises as the MNE attempts to establish

internal pricing systems which coordinate and control the allocation of limited economic resources and factors of production with the objective of achieving overall organizational goals. The transfer pricing system should enable entities to maintain their autonomy while making decisions that benefit the entire MNE. Hence, this would mean that individual entities must be allowed to pursue divisional objectives which would correspond with the objectives of the MNE which is a challenge (Kaushik, 1999). Theoretically, this indicates that the transfer price needs to reflect a balance between the two conflicting approaches of Resource Based View and Transaction Cost Economics.

Cecchini et al. (2013) suggest a framework based on Transaction cost economics (TCE) and Resource Based View (RBV) theory to assess the antecedents and consequences of transfer prices. These two theories provide basis for explaining the decision choices made by enterprises while transacting with each other within an MNE. TCE focuses on transaction costs and the associated performance risks. It also considers opportunistic behaviour where entities in exchange relationships may be guided by self-interest considerations. In summary, TCE tends to take a contractual view of governance instead of a relational view among business partners. In contrast to TCE, RBV focusses on strategic advantages of co-operation among related entities. RBV views the firm as a broad set of resources consisting of tangible and intangible assets. Through the ability to strategically deploy these resources firms are able to achieve competitive advantage and win-win benefits to create value from pooling of resources.

Using case study on one high technology company, Shelanski (2004) concluded that TCE played a significant role in choosing the process of transfer pricing. Carlo (2014) studied related party transaction as per International Accounting Standard (IAS) 24 by considering the multinational group and the directions of the parent company in the group and concluded that related party transactions should not only consider the type and nature of the transaction but also the business objective for the transaction. Abdallah and Maghrabi (2009) analysed ownership techniques of MNEs of intangible assets and choice of

transfer pricing methods and found that tax and non-tax strategies along with objectives should be present in the transfer pricing system of MNEs.

The research seeks to emphasize on management motives such as motives to enhance competitiveness, to simplify application and to ensure control over tangible and intangible assets given the internal factors such as ownership and control, contractual arrangements and inter related functions. It is proposed that the management motives will mediate the relationship between internal factors and transfer pricing method, thereby supporting the RBV theory.

## **2.2 Gaps, statement of the problem and objectives**

### **2.2.1 Research gaps**

The literature review suggests that the study of factors influencing transfer pricing in India are primarily focused on tax motivated transfer pricing. Comprehensive studies on factors influencing transfer pricing have not been found in the Indian perspective. The aforesaid studies are in the context of US and Canadian MNFs, China and Taiwan and UK based MNEs. Further, OECD has given factors mostly related to developed countries. The presence of those factors in India needs to be tested given that most MNEs have focused towards the markets in India. The current study has addressed this gap by testing the relationship between factors and transfer pricing method in Indian context.

Secondly, the literature review shows that separate studies for factors and separate studies for motives have been carried out. This has resulted in disparate listing /ranking of factors and motives with respect to transfer price. The current research seeks to address this gap by studying the factors and the motives affecting transfer price in a composite fashion, and testing their relationship with transfer pricing method.

Thirdly, the study also posits that mere presence of a factor does not affect the transfer price unless there is a motive which could be fulfilled by the factor. For example, difference in tax rates in different countries is a factor but the same does not affect the reported transfer price unless the management has a

motive of global tax reduction. Hence, we studied whether motives mediate the relationship between the factors and the method of transfer pricing. If factors are linked to motives this would help in enhancement of the knowledge amongst corporates in determining the appropriate transfer pricing methods. Further, the literature seems to emphasize the regulatory and compliance motive over management motives. This research thus, first tests the motives as the mediating factor between various factors and the method of transfer price. The research further tests whether regulatory and management motives separately mediate the external and internal factors respectively. This could bring out the salience of management motives in the decisions relating to transfer pricing method.

Further, though the factors and motives impact the transfer price, the same is justified by the tax payers or disputed by the tax regulators or settled by the appellate authorities by adopting transfer pricing methods which are suggested by the OECD and adopted by most countries including India. Hence, transfer pricing methods determine the quantum of adjustments to the transfer price to arrive at the Arm's Length Price. Additional factors and motives have been considered based on study of various case laws and rulings arising out of disputes between various business entities and the tax authorities. Thus, this research firstly collated the factors and motives in Indian Case Laws, and tested their impact on transfer pricing method that is responsible for setting the transfer price.

The study also further endeavoured to clarify whether the methods significantly differ across type of transactions, namely, tangible, and intangible transactions.

### **2.2.2 Objectives**

The objectives of this research are:

1. To study the transfer pricing factors, transfer pricing motives and transfer pricing methods of tangible and intangible transactions.

2. To study the relationship between transfer pricing factors and choice of transfer pricing method.
3. To study the relationship between transfer pricing motives and choice of transfer pricing method.
  - a. To study the relationship between transfer pricing regulatory motives and choice of transfer pricing method
  - b. To study the relationship between transfer pricing management motives and choice of transfer pricing method
4. To study the relationship between transfer pricing factors and motives taken together and choice of transfer pricing method.
5. To study whether transfer pricing motives mediate the relationship between the transfer pricing factors and choice of transfer pricing method
  - a. To study whether transfer pricing regulatory motives mediate the relationship between the transfer pricing external factors and choice of transfer pricing method
  - b. To study whether transfer pricing management motives mediate the relationship between the transfer pricing internal factors and choice of transfer pricing method
6. To study whether type of transaction moderates the relationship between the transfer pricing motives and choice of transfer pricing method

## 2.3 Proposed Conceptual Models and Hypotheses

### 2.3.1 Proposed Conceptual Models

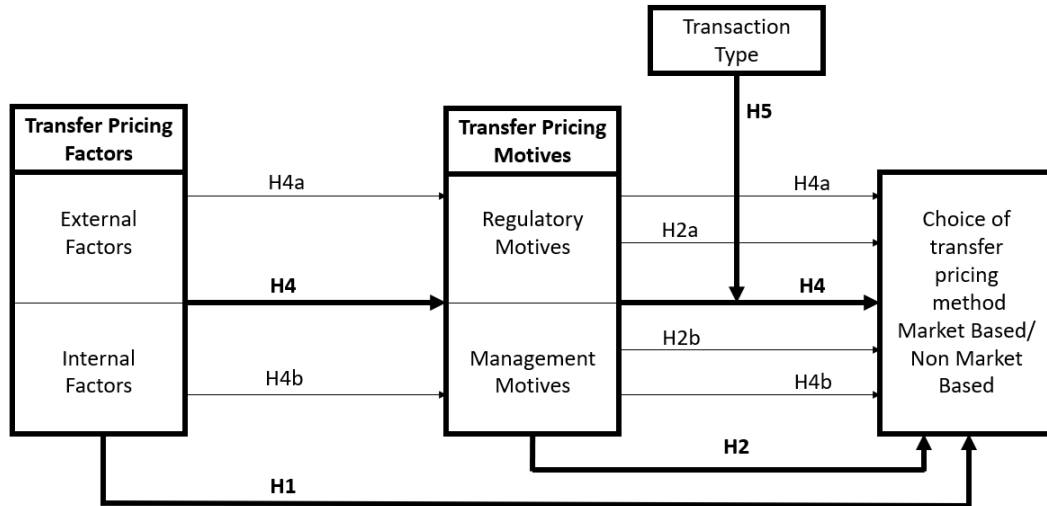


Figure 2.1: Proposed Conceptual Model 1

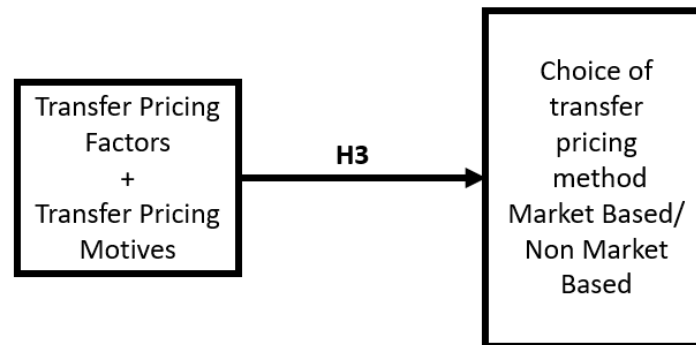


Figure 2.2: Proposed Conceptual Model 2

### 2.3.2 Hypotheses

Review of literature and exploratory study led to derivation of the following hypotheses:

H1. There is a significant relationship between transfer pricing factors and choice of transfer pricing method

H2. There is a significant relationship between transfer pricing motives and

choice of transfer pricing method

H2a. There is a significant relationship between regulatory motives and choice of transfer pricing method

H2b. There is a significant relationship between management motives and choice of transfer pricing method

H3. There is a significant relationship of factors and motives with transfer pricing method

H4 Transfer pricing motives mediate the relationship between transfer pricing factors and choice of transfer pricing method

H4a. Regulatory transfer pricing motives mediate the relationship between external transfer pricing factors and choice of transfer pricing method

H4b. Management transfer pricing motives mediate the relationship between internal transfer pricing factors and choice of transfer pricing method

H5. Transaction type moderates the relationship between motives and methods

## **2.4 Constructs under study and operational definitions**

### **2.4.1 Associated Enterprises**

As per Section 92A of the Indian Income Tax Act, "Associated enterprise", in relation to another enterprise, means an enterprise which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

### **2.4.2 Transfer Pricing Factors**

Transfer pricing factors are classified as External Factors and Internal Factors. External Factors comprise tax regulatory factors, non-tax regulatory factors, government policies, external environmental factors and availability of comparables. Internal Factors comprise ownership and control, contractual arrangements and inter-related functions

### **2.4.3 Transfer Pricing Motives**

Transfer pricing motives are classified as Regulatory Motives and Management Motives. Regulatory Motives comprise motives to avoid penalties, to ensure regulatory compliance, to reduce overall taxes, to ensure acceptability, to ensure repatriation and to ensure fund transfers. Management Motives comprise motives to enhance competitiveness, to support associated enterprise, to enable performance evaluation, to simplify application and to ensure control over assets.

### **2.4.4 Transfer Pricing Methods**

Transfer pricing methods as per OECD are classified under two categories:

A) Traditional transaction methods which consist of:

- a. Comparable uncontrolled price method: In this method, the price in a transaction which is uncontrolled but where the conditions are comparable to that of a transaction which is controlled is considered as an arm's length price.
- b. Resale price method: In this method, where a product has been procured from a related entity and is resold to a third party, the resale margin is reduced from the resale price to arrive at the arm's length price of procurement from the related entity.
- c. Cost plus method: In this method, the arm's length price is computed by taking into account the cost incurred and adding a profit margin or cost plus mark-up. The margin is determined by considering the functions, assets and risks of the supplier in addition to the market



conditions.

B) Transactional profit methods which consist of:

- a. Profit split method: In this method, the overall profit in the transaction is split between the related entities. This division is made using a valid economic basis considering that the arrangement was at arm's length basis.
- b. Transactional net margin method: In this method, the profit margin is examined based on appropriate profit level indicator such as profit as percentage of cost incurred, revenue generated, assets employed.

## **2.4.5 Permissibility of Transfer Pricing Regulations**

The methods that are permitted by various regulations in India are as follows:

### **Income Tax regulations in case of International Transactions**

India introduced transfer pricing in 2001. International transactions between associated enterprises are covered under Chapter X of the Income-tax Act, 1961 which deals with special provisions relating to avoidance of tax under Section 92 wherein the transactions values are assessed having regard to the arm's length price. As per Section 92C, Sub Section (1), the arm's length price shall be determined by any of the following methods: —

- comparable uncontrolled price method;
- resale price method;
- cost plus method;
- profit split method;
- transactional net margin method;
- such other method as may be prescribed by the Board.

### **Income Tax regulations in case of Domestic Transactions**

The domestic transactions between related parties are regulated by Clause 2(a) of Section 40A of the Income-tax Act, 1961 wherein if expenditure is excessive or unreasonable having regard to the fair market value of the goods,

services or facilities for which the payment is made, or the legitimate needs of the business or profession of the assessee or the benefit derived by, or accruing to him there from, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction.

### **Goods and Service Tax**

Under GST law various categories of related persons have been specified and as relation may influence the price between two related persons therefore special valuation rule has been framed to arrive at the taxable value of transactions between related persons. In such cases following values have to be taken sequentially to determine the taxable value:

- Open Market Value.
- Value of supply of like kind and quality.
- Value of supply based on cost i.e., cost of supply plus 10% mark-up.
- Value of supply determined by using reasonable means consistent with principles & general provisions of GST law. (Best Judgement method)

However, if the recipient is eligible for full input tax credit, the invoice value will be accepted as taxable value. It has also been provided that where the goods being supplied are intended for further supply as such be the recipient, the value shall, at the option of the supplier, be an amount equivalent to 90% of the price charged for the supply of goods of like kind and quality by the recipient to his unrelated customer.

### **Customs Laws**

In a sale between related persons, the transaction value shall be accepted, whenever the importer demonstrates that the declared value of the goods being valued, closely approximates to one of the following values ascertained at or about the same time:

the transaction value of identical goods, or of similar goods, in sales to unrelated buyers in India;

- the deductive value for identical goods or similar goods;
- the computed value for identical goods or similar goods
- residual method

### **Accounting Standards**

Accounting Standards primarily deal with reporting of Related Party Transactions and requires disclosure of nature of relationship, nature of transaction, value of transaction and amounts outstanding to be received or paid as on the date of financial statements. The method of Transfer Pricing used is not required to be disclosed under the prevailing Accounting Standards.

### **Companies Act**

Section 188 of the Companies Act, 2013 which deals with Related Party Transactions places restrictions in terms of value and requires resolutions to be passed in case of related party transactions. However, these restrictions are not applicable on transactions in the ordinary course of business if the transactions are on arm's-length basis. The expression "arm's length transaction" means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

The OECD as well as the aforementioned regulations require that the related party transactions are carried out at arm's length price which is the price that would be charged if the transactions were carried out by two unrelated parties. This is also achieved by carrying out the transaction at market price. The Comparable Uncontrolled Price method uses the market price to justify the transfer price in a transaction. Hence, this method is classified in this research as a Market based transfer price method. The other methods which are cost based, profit based or any other methods are classified as non-market based transfer price methods. This approach is also adopted by (Ho, 2009).

Based on the above, the permissibility of various transfer pricing methods and applicability of these regulations to entities and their classification is studied and classified in this research as follows:

- A. Market Based Transfer Price Method
- B. Non-Market Based Transfer Price Method

Table 2.4: Regulation wise permissibility and applicability to transaction type and entity

<b>Particulars</b>	<b>Market based transfer price permitted</b>	<b>Non-market based transfer price permitted</b>	<b>Transaction type</b>	<b>Entity</b>
Income Tax regulations in case of International Transactions	Yes	Yes	International transactions	All
Income Tax regulations in case of Domestic Transactions	Yes	No	Domestic transactions	All
Goods and Service Tax	Yes	Yes	Both	All
Customs Laws	Yes	Yes	International transactions	All
Accounting Standards	Yes	Yes	Both	All
Companies Act	Yes	Yes	Both	Companies

Source: Compiled by researcher

Table 2.5: Classification of Methods into Market Based and Non-Market Based

<b>Particulars</b>	<b>Market based transfer price permitted</b>	<b>Non-market based transfer price permitted</b>
Income Tax regulations in case of International Transactions	<ul style="list-style-type: none"> <li>• comparable uncontrolled price method</li> </ul>	<ul style="list-style-type: none"> <li>• resale price method;</li> <li>• cost plus method;</li> <li>• profit split method;</li> <li>• transactional net</li> </ul>

<b>Particulars</b>	<b>Market based transfer price permitted</b>	<b>Non-market based transfer price permitted</b>
		margin method; • such other method as may be prescribed by the Board.
Income Tax regulations in case of Domestic Transactions	• fair market value	• not applicable
Goods and Service Tax	<ul style="list-style-type: none"> <li>• open market value.</li> <li>• value of supply of like kind and quality.</li> <li>• amount equivalent to 90% of the price charged for the supply of goods of like kind and quality by the recipient to his unrelated customer</li> </ul>	<ul style="list-style-type: none"> <li>• value of supply based on cost i.e., cost of supply plus 10% mark-up.</li> <li>• value of supply determined by using reasonable means consistent with principles &amp; general provisions of GST law. (Best Judgement method)</li> </ul>
Customs Laws	• the transaction value of identical goods, or of similar goods, in sales to unrelated buyers in India;	<ul style="list-style-type: none"> <li>• the deductive value for identical goods or similar goods;</li> <li>• the computed value for identical goods or similar goods;</li> <li>• residual method</li> </ul>
Accounting Standards	• no measurement principles	• no measurement principles

<b>Particulars</b>	<b>Market based transfer price permitted</b>	<b>Non-market based transfer price permitted</b>
Companies Act	<ul style="list-style-type: none"> <li>• Same as in case of international transaction as stated above in the absence of specific regulations</li> </ul>	<ul style="list-style-type: none"> <li>• Same as in case of international transaction as stated above in the absence of specific regulations</li> </ul>

Source: Compiled by researcher

# Chapter 3

## Research Methodology

This chapter explains the mixed research methodology adopted. The research design is explained followed by the qualitative research stage and then the quantitative research stage.

### 3.1 Research design

The design of this research includes qualitative and quantitative methodology to achieve the objectives of the research.

Initially, an attempt was made to make an instrument with factors, motives and methods collated from the literature, to be administered to tax managers. However, this method was not deemed expedient as managers faced social desirability issues in answering questions particularly related to motives. Hummel et al. (2019) stated as the limitations of their research that they could not rule out the possibility of the respondents to their questionnaire being systematically biased towards the positive elements of their transfer pricing systems. Besides, Ftouhi and Ghardallou (2020) have stated that one of the issues in international tax planning research is that studies rely only on surveys results collected from annual reports of the companies (microeconomic variables). Accordingly, we discarded the initially proposed survey methodology, and preferred a mixed approached inclusive of case studies and content analysis supplemented with quantitative research.

Sikka and Willmott (2013) based on information from legal cases and reports from government concluded that tax planning schemes leading to tax avoidance are being done by big accounting firms and one of the ways is by shifting of profits to favourable tax jurisdictions achieved by transfer pricing. Since transfer pricing is case specific, case-based research needs to be carried out to develop a platform for quantitative research to develop theoretical generalization (Rossing and Rohde, 2014). Hence, this research used a two staged approach, the first being exploratory content analysis of published cases

and the second being quantitative analysis of the factors and motives coded from the cases, as explained below. Thus, the design of the research was based on adoption of mixed methodology.

