IFA News Letter
India Branch - Western Chapter

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What's in?

We are pleased to bring to you the next edition of the newsletter of IFA India Branch - Western Region Chapter.

This Edition covers Place of Effective Management with comments from China, FATCA and its implementation and with 1 week to go for the Budget, in this edition, our Authors have looked through the crystal ball to give us a flavour of what lies ahead in the Budget 2016 based on BEPS Action Plans 8-10 and 13. We hope this helps our readers to gear up towards any surprise amendments in transfer pricing based on BEPS in the Budget. We wish our readers a pleasant read.

Place of Effective Management

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Comments on Case Studies by Mr. Andrew Choy
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1. Background

Under the Indian Income-tax Act, 1961 ('Act'), residential status determines the scope of income taxable in India. A person resident in India is liable to pay tax in India on its global income.

As per provisions of the Act applicable till FY 2014-15, a foreign company was regarded as a tax resident in India only if during the year, the control and management of its affairs was situated wholly in India.

The Finance Bill 2015 proposed an amendment to Section 6(3) of the Act in the manner of determining residential status of a Company by introducing the concept of *'place of effective management'* ('POEM') which stated that a Company would be considered to be resident in India during the previous year if **at any time** during the financial year, its 'place of effective management' is in India.

The Explanatory Memorandum to the Finance Bill provided that the reason for introducing this provision is as follows:

"Due to the requirement that whole of control and management should be situated in India and that too for whole of the year, the condition has been rendered to be practically inapplicable. A company can easily avoid becoming a resident by simply holding a board meeting outside India. This facilitates creation of shell companies which are incorporated outside but controlledfrom India."

The words 'at any time' created hue and cry amongst the tax-professionals and at the time of enactment of Finance Act, the words 'at any time' were dropped and now test of residence is*'its place of effective management, in that year, is in India.'*While moving the amendment, the speech should b mentioned.

As an Explanation to Section 6(3) of the Act, POEM means a place where **key management and commercial decisions** that are **necessary for the conduct of the business of an entity as a whole are**, in **substance** made.

2. What is POEM?

'Place of effective management' (POEM) is an internationally recognized concept for determination of tax-residence of a company incorporated in a foreign jurisdiction. Let's analyse the important words that make a place as POEM:

Key management and commercial decisions
The terms 'key', 'management' and 'commercial' are not defined and one may have to rely upon general understanding of these terms. Key indicates important. Further, 'and' in between management and commercial suggests that both key 'management' and 'commercial' decisions should be taken at such place. A decision means an agreed conclusion.

Necessary for the conduct of the business of an entity as a whole
Assume a Company which has various verticals. When one talks about conduct of the business of an entity as a whole, does it mean that key management and commercial decisions about different verticals shall not be a decisive factor since it is not for the business of an entity as a whole?

[1] The views expressed in this article by the authors are personal views. The Draft Guidelines issued by the CBDT on POEM have not been covered in this Article.

Made in substance
The decision should have actually been made in that place and not where the decisions are routinely approved.

The place where the above conditions are met is the *'place of effective management'*. The problem is that the above conditions could be met at more than one place or some of the key management and commercial decisions are made at more than one place.

3. In that year - Means?

The following should be noted:

The Pre-amendment language was **control and management of affairs was wholly** in India;
Language of originally proposed amendment was POEM **at any time** in India
In enactment it is neither "wholly" nor "at any time in India" but **"in that year, is in India"**.
So can it be said that legislature presumes that "POEM" of a Company throughout the year is one and only one?

4. Guidance on POEM

4.1 Domestic Law

Section 115VC of the Act – For shipping Companies, the concept of Place of Effective Management is already considered as a factor to determine a shipping company as a qualifying company. For the purpose of this Section, "place of effective management of the company" means-
(A) the place where the board of directors of the company or its executive directors, as the case may be, make their decisions; or
(B) in a case where the board of directors routinely approve the commercial and strategic decisions made by the executive directors or officers of the company, the place where such executive directors or officers of the company perform their functions.

4.2 OECD and POEM

OECD clarifies that there cannot be one definitive rule to determine POEM.

2001- The OECD-TAG released its first discussion paper in this respect, titled "The Impact of the Communications Revolution on the Application of "Place of Effective Management" as a Tie-breaker Rule.
2003 – Discussion draft "Place of Effective Management Concept: Suggestions for Changes to the OECD Model Tax Convention".
In 2008, the definition in the OECD Model Tax Convention was amended and it reads as follows:

"The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. All relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time."

The above definition concludes that there can be only **one POEM per entity at any one time**.

4.3 UN and POEM

The UN Model Commentary defines POEM as follows:

"POEM may be due the circumstances which may, inter alia, be taken into account are the place where a company is actually managed and controlled, the place where the decision-making at the highest level on the important policies essential for the management of the company takes place, the place that plays a leading part in the management of a company from an economic and functional point of view and the ***place where the most important accounting books are kept."***

The UN Model talks about management and control and decision-making and provides guidance that it could be the place where the most important accounting books are kept.

4.4 South African Revenue Service - Income tax Interpretation Note No.6 of 2002 dated 26.3.2002 on "Place of Effective management"

Some aspects from the above interpretation note in relation to POEM are as follows:

(a) In order to determine the meaning of "place of effective management", one should keep in mind that it is possible to distinguish between-
- the place where central management and control is carried out by a board of directors;
- the place where executive directors or senior management execute and implement the policy and strategic decisions made by the board of directors and make and implement day-to-day/regular/operational management and business activities;
- the place where the day-to-day business activities are carried out/conducted.

(b) The place of effective management is the place where the company is **managed on a regular or day-to-day basis by the directors or senior managers of the company, irrespective of where the overriding control is exercised**, or where the board of directors meets. Management by these directors or senior managers refer to the execution and implementation of policy and strategy decisions made by the board of directors. It can also be referred to as the place of implementation of the entity's overall group vision and objectives.

(c) If these management functions are not executed at a single location due to the fact that directors or senior managers manage via distance communication (e.g. telephone, internet, video conferencing, etc.) the view is held that the place of effective management would best be reflected where the day-to-day operational management and commercial decisions taken by the senior managers are actually implemented, in other words, the place where the business operations/activities are actually carried out or conducted.

(d) No definitive rule can be laid down in determining POEM and they have mentioned some indicative tests

4.5 View of Author Klaus Vogel in his treaties Double Taxation Convention [3rd edition – page 262& 263]

POEM has been explained as follows:

"the term "place of effective management" must be interpreted "autonomously". One of the results thereof is that difficulties in determining the place of effective management must not be circumvented by attaching to the statutory seat, even if it may be a domestic criterion for establishing tax residence…

What is decisive is not the place where the management directives take effect but rather the place where they are given…

It is only 'if he can and does interfere with the usual conduct of the business, if he has arranged to be constantly informed of the various transactions, and if by his decisions he has a decisive influence on how current transactions are dealt with, that the controlling shareholder or partner can be said to be in charge of the top level management."

5. POEM and Tax Treaties

Each tax treaty in India provides how residential status of a Company shall be determined. As per Section 90(2) of the Act, the provisions of the Act or Tax Treaty, whichever are beneficial, shall be applicable. This benefit should continue and the Company should meet the residential and meeting with key managerial persons status test under the Tax Treaty. Most tax treaties use the term 'place of management' and not 'place of effective management'.

As per OECD, a Company may have more than one place of management, but only one place of effective management. Some treaties deny benefits if a person is a resident of both contracting states and some other treaties provide POEM as a tie-breaker rule.

Further, there could be a situation where treaty benefits are denied. For example, under the India-US Tax Treaty, if a Company becomes resident of both the Contracting States, the Treaty is not applicable.

Hence, POEM would be required to be determined carefully in each case.

There could be some relief available to countries with which India has signed a Tax Treaty. But non-treaty countries would only be governed by the Indian Law.

6. Conclusion

The introduction of POEM may be considered as progressive and to align with the prevailing international standards. However clarity is required in the matter.Documentation would be key for determining POEM. The guidelines in this regard have to be crystal clear on how POEM has to be determined.

7. Reference could be made to the following:

The OECD-TAG released in 2001 first discussion paper in this respect, titled "The Impact of the Communications Revolution on the Application of "Place of Effective Management" as a Tie-breaker Rule.
2003 Discussion draft "Place of Effective Management Concept: Suggestions for Changes to the OECD Model Tax Convention".
Different definitions and meanings of POEM in the OECD Model Commentary
South African Revenue Income tax Interpretation Note No.6 of 2002 dated 26.3.2002 on "Place of Effective management"

We sought views of Mr. Andrew Choy, Partner, Ernst & Young on POEM in China, where the concept of POEM was introduced in the Corporate Income-tax Law with effect from 16 March 2007.

General Questions:

1. How is POEM defined in China and were there any reasons mentioned for introducing the concept in the Law? Was there any lacuna in the existing manner of determining residential status of a Company?

   Under the prevailing People's Republic of China ('PRC') corporate income tax law, PRC tax resident enterprises ("TRE") would include companies that are incorporated outside of the PRC under the foreign laws whilst its place of effective management organization ("POEMO") is within the PRC. If a foreign company is deemed as a PRC TRE, then its worldwide income would be subject to PRC CIT in the year when it is generated, regardless of whether or not it is distributed. The "effective management organization" refers to an organization that has an overall management and control of the business operation, people, finance and assets of the company.

