

# **An Analysis of Transfer Pricing Disputes in India**

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## Abstract

The transfer pricing regime in India, since its inception, has been criticised for pronounced and protracted litigation. In this context, this paper evaluates the transfer pricing regime over the span of a decade (2003-04 to 2013-14) using 6731 case orders. It presents the first evidence of the duration of transfer pricing cases, delineated into pre-ITAT and post-ITAT phases, and compares the performance of the two pre-ITAT forums — the CIT(A) and the DRP. Further, the paper presents evidence on issues such as repeated litigation on identical grounds and remand orders that place companies in cycles of litigation. We find that while the DRP, as an alternative dispute resolution mechanism, may have led to a reduction in case duration in the initial years, this benefit may have now peaked leading to a convergence across forums. Further, we find that often grounds for litigation are similar across years, and therefore joint audits for multiple years may be a superior strategy for transfer pricing cases than the current one.

**Keywords:** Transfer pricing, Income Tax Appellate Tribunal, Dispute Resolution Panel

**JEL classification:** K34, K41, M41, M42

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# Contents

<b>Acronyms</b>	<b>5</b>
<b>1 Introduction</b>	<b>6</b>
<b>2 Transfer pricing regime in India</b>	<b>9</b>
<b>3 Research questions and methodology</b>	<b>11</b>
3.1 Methodology . . . . .	11
3.1.1 Duration . . . . .	12
3.1.2 Reopened assessments . . . . .	12
3.1.3 Route . . . . .	12
3.1.4 Outcome . . . . .	13
<b>4 Results</b>	<b>13</b>
4.1 Sample description . . . . .	13
4.2 Total time taken: Assessment to pronouncement . . . . .	14
4.3 Time taken: CIT(A) vs. DRP . . . . .	16
4.4 Repeated disputes . . . . .	18
4.4.1 Remand and Re-opening . . . . .	18
4.4.2 Similar issue . . . . .	22
<b>5 Appellant and case outcomes</b>	<b>22</b>
<b>6 Conclusion</b>	<b>24</b>
<b>A Annexure</b>	<b>27</b>
A.1 Specifications for filtering transfer pricing cases . . . . .	27
A.2 Specifications for extracting sections of IT Act . . . . .	27
A.3 Specifications for extracting route data . . . . .	27
A.3.1 CIT(A) / DRP . . . . .	27
A.4 Specifications for extracting outcome data . . . . .	28
A.4.1 Own case . . . . .	28
A.5 Samples of text of ITAT orders . . . . .	29

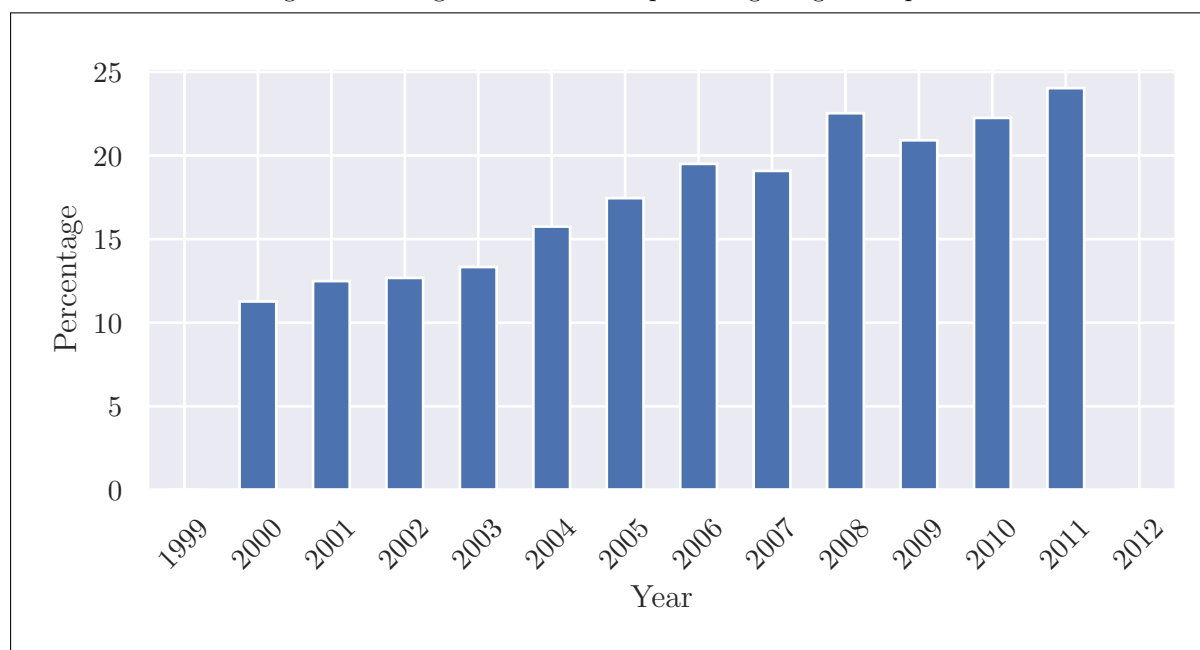
## Acronyms

ALP	Arm's Length Price.
AO	Assessing Officer.
APA	Advance Pricing Agreements.
AY	Assessment Year.
CBDT	Central Board of Direct Taxation.
CIT(A)	Commissioner of Income Tax (Appeals).
DRP	Dispute Resolution Panel.
IT Act	Income Tax Act, 1961.
ITAT	Income Tax Appellate Tribunal.
TP	Transfer Pricing.
TPO	Transfer Pricing Officer.

# 1 Introduction

In the 2000s India witnessed a rapid expansion in trade and investment. This increase in international transactions was accompanied by a rise in global production networks, which have allowed the production, sale and distribution of a product to be undertaken in different countries. With production and sales of products located in different parts of the world, it is expected that there would be a commensurate increase in intra-group transactions. The share of foreign value added in India exports in part reflects such transactions. Figure 1 shows that these have expanded over the last decade.

Figure 1: Foreign value added as percentage of gross exports



Source: TiVA database, OECD

An alternative measure of intra-company transactions are related party transactions reported in company accounts. The number of one type of such transactions — the income from sale of goods and services by holding and subsidiary companies — is observed to have increased.

With increase in economic activity reported by MNCs, there has been growing concern over manipulation of the price charged or paid in intra-group transactions.<sup>1</sup> Prompted by concerns over such avoidance practices, Indian government, in the *Finance Bill, 2001*, introduced the **Transfer Pricing (TP)** regulations. The *Finance Bill, 2001* introduced sections 92A to 92F to the **Income Tax Act, 1961 (IT Act)**.<sup>2</sup> In the same year the law was operationalised using Rules 10A to 10E. The amendment to the **IT Act** inserted definitions of the terms *associated enterprise*, *international transactions* and *Arm's Length Price (ALP)*. Further, it laid out the process of determining arm's length price and compliance procedures in terms of the accompanying documentation. The rules adopted are largely in line with international practices.<sup>3</sup>

Determination of arm's length price is a fact-intensive exercise carried out by the taxpayer. The tax department can scrutinise these workings and may raise objections on various grounds such as methodology adopted, comparable selected or the risk adjustments made to a transaction. Over the years, the transfer pricing audits have risen fourfold, from 1000 in 2005–06 to 4290 in 2014–15. Correspondingly, the proportion of adjustment cases have increased from 23 per cent in 2005–06 to more than 50 per cent in 2014–15.<sup>4</sup>