### **3.2 First stage of Mixed Research Methodology – Qualitative research**

Two case laws relating to transfer pricing disputes from the automobile industry were selected for initial exploratory case analysis. Liberalisation in India resulted in increased FDI in India. Currently, the major automobile suppliers in India include foreign entities which have set up their subsidiaries or joint ventures in India. Considering the nature of the product, these entities have several types of transactions with their associated entity in India ranging from sale of complete automobile and spare parts to use of brand and technology.

The method of transfer pricing adopted by companies is not available in the public domain. However, orders on transfer pricing disputes issued by the Income Tax Appellate Tribunal (ITAT) could be analysed. The ITAT is the final fact-finding authority for income tax disputes and higher courts take up the matter only if it is a substantial matter of law. These ITAT cases provide an insight into all relevant facts involved in the transfer pricing case. Hence, we used these cases for our research and did content analysis to discern the factors and motives. Two case studies are stated below as examples.

1. Mercedes-Benz India Pvt Ltd VS Assistant Commissioner of Income Tax [TS-9028-ITAT-2018(Pune)-O], (2018) 196 TTJ 464 (Pune) IN THE ITAT OF PUNE.

2. Deputy Commissioner of Income Tax VS Man Trucks India Pvt Ltd [TS-6887-ITAT-2018(Pune)-O] IN THE ITAT OF PUNE

Analysis was done as per the methodology suggested by Yin (2009), wherein he states that “if the case study is an explanatory one, the patterns may be related to the dependent or the independent variables of study”. Findings from the analysis suggested that “the management of the company has to reconcile



various regulatory and non-regulatory factors and objectives at the time of pricing of the related party transactions which are beyond tax saving motivations or compliance with tax regulations. Further, the management is also bound by commitments, whether contractual or not, to other stakeholders. The management has to be sensitive to the market, competition and economic environment in order to retain its market share and to sustain operations. Objectives of compliance with regulations and prudent decision-making practices to manage the business need to be brought together to adopt a single method of pricing for a transaction. The method so adopted needs to play a dual role of satisfying the business requirements and be acceptable to the tax regulators. In both cases, the management adopted the transfer pricing method after due consideration of various factors and objectives affecting the transaction. The tax authorities on the other hand had preferred a different method to arrive at the transfer price with the primary objective of protecting the interest of the revenue.” (Kamath, 2022)

The findings were published in *The Chartered Accountant Journal*, April 2022 issue (pg. nos. 1232-1238), along with the factors and motives culled out by the researcher and validated by five experts, three from industry and two from academia. These two cases served as pilot cases for developing a protocol for analysis of other cases as suggested by Yin (2009). Thus, pattern matching and explanation building by relating the case to factors and motives pre-derived from the literature review was the methodology adopted for case analysis, as suggested by Yin (2009). The process is further described in detailed manner in following paragraphs. For deriving generalisations, the quantitative analysis was adopted, with coding and statistical analysis as described further.

Besides factors and motives taken from the literature review, researcher identified another factor – availability of comparables, with the case analysis.

### **3.2.1 Case Study Approach**

Case Study Approach is adopted using Case Laws / Judgements / Orders of the Income Tax Appellate Tribunals. The case selection process is described below:

1. **Source:** The cases are selected based on search from Transfer Pricing Digest hosted by [www.itatonline.org](http://www.itatonline.org) where summary of cases is listed and the portal [database.taxsutra.com](http://database.taxsutra.com) hosting the ITAT judgements.
2. **Search Parameters:** Key words used for searching the cases are: Transfer pricing method, Comparable Uncontrolled Price, Cost Plus Method, Transaction Net Margin Method, Profit Split Method, Retail Price Method.
3. **Sampling Method:** The sampling method adopted is purposive sampling since all cases do not relate to choice of transfer pricing method or selection of Most Appropriate Method (MAM)
4. **Method of Elimination:** Reading of summary indicated whether the cases relate to choice of method. The case law is selected based on scrutiny to determine:
  - a. whether the case law relates to dispute regarding the method
  - b. whether the case law contains the facts regarding the transactions under transfer pricing assessment and reasoning for adoption of the method.

**Elimination reasons:** The reasons for elimination of cases are

- a. Case pertains to whether the transaction is an international transaction which required adjudication under transfer pricing regulations. For example, if advertising expenditure incurred in India by a subsidiary company was held by the TPO to be an international transaction as it resulted in enhancement of brand of the foreign holding company. If any such case was held not to be an international transaction, such case was eliminated.
- b. Case pertains to whether the Company has been given sufficient opportunity to justify the choice of method adopted and in the absence of the same case is remanded back to the TPO. Where the relevant facts in such cases are deemed incomplete by the researcher,

the same was eliminated.

- c. Case does not pertain to the method of transfer pricing but other aspects of transfer pricing regulations such as whether the Company was allowed to approach alternative dispute resolution mechanism being the Dispute Resolution Panel or Advance Pricing Agreements/ Mutual Agreement Procedure.
- d. Case pertains to choice of transfer pricing method but does not provide sufficient facts of the case regarding the transaction and directly goes to the judgement paragraphs.

**5. Result:** Total of 60 transactions from 43 Case Laws are analysed to conclude on the research findings.

**6. Sample quantity:** The researcher decided to stop at 60 as the variations across cases had decreased and marginal incremental addition led to theoretical saturation, with repetitive cases. Only one additional factor, i.e., “availability of comparables” was found after case analysis besides those from literature review. However, this factor is a prime affecting factor seen in multiple cases such as Amphenol Interconnect India and Effective Teleservices. Further, the cases comprised in the analysis pertained to tangible goods, services, intangibles such as brands and technical know-how and debt. The sample covers sufficient number of each of these transaction types.

**7. Scope:** The scope of the study was limited to the cases decided by Indian Income Tax Appellate Tribunals only. The impact of adjudication by other regulatory authorities is not considered as generalisations would be difficult. The detailed process of elimination is mentioned above. Methods for the study are grouped as market based methods and non-market based methods. Both type pf transactions, i.e., tangible and other than tangible have been included. The unit of analysis is the transaction which is assessed in the case.

### **3.2.2 Content Analysis**

Content analysis of the case laws were attempted thereafter. The case law is converted into MS Word document format. Thereafter, in-depth reading is done and the statements are marked using comment feature wherein the factor or motive as identified is marked as comment using the coding. Similar statements or repetitive remarks on same issue are ignored. Statements quoted in citation from other cases are also not considered.

Content Analysis of the case law: An example: Deputy Commissioner of Income Tax VS Man Trucks India Pvt Ltd [TS-6887-ITAT-2018(Pune)-O]

**FACTS:** The Company manufactured cargo line shell trucks which is a special line of trucks specifically for Indian market and other developing countries' markets. The trucks were manufactured as per emission norms which were acceptable in India and other developing countries, but not acceptable in Germany. Due to excess manufacturing capacity available, the Company manufactured trucks for export sale to Germany, for ultimate sale in developing countries like South Africa, Ethiopia and Indonesia. Due to stricter emission norms in Europe, these trucks were directly dispatched to the developing countries. The sales were invoiced to Germany at Cost plus 25% less EUR 500 for warranty commitments which would not been borne by the Company but would be passed on to the Associated Enterprises. Company thus adopted CUP and CPM method, for import of parts and for export of truck internal TNMM was used as transfer pricing method.

**TRANSACTIONS:** Two transactions of import of raw material and export of trucks were listed.

**ANALYSIS FOR THE FACTORS:** Various factors affecting transfer pricing can be identified from the case based on the aspects considered by the ITAT in the course of arriving at the conclusion regarding the method of pricing to be adopted. The Company is a Joint Venture which indicates that contractual arrangements impact the transfer pricing method. The transactions are subject matter of transfer pricing assessment under Income tax Act and hence were justified by the Company by applying CUP and internal TNMM. This indicates that firstly, tax regulations do impact the transfer pricing method. The Tribunal

has drawn reference to segmental reporting to be certified by auditor, i.e., application of Accounting Standards apart from Income tax Rules while assessing the aggregation of transaction for application of TNMM. This again confirms that non-tax regulations also impact the transfer pricing method. The consideration of whether the Company or the Associated Enterprise will provide after sales service and warranty in pursuance of commitments to customers is a pointer to the role of contractual arrangements.

**ANALYSIS FOR THE MOTIVES:** Further, various objectives (motives) behind transfer pricing can be identified from the case based on the various factors considered by the ITAT in the course of arriving at the conclusion regarding the method of pricing to be adopted. The decision to manufacture and export trucks due to low sales and availability of capacity indicates the objective of the Company to enhance competitiveness. The routing of the trucks to the developing countries directly without entering Europe satisfies the goal to ensure regulatory compliance and to avoid penalties. The sales were controlled by the German company which indicates a prime purpose to control the assets. The German company was selling third party material to the Indian company and applying surcharge for handling. This also affirms the intention to control the assets and also to enable performance evaluation.

Thus, such detailed analysis was done of all the transactions in the cases and the factors and motives were derived, and the method was noted.

### **3.2.3 Validation**

The two case laws mentioned in the exploratory study are then checked by two experts from academics and three experts who are dealing with transfer prices in the industry. Validation reports are attached herewith as Annexure 1. Thereafter, the cases along with the factors derived and the motives are published as an article in 'The Chartered Accountant' to validate the process of extraction of factors and motives.

## **3.3 Second stage of Mixed Research Methodology – Quantitative Analysis**

### **3.3.1 Coding**

The coding used for analysis is as follows:

EF = External Factors

IF = Internal Factors

RM = Regulatory Motives

MM = Management Motives

TT = Transaction Type

AM = Assessee Method

TM = Transfer Pricing Officer Method

IM = ITAT Method

SECTOR = Sector in which entity operates

Further each individual factor and motive is coded as follows:

EF1 = Tax Regulatory Factors

EF2 = Non-Tax Regulatory Factors

EF3 = Government Policies

EF4 = External Economic Factors

EF5 = Availability of Comparables

IF1 = Ownership and Control

IF2 = Contractual Arrangement

IF3 = Inter-related Functions

RM1 = To avoid penalties

RM2 = To ensure regulatory compliance

RM3 = To reduce overall taxes

RM4 = To ensure acceptability

RM5 = To ensure repatriation

RM6 = To honour commitments

MM1 = To enhance competitiveness

MM2 = To support associated enterprise

MM3 = To enable performance evaluation

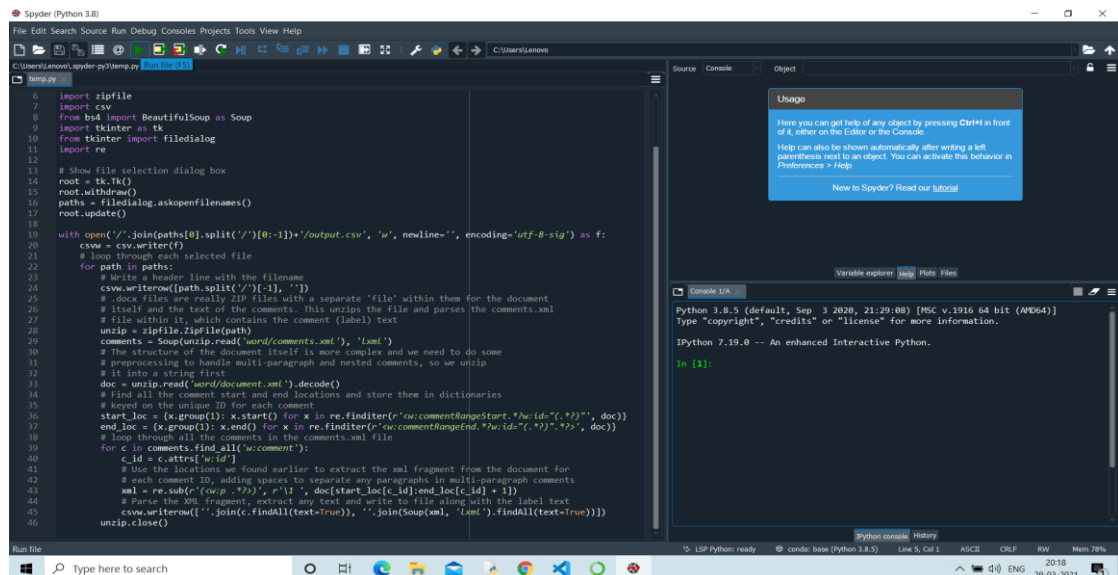
MM4 = To simplify application

MM5 = To ensure control over assets

### 3.3.2 Extraction for quantitative analysis

Thereafter, the MS Word document, which has been marked with comments being the codes as stated above, is run through “Spyder” software. Spyder is a free and open-source scientific environment written in Python. This has been designed by and for scientists, engineers and data analysts. It features a unique combination of the advanced editing, analysis, debugging, and profiling functionality of a comprehensive development tool with the data exploration, interactive execution, deep inspection, and visualization capabilities of a scientific package.

The code extracts comments and exports the same in “.csv” format to enable further data analysis using tools such as Excel.



```
6 import zipfile
7 import csv
8 from bs4 import BeautifulSoup as Soup
9 import tkinter as tk
10 from tkinter import FileDialog
11 import re
12
13 # Show file selection dialog box
14 root = tk.Tk()
15 root.withdraw()
16 paths = FileDialog.askopenfilenames()
17 root.update()
18
19 with open(''.join(paths[0].split('/')[-1])+'/output.csv', 'w', newline='', encoding='utf-8-sig') as f:
20     csvw = csv.writer(f)
21     # loop through each selected file
22     for path in paths:
23         # Write a header line with the filename
24         csvw.writerow([path.split('/')[-1], ''])
25         # docx files are really ZIP files with a separate 'file' within them for the document
26         # itself and the text of the comments. This unzips the file and parses the comments.xml
27         # file within it, which contains the comment (label) text
28         unzip = zipfile.ZipFile(path)
29         comments = Soup(unzip.read('word/comments.xml'), 'lxml')
30         # The structure of the document itself is more complex and we need to do some
31         # preprocessing to handle multi-paragraph and nested comments, so we unzip
32         # it into a string first
33         doc = unzip.read('word/document.xml').decode()
34         # Find all the comment start and end locations and store them in dictionaries
35         # keyed on the unique ID for each comment
36         start_loc = (x.group(1): x.start() for x in re.finditer(r'<w:commentRangeStart.*?w:comment.*?>', doc))
37         end_loc = (x.group(1): x.end() for x in re.finditer(r'<w:commentRangeEnd.*?w:comment.*?>', doc))
38         # loop through all the comments in the comments.xml file
39         for c in comments.findall('w:comment'):
40             c_id = c.attrib['w:cid']
41             # Use the locations we found earlier to extract the xml fragment from the document for
42             # each comment ID, adding spaces to separate any paragraphs in multi-paragraph comments
43             xml = re.sub(r'<w:comment.*?>', r' | ' + doc[start_loc[c_id]:end_loc[c_id] + 1])
44             # Parse the XML fragment, extract any text and write to file along with the label text
45             csvw.writerow([''.join(c.findall(text=True)), ''.join(Soup(xml, 'lxml').findAll(text=True))])
46         unzip.close()
```

Figure 3.1: Code for extracting comments in word file to excel

Source: Knoch (2020) <https://carstenknoch.com/2020/02/qualitative-data-analysis-with-microsoft-word-comments-python-updated/>

When the code is run, the output is in the form of a comma separated values (csv) file. This file when opened in excel, places the data in respective columns, i.e., the code in one column and the relevant statement in the corresponding column.

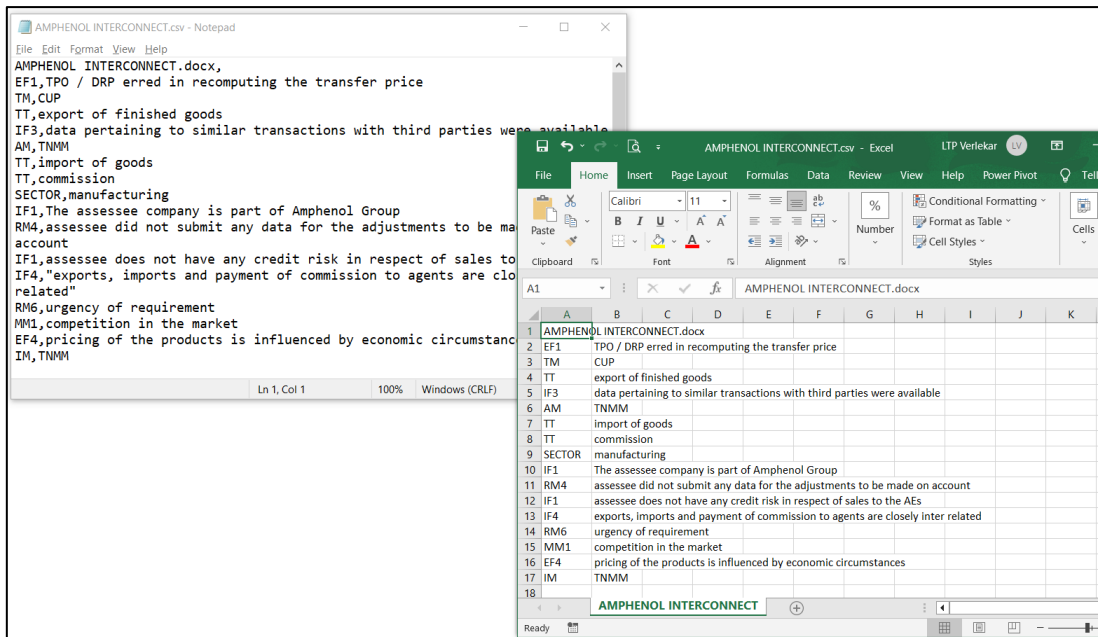


Figure 3.2: Extraction of comments into csv file and excel

The extracted comment and code are saved in Excel and coded as follows:

EF If present in the case, marked as 1 else 0

IF If present in the case, marked as 1 else 0

RM If present in the case, marked as 1 else 0

MM If present in the case, marked as 1 else 0

DV = AM If CUP, i.e., Market Method then marked as 1, in case of any other method marked as 0

The total count of the independent variables i.e., EF, IF, RM and MM is considered. After converting the comments / code into values in Excel, the data is transmitted to SPSS for quantitative analysis using logistic regression.

### 3.3.3 Analysis using SPSS

The Dependent Variable being binary, the data is analysed using Binary Logistic Regression. Multinomial logistic regression was also used for testing relationship between factors and motives.