   Circular Guoshuifa [2009] No.82 ("Circular 82") further elaborates that if a foreign-registered China-controlled enterprise satisfies ALL the following conditions, it shall be identified as a resident enterprise due to their effective management organization is located within the territory of China:

   - The places where senior management and senior management departments that are responsible for daily production, operation and management of the enterprise perform their duties are mainly located within the territory of China;
   - Financial decisions (such as money borrowing, lending, financing and financial risk management) and personnel decisions (such as appointment, dismissal and salary and wages) are decided or need to be decided by organizations or persons located within the territory of China;
   - Main assets, accounting books, corporate seal, the board of directors and files of the minutes of shareholders' meetings of the enterprise are located or preserved within the territory of China; and
   - One half (or more) of the directors or senior management staff having the right to vote habitually reside within the territory of China.

2. How does the place of effective management defined in your Country converge with the OECD Commentary? Does your country adopt the OECD principles or have they expressed reservation to the same?
   We consider the concept of POEMO under China corporate income tax law is generally in line with the definition of POEM under the OECD commentary.

3. Your views on the UN Commentary on POEM.
   It seems that UN Commentary on POEM more emphasizes on the level of the decision should be the highest, the importance of the policies should be essential for the management, and the place should play a leading part in the management of a company *from an economic and functional point of view* and should be where the important accounting books are kept. It does NOT emphasize the place should be where the most senior person or group of persons makes its decisions like OECD Commentary does.

4. Whether the POEM definition proposed under the Indian provisions is wider than internationally accepted interpretation of this term?
   The POEM definition itself is not wider, but the condition of "during that year" is broader.]

5. Which decisions would you interpret to be 'key management and commercial decisions that are necessary for conduct of the business of an entity as a whole?
   We think most decisions that according to a company's Article of Association need to be determined at the board meeting can qualify for this definition.

Case Studies

Facts:
UK Co., a Company incorporated in the UK, is an equipment manufacturer has established a subsidiary Company in India (hereinafter referred as 'I Co'). The I Co is engaged in distribution of equipment to customers globally. India and US are the biggest markets for UK Co.

Scenario 1:
The shareholders and directors of UK Co., other than the Group Sales and Marketing Director, are Indian citizens and tax residents in the UK. The Group Sales and Marketing Director is an Indian citizen and resident in India and maintains the office in India. All the board meetings of UK Co. are held in UK. The Group Sales and Marketing Director travels to the UK for the Board Meetings.
Till date UK Co. is tax resident of UK as central control and management of the company (based on board meetings held in UK).
The sales and marketing strategy for entire company is designed in and directed from India, subject to approval in the Board Meeting.

Questions:
1. Whether designing and directing sales and marketing strategy from India amounts to taking 'key management and commercial decisions for conduct of business' from India?
   Not really, cause in this case, the sales and marketing strategy for entire company is still subject to approval in the Board Meeting held in UK. So the final decisions are not made from India.

2. The marketing strategy designed by marketing director is only implemented after board approval and board meetings took place outside India. Can it be said that POEM is in India?
   No, I don't think so as explained above.

3. If there was one Board Meeting in India which approved the sales and marketing strategy, how would that affect the POEM, considering that the Indian Law proposes at any time during the year?
   In this case, India becomes the POEM because some key management and commercial decisions i.e. the sales and marketing strategy of the whole company that are necessary for the conduct of the business of the UK Co.

as a whole are, in substance made in India. And because during the financial year, the company's POEM is in India, the UK Co. could be defined as an Indian tax resident according to the Amendment.

4. What would be considered as vital positive evidence to prove that, decision in substance was made in India?
   Board meeting minutes could serve this purpose.

5. Whether there is apprehension that, in absence of POEM definition in tax treaties, the Indian tax authorities would resort to Article 3(2) for imputing POEM definition as per domestic law for tie - breaker rules?
   Yes, there could be such apprehension.

Scenario 2:

The shareholders of UK Co are Indian citizens and tax residents in the UK. There are 3 Directors of UK Co. who are Indian citizens but tax residents in UK, India, and US. The Directors travel frequently for
For each important managerial decision, there are a number of video conference calls, with the Directors at their countries of residence.
They meet once in 2 months at the London Head Office.
During the previous year, the Company rolled out a new strategy which was discussed by the key managerial personnel (KMP) first at UK, then at India, at the Company's offsite trip to US and the final decision was taken at a Conference in China.

Questions:

1. Whether 'during the year' may be concern for companies whose decision makers are business travellers and may attend board meetings through video conference?
   It should not be a concern because POEM definition was not met in any time in India (final decision was taken in China.

2. What are the factors to be considered in determining POEM? Is the Directors or the KMP residential status a deciding factor to determine the place of effective management of the Company?
   No, the residential status should not be a deciding factor to determine the POEM of the Company, as when the three directors participated conference calls in their respective countries of residence, neither of those countries should be consider as the POEM. According to the OECD Commentary, an entity may have only one place of effective management at any one time.

3. Where the KMP formally finalize and/or routinely approves key management, commercial and strategic decisions necessary for the conduct of the entity's business in one State but these decisions are in substance made in another State, where would be the POEM?
   The POEM should be in another state according to the definition of POEM of India and the OECD Commentary.

4. In determining the place where a decision is in substance made, should one consider the place where advice on recommendations or options relating to the decision were considered and where the decision was ultimately taken.
   Where the decision was ultimately taken should matter here as there could be many places where advice on recommendations or options was considered, but there should be only one place the decision was ultimately taken. An entity may have only one POEM at any one time.

5. Can benefit be taken of the concept of POEM under the Treaty since the definition under the treaty would be restricted as compared to the Indian Laws?
   As per India-UK Tax Treaty, Article 4(3) states that *"Where by reason of the provisions of Paragraph 1 of this Article, a person other than an individual is a resident of both contracting States, then it shall be deemed to be a resident of the Contracting State in which its place of effective management is situated."*As per the Treaty, at any time during the year, has not been mentioned. Hence, in this case, subject to

fulfilment of documentation conditions for application of Treaty, can benefit be taken under the Tax Treaty?
Yes, benefit can be taken in the context of India-UK Tax Treaty which can override Indian domestic tax rules.

6. What happens to countries with which there is no Treaty and one Meeting was held in India? Can all the other Meetings be disregarded and because one Meeting was held in India, the POEM may be considered as India?
It depends if the POEM definition has been met at this meeting i.e. whether key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole were, in substance made in the meeting. If so, the other meetings may be disregarded as there is actually one time during the year that POEM is in India according to the Amendment.

On behalf of IFA WRC, we are thankful to Mr. Andrew Choy for his valuable contribution.

An Insight into CBDT's detailed guidance note on implementation of FATCA & CRS

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"True guidance is like a small torch in a dark forest. It does not show everything at once, but, gives enough light for the next step to be safe."….

1. INTRODUCTION AND BACKGROUND

On 9 July 2015, India signed an Inter-Governmental Agreement ('IGA'[2]) with the United States of America ('US') for the implementation of US Foreign Account Tax Compliance Act ('FATCA') to promote transparency between the two nations on tax matters and facilitate the exchange of information. The IGA has been entered into force w.e.f 31st August 2015. Similarly, earlier on 3rd June 2015, India signed the Organization for Economic Cooperation and Development (OECD) Common Reporting Standard ('CRS') Multilateral Competent Authority Agreement, which is effective from 1st January 2016 for the automatic exchange of information.

To pave path for the implementation of US FATCA and OECD CRS an amendment[3] was made to section 285A of the Income Tax Act, 1961 ('ITA') enabling requirements for specified financial institutions to report information with respect to financial accounts being held by specified persons. Further, Rules 114F, 114G & 114H were inserted by amendment to Income Tax Rules, 1962 ('ITR') to provide for the registration of persons, due diligence, maintenance of information and other procedure relating to the statement of reportable accounts. Accordingly, Form 61B was prescribed for compliance of maintaining and reporting of information under FATCA and CRS.

Soon thereafter, a guidance note[4] on the implementation of reporting requirements under Rule 114F to 114H of ITA was issued on 31st August, 2015. However, this guidance note provided basic clarifications and sought stakeholder's comments for preparation of detailed guidance note before commencement of the reporting requirements from 1st January, 2016. Basis this,,on 31stDecember 2015,CBDT issued a more detailed guidance note on implementation of FATCA and CRS reporting requirements. The objective of this guidance note is to provide more clarity on the specific definitions and related implementation guidelines with illustrative examples for the benefit of Indian Financial Institutions and officers of Income Tax Department. Further, it has been clarified in the guidance note that where there exists any inconsistency between the Rules and the Guidance Note, the statutory position contained in Rules shall prevail.