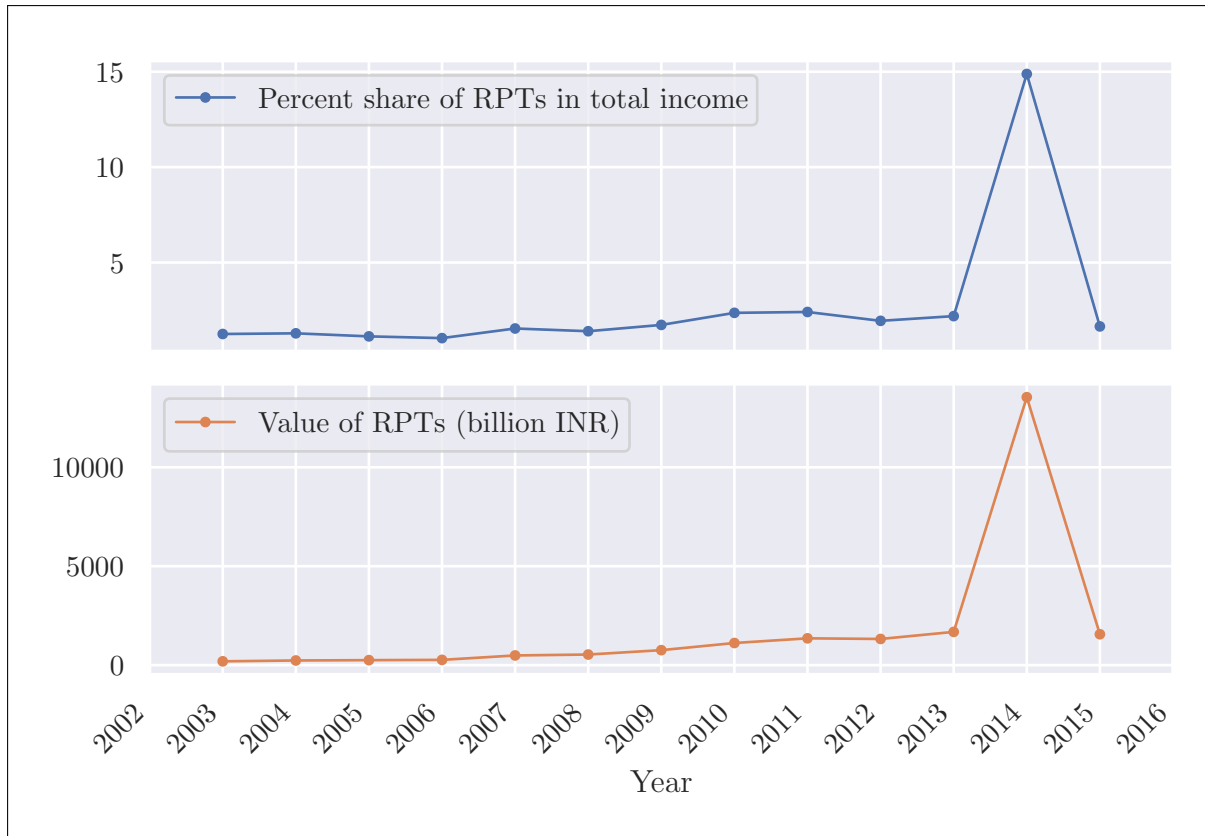
<sup>1</sup>Ministry of Finance, Government of India 2001.

<sup>2</sup>These replaced the earlier section 92

<sup>3</sup>A few changes such as the use of range and multiple year information were not available in the years close to introduction of the law and were introduced subsequently.

<sup>4</sup>Ministry of Finance, Government of India 2014; Ministry of Finance, Government of India 2015.

Figure 2: Value and Share of Related Party Transactions



Source: Prowess, CMIE

In case an adjustment is made to the existing tax liability, it is likely that the assessee will present his case based on his calculations and litigation may follow. As a result, transfer pricing litigation has also witnessed an increase. In 2012, India had the third largest stock of transfer pricing disputes.<sup>5</sup>

The *OECD/IMF Report on Tax Certainty - 2018 Update* underscored the heightened concern over uncertainty in tax matters especially in the context of international taxation. It was suggested that dispute resolution mechanisms, including timescales were an important consideration for businesses, which they perceived as drivers of uncertainty. In this context, transfer pricing disputes form an important element, especially in India.

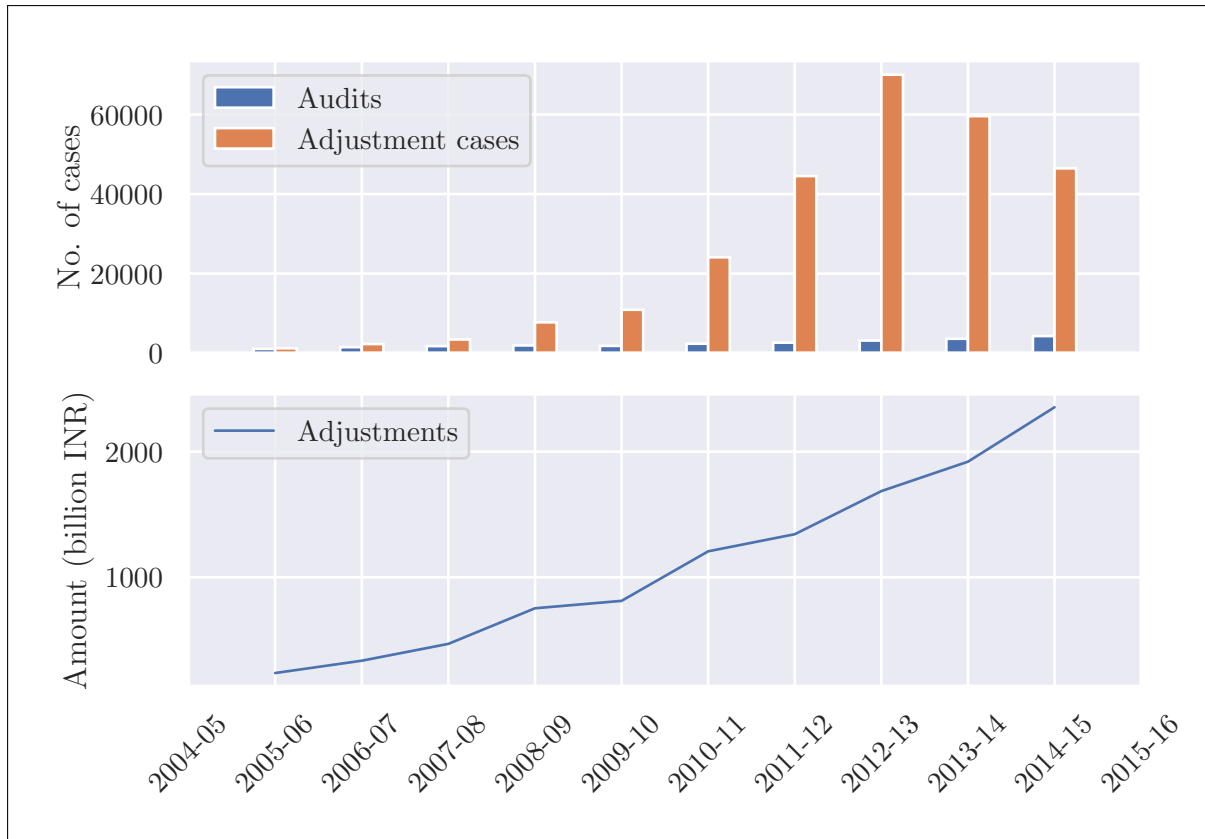
Considering that companies undertake similar international transactions across years, an unresolved issue can create uncertainty across years. In terms of amount of adjustment this can be quite substantial. Transfer pricing disputes are a pressing issue not just for the taxpayer but also for administration that is strained for manpower. It is therefore important that disputes are resolved more efficiently in a shorter time frame. In this context, improvements such as the alternate dispute resolution mechanism were introduced to reduce delays. It is important to examine whether these interventions have expedited the disposal of appeals.