# Chapter 4

## Case Analysis

The Chapter consists of within case analysis of 43 cases. Initially the facts of the case are stated. Thereafter inferences about the presence of factors and motives are drawn based on the reasonings derived from the elucidations by the Companies as well as the Authorities.

### 4.1 Summary of case analysis

#### 4.1.1 Amphenol Interconnect India

Amphenol Interconnect India is mainly engaged in the business of manufacturing of connectors, accessories, cable assemblies and system integration for application in various industries such as military, aerospace, telecom, etc. The products are specialized in nature as they are being used in defence, aerospace, etc. The products are manufactured only against the specific orders i.e., they are customized products. The Company is part of Amphenol Group which is one of the largest manufacturers of interconnect products in the world.

The Company entered into transaction of export, import and commission with its AEs. The transfer price was justified using the Transaction Net Margin Method (TNMM) by the Company. The Company identified 12 companies as comparable with the Company and average Operating Margin as the Profit Level Indicator (PLI). On the other hand, the TPO has held that the CUP method could be applied in this scenario.

The Company in the ground of appeal states that the learned TPO / DRP erred in recomputing the transfer price of the international transactions relating to exports and import of goods and payment of commission. The objective of the Company to reduce the overall tax is indicated here and that of the Assessing Officer to regulate such practices is apparent.

The Company stated that it has paid lower prices to its AE as compared to third parties which indicates that the pricing of the products is influenced by

economic circumstances and underlying transactional differences. This indicates that external economic factors are considered.

The Company is part of Amphenol Group is brought out in the case. Further, it is stated that the Company does not have any credit risk in respect of sales to the AEs which is an important factor. This indicates that ownership structure and control have been considered.

It is stated that the learned TPO / DRP erred in holding that the CUP method was the most appropriate method for determining the ALP in respect of some of the transactions of export of goods merely on the basis that the data pertaining to similar transactions with third parties were available. This indicates that the availability of comparables is considered.

The Company while justifying use of TNMM states that the transactions of exports of goods, import of goods are all part of the Company's business and the commission is paid to various parties to boost the sales of the Company's products. Therefore, the transactions of exports, imports and payment of commission to agents are closely inter related and are part of single business activity of the Company and the profit earned by the Company is collective result of all these transactions and hence, it is impractical to analyse the profits of each individual transactions.

It is stated that pricing of the products depends on the urgency of requirement, competition in the market. This indicates that the motives to honour commitment and to enhance competitiveness has been taken into account.

The TPO has stated that that the Company did not submit any data for the adjustments to be made on account of the differences in respect of sales to AEs and Third Parties. This indicates the motive to ensure acceptability is an issue that has been considered.

#### **4.1.2 AWB India**

The Company is engaged in the business of trading in food grains. It is a part of AWB group Australia and its 99.999% equity is held by AWB Australia Limited and the balance .001% equity is held by another group company,

namely AWB Investments Limited.

The Company entered into transaction of payment for management services with its AE and the price was justified using TNMM. On the other hand, the TPO held that the right course of action will be to follow CUP method because the value under CUP method will be best indicator of the value of these services.

The Company is part of the AWB Group Australia and the shareholding is brought out in the case law which indicates that ownership and control is considered in the case.

It is observed in the case that one of the very basic pre condition for use of CUP method is availability of the price of the same product and service in uncontrolled conditions. It is on this basis that ALP of the product or service can be ascertained which indicates that the availability of comparables is an issue that has been considered.

It is stated in the case that a business enterprise incurs the expenditure on the basis of what is commercially expedient and what is not commercially expedient thus indicating the impact of motive to enhance competitiveness.

It is observed in the case that as long as agreement is not found to be a sham agreement, the value of the services covered under the agreement cannot be taken as 'nil' just because these services were not actually required by the Company. This indicates the motive is to reduce taxes is taken into account.

The TPO has stated that the Company has not furnished any specific input on training and development of human resources and it is also noticed that these services are of routine nature and duplicate at best. This indicates that the motive to ensure acceptability on part of the Company has an impact.

#### **4.1.3 BMC Software India**

The Company is engaged in the business of providing software development services, IT enabled services and sales support services to overseas BMC group entities.

The Company entered into transaction to provide software development services to the AE.

It is stated that company also submitted Transfer Pricing (TP) study report wherein, the Company adopted the Transactional Net Margin Method (TNMM) as the most appropriate method for the purpose of benchmarking the above international transactions with Profit Level Indicator (PLI) of Operating Profit/Operating Cost (OP/OC). In the TP study report, the Company adopted 3 years weighted average arithmetic mean of the comparables for the purpose of benchmarking the international transactions. This indicates the presence of motive to ensure acceptability has been considered.

The case states that the TPO rejected certain comparable companies selected by the Company and accepted certain additional Companies as comparables. This indicates that the availability of comparables have been considered.

#### **4.1.4 Bose Corporation India**

The Company is a distributor of Bose audio products in India. The Company entered into transactions with its AE for purchase of goods and spare parts.

The Company justified the price using RPM method. On the other hand, the TPO adopted TNMM method for computing the ALP.

The case states that it is observed from TP study that the Company has portrayed itself to be a wholly owned subsidiary of Bose Corporation. This indicates that ownership and control is considered.

It is stated in the case that the TPO in computing the arm's length margin under the TNMM, has used the same set of comparables as that used by the Company for adopting RPM. This indicates that availability of comparable is relevant in the case.

It is stated that the though the TPO adopted a different method, the TPO accepted the search adopted by the Company in respect of comparables selected. This indicates that the motive to ensure acceptability was observed.

The Company has substantiated its argument by way of order passed by Customs Department in respect of the valuation of imported goods. This indicates that other tax regulations such as the Customs laws have been considered.

The Company has also submitted that prices declared by the Company are commensurate with the export price lists published. This indicates the presence of motive to ensure regulatory compliance.

It is observed in the case that from the TP study it appears that Company is primarily a sales organization that is also involved in creating brand awareness in India. This indicates that the motive to enhance competitiveness is considered.

It is also observed that Bose US (AE) holds title to the brand name and is involved in the primary responsibility of R&D. This indicates presence of the motive to ensure control over intangible assets.

#### **4.1.5 Effective Teleservices**

The Company is engaged in providing various call centre services such as operations support staff services, TQM verification, data entry etc. to its Associated Enterprises in USA and other unrelated parties both within and outside India.

The Company has justified ALP of the transactions using internal CUP method. On the other hand, the TPO adopted external TNMM as the transfer pricing method.

It is stated in the case that the taxes rates in the USA are higher than the tax rates prevailing in India. This indicates that differential tax jurisdictions arising out of relevant regulations are observed.

It is observed in the case that the Company is eligible for tax holiday u/s. 10A of the Act, no merit was found in holding that the Company manipulated the prices and shifted the profits to the overseas jurisdiction for avoiding taxes in India. This indicates that the motive to reduce overall taxes has been

considered in the case.

The case states that net profit computations, in the case of internal comparables (i.e., Company's transactions with independent enterprise), are based on the audited books of accounts or the books of accounts regularly maintained by the Company. There is also mention of vague generalizations by the TPO to the effect that these accounts are manipulated. This indicates the presence of non-tax regulatory factors such as Accounting Standards, Companies Act and other accounting related safeguards.

It was observed in the case that the Company has painstakingly taken through the segmental accounts, pointed out the basis of allocation of the expenses and also submitted additional analysis in the form of Internal Transaction Net Margin Method. This indicates that the motive to ensure acceptability was considered.

It is stated in the case that the TPO concluded the A.Y. 2009-10 proceedings by applying the external TNMM by adopting five comparables. The TPO rejected the search undertaken by the appellant company and the external comparable companies given by the appellant. This indicates that the availability of comparables has been considered.

The TPO rejected the internal TNMM analysis on the basis that as the appellant has made operating loss in non-AE business, the transactions with non-AEs are not at independent rates and they have been undertaken only to increase capacity utilization. This indicates presence of the motive to enhance competitiveness by increasing capacity.

#### **4.1.6 Frigoglass India**

The Company is a subsidiary of Norcoolding ASA, Norway and is engaged in the business of glass door merchandising. It has a manufacturing plant which caters to the domestic market as also to exports to neighbouring Asian countries.

The Company entered into transaction of payment of management fees and royalty and license fees and adopted TNMM as the transfer pricing method.

On the other hand, the TPO adopted the CUP method and determined ALP as Nil.

It is observed in the case that the Company is a subsidiary of Norcoolding ASA, Norway. This indicates that the ownership and control is considered.

It is stated in the case that the Company was informed by his key customer, i.e., Coca Cola, of likely performance failure in some of the visicoolers sold and installed by it. Subsequently, because of the fault of the products already sold, the Company's sale dwindled resulting in capacity utilisation. This indicates impact due to the performance not meeting the agreed standards.

The declining capacity utilisation adjustment by the TPO by adopting CUP suggests that the motive to enhance competitiveness by ensuring capacity utilisation impacts transfer pricing method.

It is stated in the case that the TPO was of the opinion that the AE should have provided some price support to the Company which would have resulted in lowering finance costs. Hence, the motive to reduce finance costs is considered to have impact.

The case states the stand of the TPO that, it was noted that the Company does not carry out any R&D activities or product design of its own, and, therefore, the underutilization of capacity is due to mistakes of the AEs. The AEs protect the product design and R&D to ensure control over the same. Hence, the motive to ensure control over intangible assets is observed in the case.

It is stated in the case that as per the TPO, as the Company does not have the liberty to work for any other customer, and is wholly dependent on its AE for productive use of its capacity to work, the AE should normally make good any losses to the captive unit caused by its not being able to make use of the available capacity. This indicates that the motive to honour commitments is considered.

#### **4.1.7 Gates Unitta India**

The Company has manufacturing operations where the import content of raw

material which has undergone calendaring process and is not just polymer or rubber. These products are used by auto manufacturers.

The Company has entered into transaction of import of raw materials. The Company has adopted TNMM for determining the ALP. The TPO on the other hand included 30% of the customs duty as part of the operating cost to determine the operating profit to sales ratio being the Profit Level Indicator.

The TPO has included 30% of the customs duty as part of operating cost. The DRP on the other hand has stated that foreign exchange should have been excluded from the operating income, even the Safe Harbour Rules have such provisions. This indicates that other tax regulatory factors such as customs duty and Safe Harbour Rules are taken into account.

Further, the non-inclusion of foreign exchange indicates the impact of external economic factors in the case.

It is stated that since the Company has very high import content, the comparables where import content was less than 30% was excluded in order to eliminate differences between the Company and the comparables. This indicates that the availability of comparables as well as the motive to ensure acceptability has been considered.

The case states that the TPO noted that the Company has not submitted any competitive factors that compelled them to sell their products at lesser price, than their production cost. This indicates that the motive to enhance competitiveness has been considered.

It is stated in the case that the customs duty was eliminated from the comparable also to bring in uniformity. This indicates the motive to simplify application in the case.

#### **4.1.8 Gharda Chemicals**

The Company is the holding Company of a wholly owned subsidiary Ghardha USA Inc. The Company entered into transaction of export sale of Dicamba to the subsidiary.



The Company determined the ALP by adopting the external CUP method. The TPO on the other hand adopted the internal CUP method being the price at which the Company sold the goods to other unrelated parties in several other countries.

It is stated that the AE is a wholly owned subsidiary of the Company. This indicates that ownership and control has been considered.

The case states that the Company furnished a report of a specific person, which indicated that the price charged by the Company from its AE was higher than the price charged by China from similar goods exported to USA to some other party. This indicates that the motive to ensure acceptability by the Company is considered.

It is stated by the Company that it was not a case in which the Company had endeavoured to reduce any income or the incidence of tax. This indicates that the motive to reduce overall tax is taken into account in the case.

It has been stated in the case that it was essential to have enterprise at USA as direct export to USA was not permissible due to local laws of USA. This indicates that the Government policies in foreign countries have an impact in the case.

It is further stated in the case that the external CUP method disregards the price charged or paid by the Company to or from its unrelated parties and contemplates the comparison of the price so charged from or paid to its AE with some external independent reliable price data under similar circumstances of transactions with AE. Hence, availability of comparables impacts the case.

#### **4.1.9 Henkel Adhesives Technologies India**

The Company is engaged in the business of manufacture and trading of adhesive products. The Company deals in engineering adhesives, sealants & specialty maintenance solutions in India. The Company is a part of worldwide Henkel group, a Germany based MNC, which is engaged in manufacturing and marketing of a broad range of high technology sealants, adhesives and coatings across the world.

The Company entered into transactions of import of raw materials and packing materials, export of finished goods and drop shipment commission receipts and adopted TNMM using aggregation approach. The TPO on the other hand selected internal CUP method as the most appropriate method.

It is stated that the Company is a part of worldwide Henkel group, a Germany based MNC. This indicates that ownership and control has been considered.

The Company has stated that adoption of CUP method as the most appropriate method requires a much higher degree of comparability as the prices charged are sensitive to even minor changes in attributes, geographical differences, risk differences, etc. and hence justifies adopting TNMM. Further, the case states that having regard to the existence of internal comparable uncontrolled transactions, the CUP method has been rightly selected as the most appropriate method. This indicates the impact of availability of comparables.

The Company has drawn reference to provisions of Income Tax Rules and submitted that the choice of the most appropriate method depends, inter-alia, on the availability of reliable data, degree of comparability between the controlled and uncontrolled transactions and the feasibility of making reasonably accurate adjustments. The impact of tax regulatory factors on the transfer pricing method is thus apparent.

It is stated that the Company in the TP Study aggregated the international transactions into two broad segments for benchmarking based on whether they related manufacturing or trading activities. Further, justifying the aggregation approach, it has been explained that the three activities of the Company are closely linked to the manufacturing process. This indicates the presence of inter related functions has been taken into account.

It is stated in the case that Company has to incur significant costs and perform critical function of creating a market by carrying out pre-engineering sales for its end-customers. This indicates that the motive to enhance competitiveness has been considered.

The case states that a voluminous Paper Book containing submissions and

material furnished before the lower authorities has been placed on record, wherefrom, the relevant material was referred to in the course of the hearing and that the onus shall be on the Company to justify suitable adjustments to the comparable uncontrolled transaction. This suggests the presence of motive to ensure acceptability.

In the case, TPO noticed that export sales to the associated enterprises have been made at prices which were at a discount of approximately 80% than the average prices charged from the non-associated enterprises. This indicates that the motive to ensure repatriation by under invoicing exports has been considered.

The Company has stated in the case that it bears product liability risk and warranty risk for goods sold to the domestic third parties. This suggests that the motive to honour commitments has been taken into account.

#### **4.1.10 Hyundai India**

The Company is a fully owned subsidiary of South Korean automobile giant Hyundai Motor Company (HMC, in short)- fourth largest automobile manufacturer in the world, and is engaged in the business of manufacturing cars in India.

The case states that the TPO faulted the Company for not having benchmarked "the international transactions relating to brand development" and proceeded to add, based on his analysis of certain observations in paragraph 1.42 of the OECD's Transfer Pricing Guidelines. This indicates that the tax regulatory factors have been considered.

The case states that there can never be a comparable controlled price input for this kind of a transaction, because, the moment use of an intangible like this is involved, the entities entering into the transactions will become AEs. This indicates that availability of comparables has have been considered.

It is stated in the case that the technology owned by the AE abroad is in the field of motor vehicles, and, with a view to ensure that the AE, owning this technology- which owns the brand name too, continues to be identified with

the products manufactured with the use of its technology, it is a common commercial practice, and quite understandable a commercial practice too, that the use of AE's brand name in the name of motor vehicle is made mandatory. This indicates the presence of motive to ensure control over intangible assets by the AE.

It is stated that the Company is to mandatorily, under the agreement with HMC Korea, use the badge with trademark in every vehicle manufactured by it. The agreement indicates that contractual arrangements have been considered.

The case states that the TPO held that the benefit received by HMC has transmuted into part of the enhancement of its market capitalization, an enhancement in value that has come free after accruing to HMC's credit in India and has escaped tax incidence in India. This indicates that the motive to reduce overall taxes have been considered.

It is stated in the case that the incentive on focus market scheme is to offset high freight cost and other externalities to select international market with a view to enhance India's export competitiveness in those countries.

#### **4.1.11 India Kawasaki Motors**

The Company is engaged in the business of trading and distribution of Completely Knocked Down (CKD) Parts of Motorbikes.

The Company entered into transactions of trading services and trading services fees by adopting CPM with Gross Profit to Cost as the PLI. The TPO made adjustments to the transactions by adopting CPM using different set of comparables.

The case states that the Company submitted that as it had fully imported the trading goods which resulted in higher incidence of customs duty on traded goods, accordingly, it increased the cost of the traded goods which directly affected the gross profit margin. This indicates that impact of other tax regulations such as customs duty is considered.

It is stated that the Company selected AEs as tested party identifying 11

comparables on the basis of FAR analysis. Thus, the role of availability of comparables is taken into account.

The Company states that it had furnished all the necessary evidence to establish that actual conditions of services. This indicates presence of motive to ensure acceptability.

#### **4.1.12 Infineon Technologies India**

The Company renders software development services to its Associated Enterprises.

The Company entered into transactions of provision of software development services, marketing services and reimbursement of communication expenses received with its AE and adopted TNMM as the Most Appropriate Method. The TPO on the other hand adopted CUP and applied the average industry hourly rate.

The case states that it is a settled principle that a proper TP comparability analysis is carried out for each taxpayer, for each assessment year to decide the Most Appropriate Method to be adopted, filters to be applied and the comparable companies to be selected. Hence, the role of availability of comparables is emphasised.

The Company states in the case that the TPO has adopted CUP method in place of TNMM used by the Company to arrive at the ALP without rendering any finding or reasoning as to why TNMM was rejected and CUP Method was adopted. Further, it is stated that the Company shall be afforded adequate opportunity of being heard and to file details and submissions. This indicates that the motive to ensure acceptability has been taken into consideration.

#### **4.1.13 Infogain India**

The Company is engaged in the business of software development. The Company provided Software Development Services to its AE – Infogain Corp US which in turn provides these services to the end customers.

The Company applied PSM to determine the ALP of the transaction. On the

other hand, the TPO adopted TNMM as the most appropriate method.

The case states that persuasive value of OECD guidelines has been considered and the relevant case laws. This indicates the role of other tax regulations in the case.

The case states that the Company was setup as a back-end software services company which performed services mainly for its parent Infogain Corp US. The reference to the relationship between the Company and the AE indicates consideration of ownership and control.