CONTENTS AND STRUCTURE OF THE GUIDANCE NOTE

Chapter	Content	Coverage
1.	Introduction	Legislative enactment & overview
2.	Reporting Financial Institutions	Steps to determine Reporting Financial Institutions & Definitions
3.	Financial Accounts	Categories of Financial Accounts, Exclusions
4.	Financial Accounts which are Reportable Accounts	Criteria for identification of various financial accounts
5.	Due Diligence Procedure	Classification for due diligence procedure, degree to check and methods of identification
6.	Reporting Requirements	Specification of information to be obtained, maintained and reported
7.	Issues Related to Trusts	Specific issues and clarifications
8.	Procedure for Furnishing Report	Guidance on filing requirements & procedure
9.	Monitoring and Compliance	Scope of roles & responsibilities of various authorities
Annexure A	**Jurisdictions committed to implement AEOI in accordance with CRS and signatories of MCAA**	
Glossary	Glossary of terms used and referred in the Guidance Note	

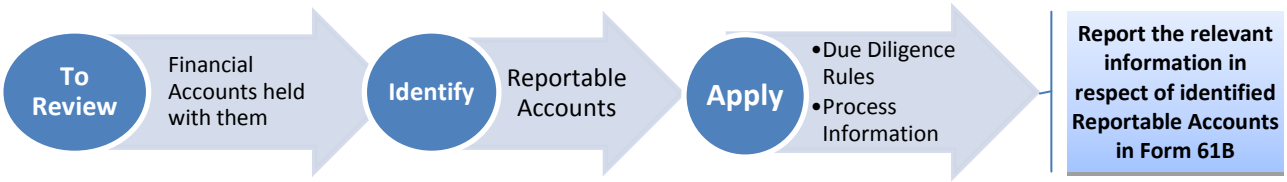
[2]Model 1 IGA where exchange of information shall be through Competent Authorities of the countries
[3]Rule 114F, 114G & 114H inserted by the Income-tax (Eleventh Amendment) Rules, 2015 w.e.f. 7-8-2015
[4] Issued by The Foreign Tax and Tax Research Division of the Ministry of Finance's Department of Revenue through letter no. F. No. 500/137/2011-FTTR-III, dated 31 August 2015

Chapter	Content	Coverage
Appendix A	IGA between India and USA	
Appendix B	Common Reporting Standard	
Appendix C	Rules 114F to 114H of ITR and Form 61B	
Appendix D	Draft Self Certification for individual	
Appendix E	Draft Self Certification for Entities	

2. OVERVIEW OF REPORTING UNDER FATCA & CRS

The compliance norms related to reporting under FATCA & CRS basically involves. a) ***Who*** is required to report; b) ***What*** is required to be reportedc) In ***Which*** format reporting is to be done andd) timeline involved. In simple words, an entity needs to identify whether it is a Reporting Financial Institution and if yes, then undertake due diligence procedure to identify financial accounts which is a reportable account. Once identification process is over, information is to be reported in prescribed Form 61B in respect of identified reportable account. The flow of reporting process is summarised as under:

Figure 1 Process of Reporting under FATCA & CRS: **Reporting Financial Institutions**



3. REPORTING FINANCIAL INSTITUTIONS

The reporting obligation has been casted upon entities which may be legal persons or legal arrangements such as corporations, a trust, or a partnership etc. It has been clarified that individuals and proprietorship concerns do not fall within the scope of an entity for the purpose of identifying a Reporting Financial Institutions. However, Hindu Undivided Family ('HUF') has been considered as legal arrangement and accordingly, forms part of Reporting Financial Institution. For the purpose of compliance, Reporting Financial Institution ('RFI')[5] includes Financial Institution which is resident in India or is branch of non-resident located in India and excludes Non-reporting Financial Institutions.

Further, various categories of Financial Institutions have been defined and criteria for inclusions and exclusions has been provided in the guidance note. A brief snapshot on the types of Financial Institution is given in table below:

Term	Definition	Example/Clarification
Custodial Institutions[6]	Entities holding substantial portion of its business, financial assets for the account of others and their income attributable equals or exceeds 20% of its gross income during 3 financial years that ends on 31st March prior to the year in which determination is made or period during which the entity has been in existence, whichever period is less.	Entities such as central depositories, custodians, banks, brokers, depository participants, etc. [Ex: CSDL and NSDL]
Depository Institutions[7]	Entities that accepts deposits in the ordinary course of a banking or similar business. Banking or similar business includes activities of a) accepting deposits or similar investment of	Entities such as saving banks, commercial banks, credit unions, etc. and Non-Banking Financial Companies (NBFCs)

[5] As defined in Rule 114F(7) of ITR
[6] As defined in Explanation (a) to Rule 114F(3) of ITR
[7] As defined in Explanation (b) to Rule 114F(3) of ITR

	funds, b) provision of loans (industrial, mortgage, commercial or other), credits facilities etc. c) purchase, sells, discounting or negotiation of bills of exchange d) issuance of letter of credit, draft negotiation etc e) providing trust or fiduciary services f) financing foreign exchange transactions; or g) purchase or disposal of finance leases or leased assets.	
Investment Entities[8]	Entities whose primary business consists of engaging in activities, on behalf of a customer, in the nature of: a) trading in money market instruments, interest rate and index instruments, transferable securities or commodity futures; b) individual or collective portfolio management; or c) investing, administering or managing financial assets or money on behalf of other persons; and the gross income from such business activities is equal or more than 50% of the gross income over a 3 years period. This is also includes entities engaged in above mentioned activities and such entity is managed by another entity which is depository institution or custodial institution or an investment entity or a specified insurance company	Entities such as mutual funds, collective investment vehicles, exchange traded funds, private equity funds, venture capital funds, etc. **Exception:** Entities engaged only in rendering investment advice, portfolio management and executes trade, for and on behalf of customer for the purposes of investing, managing or administering funds or securities deposited in the name of customer with a financial institution. Example: Stock brokers, investment advisors, portfolio management entities etc.
Specified Insurance Companies[9]	Entities that are an insurance company or holding company of an insurance company that issues or is obligated to make payments with respect to, Cash Value Insurance Contract or an Annuity Contract. For this purpose, cash value contract means insurance contract (other than indemnity insurance between two insurance company) that has a cash value. However, for US reportable account threshold of USD 50,000 has been provided in this regard.	Excludes insurance companies providing following products: a) General Insurance & Term Life Insurance; b) Indemnity reinsurance contracts; c) Specified single premium life insurance contracts
Non Reporting Financial Institutions[10]	Entities covered under this category are broadly a) government entities, international organisations, central banks; b) retirement or pension funds of a entities covered in a) above; c) Non-public fund of the armed forces, Employees' State Pension funds, a gratuity fund or a provident fund; d) Qualified credit card issuer;	

[8] As defined in Explanation (c) to Rule 114F(3) of ITR
[9] As defined in Explanation (d) to Rule 114F(3) of ITR
[10] As defined in Rule 114F(5) of ITR

	e) Investment entity which is directly held by entities explained in a), b) & c) above f) An exempt collective investment vehicle g) A local bank h) A trust provided its Trustees are Reporting Financial Institution i) A financial institution with local client base and/or with only low-value accounts.

It has been clarified in the guidance note that where a reporting entity qualifies for more than one category of financial institution [e.g. Depository Institution and Custodial Institution], in that case, while the reporting entity would be required to register with US IRS under a single Global Interrnediary Identification Number (GIIN), it would need separate registrations for each categories with the Indian Tax Authorities. Further, such entity would also be required to submit separate Form 61B for each categories of registration with the Indian tax authorities.

It also envisages a situation where a reporting entity qualifies as a financial institution under a specific category. However, the entity maintains multiple categories of reportable accounts such as depository accounts, custodial accounts, etc. In such a scenario, it has been clarified that while that the reporting entity would need to only register itself under the specific category of financial institution, it would however need to report both category of accounts under this registration.

4. FINANCIAL ACCOUNTS

A Financial Account is an account maintained by a Financial Institution ('FI') and includes specific category of accounts. RFI are required to review the financial accounts maintained by them and identify whether any of financial account is held by a reportable person and on identification such accounts are known as reportable accounts. Broadly there are five types of financial account:

Accounts	**Financial Institution generally considered to maintain them**
Depository Account	The FI that is obligated to make payments with respect to the account (excluding an agent of a Financial Institution).
Custodial Account	The FI that holds custody over the assets in the account
Equity and debt interest in certain Investment Entities	The equity or debt interest in a FI is maintained by that FI
Cash Value Insurance Contract	The FI that is obligated to make payments with respect to the contract.
Annuity Contracts	The FI that is obligated to make payments with respect to the contract.

There are few categories of financial accounts which have low risk of being used to evade tax and thus, have been excluded from the requirement of being reviewed or reported. These accounts are termed as "Excluded Accounts[11]". These accounts broadly include retirement or pension fund accounts, non-retirement tax-favored accounts, senior citizens savings scheme account, term life insurance contracts meeting specified conditions, escrow accounts etc.

5. FINANCIAL ACCOUNTS THAT ARE REPORTABLE

This section of the guidance note is most relevant as it covers various terms which related to classification of entities and their reportable status. RFI is required to report financial account which is maintained with it in the prescribed Form 61B provided such account is held by reportable person; or a non-US based entity with one or more controlling persons that is specified US person; or a passive non-financial entity with one or more US reportable person. For this purpose, US reportable person includes US specified person and a person non-resident in India (except US resident) not falling in exclusions of US specified person. Thus, in other words, an account becomes reportable either by virtue of its account holder or account holder's controlling person.

[11] As defined in Explanation (h) to Rule 114F(1) of ITR

In terms of India-US IGA, Reportable Person[12]means one or more specified US persons; or one or more persons other than i) a listed corporation whose stocks are traded on established securities markets and its related entity; ii) Governmental entity; iii) an International Organisation; iv) a Central Bank; or v) a financial institution; that is resident of country or territory outside India (except US) including estate of decedent that was a resident of any such country. Thus, reportable person comprises of US person and person from any country other than India and US**.**

US personhas been defined to include a) an individual who is citizen or resident of US; b) a partnership or corporation setup under the laws of US; c) trust in respect of which a court in US has jurisdiction concerning substantially all issues regarding administration of trust, and one or more US persons have the authority to control all substantial decisions of the trust; and/or d) an estate of a decedent who was a citizen or resident of US.