Further, a connected but equally critical issue is that of case resolution. It is important to assess if the case finally stands resolved or is it merely disposed. There is a subtle difference between the two, yet each has different implications for the taxpayer. As the following section shall discuss, disposal may not always result in resolution. To wit, an appeal may be disposed of by being remanded to the assessing officer for fresh adjudication. To examine these issues, we constructed a database of 6731 cases from the *Income Tax Appellate Tribunal (ITAT)* and employed natural language processing tools to study them.

Earlier studies have adopted a similar approach to examine issues of judicial delay in the context of Debt

<sup>5</sup> India has 3rd largest number of transfer pricing cases: E&Y 2014.

Figure 3: Audits and Adjustments



Source: Annual Reports of MoF, 2013-14 and 2014-15

Recovery Tribunals<sup>6</sup>, High Courts<sup>7</sup> and ITAT<sup>8</sup>. Further, Chatterjee, Shaikh, and Zaveri (2017) use order details of the National Company Law Tribunal in cases pertaining to Insolvency and Bankruptcy Code to examine the time taken as well as the nature of evidence presented in the case and case outcomes. The present study differs from the existing literature in two significant ways. First, the study seeks to estimate the duration of the case not just with the purpose of assessing the *delay* associated with a particular institution. Instead it seeks to assess an entire administrative process and a range of institutions associated with it. This allows us to gain a better understanding of the contribution each makes specifically to the length of the transfer pricing case. Moving beyond the duration, this paper also evaluates various dimensions of transfer pricing cases such as efficacy of alternate dispute resolution mechanisms, case disposal and case outcome. Identifying each of these elements is extremely useful in devising a set of effective reforms.

The paper begins by describing the transfer pricing regime in India (Section 2). This includes the assessment and dispute resolution process. The analysis in this paper is based on the data constructed from orders pronounced. The protocol for extracting relevant information from case laws as well as its characteristics are detailed in Section 3.1. Based on the information collected, the paper analyses the functioning of institutions as well as the outcomes of transfer pricing disputes (Section 4). This is to identify reforms that may be necessary to better the transfer pricing regime followed by conclusion (Section 6).

<sup>6</sup>Regy and Roy 2017.

<sup>7</sup>Khaitan, Seetharam, and Chandrashekar 2017.

<sup>8</sup>Datta, Prakash, and Sane 2017.



## 2 Transfer pricing regime in India

A corporate assessee that undertakes an international transaction with an associated enterprise is expected to document the details of such transactions in the prescribed form<sup>9</sup>, and have it verified by the accountant. Section 92D of *Income Tax Act, 1961 (IT Act)* and Rule 10D prescribe that contemporaneous information on entity<sup>10</sup>, price<sup>11</sup> and transactions<sup>12</sup> must be maintained. Once the required documentation has been filed, the Assessing officer selects cases for scrutiny based on the criteria for selection. The criterion for audit has changed over time from one based on monetary thresholds to one based on risk. The monetary threshold was initially set at INR 50 million, which was subsequently revised to INR 150 million. Further, Instruction No.6 of 2014 issued by the *Central Board of Direct Taxation (CBDT)* provided that the selection of cases was to be based on an automated process called the CASS.<sup>13</sup> However, this Instruction required mandatory selection of cases for *Transfer Pricing (TP)* audits if a taxpayer was subject to a TP adjustment exceeding INR 100 million in the prior years. Thereafter, in line with the recommendations of Tax Administration Reform Commission (TARC), *CBDT* issued the Updated Guidance in October 2015, according to which, selection of cases for TP audits was based on “risk parameters” as against the monetary threshold.<sup>14</sup> On selecting a case for audit, the assessing officer *may* refer it to the *Transfer Pricing Officer (TPO)*. Although the *Income Tax Act* mentions that the *Assessing Officer (AO)* may refer the case to TPO if he considers it *necessary and expedient*, instruction no.3 in 2003 made the reference mandatory for cases where international transaction is in excess of INR 50 million.<sup>15</sup> This was later set at INR 150 million. Subsequently, the *CBDT* issued a revised guidance that made it mandatory for cases selected on the basis of TP risk parameters to be referred to the TP officer.<sup>16</sup> The TPO has to determine the *Arm’s Length Price (ALP)*.

On receiving the order from the TPO, the AO proceeds to compute the total income in conformity with the ALP and thereafter forwards the draft order to the assessee for his objections. The assessee may accept the draft order within 30 days or file objections against the draft order before the *Dispute Resolution Panel (DRP)* within 30 days of the receipt of the draft order<sup>17</sup>. Alternatively, he can file an appeal before the *Commissioner of Income Tax (Appeals) (CIT(A))* within 30 days of receipt of the final order.<sup>18</sup> The period of assessment was originally capped at 3 years, but on 1st June 2016 it was capped at 33 months for transfer pricing cases.<sup>19</sup>

The assessee has two channels for appeal. One before the *CIT(A)* against the final order and other before *DRP* against the draft order. The *Finance Act, 2009* introduced the alternate dispute resolution mechanism or the *DRP* with the intent to expedite dispute resolution. Until 2012, the Revenue Department could not appeal against the order of the *DRP*. However the *Finance Act, 2012* amended section 253(2A) of the *IT Act*. As per the amendment, Principal Commissioner or Commissioner could appeal before the *Income Tax Appellate Tribunal (ITAT)*, against the order of the *DRP* in respect of any objection filed on or after the 1st day of July 2012.

The *Income Tax Act* specifies different time limits for the disposal of appeals by the two dispute resolution bodies. Sections 250(6A) and 254 provide that *where it is possible*, the *CIT(A)* and the *ITAT* respectively shall dispose off the appeal within the time specified. For the *CIT(A)* this is one year from the end of the financial year in which appeal is filed. Whereas for the *ITAT* it is a period of four years from the end of the financial year in which appeal is filed. However, in the case of the *DRP* the Act mandates u/s 144C(12) that no direction shall be issued by the *DRP* after *nine months* from the end of the month in which the draft order is forwarded to the eligible assessee. Therefore, although the law prescribes a time frame, only in the case of *DRP* is it binding. The *ITAT* is the last fact-finding authority. Any appeal pertaining to a matter of law proceeds to the High Court and then Supreme Court.

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<sup>9</sup>Form 3CEB

<sup>10</sup>Ownership structure, profile of the MNC group, industry of the assessee and AE

<sup>11</sup>Comparability, most appropriate method, adjustments, FAR

<sup>12</sup>Nature and terms of international transactions

<sup>13</sup>Central Board of Direct Taxation 2014b.

<sup>14</sup>E&Y 2016.

<sup>15</sup>Central Board of Direct Taxation 2014a.

<sup>16</sup>CBDT 2015.

<sup>17</sup>DRP is a collegium comprising of three Commissioners of Income-tax constituted by the Board

<sup>18</sup>The AO is required to pass the final assessment order within 1 month from the end of the month or acceptance or period of filing of objection expires

<sup>19</sup>Under Section 153 of Government of India 1961.