The case states that contractual arrangements for services was made by the AE with the customer which further made a contractual arrangement for development. It was observed in the case that the Company has carried out the contractual obligation. This indicates that the case takes into account presence of contractual arrangements.

It was observed in the case that the Company has not demonstrated comparability while adopting PSM. Further, the Company objected that the TPO collected selective information of companies which was not available to the Company in public domain. This indicates that the availability of comparables is taken into account.

The case states that the different activities performed by the Infogain India i.e., Company and Infogain US are inextricably linked and both the entities are contributing significantly to the value chain of provision of software services to the end customers. This indicates presence of inter-related functions has been considered.

The case states that the delivery model of the Company is such that Infogain US develops onshore in addition to sales and marketing services and Infogain India after the development process is over delivers directly to clients. Further, it was submitted that the organizational structure was aligned by client services and delivery function and currently the team at Infogain US has been reduced to one-fourth since the conversion year. The case also refers to the role of the global delivery organization group wherein the primary objective of the group

is to bring synergies amongst geographic groups and project, to make efficient use of the available resources, to broaden areas of service offerings, to improve opportunity fulfilment ration, and to maximize customer satisfaction with each project execution. These statements point to the presence of motive to enhance competitiveness which has been considered in the case.

The case states that the Company has not submitted any information evaluating the contribution made by Infogain India and Infogain US on the basis of FAR of each one of them and have reliably employed any external market data which may be indicative of how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances. The motive to enable performance evaluation of individual entities in the group has been highlighted.

It has been submitted in the case that the entire pricing decision based on project costing estimates, resource requirements, time commitments has entirely shifted to Infogain India and that since the majority of the conceptualization and designing functions are being performed in India, the unique intangibles, if any are in India itself. The reference to location of the intangibles and reasoning suggests the motive to ensure control over assets which has been considered in the case.

It is also submitted in the case that the TP study is undertaken on the basis of functions / responsibilities and based on interviews with the key management personnel and that pre-migration and post-migration flowcharts were provided. Further, the case also states that PSM was adopted to merely camouflage loss is only an allegation. These efforts indicate the motive to ensure acceptability which has been considered in the case.

It is stated in the case that the major functions such as conceptualization and designing is performed in India and still the US entity has the larger chunk of the split, it is assuming a huge disproportionate profit chunk for the alleged sales and marketing function. This indicates that the case has taken into account the motive to ensure repatriation.

#### **4.1.14 Interpump Hydraulics India**

The Company is a wholly owned subsidiary company of M/s Hydraulics SpA, Italy. The Company entered into transaction with the Holding Company for purchase of machinery.

The Company adopted CUP method for determining the ALP of the transaction which is the market value of the machinery. The TPO on the other hand adopted the written down value of the machinery in the books of the Holding Company as the ALP.

The case states that the relation of the Company with the AE is that of a wholly owned subsidiary. This suggests that the ownership and control has been considered in the case.

It is also submitted that the machinery would automatically depreciate at a particular rate which was recognized under both the Companies Act and the Income-tax Act whereas when an independent buyer purchases second hand machinery, the buyer would analyse the cost and depreciated value. This indicates the impact of non-tax regulatory as well as tax regulatory factors.

The case states that even though a statutory deduction was provided under the Income-tax Act and the Companies Act, the price of the machinery has to be compared with comparable machinery in the uncontrolled market. This indicates that the availability of comparables is taken into account.

#### **4.1.15 Kailash Jewels**

The company is engaged in the business of manufacturing and trading of Gold & Silver Jewellery etc. During the year the Company entered into international transaction with Associate Enterprises in Dubai (UAE) of job work.

The case states that the TPO held that TP study furnished by the Company does not contain any comparison with the external comparable companies and had to carry out the fresh search of comparables for the purpose of benchmarking analysis. This indicates that availability of comparables has been considered in the case.



The case draws reference to the Sale of Goods Act, 1930 for definition of contract to examine the transaction. This indicates that non-tax regulatory factors have been considered in the case.

#### **4.1.16 Kaypee Electronics**

The Company is engaged in the business of manufacturing of Magnetic based Electronic Coils, transformers and inductors. It is a subsidiary of M/s. Falco Limited, Hongkong.

The Company entered into transaction of payment of royalty as percentage of sales to the AE. The Company adopted TNMM to justify the ALP of the transaction. The TPO on the other hand, determined the ALP by computing royalty as percentage of value addition.

It is stated that the Company is a subsidiary of M/s. Falco Limited, Hongkong and that 80% of equity capital of the appellant is held by the said M/s. Falco Limited. This reference to the status and shareholding indicates that the ownership and control is considered in the case.

It is stated that the Company also entered into Technology Collaboration Agreement with M/s. Falco Limited for manufacturing electronic components by using technology, expertise and knowhow of Falco and marketing and selling components under the brand name of Falco in India as well as abroad. This indicates presence of contractual arrangement has been taken into account.

The case states that the Company failed to establish that the transaction royalty payment is closely linked with the other transactions carried out with AE. This suggests that inter related functions are considered.

The Company submitted that royalty is paid to M/s. Falco Limited for the use of brand name. This indicates presence of motive of the Holding Company to ensure control over the intangible assets by charging royalty.

The case states that onus always lies on the Company to establish the justification for clubbing and aggregation of the transaction of payment of

royalty with other transactions. Thus, importance of motive to ensure acceptability by the Company is highlighted.

#### **4.1.17 Knorr Bremse**

The Company is a wholly owned subsidiary of Knorr-Bremse Asia Pacific (Holding) Ltd. The Company deals in air brake sets of passenger cars & wagon coaches, shock absorbers for passenger cars & locomotives, distributor valves, computer control brake system, tread break unit, brake accessories and other related products.

The Company entered into transactions with AEs – professional consultancy, management fee for support services, purchase of raw materials and consumables, purchase of finished goods and import of capital items. The Company aggregated the above transactions and adopted TNMM as the most appropriate method. The TPO on the other hand adopted CUP method to determine ALP of these transactions.

It is stated that the Company is a wholly owned subsidiary of Knorr-Bremse Asia Pacific (holding) Ltd. The reference to the structure of holding indicates that ownership and control have been considered in the case.

It is stated in the case that the Company aggregated the transactions under TNMM as the transaction was closely linked with other transactions. This suggests that presence of inter related functions impact the choice of transfer pricing method.

The Company has submitted that intra group services payments have contributed to the improved client services and profitability of the Company. This indicates presence of motive to enhance competitiveness is noted in the case.

The Company has justified the management support services by stating that by availing the services from the AE was benefited by way of increase in exports and increase in gross margin. The Company explained that there was strong co-relation between the creation of the profit and the time spent by the employees of the AE and also furnished task sheets to the TPO to substantiate

that the services were provided by the AE with a vision to decrease direct purchases cost of the Company. The efforts of the Company highlight the motive to ensure acceptability.

Reference is drawn to OECD Transfer Pricing Guidelines issued for determining the Arm's Length Price in relation to intra-group services. This indicates that other tax regulations are considered in the case.

The Company has also submitted that it is to be seen that how much charge would have been made and accepted between independent enterprises in comparable circumstances while referring to the OECD Guidelines. Thus, the availability of comparables is emphasised.

The case states that the only question is whether the transaction was entered into bona fide or not or whether it was sham and only for the purpose of diverting the profits. This indicates that the motive to reduce overall taxes is taken into account in the case.

It is stated in the case that the company does not have any in-house research team and does not have the requisite knowhow and accordingly sought support of its AE. Hence, the Company sought to lower costs by using the research and knowhow of AE rather than develop its own and hence indicates presence of motive to lower finance costs.

The case states that the internal data submitted by the Company was very helpful particularly when the allocation key was based on cost accounting system. The cost accounting records being a requirement of non-tax regulation indicates that non-tax regulatory factors have been considered.

#### **4.1.18 Lenovo (India)**

The Company is engaged in the business of manufacture, import, marketing, distribution and export of information technology systems, software and maintenance services etc.

The Company entered into transaction of sale of imported parts of raw-material, purchase of imported parts of raw material, software licence and

royalty. The Company adopted RPM as the most appropriate method for determining the ALP. The TPO on the other hand adopted TNMM.

It is submitted in the case that the Company has followed various methods for computing the ALP of different transactions depending on the nature of transactions and the comparables available. This indicates that the availability of comparables has impact on the transfer pricing method.

The Company has drawn reference to judicial precedents on the issue to demonstrate that where TPO has not been able to find any fault with the method adopted by the Company for the said purpose, the TPO is bound to accept the TP analysis conducted by the Company and cannot take a different view. This indicates presence of the motive to ensure acceptability.

The case states that for the subsequent assessment years, the very same TPO had accepted the methods adopted by the Company for arriving at the ALP for similar transactions and there was no TP adjustment made. This indicates that the motive to simplify application by adopting same methods for similar transactions has been considered.

The Company has submitted that it has provided either 1 year or 3 years warranty on sale of PC's and laptops made to its customers in India and the prices for warranty services has been loaded in the sale price of PC's or laptops itself. Further, the Company has submitted that as part of the personal computer business acquired by the Company from IBM, it had entered into a market support agreement (MSA) with IBM. This indicates that contractual arrangements such as warranty or market support agreement have been considered.

In the case, the Company has submitted that the MSA was entered into with a view to retain a market share in the stipulated business. This indicates that the presence of motive to enhance competitiveness.

It is submitted that the payments to IBM cannot be termed as goodwill as it is not for using any brand, logo or any trademarks of IBM. This indicates that the impact of motive to ensure control over intangible assets such as brand, logo

or trademarks has been considered in the case.

In the case, it is observed that when the Company has taken over the division of desktops and laptops from IBM, it has also taken over the liabilities, which include the commission and discounts to the dealers. Further, the Company is bound to carry on business with the said dealers in future and for that purpose it must maintain cordial and good relationship with the said dealers. This indicates presence of motive to honour commitments is considered.

#### **4.1.19 LG Electronics India**

The Company is engaged in the manufacture and sale of colour televisions.

The Company paid royalty and commission to LG Korea. The Company determined ALP of the transaction by adopting TNMM. The TPO on the other hand adopted CUP Method for computing the ALP and made transfer pricing adjustments.

It is submitted in the case that royalty at 5% as paid by the Company to its AE was duly permitted/approved by the Government of India and Reserve Bank of India. The approval is required as part of non-tax regulatory framework and accordingly this indicates that non-tax regulatory factors have been considered in the case.

The case also states that the Company had taken a perpetual license, entered into a technical assistance on perpetual basis and royalty agreement, and also entered into an agreement for paying commission to LG Korea. This suggests that the presence of contractual arrangements has been considered in the case.

It is observed in the case that the Company chose eight companies as comparable. The TPO reduced it to one and the DRP enhanced their number to three. This indicates that the availability of comparables have been considered in the case.

It is submitted in the case that without the payment of royalty, the Company could not have carried on its business and, hence, this transaction should be viewed as an integral part of other transactions including import of raw

materials, import of service spare, export of finished goods, export of service spares, commission, design and development fee and import of production equipment, etc., so as to qualify for the determination of its ALP under TNMM on entity level. This indicates that presence of inter-related functions has impact on the transfer pricing method.

It is stated in the case that Company made a claim made before the DRP about LG Korea having rendered several services to promote the export of Colour TVs in Middle East and South Asian countries. This indicates presence of motive to enhance competitiveness by expanding the customer base is considered in the case.

It is stated in the case that the Agreement provides that the licensor grants to the licensee an exclusive non-transferrable license without the right to sub-license. Further, it is also observed that the agreement simply allows the use of Technical Information and IPRS without granting any ownership rights in it to the Company. These restrictions indicate that the presence of motive to ensure control over intangible assets have been assessed in the case.

It is stated in the case that the Company submitted a list of eight companies as comparables. The Company also filed with the TPO copies of emails to justify the payment of commission. Hence the motive to ensure acceptability has been taken into account.

It is stated in the case that the AO treated export commission paid as diversion of profits to LG Korea and held that the commission payment was only a mechanism for extracting profits from India based on which transfer pricing adjustment was made. This indicates that the presence of motive to ensure repatriation has been examined.

The case states that the Agreement has a confidentiality clause which prohibits the Company from disclosing the information received pursuant to this Agreement, to anyone else either during the continuation of this agreement. This indicates that the presence of motive to honour commitments has been considered in the case.

#### **4.1.20 Maersk Global Centres India**

The Company is a wholly owned subsidiary of Maersk GSC Holdings A/S, which in turn is a downstream subsidiary of APMM Group ("Maersk Group). It is engaged, inter alia, in the business as shared service centre and renders transaction processing, data entry, reconciliation of statements, audit of shipping documents and other similar support services. It also renders I.T. services such as process support, process optimization and technical support services.

The case states that the TPO rejected twelve of the thirteen comparables selected by the Company and considered some additional filters or criteria which, according to him, would lead towards selecting proper comparables. This indicates that availability of comparables have been considered in the case.

Reference is drawn in the case to OECD Transfer Pricing Guidelines wherein it is stated that the information on product characteristics might be more important if the method applied is a comparable uncontrolled price method than if it is TNMM. This indicates that tax regulatory factors impact choice transfer pricing method.

The case places appreciation for the assistance provided by the Id. Representatives of both the sides by making elaborate submissions which helped us to analyse the legal position emanating from the interpretation of the relevant provisions. This indicates that the presence of motive to ensure acceptability has been noted in the case.

#### **4.1.21 Makemy Trip (India)**

The Company is engaged in the business of online selling of travel products and solutions. It offers comprehensive services for the global traveller including air tickets, hotel reservations, car bookings and holidays. MMT India caters exclusively to the inbound 'into India' leisure and small-business travel market.

The Company entered into transaction with AE tour and travel related services.

The Company adopted TNMM to determine the ALP of the transaction. The TPO made additions invoking the bright-line principle on account of AMP expenses.

It is stated in the case that the trademark 'MakeMyTrip' has been registered in the name of MakeMyTrip (India) Private Limited as evidenced by registration certificate issued by Government of India, Registrar of Trade marks. The trade mark regulations are non-tax regulations and this indicates that non-tax regulatory factors have been considered in the case.

It is also stated that MMT Mauritius had been granted a Category 1 Business licence and conditions as mentioned in said licence certificate mention that the stated purpose of the company is to engage in investment holding activities. The business license is as per non-tax regulations in Mauritius and this indicates the non-tax regulatory factors have been considered.

The case states that if because of robust economic growth of a Company, there is appreciation in market value of capital investment of its shareholders, then the Company has no legal, economic or moral right to get reward/compensation from its shareholders out of such appreciation. This indicates that external economic factors that determine the growth and market value have been taken into account.

The case states that the TPO has taken a view in the case that beneficiary of the excess AMP was parent company MMT Mauritius. The reference to the relation of MMT Mauritius being the parent company indicates that the ownership and control have been considered.

It is stated in the case that the Company had selected nine comparable companies from the ITES sector for benchmarking the charge received by it from MMT US for its back-office activity for rendering ticketing services and tours and travel related services to MMT US. Out of the nine companies selected by the Company, financials of six companies for the specified year were available. This indicates that the availability of comparables is taken into account.



The case states that the TPO noted that the Company did not incur the expenses claimed as ‘Advertisement and business promotion’ expenses incurred wholly and exclusively for the purpose of its business. This indicates that the presence of motive to enhance competitiveness has been considered in the case.

The case states that the TPO further has noted that the expenses are incurred to further the interest of other persons including the group companies. This indicates that the presence of motive to reduce finance costs of the group companies by bearing their expenses has been assessed.

The TPO has further brought out that nature of such expenses is capital nature since these are incurred to give enduring benefit to the multinational group trading in Indian market and are incurred for creating brand name of a multinational group in India. The case however states that MMT India is the owner and sole beneficiary of MMT brand. The Company has submitted that registration of the trademark in Mauritius was done to protect future business interests of the Company’s planned business operations in Mauritian territory. Thus, the motive to ensure control over intangible assets has been examined and considered.

It is stated that the Company had used nine companies as comparables, computed the average arithmetic mean for three years of comparable companies and shown that it is less than the margin of the Company and hence the transactions were claimed to be at arm’s length. The efforts of the Company have been noted which indicates that the motive to ensure acceptability has been considered.

The TPO has taken a view that MMT Mauritius has been benefitted by the listing of the company in the US at a premium. When the Company MMT India was in losses, the shares of its parent MMT Mauritius were being quoted at a premium at Nasdaq in USA. Hence MMT Mauritius should have compensated MMT India for services rendered in connection with promotion of marketing intangibles which accrued to the benefit of MMT Mauritius. This indicates that the presence of motive to ensure repatriation has been examined.

#### **4.1.22 Man Trucks India Pvt Ltd**

The Company was a JV between Force Motors Ltd. and Man Group of Companies in Germany. The Company manufactured cargo line shell trucks which is a special line of trucks specifically for Indian market and other developing countries markets. The trucks were manufactured as per emission norms which were acceptable in India and developing countries but not acceptable in Germany. Due to excess manufacturing capacity available, the Company manufactured trucks for export sale to Germany for ultimate sale in developing countries like South Africa, Ethiopia and Indonesia. Due to stricter emission norms in Europe, these trucks were directly dispatched to the developing countries. The sales were invoiced to Germany at Cost plus 25% less EUR 500 for warranty commitments which would not be borne by the Company but would be passed on to the Associated Enterprises. However, the Assessing Officer aggregated the transactions and applied TNMM after rejecting CUP and CPM method adopted by the Company.

The Company is a Joint Venture which indicates that contractual arrangements have been considered.

The Tribunal has drawn reference to segmental reporting to be certified by auditor, i.e., application of Accounting Standards apart from Income tax Rules while assessing the aggregation of transaction for application of TNMM which indicates that non-tax regulations have been considered.

The matter of whether the Company or the Associated Enterprise will provide after sales service and warranty in pursuance of commitments to customers is considered which indicates that contractual arrangements have been considered in the case.

The discussion of higher emission norms being applicable in Germany and hence the trucks could not be sent there and had to be dispatched directly to the developing nations indicates that Government policies and non-tax regulations have been considered.

The consideration of geographical differences arising out of exports to

developed vis a vis developing countries indicates that the level of development has been considered.

The disagreements of the Assessing Officer over the comparable used by the Company and the stand of the Company that where comparison was available at hand, an endeavour should be made to use the internal comparables available indicates that availability of comparables have been considered.

The fact that the trucks were exported to developing countries but the orders were through the German Company indicates that control of the German Company has been considered.