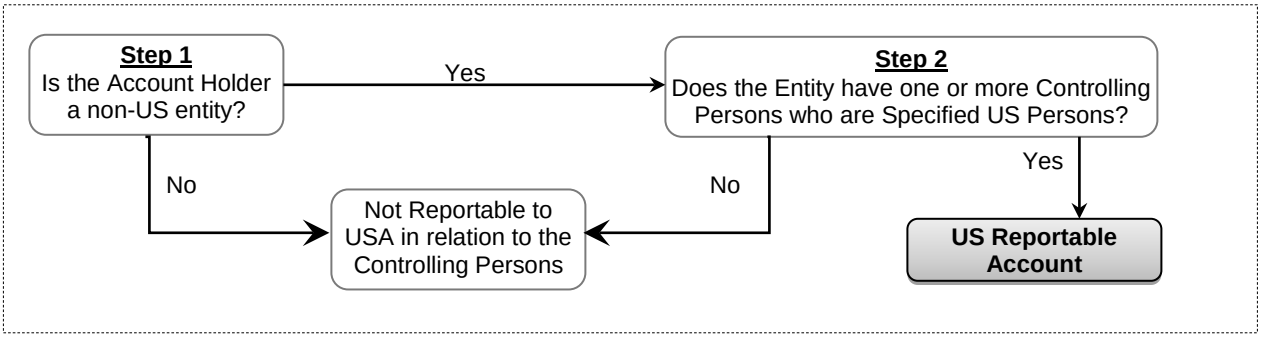
Specified US Person shall have meaning as defined[13] in IGA between India-US and for easy understanding Specified US Person means a US person other than listed US corporations, related entities of US Corporations, government or governmental organisations, exempt organisations, banks, entities which are otherwise regulated in US by the U.S. Securities and Exchange Commission etc.

Reportable Accounts by virtue of the Account Holder's Controlling Person

Irrespective of the fact that whether a financial account is a reportable account by virtue of account holder, a second test is relation to the controlling persons of certain entity accounts is required to be applied to ascertain whether such entity account is reportable account.

In case of USA, for the purpose of FATCA reporting, any account which is held by a non-US entity is required to be examined from the perspective of its controlling person to determine whether such non-US entity is controlled by Specified US person. For easy understanding determination of US reportable account is explained in figure below:

Figure 2 Steps for US Reportable Account

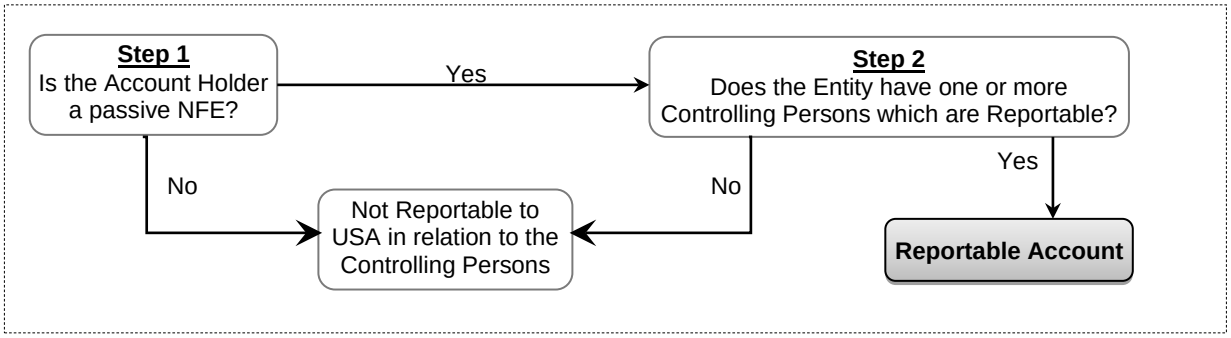


In case of other countries/territories, any account which is held by a passive Non-Financial Entity ('NFE') with one or more controlling persons resident in country/territory outside India, then account will be reportable. This criterion is relevant from the perspective of Automatic Exchange of Information, whereas the principles for determination of a reporting account are similar to that of FATCA. For easy understanding determination of other reportable account is explained in figure below:

[12] As defined in Rule 114F(8) of ITR

[13] Refer clause (ff) of Article 1 of IGA between India and US (*Appendix A to Guidance Note dated 31.12.2015*)[http://incometaxindia.gov.in/news/guidance-note-forfatca-crts-31-12-2015.pdf]

Figure 3 Steps for Other Reportable Account



In relation to the Reportable accounts, following terms have been defined and these terms are important to be understood by reporting entities, FIs and income tax authorities concerned. These terms include Non-Financial Entity, Passive NFE etc.

Non-Financial Entity[14] i.e. NFE is an entity which is not a FI and would include entities which are engaged in non-financial activities such as business, trade etc. NFEs are categorised as active and passive. The RFI is required to determine whether the passive NFE is controlled by one or more Reportable persons.

Passive NFE[15] is defined as any NFE which is not an active NFE or an investment entity[16]which is not a withholding foreign partnership or withholding foreign trust. The general rule is that a Passive NFE is an NFE that is not an Active NFE. The definition of **Active NFE** includes entities that are publicly traded (or related to a publicly traded Entity), Governmental Entities, International Organisations, Central Banks, or a holding NFEs of non-financial groups and essentially excludes entities that primarily receive passive income or primarily hold amounts of assets that produce passive income (such as dividends, interest, rents etc.). It has been provided that if an Entity Account Holder is a Passive NFE then the FIs must "look-through" the entity to identify its Controlling Persons. If the Controlling Persons are Reportable Persons then information in relation to the Financial Account must be reported, including details of the Account Holder and each reportable Controlling Person.

Controlling Person[17] means the *natural person(s)* who exercises control over an entity and includes a beneficial owner[18] as defined under Prevention of Money-laundering (Maintenance of Records) Rules, 2005. It has been also specified that in determining the beneficial owner, the procedure specified in the circularsissued by Reserve Bank of India[19] ('RBI'), Securities and Exchange Board of India [20]('SEBI') and Insurance Regulatory and Development Authority[21] ('IRDA') as amended from time to time shall be applied.Beneficial owners as defined from different entity's perspective are described as under:

Entity	**Beneficial owner is natural person(s) who whether acting alone or together or through one or more juridical person**
Company	(a) has a controlling ownership interest (>25%) or (b) who exercises control through right to appoint majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreement or voting agreements
Partnership Firm	has ownership of or entitlement to more than 15% of capital or profits of the Partnership

[14] As defined in Explanation (A) to Rule 114F(6) of ITR
[15] As defined in Explanation (D) to Rule 114F(6) of ITR
[16] As described in sub-clause (B) of clause (c) of the Explanation to clause (3) of Rule 114F (iii)
[17] As defined in Explanation (B) to Rule 114F(6) of ITR
[18] Refer sub-rule (3) of rule 9 of the Prevention of Money-laundering (Maintenance of Records) Rules, 2005
[19] Refer circular - DBOD.AML.BC. No.71/14.01.001/2012-13, issued on the 18th January, 2013 by the RBI
[20] Refer circular - CIR/MIRSD/2/2013, issued on the 24th January, 2013 by the SEBI
[21] Refer circular - IRDA/SDD/GDL/CIR/019/02/2013, issued on the 4th February, 2013 by the IRDA

Entity	Beneficial owner is natural person(s) who whether acting alone or together or through one or more juridical person
Unincorporated Association or Body of Individuals	has ownership of or entitlement to more than 15% of property or capital or profits of such association or body of individuals

In the context of beneficial ownership it has been further clarified that where no natural person is identified as explained above, the beneficial owner shall be the relevant natural person who holds the position of senior managing official. However, where the owner of the controlling interest (directly or indirectly) is a company listed on a stock exchange it is not necessary to identify and verify the identity of any shareholder or beneficial owner of such companies.

In the case of a trust, the controlling person means the settlor, the trustees, the protector (if any), the beneficiaries or class of beneficiaries, and any other natural person exercising ultimate effective control over the trust, and in the case of a legal arrangement other than a trust, the said expression means the person in equivalent or similar position. Further, it has been provided that if the settlor, trustee, protector, or beneficiary is an Entity, the RFI must identify the Controlling Persons of such Entity as explained above. It is important to note that the OECD commentary on Automatic Exchange of Information clarifies that trustees, protectors, beneficiaries, etc. need not actually be exercising ultimate effective control over the trust to be a controlling person.

Thus, from Automatic Exchange of Information perspective, if the Controlling Persons of a Passive NFE having an account in a RFI are persons resident of a country/territory outside India, the account becomes a Reportable Account for all such countries/territories outside India, for which the controlling persons are tax resident. The details of the controlling person(s) will also be reportable to the respective country (ies) or territory (ies) outside India.

6. DUE DILIGENCE PROCEDURE

The obligation to identify and report Reportable Accounts have been casted upon the RFIs and accordingly, a systematic and uniform approach is essential for meeting reporting requirements by RFIs. While, on the one hand, introduction of reporting requirements under FATCA and Multilateral Automatic Exchange of Information will facilitate various countries and their tax and regulatory authorities to check avoidance of tax, on the other hand, it has resulted in additional responsibility on the FIs for creating and maintaining reporting mechanism for enabling exchange of information. FIs have largely raised concerns over burden of additional cost put on them due to increased compliance requirements.

In order to implement the reporting requirements, extensive due diligence procedures are required to be introduced by the RFIs and to efficiently execute the due diligence process, separate requirements for individual accounts and entity accounts have been laid down. Further, the accounts have been classified into pre-existing accounts and new accounts and different set of criteria is laid down for each category of accounts. For further segregation, value based criteria has be prescribed whereby lower value accounts are subject to lessor in-depth due diligence procedure as compared to high value accounts. From reporting perspective, high value accounts are those having balance exceeding USD 1 million and lower value accounts are those having balance exceeding USD 50,000 but less than USD 1 million. Accounts below lower value threshold have been excluded from reporting obligations for years 2014 and 2015.
The guidance note has provided clarifications in respect certain concepts in relation to due diligence procedure. These clarifications are summarized hereunder:

Curing of Indicia: It is provided that where the electronic search gives an indication of residence which the financial institution considers to be incorrect it could cure such indicia by obtaining a self-certification from the account holder. The FI could rely on a self-certification obtained previously. It is pertinent to mention that above relaxation is not provided as general rule and is merely provided as an exceptional remedy.

