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SUB-SECTION (ii)

GOVERNMENT OF INDIA
MINISTRY OF FINANCE
DEPARTMENT OF REVENUE
CENTRAL BOARD OF DIRECT TAXES

... ..

New Delhi, the 21st August, 2001

NOTIFICATION
INCOME-TAX

S.O. 808(E).- In exercise of powers conferred by section 295, read with sections 92C, 92D and 92E of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby makes the following rules further to amend the Income-tax Rules, 1962, namely:-

1. (i) These rules may be called the Income-tax (21st Amendment) Rules, 2001.
(ii) They shall come into force on the date of their publication in the Official Gazette.

2. In the Income-tax Rules, 1962, -

- (i) after rule 10, the following rules shall be inserted, namely:-

"10A. Meaning of expressions used in computation of arm's length price

For the purposes of this rule and rules 10B to 10E,-

- (a) 'uncontrolled transaction' means a transaction between enterprises other than associated enterprises, whether resident or non-resident;
- (b) 'property' includes goods, articles or things, and intangible property;
- (c) 'services' include financial services;
- (d) 'transaction' includes a number of closely linked transactions.

10B. Determination of arm's length price under section 92C

(1) For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely:-

- (a) comparable uncontrolled price method, by which,-

- (i) the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;
- (ii) such price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the price in the open market;
- (iii) the adjusted price arrived at under sub-clause (ii) is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction;

(b) resale price method, by which,-

- (i) the price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise, is identified;
- (ii) such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;
- (iii) the price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;
- (iv) the price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;
- (v) the adjusted price arrived at under sub-clause(iv) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise;

(c) cost plus method, by which,-

- (i) the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;

- (ii) the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;
 - (iii) the normal gross profit mark-up referred to in sub-clause (ii) is adjusted to take into account the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;
 - (iv) the costs referred to in sub-clause(i) are increased by the adjusted profit mark-up arrived at under sub-clause (iii);
 - (v) the sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise;
- (d) profit split method, which may be applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which-
- (i) the combined net profit of the associated enterprises arising from the international transaction in which they are engaged, is determined;
 - (ii) the relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;
 - (iii) the combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under sub-clause (ii);
 - (iv) the profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction:

Provided that the combined net profit referred to in sub-clause (i) may, in the first instance, be partially allocated to each enterprise

so as to provide it with a basic return appropriate for the type of international transaction in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution in the manner specified under sub-clauses (ii) and (iii), and in such a case the aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction;

(e) transactional net margin method, by which,-

- (i) the net profit margin realised by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;
- (ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;
- (iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;
- (iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii);
- (v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction.

(2) For the purposes of sub-rule (1), the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the following, namely:-

- (a) the specific characteristics of the property transferred or services provided in either transaction;

- (b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;
 - (c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;
 - (d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.
- (3) An uncontrolled transaction shall be comparable to an international transaction if –
- (i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or
 - (ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences.
- (4) The data to be used in analysing the comparability of an uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into:

Provided that data relating to a period not being more than two years prior to such financial year may also be considered if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared.

10C. Most appropriate method

- (1) For the purposes of sub-section (1) of section 92C, the most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction, and which provides the most reliable measure of an arm's length price in relation to the international transaction.

- (2) In selecting the most appropriate method as specified in sub-rule (1), the following factors shall be taken into account, namely:-
 - (a) the nature and class of the international transaction;
 - (b) the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;
 - (c) the availability, coverage and reliability of data necessary for application of the method;
 - (d) the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;
 - (e) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;
 - (f) the nature, extent and reliability of assumptions required to be made in application of a method.

10D. Information and documents to be kept and maintained under section 92D

- (1) Every person who has entered into an international transaction shall keep and maintain the following information and documents, namely:-
 - (a) a description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises;
 - (b) a profile of the multinational group of which the assessee enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions have been entered into by the assessee, and ownership linkages among them;
 - (c) a broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the associated enterprises with whom the assessee has transacted;
 - (d) the nature and terms (including prices) of international transactions entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;
 - (e) a description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involved in the international transaction;

- (f) a record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately, which may have a bearing on the international transactions entered into by the assessee;
 - (g) a record of uncontrolled transactions taken into account for analysing their comparability with the international transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions;
 - (h) a record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;
 - (i) a description of the methods considered for determining the arm's length price in relation to each international transaction or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case;
 - (j) a record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions;
 - (k) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price;
 - (l) details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under these rules and consequent adjustment made to the total income for tax purposes;
 - (m) any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.
- (2) Nothing contained in sub-rule (1) shall apply in a case where the aggregate value, as recorded in the books of account, of international transactions entered into by the assessee does not exceed one crore rupees:

Provided that the assessee shall be required to substantiate, on the basis of material available with him, that income arising from international transactions entered into by him has been computed in accordance with section 92.