The appeal in question is on account of dispute regarding the taxation arising from the pricing of the transactions wherein the Assessing Officer has demanded higher tax. Hence, the motive of the Company to reduce the overall tax is indicated here.

The justification to manufacture and export trucks due to low sales and availability of capacity indicates the motive of the Company to enhance competitiveness.

The routing of the trucks to the developing countries directly without entering Europe indicates the motive of the Company to ensure regulatory compliance and to avoid penalties.

The application of internal TNMM for exports by the Company indicates the motive of the Company to simplify application.

The exports could have been made directly to the developing countries and the question of transfer pricing would not arise as these sales would be directly to dealers who are unrelated. However, the sales were controlled by the German company which indicates motive to control the assets.

The German company was selling third party material to the Indian company and applying surcharge for handling. This indicates motive to ensure control of assets and also to enable performance evaluation.

The change in stand of the Company before the DRP and providing certificate of negative contribution of the transactions by the German company indicates the motive of the Company to ensure acceptability.

#### **4.1.23 Mercedes-Benz India**

The Company is engaged in manufacture and sale of Mercedes Benz passenger cars in Indian market. The transactions are subject matter of transfer pricing assessment under Income tax Act and hence was justified by the Company by applying TNMM.

The Tribunal has drawn reference to Accounting Standards apart from Income tax Rules while assessing the aggregation of transaction for application of TNMM which indicates that non-tax regulations impact the transfer pricing method.

The Company is bound by terms of Warranty Contract with the customers which was a stand taken by the Company to justify aggregation and use of TNMM indicates that contractual arrangements have been considered.

The stand of the Company that the royalty rate was approved by various regulatory authorities like RBI, DIPP indicates that Government policies have been considered.

The Assessing Officer has stated that the comparable companies which were Chinese Companies received subsidies from the Government and rejected the comparables for use of TNMM which indicates that Government policies have been considered.

The disagreements of the Assessing Officer over the comparable used by the Company and the rejection of the use of RPM as well as CUP method by the tribunal due to unsuitable comparable used indicates that availability of comparables have been considered.

The Company was paying royalty to the Holding Company for technical know-how thereby indicating that ownership of the assets has been considered.

The appeal in question is on account of dispute regarding the taxation arising from the pricing of the transactions wherein the Assessing Officer has demanded higher tax. Hence, the motive of the Company to reduce the overall tax is indicated here.

The justification for bringing CBU units to India indicates the motives of the Company to provide entire range of products, to provide models available globally hence indicating that the transaction was entered into to provide customer satisfaction and to build reputation in the market. Further, the CBU units were brought in order to widen the customer base and penetrate the market.

The import of spares and restricting the dealers to only use spares imported indicates the motive of the Company to honour warranty commitment, to maintain efficiency of the cars and to keep the standard of its products.

The close interlinking of transactions and aggregation of transactions indicates the motive of the Company to simplify application. The use of TNMM to cover all transactions and compare it on an overall basis with other Companies is another indication of the intention of the Company to simplify application.

The Company itself has provided separate benchmarking and detailed information regarding the Royalty payment. This further indicates the motive to ensure acceptability and justifiability.

The payment of royalty by the Company to the Group for technical know-how indicates the motive of the Group to maintain control over the intangible assets and ensure compensation for use. Further, the payment of royalty also indicates that the need to ensure repatriation of funds and to enable performance evaluation.

#### **4.1.24 Micro Ink**

The Company is a leading ink manufacturer in India. The Company has a wholly owned subsidiary in Austria, by the name of Micro Inks GmbH which, in turn, owns Micro Ink Co USA which manufactures printing ink by using the base material supplied by the Company. The Company also has trading

subsidiaries in China and Hong Kong.

The Company sold goods to Micro Ink Co USA and allowed higher credit period than it allowed to independent enterprises. It also issued corporate guarantees on behalf of its AEs. The Company adopted TNMM as the basis of determining ALP. The TPO, taking a view that the credit period was higher and that guarantees were issued without charging the AEs, made addition to the total income of the Company as an ALP adjustment.

It is stated that the Company has a wholly owned subsidiary in Austria, by the name of Micro Inks GmbH which, in turn, owns Micro Ink Co USA. Further, it is also stated that the Company has trading subsidiaries in China and Hong Kong. The reference to the structure of the group indicate that ownership and control have been considered in the case.

It is stated in the case that the TPO has observed that the Company allowed the AE an average credit period of 186 days as against average credit period of 130 days allowed to independent enterprises. This indicates that the motive to lower finance costs of the AE has been taken into account.

The case states that the TPO determined the adjustment by taking the LIBOR as a basis for computing the time value of money. LIBOR being a benchmark rate driven by various factors in the external economic environment of the Company suggests that external economic factors have been considered in the case.

The case also states that Company issued various corporate guarantees on behalf of its AEs. This indicates that the motive to lower finance costs of the AE has been taken into account.

It is stated in the case that the Company had trading transactions in respect of the finished goods with trading subsidiaries in China and Hong Kong but it is not even the case of the TPO that excessive credit period was allowed to these AEs. This comparison of credit period in similar transactions suggests that the availability of comparables has been considered in the case.

It is observed in the case that the DRP relied upon, ‘OECD Transfer Pricing Guidelines for Multinational Enterprise and Tax Administrations’, ‘OECD Report on Attribution of Profits to Permanent Establishments’ and decision of the Tax Court of Canada. This indicates consideration of other tax regulations in the case.

#### **4.1.25 Moet Hennessy India**

The Company is a subsidiary of Champagne Moet & Chandon France (CMC), one of the leading producers of champagne, which holds 99% equity in the Company. The Company is engaged in the business of importing and distribution of the different categories of wines and spirits.

The Company has incurred an extremely high level of advertising and market promotion expenditure and the TPO made an ALP adjustment in respect of international transaction on account of advertisement, promotion and marketing expenses said to have been incurred on behalf of its parent company.

It is stated that the Company is a subsidiary of Champagne Moet & Chandon France. The reference to the type of relationship indicates that ownership and control have been considered.

The cases states that the Company has alleged misinterpreting or placing incorrect reliance on the international guidance in relation to the ‘marketing intangibles’ and ‘bright line test’ from Organisation for Economic Co-operation and Development (‘OECD’), US TP Regulations and Australian Tax Office (‘ATO’). This indicates other tax regulatory factors have been considered.

It is stated that the Company is assisted by the AEs in carrying out the function of importing and distribution of the different categories of wines and spirits and that it imports advertising and promotional material from its associated enterprises such as wine glasses, menu holders etc to be given as complimentary products to its esteemed customers.

It is stated in the case that AE is the legal owner of the brand and that when the brand value increases, the AE is the beneficiary. It is also stated that the

Company is creating marketing intangibles. This indicates presence of motive to ensure control over the intangibles.

The Company has contended that there has to be explicit agreement or understanding for promotion of brand of the foreign AE in India and existence of an international transaction cannot be a matter of inference or deduction. This indicates that the presence of contractual arrangement has been considered in the case.

The Company has stated that in assessment of earlier years, the AMP expenses were held to be in contravention of law and hence inadmissible deduction. This indicates that other tax regulations have been considered in the case.

The Company has stated that in assessment of earlier years, the AMP expenses were held to be capital expenditure as it resulted in enduring benefits. It is also observed in the case that the expenditure incurred by the Company was in nature of bona fide business expenditure in furtherance of its legitimate business interests. This indicates presence of motive to enhance competitiveness is taken into account.

It is stated in the case that the sum incurred by it on advertisement and sales promotion is considered from the audited financial of the Company. As the audited financial statements are drawn up in compliance with provisions of Companies Act, this indicates that non-tax regulatory factors are considered in the case.

The case states that onus which was on the Company to benchmark the international transaction relating to the expenditure incurred on AMP has not been discharged. This indicates that the presence of motive to ensure acceptability has been considered in the case.

The cases states that since the brand name was owned by the AE, the Company should have been compensated by the AE but the Company has not received any payment in this regard from the AE. This indicates that the motive to ensure repatriation has been considered in the case.



The case draws reference to comparable expenses, for the same period, in respect of other similar companies dealing with alcoholic products. This suggests that the availability of comparables has been considered in the case.

#### **4.1.26 Netafim Irrigation India**

The Company was formed in pursuance to a joint venture agreement between Netafim Yiftah Irrigation Equipment & Drip systems, Israel (Netafim, Israel), Excel Industries Ltd. and Jalbindu Agritech Pvt. Ltd. (Jalbindu) on the shareholding of 75%, 15% and 10% respectively. The Company undertakes manufacturing, assembling and marketing in India of Typhoon family of non-pressure compensated Driplines and Botton Drippers and provides technical and extension service according to customers' needs before, during and after sales.

The case states that the Company has drawn attention to the computation of cost plus margin of the comparable companies. This indicates that the availability of comparables have been considered.

The case states that the Company is an Indian Company, was formed in pursuance to a joint venture agreement and takes into account the shareholding. This indicates that ownership and control have been considered.

It is stated in the case that the Company submitted that royalty charges are determined based on a technical knowhow agreement which indicates that the contractual arrangements have been considered.

It is stated in the case that the Company submitted that royalty charges are determined on the basis of product manufactured and the clients committed for. This indicates that the presence of motive to honour commitments have been considered.

The case states that the Company submitted that the contention of the Department that the whole entity approach is not provided under law is unacceptable since the payment of royalty is closely linked to the other international transactions, hence, cannot be evaluated separately. This indicates that inter related functions have been considered.

The case states that the Company has also provided the updated single year margin of comparable companies. This indicates the motive to ensure acceptability have been considered.

The Company has submitted that the payment of royalty is consistent with the cost incurred by Netafim, Israel, with regard to its own proprietary intellectual property secured through a long list of innovative patents. This indicates the motive to ensure control over assets have been considered.

The case also states that the Company uses the Netafim, Israel, proprietary intellectual property and patents development by third party and paid for by Netafim, Israel. This indicates the motive to lower finance costs by centralizing R&D activities have been considered.

#### **4.1.27 PMP Auto Components**

The Company is engaged in the business of auto components. The Company had given loan to its AE.

The Company has submitted that when no interest was charged by the Company as per the agreement on moratorium for one year, then no notional interest can be added under transfer pricing adjustment. This indicates that contractual arrangement has been considered.

The Company has contended that the it charged interest to its AE at Hungary which is more than the LIBOR rate and, therefore, the same is at arm's length and no adjustment was required to be made in respect of the loan given to its subsidiary. This indicates that the motive to ensure acceptability have been considered.

It is stated in the case that the safest comparables, which can be taken as Arm's Length interest rate in such a case would be the interest on FD with the bank for a term equivalent to the term for which the loans given to the AEs. This indicates that availability of have been considered.

It is stated in the case that the Company contended that because the Company agreed for a moratorium of payment of interest, the Company did not charge

the interest for the year under consideration. This indicates that the motive to honour commitments have been considered.

It is stated in the case that there is one more reason for taking the FD as an appropriate and good comparable because the lending rate by financial institutions/bank varies depending upon the credit rating of the borrower and further on the guarantee and security provided to secure the loans. This indicates the motive to simplify application have been considered.

The case states that the Company had full control over its subsidiary which reduce the credit risk. This indicates that the motive to ensure control over assets have been considered.

#### **4.1.28 Polaris Consulting Services**

The Company is a software solution provider. The Company adopted TNMM as the most appropriate method for determining ALP of the transaction.

The case states that no reasons were provided by the TPO as to why comparable companies selected in its documentation were found to be incorrect. This indicates that the presence of motive to ensure acceptability has been examined.

The case draws reference to the principles of natural justice that firstly, the person who is likely to be adversely affected by the action of the authorities should be given notice to show cause thereof and granted an opportunity of hearing and secondly, the orders so passed by the authorities should give reason for arriving at any conclusion showing proper application of mind. This indicates that non-tax regulatory factors have been examined.

The case states that the Company has submitted that the CUP method is the appropriate method for benchmarking transactions with Citi Group and some of its comparables also meet the filters adopted by the TPO. This indicates that availability of comparables have been considered in the case.

#### **4.1.29 RAK Ceramics India**

The Company is a wholly owned subsidiary of RAK Ceramics PSC, United

Arab Emirates (RAK Holdings) and manufactures vitrified tiles and sanitary ware products in India. The products manufactured by Company are sold in domestic and export market.

The Company has entered into transactions with AEs in respect of payment of royalty. The Company adopted TNMM as the most appropriate method and operating profit to sales as the profit level indicator (PLI). The TPO on the other hand adopted the CUP method to determine the ALP of the transaction.

It is stated that the Company is a wholly owned subsidiary of RAK Ceramics PSC, United Arab Emirates (RAK Holdings). The reference to the ownership structure indicates that control and ownership have been considered in the case.

It is stated in the case that the Company entered into a royalty agreement with its AE, RAK, UAE and per the terms of royalty agreement, AE has to provide the technical know-how and assistance for manufacturing products. This indicates that presence of contractual obligation been considered in the case.

The case states that though Company adopted TNMM, the Company also undertook an alternative analysis under comparable uncontrolled price method (CUP) by bringing in three comparables. The effort from the Company indicates that the presence of motive to ensure acceptability has been noted.

It is stated that the TPO has rejected alternative analysis done by Company under CUP by observing that comparables selected being USA companies, the analysis made cannot be accepted. This suggests that the availability of comparables has been considered in the case.

In the case, the TPO has taken the view that TP analysis done by Company cannot be accepted as Company has aggregated intangible transactions like payment of royalty with tangible transactions, such as, sale and purchase of goods. This indicates that presence of inter related functions have been examined.

It is stated in the case that the royalty is in consideration of the ongoing technical assistance on process and product improvement to be provided or any

other services as specified in the agreement. The parent company is providing the Company with these services instead of the Company doing research and development itself with a motive to reduce finance costs of the Company.

The case states that the Company does not own any intangibles and all the intangibles are owned by the AE. This indicates that the presence of motive to ensure control over the intangible assets is taken into account.

It is stated in the case that Company has to manufacture in accordance with guidelines established from time to time by RAK, UAE and shall use apparatus, ancillary equipment, accessories and materials that will ensure that such standards, rules, specifications and guidelines are met. This also indicates that the motive of the Company to ensure control over the intangible assets is considered in the case.

It is submitted in the case that the Company required to manufacture the products strictly in terms with the technical know-how and the guidelines set by AE keeping with the international standards. This indicates that the presence of motive to honour commitments has been considered.

#### **4.1.30 Roxtec India**

The Company is a wholly owned subsidiary of Sweden Company. It is engaged in the business of manufacturing complete sealing solutions for cables and pipes. The Company imports sealing modules from its AEs and wedges of frames from local vendors who uses the design provided by the group Company and then those are assembled into customised ready to use packs and sold to the customers.

The Company entered into transaction of import of material and adopted RPM to determine the ALP of the transaction. The TPO on the other hand adopted TNMM by combining transaction of import of material with export of finished goods.

It is stated that the Company is a wholly owned subsidiary of Sweden Company. The reference to the ownership structure indicates that the ownership and control have been considered.

It is observed in the case that the Company being the front-end entity is responsible for maintaining good relationship with the customer. This suggests that the presence of motive to enhance competitiveness by maintaining good relationship has been taken into account.

It is stated that product research and development functions risk only rest with the AE and not with the Company. The AE is assuming these functions instead of the Company doing research and development functions itself which suggests that the presence of motive to reduce finance costs of the Company is examined.

It is stated that the manufacturing function risk is with the AE and not with the Company. The Company exports the local products used in assembly and frame which are tested for quality in Sweden to adhere to the strict product specification and quality norms driven by the parent company. This indicates that the presence of motive of the AE to ensure control over assets has been assessed.

It is stated in the case that with respect to the product liability risk and the warranty risk, risk rests with the associated enterprise and not with the Company except limited warranty to obtain the product from the customers and sending it to its associated enterprise. This suggests that the motive to honour warranty commitments have been considered.

#### **4.1.31 Salcomp Manufacturing**

The Company purchases critical raw materials from Salcomp Plc., Finland. Salcomp Plc., is responsible for internal and external sourcing of components used by its group companies in manufacturing of chargers.

The Company procured components and adopted CUP method to demonstrate the ALP after making adjustments on account of the credit period availed by the Company. The TPO made adjustments to the purchase price and interest paid on External Commercial Borrowings.

The case states that it is submitted that the implicit interest rate on India's external debt followed by the AO is an unadjusted industrial average, which

cannot be considered in view of the OECD guidelines. The reliance on tax regulatory guidelines such as OECD guidelines indicate that tax regulatory factors have been considered in the case.

The case states reliance on 'India's External Debt — a Status Report — FY 2010-11' issued by the Ministry of Finance. This indicates that government policies have been taken into account.

It is stated that the interest paid by the Company is in accordance with LIBOR, which is accepted and used for bench marking for such transaction. This indicates that availability of comparables is considered in the case.

In the case, the DRP has observed that though the Company has generally mentioned, the various difficult factors which determine the interest rate like credit rating, duration, collateral, fixed vs floating rate, and benchmark prime lending rate, it has not substantiated which critical factor has affected the interest rate in what way. This suggests that impact of external economic factors have been taken into account.

It is stated that Salcomp Plc., is a sourcing agent for all the group entities and procures these components from unrelated suppliers, and applies a mark-up of 5% on the third-party purchase price for its supply chain management services. The reference to this arrangement indicates that ownership and control have been considered in the case.

The case states that Salcomp Plc., also provides extended credit period of 180 days to 270 days to the Company, while the credit period received by Salcomp Plc., from its third-party vendors was 30 to 60 days. This indicates that the motive of the AE to reduce finance costs of the Company by extending credit period has been considered.

#### **4.1.32 SCM Microsystems**

The Company is a wholly owned subsidiary of M/s. SCM Microsystem Group UK Ltd. The Company is engaged in prototype design development and related supported activities based on technical specifications and product ideas obtained from the affiliates. It also undertakes product development of smart

card and bio-metric readers. The activities of the Company include design, development and testing of ASICs, hardware and software. It also maintains the smart card and bio-metric products developed by third parties.

The Company entered into agreement with SCM Singapore for services and adopted TNMM to determine the ALP of the transaction. The TPO on the other hand made transfer pricing adjustment by adopting Cost Plus Method.

It is stated that Company is a wholly owned subsidiary of M/s. SCM Microsystem Group UK Ltd. The reference to the status of the Company in the group structure indicates that the ownership and control have been considered.