Relationship Manager (RM) Test: For due diligence on high value accounts, RM Test has been recommended and in this regard, Relationship Manager is defined to mean an employee or officer of the FI who has been assigned

responsibility for specific account holders on an ongoing basis and who provides advice to Account Holders regarding their accounts as well as recommending and arranging for the provision of financial products, services and other related assistance.

Clarifications for aggregation in case of financial accounts: For the purpose of determining the aggregate balance of financial accounts held by a person, it has been prescribed that the RFI would need to take into consideration all financial accounts held by such person or any related entity. Based on this aggregation, the RFI would then need to proceed to determine the value status (high value (or) low value) of such account. Where a financial accounts' reporting manager knows, or has reason to know, that certain financials accounts are directly or indirectly owned, controlled, or established (other than in a fiduciary capacity) by the same person, then the RFI would need to aggregate all such accounts as directed. However, accounts which are exempt from being treated as financial accounts should not be included while determining such aggregate balance.

Reporting of interest in the case of custodial and depository accounts: It has been clarified that the actual interest paid or credited to the account has to be reported for FATCA & CRS purposes while interest accrued would be excluded for reporting purposes. However, the term "interest paid or credited" has not been defined specifically.

7. ISSUES RELATED TO TRUSTS

The guidance notes provides for specific clarifications in respect of trusts. These clarifications mainly include factors like:

a) if trust is an investment entity, its financial accounts will be debt and equity interests in the entity also, wherein equity interests are held by settlor or beneficiary or any natural person exercising ultimate effective control;
b) If the settlor or beneficiary is non-resident(s), their equity interests would be treated as reportable accounts;
c) Details of financial activity required to be reported for different categories of account holders in case it qualifies as RFI or Passive NFE; and
d) Residency of Trust to be determined on the basis of the residential status of the trustee. In case of more than one trustee, it has been provided that the Trust is to be considered resident of all such countries where the trustee is a resident and accordingly, reporting shall be done.

8. REPORTING REQUIREMENT

A RFI is required to report and maintain the details in respect of each identified reportable account. The information prima facie pertains to the different types of account holder i.e. individual or entities which hold the reportable account including custodial or depository account. The guidance note defines the account holder to mean person listed or identified as the holder of a financial account. Further, agents, intermediaries, investment advisor, nominee custodian of a financial account shall also be treated as account holders and accordingly, their information as prescribed shall be required to be maintained and reported.

The various information required to be maintained and reported include name, address, place and date of birth tax identification number ('TIN'), account balance etc. of the account holder. The TIN of account holders required to be quoted by the FI shall be in respect of every country where the account holder is a resident and in absence of which any functional equivalent of TIN can be used. In a case where the country does not issue any TIN to taxpayers or their domestic law does not mandate collection of TIN by FI then in such cases the RFI is not required to collect the TIN for those jurisdictions.[22]

With respect to pre-existing accounts, the RFI are required to obtain the date of birth and TIN by December 31, 2016 and report it with respect to calendar year 2017 and subsequent years. Further, for FATCA compliance, the report in respect of US related accounts for the calendar year 2014 was required to be furnished by 10th September, 2015 and for the calendar year 2015 the report is required to be submitted by 31st May, 2016.

9. PROCEDURE FOR FURNISHING REPORT/MONITORING AND COMPLIANCE

The statement in respect of each reportable account needs to be filed online by the RFIs in accordance with the specified data structure and procedure laid down by the Principal Director General of Income Tax (Systems). In

[22] The AEOI portal has a specific section on useful information in relation to TIN http://www.oecd.org/tax/automatic-exchange/crs-implementation-andassistance/tax-identification-numbers/#d.en.347759

case of any default in furnishing of the statement there exist penal implications which are provided for under section 271FA and 271FAA of the ITA.

Apart from being governed by the Income Tax Department, most of RFIs are also regulated by a regulator which issues necessary instructions and guidelines from time to time which are required to be complied by the RFIs. These instructions and guidelines relate to due diligence requirements, manner of maintaining the information etc.

The RFIs having U.S. Reportable Accounts need to register with the US IRS and obtain Global Intermediary Identification Number. GIIN also needs to be obtained by the Financial Institutions claiming exemption as Non-reporting Financial Institution.

Further, guidance note also prescribes a template for self-certification in Draft Self-Certification Forms[23] which can be suitably modified by FIs to adopt additional criterion/requirements for making the documentation more robust and reliable.

On behalf of IFA WRC, we are thankful to CA Siddharth Banwat for his valuable contribution.

[23]Refer Appendix D and E to Guidance Note dated 31.12.2015 (http://incometaxindia.gov.in/news/guidance-note-forfatca-crts-31-12-2015.pdf)

BEPS Report on Intangibles and Intra-group services – Has the genie been trapped in the bottle?

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The OECD BEPS project, bearing the genesis that current international tax standards have not kept pace with changes in global business practices, has well deserved the attention it has garnered in the recent times. It has aimed at providing clarity and direction on many issues which have played on the International Tax and Transfer pricing landscape for a long time, from an India front as well as globally. Action Plans 8-10 provide a framework for determination of the Arms' Length principle by detailing the emphasis of a robust risk analysis as well as setting out a six-step model for the same. Guidance has also been provided on commodity transactions; workability of the profit split method and cost contribution arrangements. However, the guidance on Intangibles and Intra Group Services ('IGS') stands out as it has been on the drawing board for a long time and has finally made it to the light of the day. This article has been streamed towards these torrid issues and attempts to provide a birds' eye view of the same.

Intangibles

One of the key objectives of the work under Actions 8-10 of the BEPS Action Plan is to ensure that transfer pricing outcomes better align with value creation of the Multinational Enterprise ('MNE') group. The OECD has expressed a view that there have been cases of misuse of TP provisions whereby income has been separated from the economic activities that produce such income and has been shifted to low-tax jurisdictions by arrangements involving intangibles. Action 8, therefore, targets prevention of BEPS arising from the movement of intangibles among group members.

The key clarification under the guidance is that legal ownership alone does not necessarily generate right to returns generated by exploitation of intangibles. The group companies performing and contributing to important functions, controlling economically significant risks and employing assets, as determined through the accurate delineation of the actual transaction, will be entitled to an appropriate return reflecting the value of their contributions.

Key discussions in the 2015 Guidance

A. Identification and definition of intangibles

The definition of intangibles has been an area of challenge owing to the nature of such assets and such a definition which was missing in the erstwhile 2010 OECD Guidelines. Hence, another underlying objective of the 2015 Guidance was to define intangibles to provide clarity to tax authorities and taxpayers on identifying intangibles for transfer pricing purposes and to lay the foundation stone of TP analysis of intangibles.

For the purpose of transfer pricing, the 2015 Guidance has defined an intangible asset as something *"which is not a physical or financial asset, which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances"*.

Further, examples have been included for some types of intangibles that fall within this definition, including both intellectual property, such as patents and trademarks, which can be registered, but also other assets such as know-how, trade secrets, and contractual rights. Another important aspect to note is the new definition of marketing intangible which now reads as - *"An intangible … that relates to marketing activities, aids in the commercial exploitation of a product or service, and/or has an important promotional value for the product concerned"*.

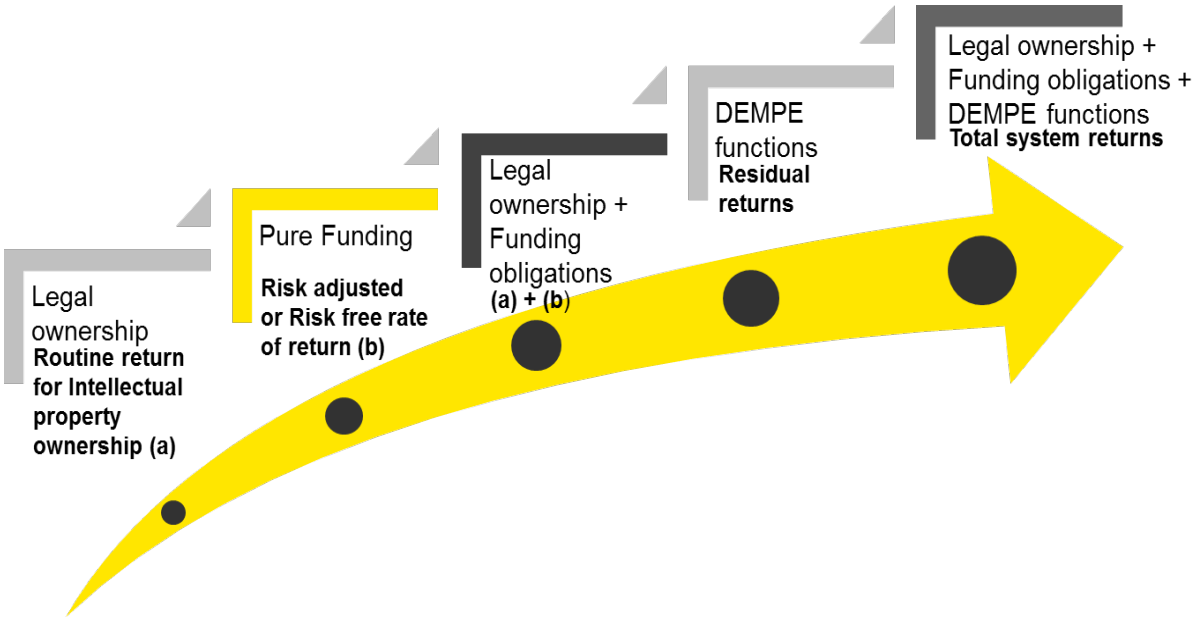
B. Ownership of intangibles and transactions involving the DEMPE of intangibles

[24] The views expressed in this article by the authors are personal views

The most crucial aspect in the transfer pricing analysis of intangibles is the fundamental question of which entity or entities within a MNE group should be entitled to a share in the economic returns from exploiting intangibles. Under the 2015 Guidance, the cornerstone of this discussion is that mere legal ownership of intangibles by an associated enterprise does not alone determine entitlement or confer any rightto returns from the exploitation of intangibles. The economic return from intangibles, and the costs and economic burdens associated with intangibles, will be allocated to the entities that perform and control the important value-creating developing, enhancing, maintaining, protecting and exploiting functions (collectively, the 'DEMPE' functions) in relation to the intangibles.