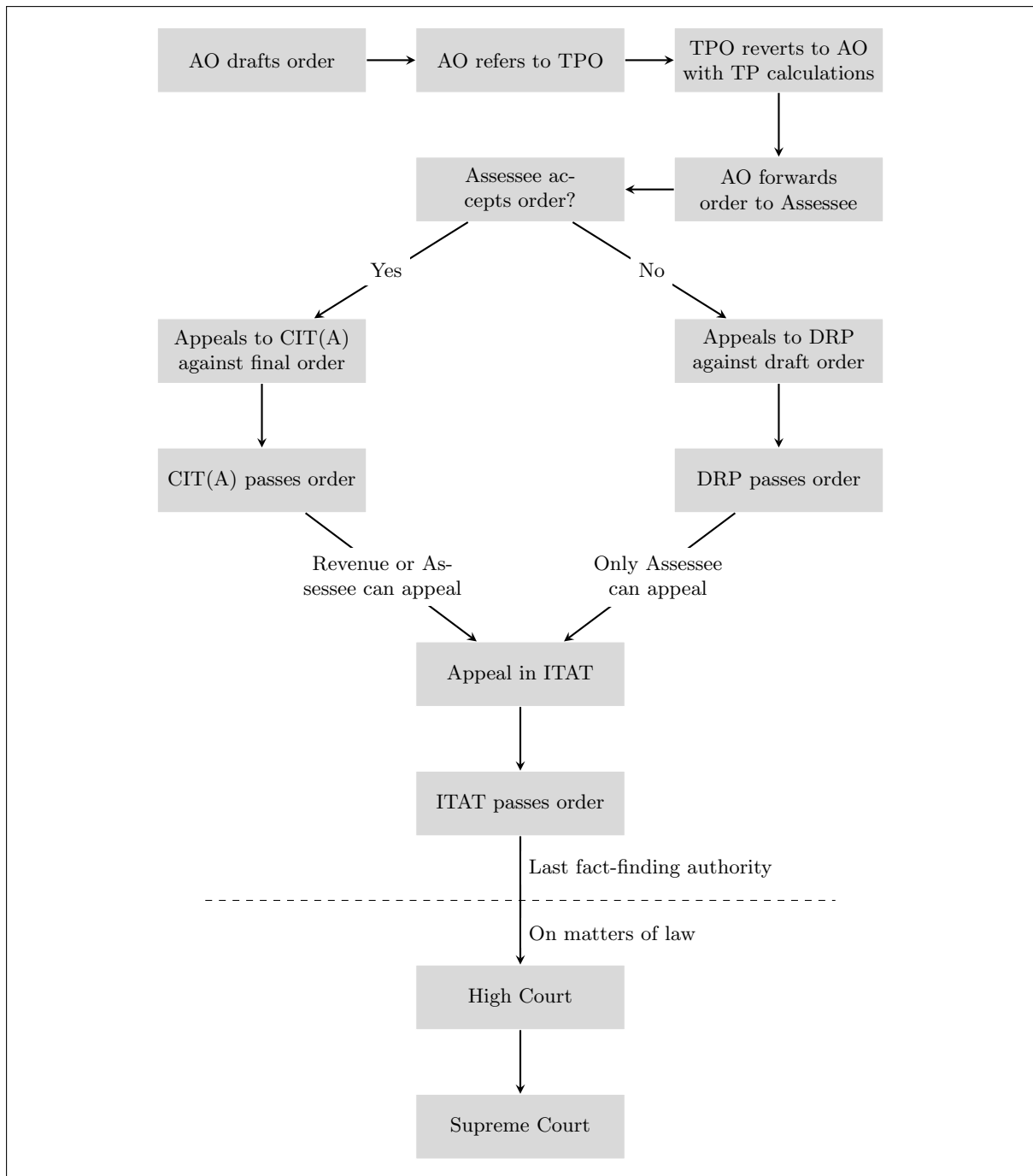


Figure 4: Dispute resolution process

Throughout the period 2005-06 to 2014-15, the number of adjustment cases have been on the rise. As is shown in Figure 3. It is in fact claimed that India accounted for third largest number of transfer pricing disputes in 2012.<sup>20</sup> To tackle the rise in transfer pricing disputes, the tax department introduced other reforms such as the [Advance Pricing Agreements \(APA\)](#) in 2012.<sup>21</sup> Initially, APAs were applicable for a period of five years from the previous year in which it was applied. Subsequently, with the introduction of the roll back provision in the Finance Act 2014 the APA is also applicable to four years preceding the first previous year for which APA is applied.

<sup>20</sup> India has 3rd largest number of transfer pricing cases: E&Y 2014.

<sup>21</sup> An APA is an agreement between a tax payer and tax authority determining the transfer pricing methodology for pricing the taxpayer's international transactions for future years. The methodology is to be applied for a certain period of time based on the fulfilment of certain terms and conditions (called critical assumptions).

### 3 Research questions and methodology

The ease with which a business can incorporate and operate in a jurisdiction is associated with the simplicity of tax law and the compliance processes. Tax disputes can interfere with such simplicity and protracted disputes can lend uncertainty in treatment of income and expenses. Establishing that related party transactions can be a complex and time consuming exercise. For large multinationals that are expected to have large intra-company transactions transfer pricing is expected to be one of the important issues. In this regard, this study evaluates dispute resolution in transfer pricing. While evaluating the institutions, it is important to understand that the law itself has evolved since the introduction of transfer pricing. For example, measures such as the APA or the alternate dispute resolution forum — DRP — or use of multiple year data for calculations are measures used to mitigate transfer pricing disputes. Using case orders from the ITAT, a time line of cases is constructed from assessment year to the case conclusion. It is then estimated if the various interventions have had any significant impact on the timing. Transfer pricing disputes typically detail the history of the case specifying the appeal route taken as well as the facts of the case. Using these case details we construct the history from the year of assessment to the year in which the ITAT pronounced the order. Although the case may move to the High Court and then the Supreme Court we do not focus on pendency. We attempt to split the journey of a case between pre-ITAT and post-ITAT periods to examine how each process has evolved and contributes to the total time taken. In this context, the introduction of alternatives such as the DRP and APAs are examined through the use of case data. That is, we evaluate whether these interventions have had a positive impact on duration.

International transactions between associated enterprises take place repeatedly over time. Thus, any delay in resolving the matter may result in accumulation of disputed sums across financial years. We therefore also analyse the incidence of identical issues being litigated by the same assessee.

Case disposal has to be differentiated from case conclusion. Essentially, transfer pricing is an economic exercise and a specialist such as the TPO has to determine if the transaction is at arm's length. Since ITAT is the final fact-finding authority, in its order it may direct the AO to carry out the computation afresh. As a result, in many cases the ITAT remits the matter to the file of the AO and this may be further contested thus delaying case closure. The paper presents incidence of disposal that is not closure. The methodology adopted for eliciting such information from case orders, is detailed in the next section.

Lastly, it is possible to compare the case outcomes by party that filed the appeal. In this paper we assess a fraction of transfer pricing disputes that are attributable to an assessee's contention with the order or that of the revenue. For such cases, it is also seen if the case was disposed in favour of assessee or revenue.

#### 3.1 Methodology

Our strategy for this study was to slice the dataset along three thematic axes:

- Duration,
- Route (whether it came through CIT(A) or DRP, who filed the appeal), and
- Outcome

We then inspected the distribution of cases along these three axes.

For this study we relied on data from the website of the Income Tax Appellate Tribunal (ITAT).<sup>22</sup> While the website has a facility to record transfer pricing cases separately, we found that in practice they are filed as income tax appeals. The data scraped from the ITAT website only contains cases which the tribunal has disposed of. While the website does contain information on ongoing cases, it was not possible to find out how many of those were transfer pricing appeals, since transfer pricing appeals are usually filed as income tax appeals, and not reported separately. As a result, the number of pending/ongoing transfer pricing cases was not available.