- (3) The information specified in sub-rule (1) shall be supported by authentic documents, which may include the following:
- (a) official publications, reports, studies and data bases from the Government of the country of residence of the associated enterprise, or of any other country;
 - (b) reports of market research studies carried out and technical publications brought out by institutions of national or international repute;
 - (c) price publications including stock exchange and commodity market quotations;
 - (d) published accounts and financial statements relating to the business affairs of the associated enterprises;
 - (e) agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions;
 - (f) letters and other correspondence documenting any terms negotiated between the assessee and the associated enterprise;
 - (g) documents normally issued in connection with various transactions under the accounting practices followed.
- (4) The information and documents specified under sub-rules (1) and (2), should, as far as possible, be contemporaneous and should exist latest by the specified date referred to in clause (iv) of section 92F:

Provided that where an international transaction continues to have effect over more than one previous years, fresh documentation need not be maintained separately in respect of each previous year, unless there is any significant change in the nature or terms of the international transaction, in the assumptions made, or in any other factor which could influence the transfer price, and in case of such significant change, fresh documentation as may be necessary under sub-rules (1) and (2) shall be maintained bringing out the impact of the change on the pricing of the international transaction.

- (5) The information and documents specified in sub-rules (1) and (2) shall be kept and maintained for a period of eight years from the end of the relevant assessment year.

10E. Report from an accountant to be furnished under section 92E

The report from an accountant required to be furnished under section 92E by every person who has entered into an international transaction during a previous year shall be in Form No. 3CEB and be verified in the manner indicated therein.”;

- (ii) Rule 11 shall be omitted;
- (iii) in the appendix, after Form No. 3CEA, the following form shall be inserted, namely:-

“FORM NO. 3CEB
[See rule 10E]

Report from an accountant to be furnished under section 92E relating to international transaction (s)

1. *I/We have examined the accounts and records of
... .. (name and address of the assessee with PAN) relating to the international transactions entered into by the assessee during the previous year ending on 31st March,
2. In *my/our opinion proper information and documents as are prescribed have been kept by the assessee in respect of the international transaction(s) entered into so far as appears from *my/our examination of the records of the assessee.
3. The particulars required to be furnished under section 92E are given in the Annexure to this Form. In *my/our opinion and to the best of my/our information and according to the explanations given to *me/us, the particulars given in the Annexure are true and correct.

**Signed

Name _____
Address _____

Membership No. _____

Place:

Date:

Notes:

1. *Delete whichever is not applicable.
2. **This report has to be signed by –

- i) a chartered accountant within the meaning of the Chartered Accountants Act, 1949 (38 of 1949); or
- ii) any person who, in relation to any State, is, by virtue of the provisions in sub-section (2) of section 226 of the Companies Act, 1956 (1 of 1956), entitled to be appointed to act as an auditor of companies registered in that State.

ANNEXURE TO FORM NO. 3CEB

Particulars relating to international transactions required to be furnished under section 92E of the Income-tax Act, 1961

PART A

1. Name of the assessee
2. Address
3. Permanent account number
4. Status
5. Previous year ended
6. Assessment year

PART B

7. List of associated enterprises with whom the assessee has entered into international transactions, with the following details:
 - (a) Name of the associated enterprise.
 - (b) Nature of the relationship with the associated enterprise as referred to in section 92A(2).
 - (c) Brief description of the business carried on by the associated enterprise.

8. Particulars in respect of transactions in tangible property

- A. Has the assessee entered into any international transaction(s) in respect of purchase/sale of raw material, consumables or any other supplies for assembling/processing/manufacturing of goods/articles from/to associated enterprises? Yes/No

If 'yes', provide the following details in respect of each associated enterprise and each transaction or class of transaction:

- (a) Name and address of the associated enterprise with whom the international transaction has been entered into.
- (b) Description of transaction and quantity purchased/sold.
- (c) Total amount paid/received or payable/receivable in the transaction -
 - i) as per books of account.
 - ii) as computed by the assessee having regard to the arm's length price.
- (d) Method used for determining the arm's length price [See section 92C(1)]

- B. Has the assessee entered into any international transaction(s) in respect of purchase/sale of traded/finished goods? Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each transaction or class of transaction:

- (a) Name and address of the associated enterprise with whom the international transaction has been entered into.
- (b) Description of transaction and quantity purchased/sold.