Essentially, the 2015 Guidance sets out a framework for analysing transactions involving intangibles, which is aimed at delineating the controlled transaction for transfer pricing purposes, in order to determine the arm's length price and other terms for the transaction. The application of this framework ensures that where an enterprise which is not the legal owner of an intangible but performs value-creating DEMPE functions in relation to the intangible, it would be entitled to an arm's length remuneration commensurate with the controls over risk associated with the DEMPE functions.

The 2015 Guidance clarifies that where an AE is providing funding and assuming the related financial risks, but not performing any functions relating to the intangible, it could expect a risk-adjusted return on its funding, in the absence of which, a risk-free return should suffice.



The moot point in this discussion is that for an enterprise to exercise control over a risk, it must have the capability to make the decision to take on, lay-off, or decline the risk-bearing opportunity, and the decision-making capability to decide whether and how to respond to risk associated with the opportunity.

C. Identifying types of transactions involving use or transfer of intangibles

Section C of the 2015 Guidance sets out the two general types of transaction where identifying the intangibles concerned and delineating the transaction accurately will be necessary for transfer pricing purposes, as under:

i. transactions involving transfers of intangibles or rights in intangibles; and
ii. transactions involving the use of intangibles in connection with the sale of goods or the provision of services.

D. Supplemental guidance, including guidance on valuation of intangibles and discussion on hard-to-value intangibles

The 2015 guidance confirms that database comparables are seldom appropriate for pricing intangible transactions and this is largely because there is rarely a correlation between the cost of developing an intangible and its value once developed (owing to uncertainty and unpredictable factors). Hence, cost based pricing methods are generally discouraged. Instead, the comparable uncontrolled price ('CUP') method or the transactional profit split method are more likely to be suitable as transfer pricing methods in matters involving transfers of intangibles. Having said that, the guidance has highlighted that particular caution should be taken with database comparables in using the CUP method.

However, in the absence of reliable comparable uncontrolled transactions, financial valuation techniques based on discounted cash flow forecasts could prove to be a useful tool in evaluating intangible transactions and may prove to be more reliable than any other pricing method. Where valuation techniques are utilized, it is necessary to apply such techniques in a manner that is consistent with the arm's length principle and the principles of the OECD TP Guidelines.

Hard-to-value intangibles

Hard-to-value intangibles are defined as *intangibles or rights in intangibles for which, at the time of their transfer between associated enterprises,*

(i) no reliable comparables exist; and
(ii) at the time the transactions was entered into, the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain, making it difficult to predict the level of ultimate success of the intangible at the time of the transfer.

Some key features in hard to value intangibles are: (a) intangible is only partially developed; (b) intangible is not expected to be commercially used or 'exploited' in the near future; and (c) financial projections are highly uncertain.

The approach entitles tax administrations to use the *ex post*(actual) evidence as presumptive evidence on the appropriateness of the *ex ante*(anticipated) pricing arrangements. This could highlight the existence of uncertainties at the time of the transaction and whether the taxpayer appropriately took into account reasonably foreseeable developments or events at the time of the transaction as well as the reliability of the information used *ex ante* in determining the transfer price for the transfer of such intangibles or rights in intangibles.

The taxpayer should be able to prove that the original pricing was based on reasonable forecasts taking into account all reasonably foreseeable eventualities. However, such presumptive evidence may be subject to rebuttal if it can be demonstrated that it does not affect the accurate determination of the arm's length price.

Low value adding Intra-Group Services

IGS have always been a matter of debate considering the amount of time and resources MNEs and the Revenue authorities alike spend on documentation and auditing as compared to the quantum involved with respect to such services. In the Indian context, IGS has been a 'red flag' for the Indian tax authorities in the last 4-5 cycles of transfer pricing audit and such has also been acknowledged in the India Chapter to the UN Manual on Transfer Pricing for developing countries.

Chapter VII of the OECD Transfer Pricing Guidelines examines "issues that arise in determining whether services have been provided by one member of an MNE group to other members of that group and, if so, in establishing arm's length pricing for those intra group services."

The chapter entails explanations for the determination of two primary questions with respect to IGS:

i. Whether an IGS has actually been provided, and
ii. Whether the charge between the AEs for such IGS passes the Arms' length test

The OECD has now stepped ahead and addressed the issues above in Action Plan 10 by providing clarity on the definition of 'low value adding IGS' and has suggested an elective, simplified approach for determination of ALP along with providing guidance on documentation and reporting requirements for the same.

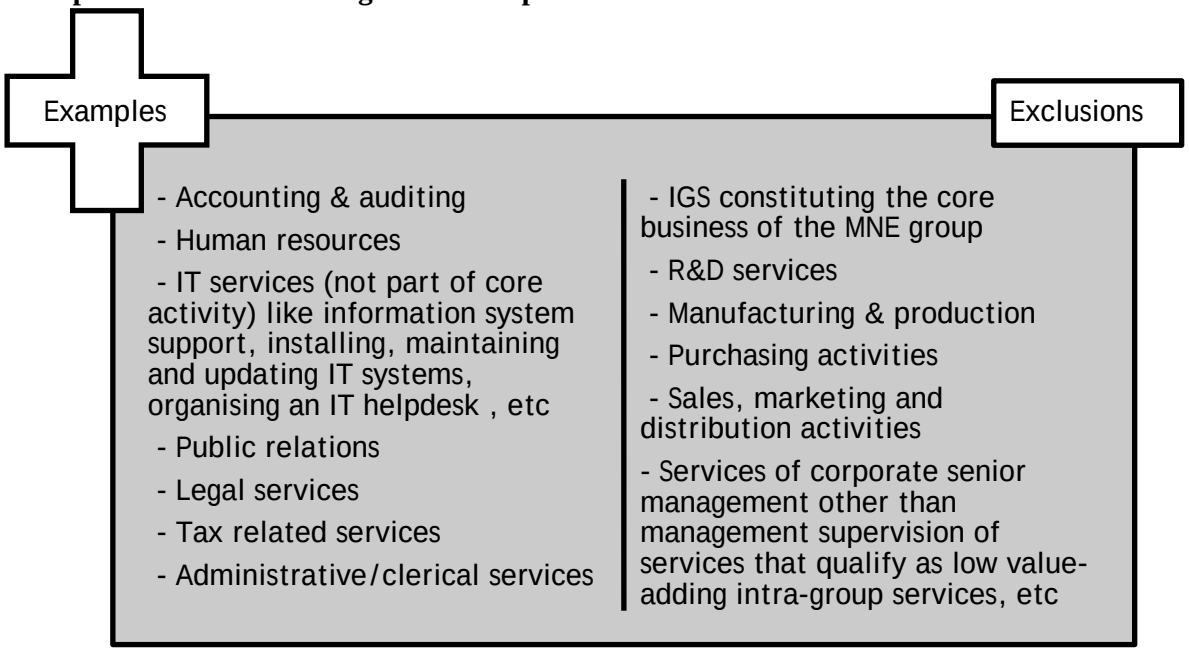
Defining low value adding IGS

Low value adding IGS have been defined as:

"*Low value-adding intra-group services for the purposes of the simplified approach are services performed by one member or more than one member of an MNE group on behalf of one or more other group members which:*

- *are of a supportive nature;*
- *are not part of the core business of the MNE group (i.e. not creating the profit-earning activities or contributing to economically significant activities of the MNE group);*
- *do not require the use of unique and valuable intangibles and do not lead to the creation of unique and valuable intangibles; and*
- *do not involve the assumption or control of substantial or significant risk by the service provider and do not give rise to the creation of significant risk for the service provider."*

Examples of low value adding Intra-Group Services



It is pertinent to note that if internal comparables exist i.e. if similar services are rendered to unrelated customers of the members of the MNE group, the guidance provided in the Action Plan shall not be applicable.

Simplified charge mechanism for low value-adding intra-group services

The simplified approach for determining arm's length charges for low value-adding intra-group services is elective for taxpayers, but should be applied as far as practical on a consistent basis either group-wide or on a regional or divisional subgroup. Where a country has not adopted the simplified approach, and as a consequence the MNE group complies with the local requirements in that jurisdiction, such compliance would not disqualify the MNE group from the application of the simplified approach to other countries.

The approach sets out a few steps, as below, adherence to which will clear the mist around IGS for taxpayers as well as the revenue authorities:

Application of the benefits test

IGS are required to comply with the Arms' length requirements if they satisfy the benefits test i.e. the activity must provide the group member expected to pay for the service with economic or commercial value to enhance or maintain its commercial position, which in turn is determined by evaluating whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in-house for itself.