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<sup>22</sup><https://www.itat.gov.in/judicial/tribunalorders>

We therefore scraped the entire dataset of completed income tax appeals with assessment years between 2003–04 and 2013–14, for which an order is available.<sup>23</sup> We then used text-mining to filter cases related to transfer pricing. This yielded a total of 6731 cases. For all text-mining, we used the Python-3 implementation of regular expressions.<sup>24</sup>

### 3.1.1 Duration

First we sought to understand the duration of each phase through which a TP dispute goes:

1. How long an AO takes to complete an assessment?
2. How long does the CIT(A)/DRP take to dispose of the first appeal?
3. How long does the ITAT take to dispose of the second appeal?

Delineated data for answering questions 1, 2 are not available due to restrictions placed by the IT Act on disclosures. However, the ITAT website does provide the following data about a case which yield insights into the duration:

- Date of pronouncement
- Assessment year
- Date on which the appeal was filed
- ITA number for the case

The time from the assessment year to the date of appeal effectively gives us the time taken by the AO for assessment plus the time taken by CIT(A)/DRP to dispose of the first appeal. The time from date of appeal to the date of pronouncement gives us the time taken by the ITAT to dispose of the appeal. Thus, we analyse the journey of a TP case in two phases (prior to ITAT, and in ITAT) instead of three.

### 3.1.2 Reopened assessments

It has been conjectured that reopening of assessments by Assessing Officers, under sections 147 and 148 of the IT Act, significantly increases the duration of IT disputes. To test this conjecture, we extracted all references to section numbers of the IT Act in each order, and identified cases which contain references to section 147 or 148. We found 555 cases which had a reference to section 147 and/or section 148 of the IT Act. We compared these cases with the rest of the cases on the aforementioned parameters of duration.

### 3.1.3 Route

The first appeal of for TP cases is heard either by the CIT(A) or by the DRP. This is the first *route* parameter on which we classified cases. After the first appeal is disposed of by the CIT(A)/DRP, either the assessee, or the Revenue Department files an appeal against the CIT(A)/DRP's order. This is the second *route* parameter on which we classified cases.

We then compared the numbers of cases, and the durations of the two phases for these categories viz.:

- cases coming through CIT(A) with cases coming through DRP, and
- appeals filed by the assessee with appeals filed by Revenue.

For finding out whether the case came through the CIT(A) or DRP, we mined the text of the order. We were able to ascertain whether the case came through the CIT(A) or DRP in 6510 cases out the total 6731. For the remaining 221 cases we were unable to ascertain the route.

Data about the appellant and respondent are provided by the ITAT website. We therefore have this data for all 6731 cases.

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<sup>23</sup>Orders are not available for all cases

<sup>24</sup>For exact search specifications refer to the Annexure

### 3.1.4 Outcome

On outcome, we examined the following parameters viz.:

1. Was the case remitted back to the [AO](#) for a fresh assessment, and
2. Did the [ITAT](#) allow the appeal, dismiss it or partly allow it.

Parameter 1 measures whether the case was a resolution or just a disposal without resolution. We extracted this information from the text of the order. While the cases which we identified as being remitted back were all true positive matches, there could be false negatives which we may not have identified. In other words, the actual number of cases which are remitted back to the [AO](#) could be higher than what we estimate.

Parameter 2 combined with information on who filed the appeal, gives information about who typically wins cases on which the [ITAT](#) judges. This information is provided by the [ITAT](#) website.

## 4 Results

### 4.1 Sample description

As stated earlier, our dataset contained 6731 appeals related to transfer pricing. There are three kind of appeals which qualify, viz. income tax (transfer pricing) appeals, cross objections and stay applications. Cross objections and stay orders typically relate to procedural appeals in relation to an income tax (transfer pricing) appeal. Of the 30 benches of [ITAT](#), we found transfer pricing cases were heard by 21 benches. Delhi and Mumbai benches have the highest number of appeals by a large margin. These two benches hear nearly 50 per cent of all transfer pricing appeals which appear before the [ITAT](#). Table 2 shows the number of different types of appeals in our sample delineated by bench.

Table 2: Bench-wise number of cases of different types

Bench	Income Tax (Transfer Pricing) Appeal	Cross Objec- tion	Stay Appli- cation	Total cases
Delhi	1663	49	12	1724
Mumbai	1411	46	111	1568
Bangalore	724	36	52	812
Pune	542	43	37	622
Chennai	547	22	39	608
Hyderabad	547	12	16	575
Ahmedabad	256	9	11	276
Kolkata	191	6	10	207
Chandigarh	50	5	11	66
Panaji	39	14	0	53
Cochin	34	1	10	45
Jaipur	35	1	2	38
Indore	32	2	1	35
Amritsar	17	3	0	20
Visakhapatnam	18	2	0	20
Rajkot	17	2	0	19
Agra	15	0	0	15
Cuttack	11	3	0	14
Lucknow	7	0	0	7
Jodhpur	6	0	0	6
Nagpur	1	0	0	1
<b>Total</b>	<b>6163</b>	<b>256</b>	<b>312</b>	<b>6731</b>

We selected appeals which had assessment years between 2004 to 2014. The years in which the appeals were filed range from 2005 to 2018. The years of pronouncement range from 2007 to 2018. Table 3 shows the number of cases by assessment year, year of appeal and year of pronouncement.

Table 3: Cases in sample by year of assessment, appeal and pronouncement

Year of assessment	No. of cases	Year of appeal	No. of cases	Year of pronouncement	No. of cases
2004	351	2004	0	2004	0
2005	433	2005	2	2005	0
2006	634	2006	12	2006	0
2007	707	2007	89	2007	0
2008	923	2008	112	2008	0
2009	917	2009	189	2009	13
2010	926	2010	719	2010	97
2011	826	2011	858	2011	253
2012	534	2012	885	2012	418
2013	329	2013	665	2013	529
2014	151	2014	1035	2014	697
2015	-	2015	904	2015	919
2016	-	2016	717	2016	1335
2017	-	2017	480	2017	1262
2018	-	2018	64	2018	1207

In 2147 of the 6731 cases, the first appeal was heard by the **DRP**, while in 3645 cases the first appeal was heard by the **CIT(A)**. In 718 cases, the **ITAT** dealt with multiple appeals in one order, and in some of the appeals the first appellate authority was the **DRP** while in some it was the **CIT(A)**. There are other appeals in which the **ITAT** dealt with multiple appeals in the same order, but in those cases the first appeals were either heard only by **DRP** or only by **CIT(A)**. They are counted in their respective figures. In our comparison of durations of appeals for appeals coming through **DRP** vs appeals coming through **CIT(A)**, we disregard these 718 appeals. In 221 cases, we could not ascertain who heard the first appeal. These 221 appeals are also disregarded in our comparison of **CIT(A)** and **DRP**.

## 4.2 Total time taken: Assessment to pronouncement

The duration of a case, that is from the assessment to the conclusion of dispute, is important for the taxpayer and the tax department. Protracted dispute can compound uncertainty for future international transactions. The estimated duration of the transfer pricing case can be divided into two parts. The first is *pre-ITAT* duration, which is from the assessment year to which the said income or expense relates, to the year in which the appeal is filed in the **ITAT**. Second is *post-ITAT* duration or time taken exclusively at the tribunal. This is measured from the year of appeal to year of pronouncement of order by **ITAT**. The purpose of bifurcating the duration in such manner is to be able to identify the stage or process that significantly contributes to the duration.