- (c) Total amount paid/received or payable/receivable in the transaction -
 - i) as per books of account.
 - ii) as computed by the assessee having regard to the arm's length price.
- (d) Method used for determining the arm's length price [See section 92C(1)]

C. Has the assessee entered into any international transaction(s) in respect of purchase/sale of any other tangible moveable/immovable property or lease of such property? Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each transaction or class of transaction:

- (a) Name and address of the associated enterprise with whom the international transaction has been entered into.
- (b) Description of the property and nature of transaction.
- (c) Number of units of each category of moveable/immovable property involved in the transaction.
- (d) Amount paid/received or payable/receivable in each transaction of purchase/sale, or lease rent paid/received or payable/receivable in respect of each lease provided/ entered into -
 - i) as per books of account.
 - ii) as computed by the assessee having regard to the arm's length price.
- (e) Method used for determining the arm's length price [See section 92C(1)]

9. Particulars in respect of transactions in intangible property:

Has the assessee entered into any international transaction(s) in respect of purchase/sale/use of intangible property such as know-how, patents, copyrights, licenses, etc.?

Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each category of intangible property:

- (a) Name and address of the associated enterprise with whom the international transaction has been entered into.
- (b) Description of intangible property and nature of transaction.
- (c) Amount paid/received or payable/receivable for purchase/sale/use of each category of intangible property -
 - i) as per books of account.
 - ii) as computed by the assessee having regard to the arm's length price.
- (d) Method used for determining the arm's length price [See section 92C(1)]

10. Particulars in respect of providing of services:

Has the assessee entered into any international transaction(s) in respect of services such as financial, administrative, technical, commercial services, etc.?

Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each category of service:

- (a) Name and address of the associated enterprise with whom the international transaction has been entered into.
- (b) Description of services provided/availed to/ from the associated enterprise.

- (c) Amount paid/received or payable/receivable for the services provided/taken -
 - i) as per books of account.
 - ii) as computed by the assessee having regard to the arm's length price.
- (d) Method used for determining the arm's length price [See section 92C(1)]

11. Particulars in respect of lending or borrowing money:

Has the assessee entered into any international transaction(s) in respect of granting/receiving loans/ advances to or from associated enterprise?

Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each loan/advance:

- (a) Name and address of the associated enterprise with whom the international transaction has been entered into.
- (b) Nature of financing agreement.
- (c) Currency in which loan/advance granted/received.
- (d) Interest rate charged/paid in respect of each loan/advance.
- (e) Amount paid/received or payable/receivable in the transaction -
 - i) as per books of account.
 - ii) as computed by the assessee having regard to the arm's length price.
- (f) Method used for determining the arm's length price [See section 92C(1)]

12. Particulars in respect of mutual agreement or arrangement:

Has the assessee entered into any international transaction with an associated enterprise or enterprises by way of a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises?

Yes/No

If 'yes' provide the following details in respect of each agreement/arrangement:

- (a) Name and address of the associated enterprise with whom the international transaction has been entered into.
- (b) Description of such mutual agreement or arrangement.
- (c) Amount paid/received or payable/receivable in each such transaction -
 - i) as per books of account.
 - ii) as computed by the assessee having regard to the arm's length price.
- (d) Method used for determining the arm's length price [See section 92C(1)]

13. Particulars in respect of any other transaction:

Has the assessee entered into any other international transaction not specifically referred to above, with associated enterprise?

Yes/No

If 'yes' provide the following details in respect of each associated enterprise and each transaction:

- (a) Name and address of the associated enterprise with whom the international transaction has been entered into.

- (b) Description of the transaction.
- (c) Amount paid/received or payable/receivable in the transaction -
 - i) as per books of account.
 - ii) as computed by the assessee having regard to the arm's length price.
- (d) Method used for determining the arm's length price [See section 92C(1)]

**Signed
Name _____
Address _____

Place:

Date:

Notes: **This annexure has to be signed by -

- i) a chartered accountant within the meaning of the Chartered Accountants Act, 1949 (38 of 1949); or
- ii) any person who, in relation to any State, is, by virtue of the provisions in sub-section (2) of section 226 of the Companies Act, 1956 (1 of 1956), entitled to be appointed to act as an auditor of companies registered in that State."

(Batsala Jha Yadav)
Under Secretary to the Govt. of India

F.No. 142/ 41/2001-TPL

Notification No. _____

Note. The principal rules were published vide Notification No.969(E) dtd. 26.3. 1962 and were last amended by the Income-tax (20th Amendment) Rules, 2001 vide Notification 248/2001 dtd. 17.8.2001.