However, considering the nature of low value adding IGS, it may be difficult to always satisfy the benefits test and hence, the 2015 guidance states that compliance with the documentation as laid out in the simplified approach should provide sufficient evidence that the benefits test is met.

Thus, the taxpayer need only demonstrate that assistance was provided rather than being required to specify individual acts undertaken that give rise to the costs charged. A single annual invoice describing a category of services should suffice to support the charge, and correspondence or other evidence of individual acts should not be required.

Determination of cost pools

Step 1: A pool of costs should be calculated annually for each category of low value-adding services. The said cost pool should include direct and indirect costs as well as the appropriate part of operating expenses (eg. supervisory, general and administrative). The cost pool should specifically identify pass-through costs as no mark-up will be levied on these costs. Costs attributable to an in-house activity which solely benefits the company conducting the activity should be excluded(including shareholder activities performed by the shareholding company).

Step 2: Identification and removal of costs relating to services performed solely on behalf of another group company from the cost pool. These costs must be treated as a separate cost pool to be allocated directly to the beneficiary of the service.

Allocation of low value-adding service costs

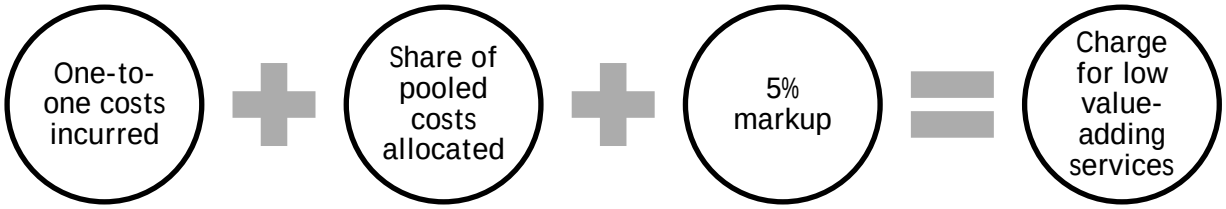
The 2015 guidance prescribes the use of allocation keys to achieve a fair split of such costs between all entities of the MNE group. Some basic rules about such allocation keys have been brought out as under:

- Based on nature of services – Services related to people may use headcount as the key, IT services may use the share of total users, accounting support services might employ the share of total relevant transactions or the share of total assets. In many cases, the share of total turnover may be a relevant key
- Consistency across same group of services
- Reflection of the level of benefit derived by each member

Profit mark-up

The 2015 guidance prescribes application of a 5% mark-up on all costs in the cost pool, with the exception of pass-through costs. The mark-up need not be justified by way of a benchmarking study and shall be sufficient to hold the low-value adding IGS at arms' length.

Charge for low-value adding services



Documentation and reporting

An MNE group electing application of the simplified methodology would need to maintain the following documentation:

- Description of the categories of low value-adding IGS provided, the benefits of such services and the reasons substantiating that such services constitute low value-adding services; the rationale for the provision of services within the context of the MNE business; a description of the selected allocation keys and the reasons substantiating that such allocation keys result in outcomes that reasonably reflect the benefits received; and the profit mark-up used
- Written contracts or agreements for the provision of services
- Documentation and calculations presenting the determination of the cost pools and the application of the specified allocation keys including details of costs of all categories and amounts of relevant costs, including costs for services provided solely to one group member
- Calculations showing the application of the specified allocation keys

The 2015 guidance further encourages tax administrations to limit any withholding taxes on low value adding services to the profit element in the charge.
It also mentions a potential threshold above which the elective simplified mechanism will not apply and further clarity is awaited on the same.

Parting thoughts

The OECD has attempted to provide pointed direction for most issues and the same can be expected to have a visible impact on the Indian transfer pricing scenario as well. While the topic on intangibles does and will remain a contentious issue, some guidance provided by the Action Plan should garner a path forward for taxpayers as well as the tax administrations.
With the Budget 2016 just around the corner, one can definitely expect some discussion on the BEPS Action Plans. While some legislative amendments on Country by Country reporting are expected to be on the cards of the Finance Minister, if we look at the guidance delved upon in Action Plans 8-10, the same may not call for any specific amendments in the legislature per say; but one could expect clarifications to the definitions of Intangibles and IGS (especially low value add IGS).
It would be interesting to see how the BEPS outcomes shape out in the Finance Bill, given India's concurrence to the BEPS project as member of the G20 (which has resounded the view emanating from the Action Plans). Having said that, some basic tenets that should not be lost sight of are the NDA Government's objective of a stable taxation policy and a non-adversarial tax administration and aim to achieve a balance between the 'need for tax revenues' and 'being tax competitive by attracting investments'.

On behalf of IFA WRC, we are thankful to CA Ankush Mehta and CA Shraddha Bathija for their valuable contribution

BEPS Action 13 – Transfer pricing documentation and Country-by-Country reporting

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Senior Tax Professionals

Introduction

The integration of national economies and markets has increased substantially in recent years. The current international tax rules which were designed decades ago have revealed weaknesses that potentially create opportunities for Base Erosion and Profit Shifting ('BEPS').This led G20 country's policy makers to take steps for ensuring that profits are taxed where economic activities take place and value is created. The idea is to strengthen "the foundations for long-term growth" and avoid policies that "promote growth at other countries' expense".

The Organisation for Economic Co-operation and Development ('OECD') estimates that tax avoidance through base erosion and profit shifting has resulted in loss of tax revenue to the tune of $100-240 billion every year - that is around 4-10% of global corporate income tax revenue[26]. The BEPS plan aims to improve transparency - for business and governments - by introducing commonly agreed minimum standards for tax administration across countries.

On 5 October 2015, OECD released final reports on all 15 focus areas in its Action Plan on BEPS. The 15-point Action Plan presented by the OECD is around three core principles – coherence, substance and transparency. Action Plan 13, *Transfer Pricing Documentation and Country-by-Country Reporting* (the Final Report) was released in a package that included final reports on all 15 BEPS Actions.

The Final Action Plan 13 Report largely follows the prior documents issued on this topic *(i.e., the Draft Report Transfer Pricing Documentation and Country-by-Country Reporting released on 16 September 2014, the Report Guidance on the Implementation of Transfer Pricing Documentation and Country-by- Country Reporting released on 6 February 2015 and the Report Country-by-Country Reporting Implementation Package released on 8 June 2015).* Action Plan 13 of the OECD's BEPS Action Plan, being part of transparency pillar, aims at re-examining transfer pricing documentation requirements and in particular requiring more information from taxpayers. Such information is expected to offer useful indicators for risk assessment and allow tax administrations to better focus their limited resources.

Overview

The Final Action Plan 13 Report contains revised standards which entail a three-tiered approach to transfer pricing documentation and Country-by-Country reporting, which consists of:

- A "master file" that provides with high-level information regarding a multinational enterprise's (MNE's) global business operations, supply chain, financing arrangements and transfer pricing policies in a single document where the MNE has operations. Master file is intended to provide a high-level overview in order to place the MNE group's transfer pricing practices in their global economic, legal, financial and tax context.
- A specific "local file" that provides information for each of local entity regarding material related party transactions, the amounts involved, and the company's analysis of the transfer pricing determinations they have made with regard to those transactions
- A Country-by-Country('CbC') reporting template that includes information on revenue (related and unrelated party), profits, income tax paid and taxes accrued, employees, stated capital and retained earnings, and tangible assets for each tax jurisdiction in which the MNE does business. In addition, the template includes information identifying each entity within

[25] The views expressed in this article by the authors are personal views.
[26] Source: Business Standard- 18 October 2015

the MNE group doing business in a particular tax jurisdiction and the business activities each entity conducts.

According to the OECD, these three documents taken together will require taxpayers to articulate consistent transfer pricing positions and will provide tax administrations with useful information on their global allocation of the income, economic activity and taxes paid among countries to assess transfer pricing risks, make determinations about where audit resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit inquiries. The Final Action Plan 13 Report further indicates that this information should make it easier for tax administrations to identify whether companies have engaged in transfer pricing and other practices that have the effect of artificially shifting substantial amounts of income into tax advantaged environments.

Further, it is mentioned that while Final Action Plan 13 Report provides guidance on Transfer Pricing documentation, the individual country can modify the transfer pricing documentation requirements taking into account the size and the nature of the local economy, the importance of the MNE group in that economy, and the size and nature of local operating entities, in addition to the overall size and nature of the MNE group.

Lets discuss about each constituent of this three tiered framework introduced by Action Plan 13

1. Master File – Blue print of an MNE group's global business model

As per the Final Action Plan 13 Report, the master file should provide an overview of the MNE group business, and its economic activity in order to place the MNE group's transfer pricing practices in their global economic, legal, financial and tax context. The information required in the master file can be grouped in five categories which are tabulated below: 1) Organisation structure 2) Business description 3) Intangibles 4) Intercompany financial activities 5) Financial and tax position.

Table 1:

Organization structure	**Business description**	**Intangibles**	**Intercompany financial**	**Financial and tax positions**
Structure chart	Important drivers of business profit	Overall strategy description	Financing arrangements for the group	Annual consolidated financial statements
• Legal ownership • Geographic location	Supply chain of: • 5 largest products/services by turnover • Products/services generating more than 5% of turnover	List of important intangibles and legal owners	Identification of financing entities	List and description of existing unilateral Advance Pricing Agreements
	Main geographic markets of above products	List of important intangible agreements	Details of financial transfer pricing policies	
	List and brief description of important service arrangements	R&D and intangible transfer pricing policies		
	Functional analysis of	Details of important		
	Business restructuring/ acquisitions/ divestitures during fiscal year			

The guidelines does not provide the exhaustive list of details to be mandatorily incorporated in the Master File, since that would have been unnecessarily burdensome for taxpayers and would also restrict the flexibility of taxpayers to prepare the Master File in a manner most appropriate for their respective businesses.