Figure 5: Total duration of cases (in years)

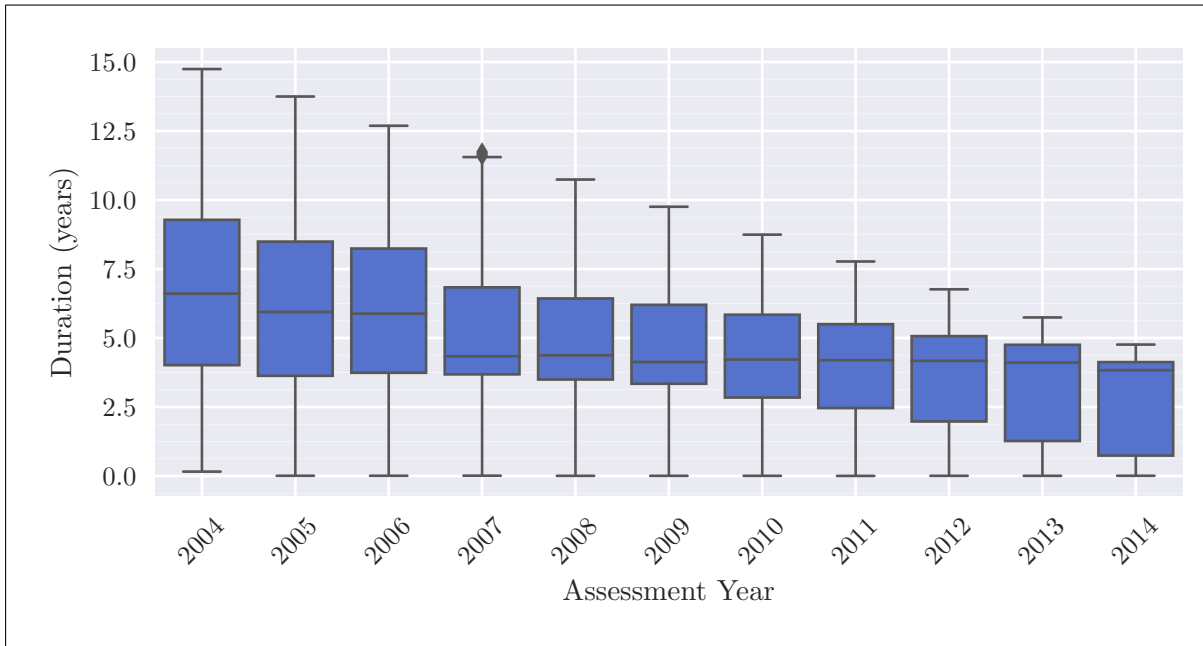
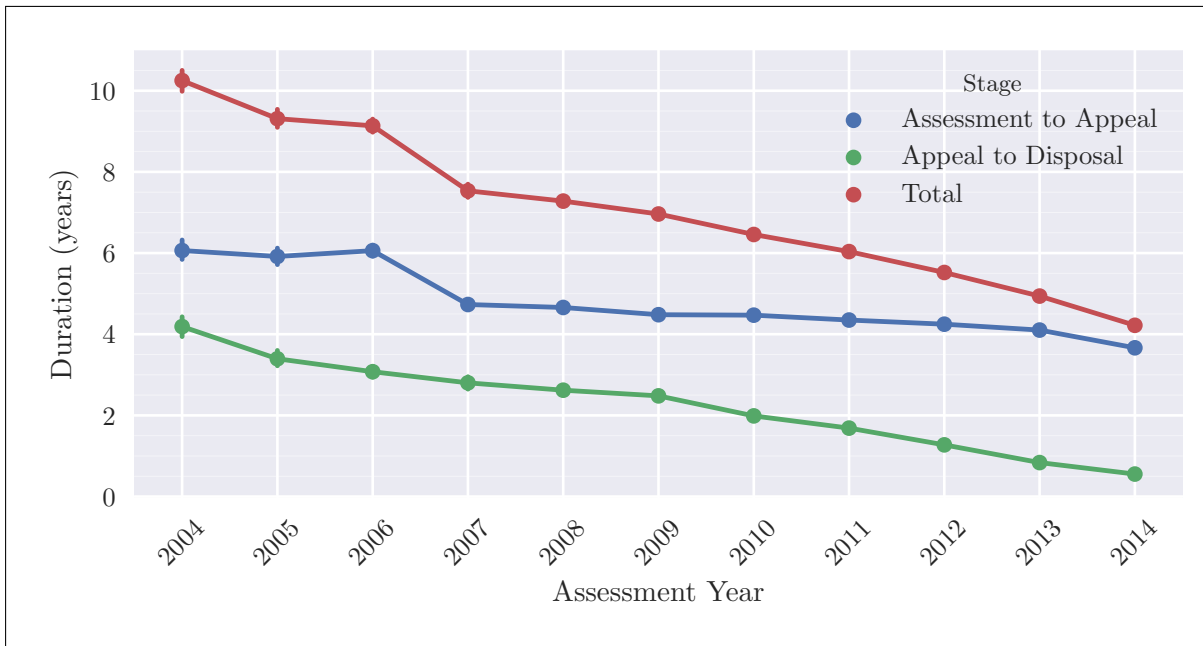


Figure 6: Stage-wise duration (in years)



From Figure 5 it can be seen that the overall duration, from **Assessment Year (AY)** to date of pronouncement, has declined over time. As Figure 6 shows, this decline is largely attributable to the reduction in average time taken by **ITAT**. The time taken by processes before the hearing by **ITAT** has not declined at the same pace. For disputes relating to assessment years 2003–04, **ITAT** took close to 4 years to pronounce an order. However, after **AY 2010** this declined to less than 2 years. In comparison, a sharp reduction in the duration is observed for the pre-**ITAT** process, which includes assessment and adjudication by **CIT(A)/DRP**, only in **AY 2006–07**. Thereafter the duration curve flattened and the average duration ranged between 4 and 5 years for all subsequent assessment years. The average is crude measure and can be affected by outliers. Therefore we provide the evidence for distribution of sample cases by duration. Notwithstanding, the leftward skew owing to short sample period and case selection,

it is seen that the variation in the case duration declined after AY 2007. The average duration of the 25th and 75th quartile reduced significantly as did the median duration. However, after 2012 the median remained unchanged yet the range varied, with a downward bias. Therefore, whether in terms of the average or the median the time taken declined and did significantly in 2007.

A possible explanation for this decline in 2009 is the creation of the **DRP**. Assuming assessments are carried out before they become time barred, the first set of cases presented before the **DRP** would relate to **AY 2006–07**. Therefore, the introduction of **DRP** that is bound to complete the process within 9 months may be associated with such positive impact. Among other reasons, the lack of judicial precedence, lack of expertise as well as constrained administrative capacity at the beginning of the transfer pricing regime were addressed through a variety of reforms and legislative amendments. The impact of these reforms is visible in the overall decline in the duration of dispute.

### 4.3 Time taken: CIT(A) vs. DRP

The Dispute Resolution Panel was created in 2009 specifically to avoid protracted disputes. An appeal against the **AO's** draft order can be made before the **DRP** that then participates in drafting of final order. The Income Tax Act mandates that all due process of the **DRP** be completed within a period of 9 months from the end of the month in which the draft order is forwarded to the taxpayer. The strict time-line for the **DRP** is conjectured to have contributed to the observed decline in pre-**ITAT** duration, as shown in the earlier section. It is possible to examine the same by separately estimating the time taken for cases that went through the **CIT(A)** and **DRP** respectively. It is seen that the average duration across the period has differed significantly across the fora, wherein the **DRP** takes less time <sup>4</sup>. Interestingly, however, even with the introduction of the **DRP**, companies still do file appeals with the **CIT(A)**. It has been conjectured that the reason for this behaviour may be that the taxpayer might get the benefit of the revised instruction on stay matters.<sup>25</sup>

Table 4: Comparison of total duration of cases coming through **CIT(A)** with cases coming through **DRP**