It is observed in the case that as per the agreement, compensation for the services rendered by the Company was to be calculated by adopting Cost Plus an appropriate mark-up. This indicates that contractual arrangements have been taken into account.

The Company has contended that the Company has taken financial data of 87 companies and to determine the gross margins of comparable companies on a reliable manner it is difficult as the accounting policies adopted by the comparable companies are inconsistent and entire details are not available in the public domain. This indicates that the availability of comparables has been considered in the case.

#### **4.1.33 Shandong Tijun Electronic Power Engg Company**

The Company is incorporated as per the laws of People's Republic of China and is engaged in the business of erection, testing and commission etc. of power plants. The Head Office (HO) of the Company entered into contract with Adani Power Limited (APL) and Jhajjar Power Limited (JPL). The project office of the Company which was the Permanent Establishment (PE) of the Company then entered into transactions with Shandong HO.

Shandong PE adopted CUP method for transactions with Shandong HO. The TPO on the other hand applied TNMM for determining the ALP and made transfer pricing adjustments.



The case states that the Company followed and complied with the Accounting Standard AS-7 issued by the ICAI and recognized the revenue as per the Percentage Completion Method on the basis of proportion of actual cost incurred to the total estimated cost of the contract. The Accounting Standards are non-tax regulations and this indicates that impact of non-tax regulatory factors is taken into account.

The case states that the entity assessed is a project office and that the management, capital and control of the permanent establishment is entirely in the hands of the head office. This indicates that ownership and control impact is considered.

The case states that the agreements are fixed price contract, in which the consideration for carrying out the services is included. This indicates that contractual arrangements have been considered.

It is stated in the case that since the project office operates in India under the conditions prevailing here and therefore Indian companies have been correctly taken as the comparable in this case by the TPO. On the other hand, the Company contends that TPO ought to have selected CUP as Most Appropriate Method over TNMM in view of availability of CUP of APL and JPL transaction with HO of the Company, more so when the transactions are functionally comparable. This indicates that availability of comparables impact the choice of transfer pricing method.

The Company has contended that it submitted bid for 30-40% of the amount than the other bidders. Further, the case states that it is not known whether the consideration agreed upon by HO was with any other objectives such as winning the contract by deliberately keeping the contract price low in order to get a foothold in Indian market. This indicates the presence of motive to enhance competitiveness has been considered.

The case states that for the purpose of computing Arm's Length Price, the basic thing which is to be examined that whether the Company has shifted the profits to its Associate Enterprises either directly charging less revenue or showing

excess cost to reduce the profits. This suggests that the presence of motive to ensure repatriation by shifting profits has been assessed.

It is also observed in the case that the Company has not submitted any details and the documents as called for in the notices issued during the proceedings. The presence of motive to ensure acceptability has been examined in the case.

#### **4.1.34 Skoda Auto India**

The Company is engaged in the business of manufacturing and selling passenger cars. The Company entered into transactions with AEs, Skoda Auto a/s, Czechoslovakia, and Volkswagen AG, Germany.

The transactions were mainly on account of purchase of materials and payment of royalty and technical know-how fees.

In the case, it is stated that in view of the accounting policy adopted by the Company, technical know-how was written off over a period of three years as a result of which profits of the Company were highly impacted. Further, the terms of contract, of the royalty arrangement, were duly approved by the Government of India, through the Secretariat of Industrial Assistance. RBI approval was given to the foreign collaboration. These indicate that non-tax regulatory factors and government policies have been considered.

It is stated that it is not that every time the Company pays the higher import duty, it must be passed on to the customers or it must be adjusted for in negotiating the purchasing price. Further, Company has also submitted that higher import content also had cascading effect on the customs duty. This indicates that customs duty being a tax regulation, other tax regulatory factors have been considered.

The case states that the Company has submitted that the basic cost of imported raw material was bound to be higher in view of high technology usage and involvement of higher labour costs as the concerned AE is in an EU (European Union) country. This indicates that external economic factors have been taken into account.

The case states that the imported raw material consumption was as high as 98.55 per cent. It was so for the reason that the Company wholly relied on the raw material imports from the AE for manufacturing purposes. This indicates that the control on account of total reliance on the AE has been considered in the case.

It is stated in the case that the TPO was of the view that out of six comparables relied upon by the Company, one comparable could not be accepted for want of availability of data for the relevant financial period and the preceding period. One of the comparables was rejected on the ground that it was the case of a company incurring sustained losses which indicated abnormality of circumstances with regard to that particular company. Further, when the TPO required the Company to submit data of the comparables, duly adjusted on account of variations pointed out by the Company, it was submitted by the Company that it is not possible to furnish the requisitioned information for the reason that such fine details of those comparables, as such an exercise would require, are not available in public domain. This indicates that the availability of comparables has been considered in the case.

The Company contended that in respect of the requisitioned information, the Company did make efforts to collect the data from corporate databases, web sites and other sources, but the Company could not succeed in these efforts. This indicates that presence of motive to ensure regulatory compliance has been examined.

The Company has contended that comparison with Hindustan Motors Ltd, Honda Sael Cars India Ltd., Hyundai Motors India Ltd. And Maruti Udyog Ltd., will be unjust as these companies are well established companies whereas the Company is a new entrant to Indian car market. It is also submitted that the Indian automobile industry is highly competitive and given this competition it is not always possible to pass on such duties to the customers. This indicates that the presence of motive to enhance competitiveness has been considered in the case.

It is stated in the case that it is ideally the parent company, which should have

taken the burden of such high duties. This indicates that motive to reduce finance cost of the Company by the parent company bearing the costs has been taken into account.

It is stated that the Company has not furnished details of royalty, including the cost incurred by the AE, i.e., the parent company, for developing the technology for which the Company has paid the royalty. The TPO requisition on the same, as also about the rate at which royalty was charged from other AEs by the parent company was turned down by stating that this information, which is treated as highly confidential by the parent company, is not available to the Company. This non-disclosure suggests the presence of motive to ensure control over intangible assets by the parent company has been considered.

The case states that the revenue has contended in the case that the Company has not co-operated in the first appellate proceedings. This indicates that the presence of motive to ensure acceptability has been examined in the case.

#### **4.1.35 SMA Nutrition India**

SMA Nutrition is wholly owned subsidiary of Nestle SA and is in the process of setting up distribution business of infant nutrition products.

The Company entered into transaction of Service Fee with its AE.

It is stated in the case that there is also no rule that if segmental accounts are certified by CA, the Assessing Officer should stop application of mind and follow it as a gospel truth. This indicates that the tax regulatory factors have been considered.

The case states that the TPO rejected the search conducted by the appellant and undertook a fresh search for comparable companies. This indicates that the availability of comparables have been considered.

The case states that SMA Nutrition is wholly owned subsidiary of Nestle SA. The reference to ownership structure indicates that ownership and control have been considered.

The transfer pricing dispute considers the segmental profitability. This indicates that presence of inter related functions have been examined.

It is stated in the case that during the course of assessment proceedings, the appellant vide submission dated April 18, 2019 furnished segment-wise employee details before the TPO. This indicates that presence of the motive to ensure acceptability has been considered.

#### **4.1.36 Toyoda Micromatic Machinery**

The Company is primarily engaged in the business of distribution in providing delivery and/or installation services of the machines tools and Company sold it directly or through third parties to the customers. The Company is jointly owned by a Japanese and an Indian company.

The Company entered into transaction of purchase of traded goods and was benchmarked by the Company adopting RPM. On the other hand, TPO adopted TNMM for determining ALP and making transfer pricing adjustments.

The case refers to the OECD transfer pricing guidelines. This indicates that other tax regulations have been taken into account.

The case states that the TPO has taken view in the case that the Company also incurred foreign exchange fluctuation loss and that in resale price method these expenses cannot be captured and it is necessary to consider all these expenses for proper comparability. Further, the same can be captured only when the transactional net margin method is used. This indicates that external economic factors such as foreign exchange fluctuation has impact on choice of transfer pricing methods.

It is stated in the case that the TPO accepted the filter suggested by the Company with respect to comparability and accordingly considered seven comparable companies. This indicates that the availability of comparables has been considered in the case.

The case states that the TPO accepted the filter for turnover suggested by the

Company on the grounds that the Company is a very small player in the industry in terms of sales turnover, turnover filter shall be allowed. This indicates that the presence of motive to ensure acceptability has been considered.

In the case, it is submitted that the Company has employed three expatriate employees whose total employee cost is high. Rational for having expatriate employees was said to be that the client of the Company is predominantly Japanese companies. This indicates that the presence of motive to enhance competitiveness by engaging expatriate employees to suit the requirement of the clients has been considered.

The case further states that it was submitted by the Company that one particular employee has the job requirement of providing training to customers and local staff over troubleshooting, application and maintenance of special-purpose cylindrical and crankshaft machines. It is also for coordination with Japan for warranty parts, technical support and arrangement for drawings as and when required. The rational for recruiting such a person was that for the machines that were supplied, skills for these machines were not available in India and therefore he was recruited as he was having a vast experience and superior capabilities. This indicates that the presence of motive of reducing costs of the Company by engaging the expatriate employee instead of developing a separate unit for after sale support and training personnel for the same has been considered in the case.

It was also submitted by the Company that a particular employee has the job requirement of after sale support to the machine users in India. This suggests that the presence of motive to honour commitments to the customers after sales by incurring salary expenditure of the expatriate employee has been taken into account.

#### **4.1.37 Toyota Kirloskar Motor**

The Company is a subsidiary of Toyota Motor Corporation, Japan and is in the business of manufacture and selling Multi Utility Vehicles under the model 'Innova and passenger cars under the model 'Camry' and 'Corolla'.

The Company entered into transactions with the Holding Company of purchase of spares and components, payment of royalty and import of Completely Built Units (CBU) and adopted TNMM as the most appropriate method by aggregating all activities. The TPO on the other hand held that manufacturing and trading activities cannot be combined under TNMM and also determined the ALP of royalty to be Nil.

The case states that the Company is a subsidiary of Toyota Motor Corporation, Japan. The reference to the ownership structure indicates that ownership and control have impact on the transfer pricing method.

It is stated that the Company had identified 7 comparables at the enterprise level by taking manufacturing segment as well as trading segment results of which the TPO accepted five companies as comparables. This indicates that the availability of comparables has been considered in the case.

The case states that the Company has submitted that the data in the public domain is not detailed enough to permit a comparison of the results at the transaction level and further that the data regarding comparable transactions are available only at the entity level and not at individual transaction level. This indicates that the presence of the motive of the Company to ensure acceptability has been considered.

The case states that the TPO on the OECD Guidelines for applying the filter. The reliance on OECD Guidelines being tax regulations indicates that tax regulatory factors have been considered in the case.

It is stated that with regard to equalizing efficiencies for comparability, TPO was of the view that the operational efficiency is indicated by how an enterprise controls its operating expenses other than cost of raw material and if an organization is able to control the indirect expenses like employee cost etc, its profitability improves. This indicates that the presence of motive to enhance competitiveness by efficiency has been considered.

The case states that the Company submitted that both the segments, manufacturing and trading, are intertwined and inter-related warranting a

“combined transaction approach”. Further it was also submitted that Company had adopted the TNMM at the entity level, in which process, the payment for royalty and other services were considered as closely linked transaction and hence was subsumed into the expenditure and accordingly already considered. This indicates that inter related functions impact the choice of transfer pricing method.

It was submitted that the Company has license to manufacture “Innova” and “Corolla” from Toyota Motor Corporation, Japan (TMC), which owns the above brands. This indicates that the presence of motive of the holding company to ensure control over the intangible assets has been considered.

The case states that the fact that the royalty rate was within the permissible limit specified by the Government of India and approved by the RBI is an additional argument in support of the legitimacy of the said payment. This indicates that government policies and non-tax regulatory factors have been considered in the case.

#### **4.1.38 Tractebel Engineering**

The company is a wholly-owned subsidiary of 'Suez Tractebel' SA Belgium and was engaged in providing engineering and project management consultancy services for gas projects, laying cross-country pipelines, city gas distribution and thermal and hydropower projects.

The case states that the 'AE' had subcontracted the contract to the Company on back-to-back basis on the price received from the customer i.e., Gas Authority of India Ltd. (GAIL), by the AE, in entirety. This indicates that contractual arrangement has impact on the transfer pricing method.

The case states that the Company has contended that it was not necessary that each and every expense would result into a benefit and the pricing of the services was dependent on several factors like cost of manufacture or service providers, availability of close competitor in the market and demand and supply relationship. This indicates that the presence of motive to enhance competitiveness has been considered.



It is stated that the company is a wholly-owned subsidiary. The reference to the ownership structure indicates that the ownership and control have been considered in the case.

#### **4.1.39 Trilogy E-Business Software India**

The Company provides software research & development services for Versata International Inc. on a contract basis and as requested by Versata International Inc. M/s. Versata International Inc., USA holds the entire share capital of the Company.

The Company provided software research & development support services to its AE and was remunerated on a cost plus basis.

The case states that Versata International Inc., USA holds the entire share capital of the Company. This indicates that ownership and control have been considered.

The case states that the Company before the TPO had also given some other additional comparables. This indicates the presence of motive to ensure acceptability.

The case states that the TPO on his own, on a search carried on in Prowess Database arrived at a set of 18 comparables over and above the 8 comparables relied upon by the Company in its TP study, which the TPO accepted were comparable. Thus, the TPO arrived at a set of 26 comparables. This indicates that availability of comparables has been considered.

The case draws reference to the ICAI TP guidance note on this aspect as laid down in para 15.4 that a transaction entered into by a Rs. 1,000 crore company cannot be compared with the transaction entered into by a Rs. 10 crore company. This indicates that tax regulatory factors such as the guidance note has been considered.

#### **4.1.40 UCB India**

The Company is a 100 per cent subsidiary of UCB S.A., Belgium and is engaged in the business of manufacture and marketing of prescription drugs in

the therapeutic areas of allergy and asthma, central nervous system and internal medicine.

The Company entered into transaction of import of raw material being two active pharmaceutical ingredients (API) from its Parent Company and adopted TNMM to determine the ALP of the transaction. The TPO on the other hand adopted CUP method to arrive at the ALP of the transaction.

It is stated that the Company is a 100% subsidiary. The reference to the ownership structure indicates that ownership and control have been considered.

Further it is submitted that the parent company supplies the two APIs to other group entities as well as to third parties in different countries but it expressed its difficulty in furnishing the information on price charged, etc. on the ground that it is not in the possession of more details and being a 100 per cent subsidiary, it would not be possible for it to obtain the said information from its parent company. This indicates that the presence of motive of the parent company to ensure control over its assets has been considered in the case.

It is stated in the case that the TPO observed that there is no information on the database to identify other licensed manufactures though the Company, classified as a licensed manufacturer with less than normal risk. Further, the revenue has drawn reference to the second schedule to the Drugs and Cosmetics Act, 1940 and submitted that the law requires that imported drugs should comply with standards of purity and strength specified therein. The case states that the revenue has drawn reference to the guidelines for Bioavailability and Bioequivalence Studies issued by the Government of India. This suggests that non-tax regulatory factors and Government policies have been considered in the case.

In the case, it is submitted by the Company that that there is no statutory requirement to maintain segmental data or the cost relating to different products. This indicates that non-tax regulatory factors such as accounting standards have been considered.

It is stated that the Company identified thirty-six companies, which according to the Company, fit into the criteria of companies engaged in similar business activity. This indicates that availability of comparables have been taken into account in the case.

The case also states that Company has undertaken a search in the “Prowess Database” and identified companies engaged in the manufacture of drugs, medicines and allied products. This indicates that the presence of motive to ensure acceptability by using a database has been considered.

The case states that reliance was placed on the OECD Guidelines to contend that the tax department should not ask for details that would not otherwise be prepared or available with the Company. The reliance on OECD Guidelines indicates the impact of tax regulatory factors in the case.

It is submitted that the transfer price is fixed in a manner so as to ensure that the overseas entity earns an adequate return for the functions performed by it and the risk assumed. Certain portion of the price was also attributable to indigenous and patents which vested with the AE. Reference was also made to the past and ongoing investments in these intangibles. Further the Company also submitted that the purchase price of the raw material is also to compensate the AE for the R&D costs incurred by it for the development of this molecule and to give a reasonable return on the AE’s ownership of intangibles, patents, and registration for this product. This indicates that the presence of motive to ensure control over intangible assets by the parent company has been examined.

It is stated in the case that the Company has submitted that after an evaluation of the market situation, the import prices were revised downwards and reason provided is reduction in prices to be due to appreciation of Euros against rupees. This indicates that external economic factors such as market situation and foreign exchange fluctuation have been considered.

Further, it is stated in the case that it is common knowledge that Chinese goods are flooding international markets with a very low pricing. It is also true that

the quality of these products is not rated by independent bodies to enable comparison in some cases. This indicates that external economic factors and availability of comparables have been taken into account in the case.

#### **4.1.41 Vistaar Systems**

The Company is a global B2B infrastructure provider, investing and incubating several neutral e-market places, technology companies and service providers in the B2B space (Internet E-commerce and software development). Vistaar provided technology and operational support to Vistaar Technologies Inc. on various projects for the shipping, chemical industry and software development services for building enterprise products.

The case states the CUP analysis undertaken by the Company fails in the present scenario due to lack of strict comparability between the uncontrolled transaction and the Company's international transactions. This indicates that availability of comparables impact the choice of transfer pricing method.

The case states that the Company submitted that it is developing specified software which only the AE can use and none else. The Company referred to the contract between the parties and submitted that it is clearly provided therein that what will be charged is the prevailing market rate. This indicates that contractual arrangement has been considered.

#### **4.1.42 Wrigley India**

The Company was set up in India in October 1993 as a wholly owned subsidiary of the legendary William Wrigley Jr Co, USA (Wrigley USA, in short) founded in 1891 and is thus part of a large network of business entities associated with Wrigley USA (collectively referred as Wrigley group) - world's largest manufacturer and marketers of chewing gum and with its network in more than 180 countries. The Company is engaged in the manufacture and sale of confectionary products like chewing gums, bubble gum lollipops and toffees.

The Company entered into transaction of contract manufacturing with the AE.

It is stated in the case that the Company was set up in India in October 1993 as a wholly owned subsidiary. The reference to the ownership structure indicates that ownership and control have been considered.

The case states that the Company produced and marketed its products in India and since the Company could not utilize its entire production capacity, the Company also produced the same products for its AEs abroad. This indicates that the presence of motive of the Company to enhance competitiveness has been considered.