As per the Action Plan 13 Report,in producing the master file, taxpayers should use prudent business judgment in determining the appropriate level of detail for the information supplied, keeping in mind the objective of the master file to provide tax administrations with a high-level overview of the MNE's global operations, policies and supply chain model for each of the businesses run by it. The Final Action Plan 13 Report indicates that information is considered important if its omission would affect the reliability of the transfer pricing outcomes. The implementation of (and thresholds, if any, for) the master file is left at the discretion of the individual jurisdictions.

2. Local File

While the master file provides a high-level overview, the local file should provide more detailed information relating to specific material intercompany transactions of each of the local entity. The information required in the local file should supplement the master file and help in assessing whether the taxpayer has complied with the arm's length principle in its material transfer pricing positions affecting a specific jurisdiction. The information to be included as prescribed in the Action Plan 13 Report, are tabulated below:

Local entity	**Controlled transactions**	**Financial information**
• Management structure • Local organization chart • Details on individuals to whom local management reports	Description of material controlled transactions and context in which they take place Identification of associated enterprises to controlled transactions and relationship Functional analysis Transfer pricing methods used and comparables used;	Local entity financial statements
Description of business and business strategy pursued	Amounts of intra-group payments and receipts for controlled transactions (i.e. products, services, royalties, interest etc.)	Reconciliation to show how financial data used in applying the transfer pricing method ties to the financial statements
Details of business restructurings and/or intangible transfers	Unilateral and bilateral/multilateral APAs and other tax rulings related to the controlled transactions	Summary of relevant financial data for comparables and sources from which data was obtained
Key competitors		R&D and intangible transfer pricing policies
		Details of important transfers

Like the new rules for the master file, the guidance for the local file contains some specific deviations from typical current documentation standards for example: local file will have to be prepared, including financial information and allocation schedules to show how the financial data used in applying the transfer pricing method tied up to the annual financial statements.

Below is the difference between documentation requirement under Indian Transfer Pricing Regulation and guidance provided Action Plan 13 Report

Documentation as per Indian Transfer Pricing Provision	**Local file as per Action Plan 13**
• Group overview and ownership structure • Business and industry overview	• Organisational structure • Detailed business strategy • Competitors

• Selection of most appropriate TP method • Description of controlled transaction • Functional analysis • Comparable transactions or companies • Economic analysis • Supporting documents	• Controlled transactions • Intercompany payments and receipts • Associated enterprises • Intercompany agreements • Detailed comparability and functional analysis • TP method selected • Tested party • Assumptions applying TP method • Explanation of multiple year analysis • Comparability adjustments • Conclusions • TP method financial information • Copy of APA's and tax rulings

3. CbC Reporting

The Final Action Plan 13 Report provides for CbC reporting to be done separately from the master file and the local file.

- What to report: The CbC reporting template is divided into three tables: 1) Table I - Overview of revenue (with break up with related parties and unrelated parties), profit, taxes, tangible assets, and number of employees by tax jurisdiction 2) Table II - List of all Constituent Entities of the MNE group included in each aggregation by tax jurisdiction, along with tax residency of each entity including designation of Main Business Activity 3) Table III - Additional Information

- Who has to report: While the implementation has been left to individual countries, final Action Plan 13 Report recommends that a CbC report covers a multinational group with consolidated group revenue of 750 million Euro or more for the preceding year. The reporting MNE may choose to use data from its consolidation reporting packages, from separate entity statutory financial statements, regulatory financial statements, or internal management accounts. It is not necessary to reconcile the revenue, profit and tax reporting in the template to the consolidated financial statements. If statutory financial statements are used as the basis for reporting, all amounts should be translated to the stated functional currency of the reporting MNE at the average exchange rate for the year.

- When to report: As per the guidance provided in the Action Plan 13 report, the first year to be covered by CbC reporting is the fiscal year beginning in 2016. The first CbC report is to be filed by December 31, 2017.

- Where to report: As per the guidance provided in the Action Plan 13 report, the primary approach is for the parent entity to report for the group to its home country tax authority. That tax authority will then share the information with other countries covered by the CbC report under its tax information exchange relationships, which can take the form of a tax treaty, a tax information exchange agreement or the multilateral agreement.

  There is a secondary approach for reporting that applies when there is a failure in the primary approach, such as where the parent's home country does not require CbC reporting. In such a situation, countries covered by the CbC report can require direct reporting by the MNE, which would involve having to file CbC reports with the multiple countries tax authorities. Alternatively, it is contemplated that the MNE could identify an entity within the group that has adopted a CbC reporting requirement to act as its surrogate reporting entity, with this entity reporting for the group to its home country tax authority.

Reporting to tax authority of revenue, profit, tax paid and employee strength in each jurisdiction would allow tax authorities to carry out analysis and raise enquiries on role of entity in value creation vis-à-vis rewards enjoyed.

International aspect

With the release of draft report on Action 13, several countries have begun – from announced to completed - the process of putting CbC reporting in place. The countries like France, United Kingdom, Australia, Spain, Poland and Mexico where CBC reporting has already been implemented and the provisions are largely similar to guidance provided by OECD. Further, countries like Netherlands, Ireland, Norway, China, Japan, etc are expected to implement CbC reporting and have issued draft regulations. Not only will companies need to watch which countries move forward with CbC reporting, they would also need to consider what is potentially enacted by each country. The comparison of the provisions in respect to CbC in some of key countries is as under:

Particular	United Kingdom	Poland	Spain	Australia	France
Who has to report	UK resident parent entitiesof multinational groups withconsolidated grouprevenue of at least £586 million (approximately €790million) in a 12 month accounting period. The regulations also include provisions for a UK resident company that is not an ultimate parent entity to voluntarily file the CbC report for the group as a "surrogate parent entity." However, the UK regulations do not foresee a mandatory secondary filing mechanism.	Ultimate parents of group with revenue of EUR 750 million or greater	Ultimate parents of group with revenue of EUR 750 million or greater. The rules would also apply to Spanish entities and permanent establishments which are, directly or indirectly, held by a non-Spanish resident head entity which is tax resident in a country which (i) has not established CbC reporting obligations in similar terms to Spain; or (ii) has not signed an automatic exchange of information agreement with Spain in relation to these obligations. The wording of the regulations is not clear on how this new rule would apply in practice.	Threshold of AUD $1 billion (approximately EUR 670 million). The tax authority will obtain CbC reports of a foreign multinational operating in Australia directly from the tax authority in the parent entity jurisdiction	Ultimate parents of groups with revenue of EUR 750 million or greater
When to report	For fiscal years starting in 2016,filing within 12 months from fiscal year end	For fiscal years starting in 2016,filing within 12 months from fiscal year end	For fiscal years starting in 2016,filing within 12 months from fiscal year end	For fiscal years starting in 2016, filing within 12 months from fiscal year-end	For fiscal years starting in 2016, filing within 12 months from fiscal year-end
Where to report	Parent entity has to file with local tax authorities.	No information available	Local filing with Spanish Tax authorities	Local filing with the Australian Taxation office.	• Local filing • Filing by named ''surrogate parent'' entity

Indian landscape

In India, the taxpayer is required to obtain an accountant's certificate regarding the arm's length nature of pricing of inter-company transactions and adequacy of the prescribed documentation being maintained by the taxpayer. Penalties apply for (a) failure to file such accountant's certificate within the prescribed time limit (b) failure to report a transaction in the accountant's report and/or documentation and (c) failure to maintain adequate documentation and/or submit the same when requested by the tax authorities.

The Senior Indian Revenue officials in various forums have indicated that India would implement Action 13 recommendations soon (this could be a part of the Union Budget 2016 proposals) and would introduce suitable legislative amendments followed by rules, as necessary. The implementation is expected to be in line with the OECD recommendations. Further, it is expected that data gathered by way of CbC reporting will be used only as a tool for risk assessment. The information contained within CbC reporting cannot solely be the basis for a Transfer Pricing adjustment.

Further, news report suggest that Indian Government is in process of setting up new centralized department within the tax administration for risk assessment (Directorate of Risk Assessment) that is competent and well equipped to analyze CbC reporting. This means information will not be inappropriately used and interpreted by field officers.

Conclusion

The big headline with respect to CbC reporting is the flurry of country activity around implementing CbC reporting. Indian MNE's should fold their sleeves up and should carry out clinical analysis of its business structure and strategies to check if there are any mismatch between the FAR analysis of entities and remuneration to such entities. Entities need to be prepared for any questions and controversy that may arise during audits which might not have been detected during the course of normal local TP documentations so far; and also take corrective measures with respect to the supply chain models.

Even where above transfer pricing documentation requirements are yet not legislated in any country (such as India), MNEs should monitor amendments in local regulations of the countries where they have operations as they may require to revisit their documentation requirements based on the those regulations. For example: Japan has proposed filing of master file to Japanese tax authorities by Japanese entity (may not be ultimate holding company) whose consolidated revenue exceeds JPY 100 bn. Therefore, Indian headquartered MNE having operation in Japan and whose consolidated revenue exceeds JPY 100 bn, would require to submit master file in Japan.

Further, the concepts of Master File and CbC Reporting should not be looked at as a mere compliance requirement under the TP regulations, but should be considered as an opportunity to undertake a review of current operating models and legal structures to identify risk zones by taking inputs from all functions and proactively manage those risks.

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