Statistic	Value
Average duration: <b>DRP</b> (in years)	6.172
Average duration: <b>CIT</b> (in years)	7.866
T-statistic	-32.284
p-value	$9.69 * 10^{-210}$

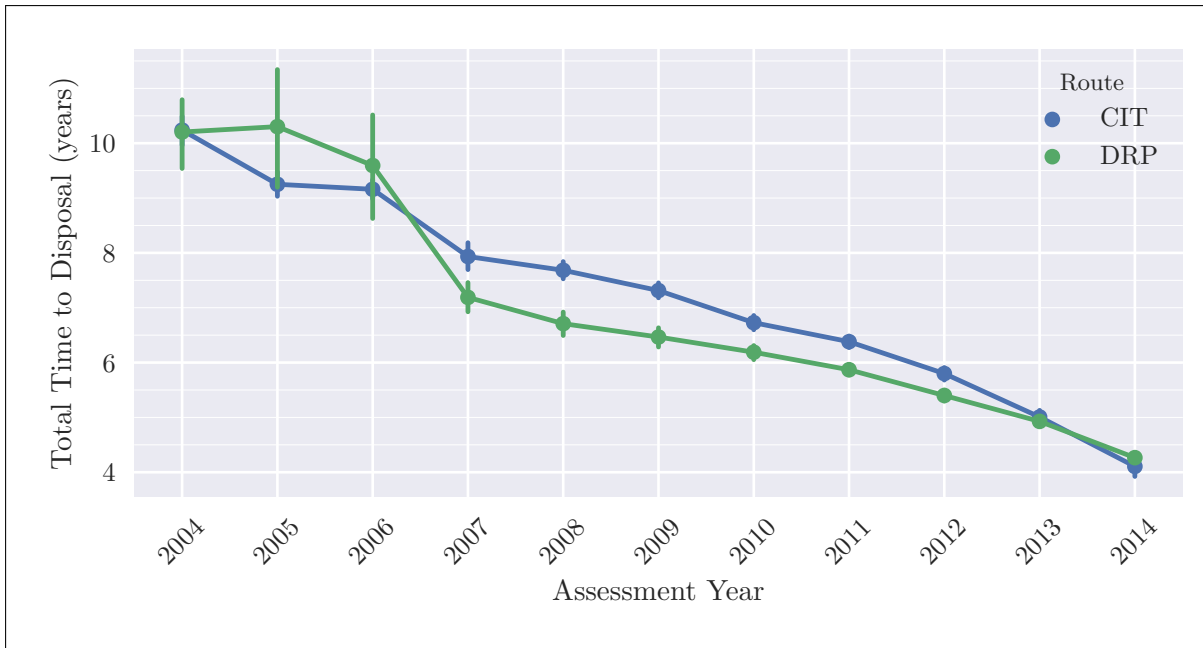
For disputes that pertained to assessment years 2003–04, the time taken for **DRP** was higher than **CIT(A)**. Since the **DRP** was only introduced in 2009, the appeal before the panel that pertains to an assessment year prior to **AY 2006–07** is expected to be disputes inherited from an earlier regime. With such backlog of disputes, it is expected that for cases relating to earlier assessment years the total duration of the dispute will necessarily be longer. However, with the exclusion of such exceptions in the subsequent years, thereafter the duration for cases that progressed through **DRP** was consistently and significantly lower than that for **CIT(A)**. and the sharp dip observed in Figure 6 is clearly associated with the introduction of **DRP** (Figures 7 and 8). It should be noted that the disparity in the duration for **CIT(A)** and **DRP** routes has declined in the subsequent years. At the beginning of the transfer pricing regime, the insufficient subject experts, including commissioner income tax were available. Subsequently, reforms were introduced such as re-organisation of the region of Principal Chief Commissioner of Income Tax (International Taxation), New Delhi and creation of new posts on 2014<sup>26</sup>. Such improvements are expected to remove the bottlenecks and reduce the duration of a case. The possible reasons for the observed convergence may be administrative reforms and the availability of precedence in transfer pricing matters the duration across the two available routes has converged.

<sup>25</sup> Jain and Makker 2016.

<sup>26</sup> Para 13.11, Page 2015, Annual Report, Ministry of Finance, 2015-16



Figure 7: Total duration of appeals



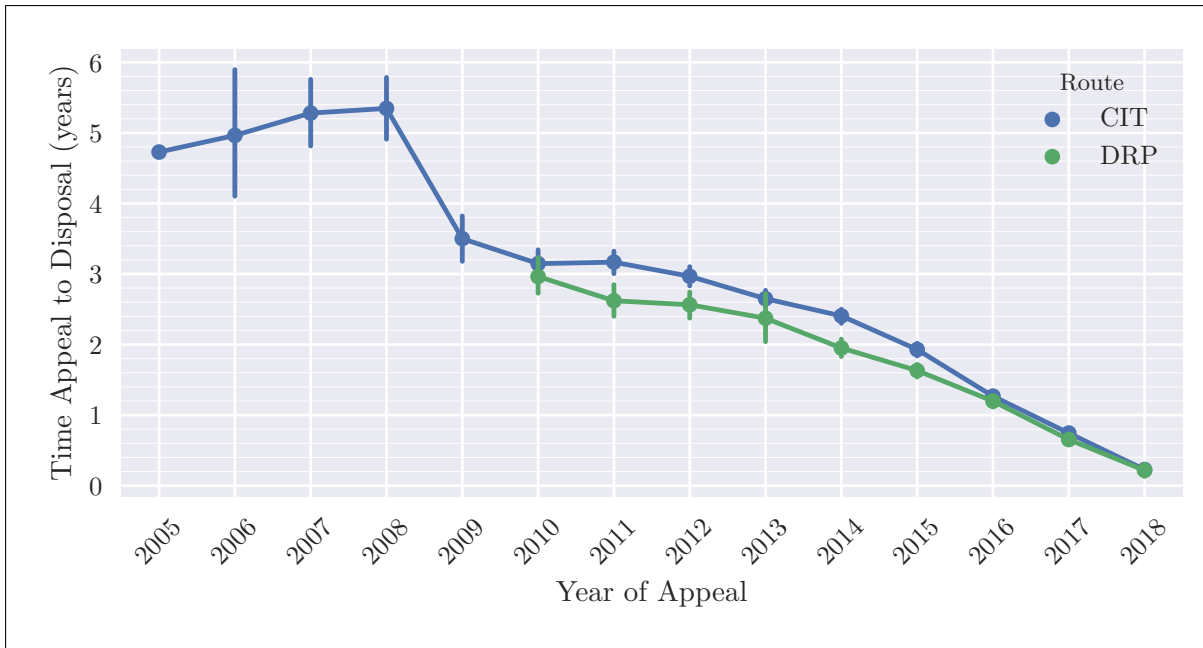
As Figure 8, there is a sharp difference in the duration of the pre-ITAT processes for the two routes. Where the DRP had a significantly lower average duration in the earlier years, a convergence is observed for the later assessment years.

Figure 8: Duration of disputes pre-ITAT



The duration of these disputes within ITAT show a steady downward trend over time as well, as Figure 9 shows. There was a sharp drop in the time taken by the ITAT to decide appeals which were filed in 2008, and were previously heard by the CIT(A). The reasons for this are unclear. This could be a subject for further research.

Figure 9: Duration of disputes in ITAT



The graphs further shows that the ITAT consistently took less time to decide on appeals which were first heard by DRP for appeals filed from 2010 to 2015. After that the time taken by the ITAT converges.