The case states that the Company selected eight comparables. Since the information for the financial year was not readily available and since the TP regulations permit use of data for up to two years prior to the relevant financial year, the financial information for the comparable companies was included for earlier years. This indicates that availability of comparables been considered.

The case states that a reference was made to the OECD Transfer Pricing Guidelines in support of the contention that while 'margin costing method' is not recognized by the Indian TP regulations. Reference is also drawn to UN Transfer Pricing Manual. This indicates that tax regulatory factors have been considered.

#### **4.1.43 Zimmer India**

The Company is a wholly owned subsidiary of Zimmer Switzerland Holdings Ltd., Switzerland. The company is primarily engaged in the business of importing, marketing and distributing Zimmer orthopaedic implant and instruments to customers in India through direct sales and also through a network of dealers.

The Company entered into transaction of purchase of hip, knee and trauma implants and instruments and reimbursements. The ALP was determined using TNMM. The TPO noted high advertising and marketing promotion expenditure and computed ALP adjustment related to Advertising, Marketing and Promotion (AMP) expenditure.

It is stated that the Company is a wholly owned subsidiary of Zimmer

Switzerland Holdings Ltd., Switzerland. The reference to the structure indicates that the ownership and control have impact on the transfer pricing method.

It is stated in the case that the marketing strategy followed by the Company was to sell its products through three principal channels, viz. hospitals, distributors and dental practices/ laboratories and after considering the same, this indicated that the expenses incurred in connection with the sale channels, like sales commissions, discounts etc. were also relevant to the issue of evaluating AMP expense. This indicates that motive to enhance competitiveness has been considered in the case.

It is stated in the case that the TPO has considered that the AMP expenditure led to creation of marketing intangible benefiting the AE. Thus, the Company has incurred expenditure instead of the AE indirectly resulting in funds remaining in the AE. This indicates that the motive to ensure repatriation is considered.

The TPO has stated that the performance of this function clearly benefits the brands and market intangibles owned by the parent company. This indicates that the presence of motive to ensure control over intangible assets is taken into account.

It is stated in the case that the comparables selected by Company in its TP study for benchmarking the distribution activity were accepted by the TPO applying TNMM but for benchmarking AMP expenditure, the TPO selected different comparables. This indicates presence of motive to ensure acceptability by the Company and availability of comparables has been considered in the case.

## **4.2 Derivation of variables for quantitative analysis**

The factors and the motives as collated from literature review were coded as specified in Section 3.3.1. The case law was converted into MS Word document format. Thereafter, in-depth reading was done and the statements

were marked with comment containing the aforementioned code wherein the factor or motive as identified was noted. Similar statements or repetitive remarks on same issue were ignored.

Thereafter, the MS Word document is run through “Spyder”. Spyder is a free and open-source scientific environment written in Python, for Python, and designed by and for scientists, engineers and data analysts. It features a unique combination of the advanced editing, analysis, debugging, and profiling functionality of a comprehensive development tool with the data exploration, interactive execution, deep inspection, and visualization capabilities of a scientific package.

The code extracts comments and exports the same in “.csv” format to enable further data analysis using Excel. After converting the comments / code into values in Excel (refer Section 3.3.2), the data is transmitted to SPSS for quantitative analysis using logistic regression.

# Chapter 5

## Findings, theoretical contributions, managerial implications and future research issues

This Chapter presents the research findings according to the objectives along with the corresponding hypothesis followed by the theoretical contributions from the research. The revised conceptual model based on the findings is presented. The theoretical contributions of this research are building of an inclusive model on antecedents of transfer pricing methods, revealing motives as mediators between transfer pricing factors and methods, inclusion of tangible and intangible components, identifying availability of comparables as an additional factor and presenting mediation of management motives in support of Resource Based View which is explained. Thereafter, managerial implications of this research and future research issues are presented.

### 5.1 Quantitative findings

#### 5.1.1 Findings according to objectives

##### **Findings according to the objectives of the study along with corresponding hypothesis**

Objectives of the study are reproduced here below:

1. To study the transfer pricing factors, transfer pricing motives and transfer pricing methods of tangible and intangible transactions.
2. To study the relationship between transfer pricing factors and choice of transfer pricing method.
3. To study the relationship between transfer pricing motives and choice of transfer pricing method.
4. To study the relationship between transfer pricing factors and motives



taken together and choice of transfer pricing method.

5. To study whether transfer pricing motives mediate the relationship between the transfer pricing factors and choice of transfer pricing method
6. To study whether type of transaction moderates the relationship between the transfer pricing motives and choice of transfer pricing method

### **5.1.2 Findings of objective 1**

#### **To study the transfer pricing factors, transfer pricing motives and transfer pricing methods of tangible and intangible transactions**

The factors and motives listed as per literature were found to be present in the cases analysed. Additionally, one external factor, i.e., availability of comparables was added to the list of factors. The factors and motives of earlier researchers were collated and classified based on the scope of this research. Factors were classified as internal and external factors. (See Table 2.1) and motives were classified as regulatory and management (See Table 2.2).

### **5.1.3 Findings of objective 2**

#### **To study the relationship between transfer pricing factors and choice of transfer pricing method**

Corresponding hypothesis:

H1. There is a significant relationship between transfer pricing factors and choice of transfer pricing method

H1. Independent Variables = Factors, Dependent Variable = Method

Table 5.1: Omnibus Test of Model Coefficients – H1

	Chi-square	df	Sig.
Step	15.275	8	.054
Step 1 Block	15.275	8	.054
Model	15.275	8	.054

Table 5.2: Model Summary – H1

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	38.793	.225	.378

Table 5.3: Hosmer and Lemeshow Test – H1

Step	Chi-square	df	Sig.
1	3.605	7	.824

Table 5.4: Classification Table – H1

Observed	Predicted		
	TP Method		Percentage Correct
	Non Market Method	Market Method	
TP Method Non Market Method	48	2	96.0
TP Method Market Method	6	4	40.0
Overall Percentage			86.7

Findings: H1 – There is a 22.5% (Cox & Snell R Square) to 37.8% (Nagelkerke R Square) probability that change in factors will correctly explain the variance in methods 86.7% of times (Classification Table). Hosmer and Lemeshow Test shows goodness of fit with Sig. 0.824. Hence, there is a significant relationship between transfer pricing factors and choice of transfer pricing method.

### 5.1.4 Findings of objective 3

#### To study the relationship between transfer pricing motives and choice of transfer pricing method

Corresponding hypothesis:

H2. There is a significant relationship between transfer pricing motives and choice of transfer pricing method

H2. Independent Variables = Motives, Dependent Variable = Method

Table 5.5: Omnibus Tests of Model Coefficients – H2

	Chi-square	df	Sig.
Step	27.312	8	.001
Step 1 Block	27.312	8	.001
Model	27.312	8	.001

Table 5.6: Model Summary – H2

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	26.755	.366	.616

Table 5.7: Hosmer and Lemeshow Test – H2

Step	Chi-square	df	Sig.
1	.000	7	1.000

Table 5.8: Classification Table – H2

Observed		Predicted			
		TP Method		Percentage Correct	
		Non Market Method	Market Method		
Step 1	TP Method	Non Market Method	45	5	90.0
		Market Method	3	7	70.0
Overall Percentage					86.7

Findings: There is a 36.6% (Cox & Snell R Square) to 61.6% (Nagelkerke R Square) probability that change in motives will correctly explain the variance in methods 86.7% of times (Classification Table). Hosmer and Lemeshow Test shows goodness of fit with Sig. 1.000. Hence, there is a significant relationship between transfer pricing motives and choice of transfer pricing method.

**To study the relationship between regulatory motives and choice of transfer pricing method**

Corresponding hypothesis:

H2a. There is a significant relationship between regulatory motives and choice

of transfer pricing method

H2a. Independent Variables = Regulatory Motives, Dependent Variable = Method

Table 5.9: Omnibus Tests of Model Coefficients – H2a

	Chi-square	df	Sig.
Step	13.727	4	.008
Step 1 Block	13.727	4	.008
Model	13.727	4	.008

Table 5.10: Model Summary – H2a

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	40.340	.205	.344

Table 5.11: Hosmer and Lemeshow Test – H2a

Step	Chi-square	df	Sig.
1	.000	2	1.000

Table 5.12: Classification Table – H2a

Observed	Predicted		
	TP Method		Percentage Correct
	Non Market Method	Market Method	
Non Market Method	48	2	96.0
Market Method	8	2	20.0
Overall Percentage			83.3

H2a - There is a 20.5% (Cox & Snell R Square) to 34.4% (Nagelkerke R Square) probability that change in regulatory motives will correctly explain the variance in methods 83.3% of times (Classification Table). Hosmer and Lemeshow Test shows goodness of fit with Sig. 1.000. Hence, there is a significant relationship between regulatory motives and choice of transfer

pricing method.

**To study the relationship between management motives and choice of transfer pricing method**

Corresponding hypothesis:

H2b. There is a significant relationship between management motives and choice of transfer pricing method

H2b. Independent Variables = Management Motives, Dependent Variable = Method

Table 5.13: Omnibus Tests of Model Coefficients – H2b

	Chi-square	df	Sig.
Step	13.684	4	.008
Step 1 Block	13.684	4	.008
Model	13.684	4	.008

Table 5.14: Model Summary – H2b

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	40.384	.204	.343

Table 5.15: Hosmer and Lemeshow Test – H2b

Step	Chi-square	df	Sig.
1	.000	3	1.000

Table 5.16: Classification Table – H2b

Observed		Predicted		
		TP Method		Percentage Correct
Step 1 Method		Non Market Method	Market Method	
		Non Market Method	50	0
	Market Method	10	0	.0
Overall Percentage				83.3

H2 b - There is a 20.4% (Cox & Snell R Square) to 34.3% (Nagelkerke R Square) probability that change in management motives will correctly explain the variance in methods 83.3% of times (Classification Table). Hosmer and Lemeshow Test shows goodness of fit with Sig. 1.000. Hence, there is a significant relationship between management motives and choice of transfer pricing method.

### 5.1.5 Findings of objective 4

**To study the relationship between transfer pricing factors and motives taken together and choice of transfer pricing method.**

Corresponding hypothesis:

H3. There is a significant relationship of factors and motives with transfer pricing method

H3. Independent Variables = Factors + Motives, Dependent Variable = Method

Table 5.17: Omnibus Tests of Model Coefficients – H3

	Chi-square	df	Sig.
Step	40.153	16	.001
Step 1 Block	40.153	16	.001
Model	40.153	16	.001

Table 5.18: Model Summary – H3

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	13.914	.488	.822

Table 5.19: Hosmer and Lemeshow Test – H3

Step	Chi-square	df	Sig.
1	.546	7	.999

Table 5.20: Classification Table – H3

Observed	Predicted
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		TP Method		Percentage Correct
		Non Market Method	Market Method	
Step 1	TP Non Market Method	47	3	94.0
	Method Market Method	3	7	70.0
Overall Percentage				90.0

Findings: There is a 48.8% (Cox & Snell R Square) to 82.2% (Nagelkerke R Square) probability that change in factors + motives will correctly explain the variance in methods 90% of times (Classification Table). Hosmer and Lemeshow Test shows goodness of fit with Sig. 0.999. There is a significant relationship of factors and motives with transfer pricing method.

### 5.1.6 Findings of objective 5

**To study whether transfer pricing motives mediate the relationship between the transfer pricing factors and choice of transfer pricing method**

Corresponding hypothesis:

H4 Transfer pricing motives mediate the relationship between transfer pricing factors and choice of transfer pricing method

H4. Testing For mediation motives

Table 5.21: Testing for mediation

Sr. No.	Independent Variable	Dependent Variable	Nagelkerke R Square
1.	Factors – H1	Methods	.378
2.	Motives – H2	Methods	.616
3.	Factors + Motives – H3	Methods	.822

Findings: The Nagelkerke R Square between factors and methods increases from from 37.8% to 82.2% after including motives. The Nagelkerke R Square between motives and methods increases from from 61.6% to 82.2% after including factors. As the increase in Nagelkerke R Square from regression of factor and methods is higher when motives are included, i.e from 37.8% to

82.2%, it is concluded that motives are mediating variables between factors and methods.

**To study whether regulatory motives mediate the relationship between external factors and choice of transfer pricing method**

Corresponding hypothesis:

H4a - Regulatory transfer pricing motives mediate the relationship between external factors and choice of transfer pricing method

H4a - Testing for mediation of regulatory motives

**Step 1: Binary logistic regression of External Factors to Methods**

Table 5.22: Omnibus Tests of Model Coefficients – H4a – External Factors to Methods

		Chi-square	df	Sig.
Step 1	Step	3.654	5	.600
	Block	3.654	5	.600
	Model	3.654	5	.600

Table 5.23: Model Summary – H4a– External Factors to Methods

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	50.414	.059	.099

Table 5.24: Hosmer and Lemeshow Test – H4a– External Factors to Methods

Step	Chi-square	df	Sig.
1	.000	3	1.000

**Step 2: Binary logistic regression of Regulatory Motives to Methods**

Table 5.25: Omnibus Tests of Model Coefficients – H4a - Regulatory Motives to Methods



		Chi-square	df	Sig.
Step 1	Step	13.727	4	.008
	Block	13.727	4	.008
	Model	13.727	4	.008

Table 5.26: Model Summary - H4a - Regulatory Motives to Methods

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	40.340	.205	.344

Table 5.27: Hosmer and Lemeshow Test - H4a - Regulatory Motives to Methods

Step	Chi-square	df	Sig.
1	.000	2	1.000

### Step 3: Binary logistic regression of External Factors + Regulatory Motives to Methods

Table 5.28: Omnibus Tests of Model Coefficients – H4a - External Factors + Regulatory Motives to Methods

		Chi-square	df	Sig.
Step 1	Step	15.346	9	.082
	Block	15.346	9	.082
	Model	15.346	9	.082

Table 5.29: Model Summary - H4a - External Factors + Regulatory Motives to Methods

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	38.722	.226	.380

Table 5.30: Hosmer and Lemeshow Test – H4a - External Factors + Regulatory

Motives to Methods

Step	Chi-square	df	Sig.
1	.767	6	.993

**Step 4: Multinomial Logistic Regression of External Factors to Regulatory Motives**

Table 5.31: Model Fitting Information – H4a – External Factors to Regulatory Motives

Model	Model Fitting Criteria	Likelihood Ratio Tests		
	-2 Log Likelihood	Chi-Square	df	Sig.
Intercept Only	79.705			
Final	1447898.149		20	

Table 5.32: Pseudo R-Square – H4a – External Factors to Regulatory Motives

Cox and Snell	0.000
Nagelkerke	0.000
McFadden	0.000

Table 5.33: Likelihood Ratio Tests – H4a – External Factors to Regulatory Motives

Effect	Model Fitting Criteria	Likelihood Ratio Tests		
	-2 Log Likelihood of Reduced Model	Chi-Square	df	Sig.
Intercept	1447898.149	0.000	0	
TEF	79.705		20	

Table 5.34: Testing for Mediation – H4a – External Factors to Regulatory Motives

Sr. No.	Independent Variable	Dependent Variable	Nagelkerke R Square
1.	External Factors	Methods	.099
2.	Regulatory Motives	Methods	.344
3.	External Factors + Regulatory Motives	Methods	.380
4.	External Factors	Regulatory Motives	.000

Findings: The multinomial regression does not show significant relationship of external factors and regulatory motives. It can thus be concluded that regulatory motives are not mediating variables between external factors and transfer pricing methods.

**To study whether management motives mediate the relationship between the internal factors and choice of transfer pricing method**

Corresponding hypotheses:

H4 b. Management motives mediate the relationship between internal transfer and choice of transfer pricing method

H4 b - Testing for mediation of management motives

**Step 1: Binary logistic regression of internal factors to methods**

Table 5.35: Omnibus Tests of Model Coefficients – H4b - Internal Factors to Methods

	Chi-square	df	Sig.
Step 1 Step	12.341	3	.006
Block	12.341	3	.006
Model	12.341	3	.006

Table 5.36: Model Summary – H4b - Internal Factors to Methods

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	41.727	.186	.313

Table 5.37: Hosmer and Lemeshow Test– H4b - Internal Factors to Methods

Step	Chi-square	df	Sig.
1	.000	2	1.000

**Step 2: Binary logistic regression of Management Motives to Methods**

Table 5.38: Omnibus Tests of Model Coefficients – H4b - Management Motives to Methods

		Chi-square	df	Sig.
Step 1	Step	13.684	4	.008
	Block	13.684	4	.008
	Model	13.684	4	.008

Table 5.39: Model Summary – H4b - Management Motives to Methods

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	40.384	.204	.343

Table 5.40: Hosmer and Lemeshow Test – H4b - Management Motives to Methods

Step	Chi-square	df	Sig.
1	.000	3	1.000

**Step 3: Binary logistic regression of Internal Factors + Management Motives to Methods**

Table 5.41: Omnibus Tests of Model Coefficients - H4b - Internal Factors +

### Management Motives to Methods

		Chi-square	df	Sig.
Step 1	Step	19.269	7	.007
	Block	19.269	7	.007
	Model	19.269	7	.007

Table 5.42: Model Summary- H4b - Internal Factors + Management Motives to Methods

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	34.799	.275	.463

Table 5.43: Hosmer and Lemeshow Test- H4b - Internal Factors + Management Motives to Methods

Step	Chi-square	df	Sig.
1	5.623	8	.689

### Step 4: Multinomial Logistic Regression of Internal Factors to Management Motives

Table 5.44: Model Fitting Information – H4b - Internal Factors to Management Motives

Model	Model Fitting Criteria	Likelihood Ratio Tests		
	-2 Log Likelihood	Chi-Square	df	Sig.
Intercept Only	71.366			
Final	28.910	42.456	12	.000

Table 5.45: Pseudo R-Square - H4b - Internal Factors to Management Motives

Cox and Snell	.507
Nagelkerke	.532
McFadden	.230

Table 5.46: Likelihood Ratio Tests - H4b - Internal Factors to Management Motives

Effect	Model Fitting Criteria	Likelihood Ratio Tests		
	-2 Log Likelihood of Reduced Model	Chi-Square	df	Sig.
Intercept	28.910	0.000	0	
TIF	71.366	42.456	12	.000

Table 5.47: Testing for Mediation - H4b - Internal Factors to Management Motives

Sr. No.	Independent Variable	Dependent Variable	Nagelkerke R Square
1.	Internal Factors	Methods	.313
2.	Management Motives	Methods	.344
3.	Internal Factors + Management Motives	Methods	.463
4.	Internal Factors	Management Motives	.532

Findings: The multinomial regression shows Nagelkerke R Square of 53.2% which indicates significant relationship of internal factors and management motives. The Nagelkerke R Square between internal factors and methods increased from 31.3% to 46.3% after including management motives. The Nagelkerke R Square between management motives and methods increased from 34.4% to 46.3% after including internal factors. As the increase in Nagelkerke R Square from regression of internal factors and methods is higher when management motives are included, i.e., from 31.3% to 46.3%, it is

concluded that motives are mediating variables between factors and methods.

### 5.1.7 Findings of objective 6

**To study whether type of transaction moderates the relationship between the transfer pricing motives and choice of transfer pricing method.**

Corresponding hypothesis:

H5 Transaction type moderates the relationship between motives and methods

H5 Testing for whether transaction type moderates the relationship between motives and methods

Logistic regression of the interaction variable (motive with transaction type after normalizing) with the method

Table 5.48: Omnibus Tests of Model Coefficients – H5 – Motives to Methods

	Chi-square	df	Sig.
Step	5.666	1	.017
Step 1 Block	5.666	1	.017
Model	5.666	1	.017

Table 5.49: Model Summary

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	48.402	.090	.152

Findings: Transaction type does not moderate the relationship between motives and methods as there is only 9% to 15.2% probability that change in interaction of motive and transaction type will correctly explain the variance in the method.

## 5.2 Summary of hypotheses testing

Table 5.50: Hypotheses testing results

Hypothesis	Description	Result
<b>H1</b>	Relationship between factors and method	Hypothesis supported

<b>H2</b>	Relationship between motives and method	Hypothesis supported
<b>H2a</b>	Relationship between regulatory motives and method	Hypothesis supported
<b>H2b</b>	Relationship between management motives and method	Hypothesis supported
<b>H3</b>	Motives mediate between factors and method	Hypothesis supported
<b>H4a</b>	Regulatory motives mediate between external factors and method	Hypothesis not supported
<b>H4b</b>	Management motives mediate between internal factors and method	Hypothesis supported
<b>H5</b>	Transaction type moderate between motives and method	Hypothesis not supported

### 5.3 Summary of findings

1. The factors and motives listed as per literature were found to be present in the cases analysed. Additional factor being availability of comparables was found.
2. There is a significant relationship between transfer pricing factors and choice of transfer pricing method.
3. There is a significant relationship between transfer pricing motives and choice of transfer pricing method.
  - a. There is a significant relationship between regulatory motives and choice of transfer pricing method.
  - b. There is a significant relationship between management motives and choice of transfer pricing method.
4. Motives are mediating variable between factors and methods.
  - a. Regulatory motives are not mediating variables between external factors and methods.
  - b. Management motives are mediating variables between internal factors and methods.



- Transaction type does not moderate the relationship between motives and methods.

## 5.4 Revised conceptual models

The proposed conceptual model was revised based on the above findings.

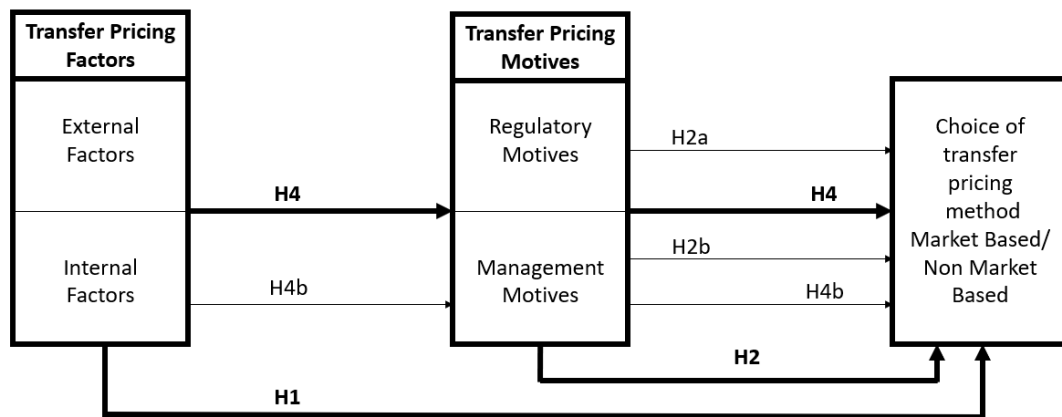


Figure 5.1: Revised conceptual model 1

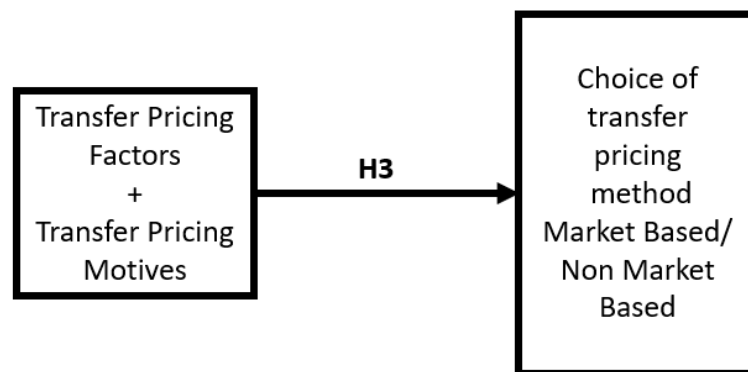


Figure 5.2: Revised conceptual model 2

## 5.5 Qualitative findings

The findings from case analysis are as follows:

- The case analysis revealed that a total of 138 external factors were

identified in the transactions analysed as against 100 internal factors identified. Accordingly, prevalence of external factors was higher than internal factors.

2. Among the external factors, availability of comparables was found to be the dominant factor with 54 occurrences followed by tax regulatory factors which were identified in 33 transactions. Among the internal factors, ownership and control was found to be the dominant factor which was identified in 46 transactions.
3. The dominance of availability of comparables among external factors is on account of the fact that market based method, i.e., the CUP method requires comparables of highly similar transactions. When the Company is unable to obtain data of such transactions, they turn to non-market based methods such as TNMM. However, the availability of comparables for benchmarking the PLI by identifying comparable entities still remains an issue in transfer pricing disputes.
4. The prominence of ownership and management as the foremost internal factor stems from the fact that the MNEs involved determine the transfer pricing policy for the related AE based on the structure of ownership such as joint venture or subsidiary and based on percentage of holding and control over the AE. In case of 100% subsidiaries, the MNEs generally adopt group policies which are considered in the transfer pricing policy.
5. The case analysis also revealed that a total of 108 regulatory motives were identified in the transactions analysed as against 112 management motives. Accordingly, prevalence of management motives was higher than regulatory motives. This is on account of the fact that the MNEs need to focus on making the product attractive in the location of the market and at the same time ensure the viability of the business. The regulatory motives could sometimes assume lower importance in such circumstances. For instance, the Company may have motive to enhance competitiveness and may end up selling products at lower costs as the

motive to ensure repatriation may not be considered significant.

6. Among regulatory motives, the motive to ensure acceptability was found to be the foremost motive with 51 occurrences. Among the management motives, the motive to enhance competitiveness was found to be the dominant motive which was identified in 41 transactions followed by the motive to ensure control over assets which was identified in 32 transactions. The motive to ensure acceptability holds dominance on account of the fact that transfer pricing is a policy and needs a benchmark and justification.
7. There was no difference observed in the occurrence of factors and motives between different transaction types. This was revealed in the cases where it was observed that the transactions in tangibles and other than tangibles were often inter related and the choice of transfer pricing was non market based after taking into account the aggregate margins. This was also confirmed in the quantitative analysis while testing the hypothesis H5 – that transaction type does not moderate the relationship between motives and methods.
8. The mere presence of factors does not necessarily impact the choice of transfer pricing method unless there is a motive. For instance, it was observed in the case analysis that the motive to ensure acceptability was identified in the case of RAK Ceramics. Though Company adopted TNMM, the Company also undertook an alternative analysis under comparable uncontrolled price method (CUP) by bringing in three comparables. Though comparables were available for adoption of TNMM, the motive to ensure acceptability had an impact on transfer pricing method. This is also confirmed in the quantitative analysis that motives mediate between factors and methods in the testing of hypotheses H4.
9. It was also observed in the case analysis of UCB India wherein the Company expressed its difficulty in furnishing the information on price charged, etc. on the ground that it is not in the possession of more details

and being a 100 per cent subsidiary, it would not be possible for it to obtain the said information from its parent company. This indicates that though the control and ownership being an internal factor impacts the choice of transfer pricing method, the motive to ensure control over the assets by the parent company by not sharing information mediates the impact. This is also confirmed in the quantitative analysis that the management motives mediate between internal factors and the choice of transfer pricing method in the testing of hypothesis H4b.

10. The case analysis also pointed out that external factors are not affected by regulatory motives as the Company is mandated by statutes for compliance of the same. Hence, if an external factor exists, the same impacts the transfer pricing choice even in the absence of regulatory motive. This is also confirmed in the quantitative analysis that the regulatory motives do not mediate between external factors and the choice of transfer pricing method in the testing of hypothesis H4b.

## **5.6 Theoretical contributions**

The theoretical contributions from this research are presented below:

### **5.6.1 Building of an inclusive model on antecedents of transfer pricing methods**

Reese et al. (1989) observed that the survey results from studies by Kim and Miller (1979), Burns (1980) and Tang (1980) predominantly listed and ranked various external factors affecting transfer pricing policies and Yunker (1983) listed and ranked internal factors and motives affecting transfer pricing policies. The research on transfer pricing further progressed in establishing a relationship between transfer pricing methodology and the factors and motives taken together, without separate identification of factors and motives (Ho, 2009). Doğan et al. (2013) has found the relationship between transfer pricing methodology and external factors.

Lin and Chang (2010) studied the internal and external motivations for transfer pricing manipulation by Multi National Enterprises and the pricing strategy

under different motives. The motives comprised (a) External Motives which included reducing global tax, indirect taxes and tariffs, risk of foreign exchange fluctuations and political risk; increasing of profits and capital assets; avoiding controls at local level and ensuring repatriation of funds and (b) Internal Motives which included assisting joint ventures and supporting subsidiaries apart from making the entity competitive. Thus, transfer pricing motives were related to transfer pricing policies by differentiating between internal and external motives. The above literature demonstrates that the transfer pricing methods were related separately with factors and motives or by pooling them together, by earlier researchers. The present research comprehensively built a model linking both factors and motives to the transfer pricing methods, duly classified. Thus, the research builds a larger and inclusive perspective to the research agenda on antecedents of transfer pricing.

### **5.6.2 Motives as mediators between transfer pricing factors and methods**

The literature review did not reveal any attempts by earlier researchers to investigate into the mediation effect of motives between factors and methods of transfer pricing. Thus, establishing that motives mediate between factors and methods of transfer pricing is a unique primary contribution of this research.

Further, the motives were classified as regulatory and management motives. The research established that management motives mediate between internal factors and methods. Thus, research brings to the fore the significance of management motives which are responsible to augment the impact of internal factors on the transfer pricing method.

This research thus carried forward the research on motives by Lin and Chang (2010) by establishing that motives are mediators between factors and methods.

### **5.6.3 Inclusion of transfer pricing transactions with tangible and intangible components**

Gupta (2012) recommended as future research an elaborate exercise by including the impact of intangible assets on transfer pricing manipulations. Accordingly, this research included a variable namely type of transaction covering transactions relating to tangible as well as intangible components. However, the findings revealed that the type of transaction did not moderate the relationship between motives and methods. This has been explained by findings of qualitative analysis (refer Sr. No. 7 in 5.3 Qualitative Analysis) mainly due to presence of composite transactions in many cases of transfer pricing.

#### **5.6.4 Identification of availability of comparables as an additional factor**

The research on antecedents of transfer pricing methods is seen to have more emphasis on external factors. Taxes in home countries, tariffs and customs duties, penalties, incentives and regulations, competition and market conditions have been listed as external factors by Reese et al. (1989) and Ho (2009).

Sikka and Willmott (2010) has identified location of holding company as an external factor. One of the concerns raised is the poor selection of comparables based on geographical proximity, instead of considering country risk (Steens et al., 2022). The literature thus points out that the extant practice of determination of market price based on location may not be appropriate. Thus, proper availability of comparables remains the major impetus for selection of method, particularly the market-based method. The earlier literature had not included “availability of comparables” as a factor affecting the choice of transfer pricing method. The qualitative analysis of the cases has demonstrated that this has often been the prime factor affecting the choice of method (refer Sr. No. 3 in 5.3 Qualitative Analysis).

Applying the arm’s length principle involves an appraisal of whether the transfer price adopted by a multinational is consistent with the price adopted by independent parties in a benchmark transaction conducted at arm’s length. A transaction (or transactions) involving an independent firm has to be

identified as a basis for comparison. However, given the diversity prevalent in different business context, the transactions being identical is a rarity. Hence, the notion of comparability is fundamental. The differences in transactions may be due to product differentiation, differences in contractual terms, differences across economic circumstances and so on. Hence, arriving at a proper analysis of the differences across transactions will be paramount for deciding transfer price. This has been brought out by the current research.

### **5.6.5 Mediation of management motives in support of Resource Based View (RBV) as against Transaction Cost Economics (TCE)**

RBV posits that the entity can create value from pooling of resources such as tangible and intangible assets by aggregating, sharing, and exchanging valuable resources. RBV thus focuses on strategic value maximisation through effective use of resources, whereas TCE focuses on transaction costs. Traditionally recommended OECD procedures support TCE view based on availability of comparables, though there is admission of difficulty to obtain comparables. Partial recognition of the issue of availability of comparables is evident as OECD recommends markups on comparables. This is a view of pricing based on individual entity concept.

This research has found that Management Motives mediate between Internal Factors and Transfer Pricing Method. The MNE level motives such as to enhance competitiveness, to simplify application and to ensure control over tangible and intangible assets dominate given the internal factors such as ownership and control, contractual arrangements and inter related functions. Thus, this research seems to support the RBV that a broad-based approach from the perspective of all stakeholders needs to be adopted wherein factors beyond those beneficial to a single entity need to be considered while evaluating the transfer pricing method adopted. (Kamath, 2022). The qualitative analysis has also reiterated the (un)availability of comparables as an impediment as explained in (refer Sr. No. 3 in 5.3 Qualitative Analysis)

## **5.7 Managerial implications**

Most of the literature review focuses on the tax motive and the resulting benefits to the firm due to adoption of transfer pricing methods. In continuance of tax motivated transfer price decisions, the corresponding response of regulatory authorities is also researched. This research focuses on the less researched management motives, i.e., to enhance competitiveness, support associated enterprise, enable performance evaluation, simplify application and to ensure control over assets. These motives are essential for the very survival of the firm. Hence, this research emphasises and supports management motives, which adds the much-needed dimension to the research on transfer pricing motives, in support of Corporates to argue their case with authorities.

Similarly, the research brings to the fore, the salience of internal factors such as inter related functions, contractual arrangements which significantly affect the choice of transfer pricing method. Hence, the research justifies that internal management driven factors are essential constituents of decision making related to transfer pricing method. This study thus provides the additional direction relevant to management motives and management driven internal factors which influence the choice of transfer pricing methods.

The research has also unearthed another factor, i.e., availability of comparable, which is a critical factor, since the availability of comparable or lack of it, often limits choices in terms of selection of the transfer pricing method and hence the research justifies a decisive factor in choice of non-market based methods by firms.

This research has also shown that management motives mediate between internal factors and the choice of transfer pricing methods. Hence, it highlights that management needs to have conscious motivation to choose their transfer pricing method in the presence of internal factors. Ex. Management needs to maintain ownership and control of assets and hence get into technology sharing and charging of royalty or fees for technical services and accordingly adopt the transfer pricing method for these transactions. Thus, this research validates the choice of method with due cognizance of management motives.

This research has also compiled the permissible methods across different



regulations that affect an entity. This brings out the difficulty of the management in reconciling all such differences in the methods at the time of adopting a single transfer price for a transaction which is governed under these regulations. There cannot be separate pricing for tax compliance and for accounting since both are oriented towards reporting at the fair values. Hence, this research has highlighted the need for a comprehensive approach, wherein uniformity is introduced in the methods and reporting of related party transactions under the various tax and non-tax regulations. Further, mutual recognition of the methods by the regulators could be brought in. A uniform reporting system with mutual recognition would benefit all stakeholders facilitating the evaluation of the impact of the same. This would bring in relief to the management, reduce compliance costs and also be a major step towards achieving ease of business.

The role of tax professionals to help MNEs manage their transfer pricing issues can be classified into four primary areas being (i) planning, (ii) compliance and documentations, (iii) implementation and (iv) assisting in advance pricing agreements, negotiations, arbitration and litigation (Holtzman and Nagel, 2014). The findings of this research will help the tax professionals in all the areas mentioned above.

## **5.8 Limitations**

We have not considered social factors such as racist policies, civil warfare, religious conflicts, human rights violation as mentioned by Doğan et al. (2013). These were not included as these factors are not reflected in the cases analysed in this research.

## **5.9 Future research issues**

We have classified methods into market based and non-market based. Future research can be attempted by further classification of non-market based methods into profit based, cost based and such other methods. We have also classified factors as internal and external and motives as regulatory and management motives. This was crucial in this research to evidence the significance of management motives. Future research may be done with other

classifications and test the relationships.

Future research may be done taking into account social factors as an additional external factor.

We have examined the antecedents of transfer pricing. The model proposed by Cecchini et al. (2013) considers the consequences of transfer pricing policy under the RBV and TCE theories. Future research may be done by investigating the consequences of transfer pricing on the MNEs.

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# **Annexure 1 - Validation reports**

Validation report from 3 professionals and 2 academics is attached.

## **Annexure 2 – Research paper published**

Sr. No.	Title of paper	Name of the Journal	ISSN	Volume Issue and Page Number	Year
1.	Transfer Pricing of Related Party Transactions – Only a Tax Concern?	The Chartered Accountant	0009-188X	Volume 70, No. 10, pg. nos. 1232-1238	2022

## **Annexure 3 – Presentation at conferences**

- 1) **“Arm’s Length Price in Related Party Transactions – Sec 188”** at Full Day Programme of Goa Chapter of Western India Regional Council of Institute of Company Secretaries of India at Panaji, Goa. Event date: January 19, 2019
  
- 2) **“Transfer Pricing vis-à-vis Related Party Transactions”** at Annual Regional Conference of Western India Regional Council of Institute of Company Secretaries of India at Calangute, Goa. Event date: January 09, 2021