#### 4.4 Repeated disputes

An important point to note is that the average number of years taken for disposal at the beginning of the transfer pricing regime was 7 years. The IT Act prescribes time limits on assessment and passing of orders by the CIT(A), DRP and ITAT. Where only in the case of the AO and DRP are these limits binding. The fact that the total time taken surpasses the cumulative time limits prescribed in the Act may be the result of one or more reasons such as assessment carried out just before being time-barred, protracted decisions by the CIT(A) and /or ITAT. Another explanation for the extended period of resolution could be that the ITAT may at the conclusion of the case, i.e. finding that the method to be used is different or comparables are acceptable, refer the case back to the AO for fresh calculation. It is possible that an order wherein the ITAT remands the matter to the AO, it is again challenged.

Remand is one typology of “repeated dispute” which can burden an assessee with more litigation that would be apparent from a surface level analysis of the data. Another typology would be disputes where an assessee gets involved in litigation over a similar or identical repeatedly. This may, in part be due to the fact that transfer pricing involves repeated transactions of a similar nature each year, leading to similar/identical disputes over and over again.

We investigated both these kinds of repeated disputes.

##### 4.4.1 Remand and Re-opening

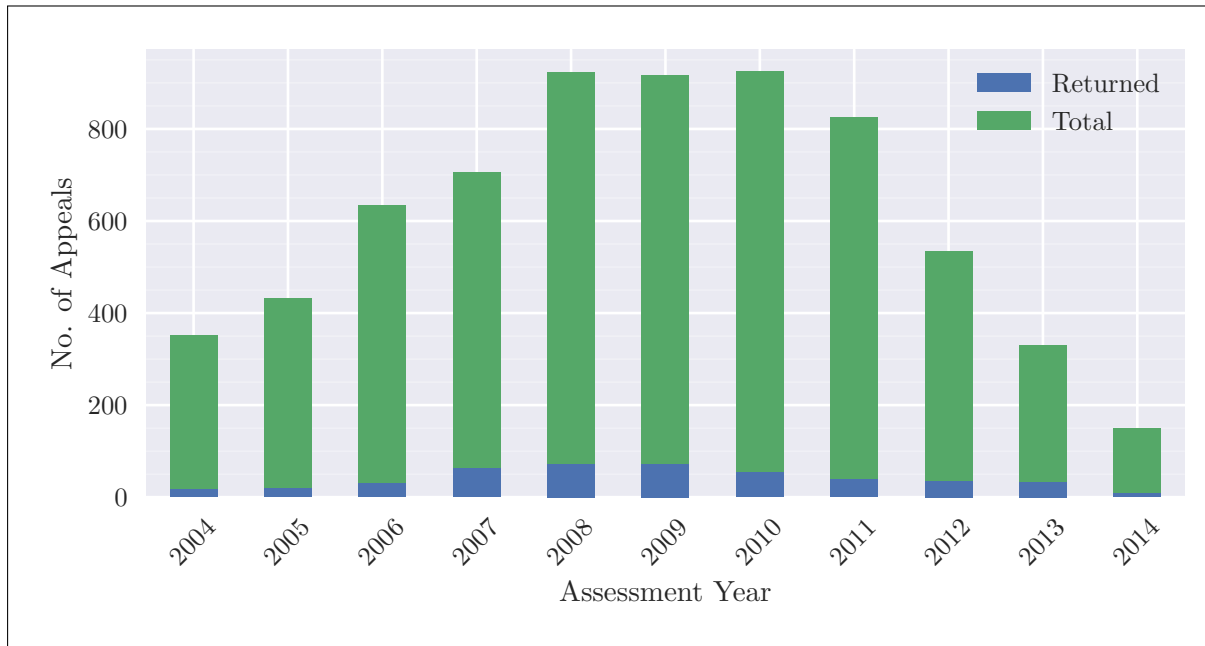
In our dataset we found instances where a matter disposed by the ITAT was sent back to the AO for fresh computation. The fresh computation by AO was later challenged by the assessee. It is difficult to establish if a current dispute relates to an earlier remand.<sup>27</sup> However, it possible to estimate the proportion of orders pronounced by ITAT that remand the matter to the AO for fresh calculation. From

<sup>27</sup>This is because the ITA number may be different and the earlier ITA may not be referenced. Another avenue we explored was to check for multiple cases for the same assessee having the same assessment. This method did not yield accurate results since we found that sometimes the same assessee has multiple appeals relating to different matters under different aspects of TP for the same assessment year.

the orders it is possible to identify proportion of final orders pronounced by the ITAT that refer the matter to the AO/TPO for fresh calculation.

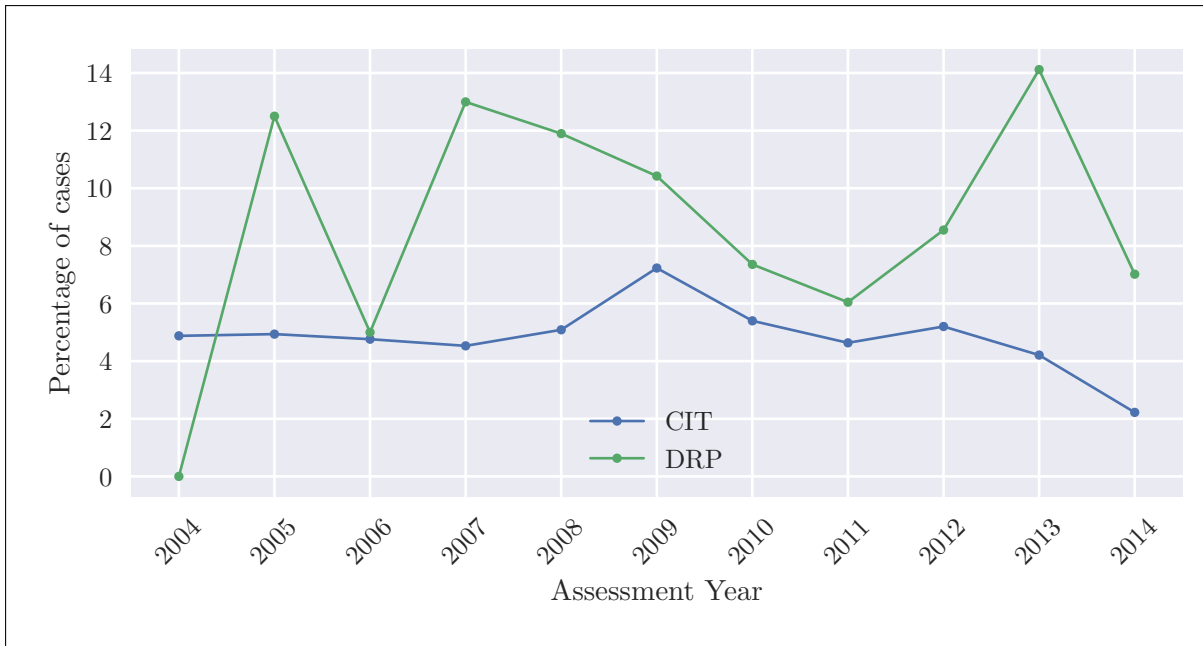
This aspect is important from the point of view of finality of judicial proceedings. While it is possible that this option is exercised by the ITAT to provide a more settled answer, it prolongs litigation. Such cases would add to the existing stock of pending cases and delay case closure. In our sample, the incidence of cases that were reverted to the AO for fresh calculations was on an average 6.4 per cent of cases across assessment years. These represent a conservative estimate. If we discount assessment year 2008, we see a steady decline in the proportion of cases remanded to the AO (Figure 10). This trend could be interpreted as an improvement.

Figure 10: Appeals returned to AO or TPO



The DRP, a panel of tax officials, is involved in the drafting the final order. It is expected that the rate of remand would be lower in the case where DRP is involved in the drafting of the order.

Figure 11: Percentage of cases sent back to AO or TPO



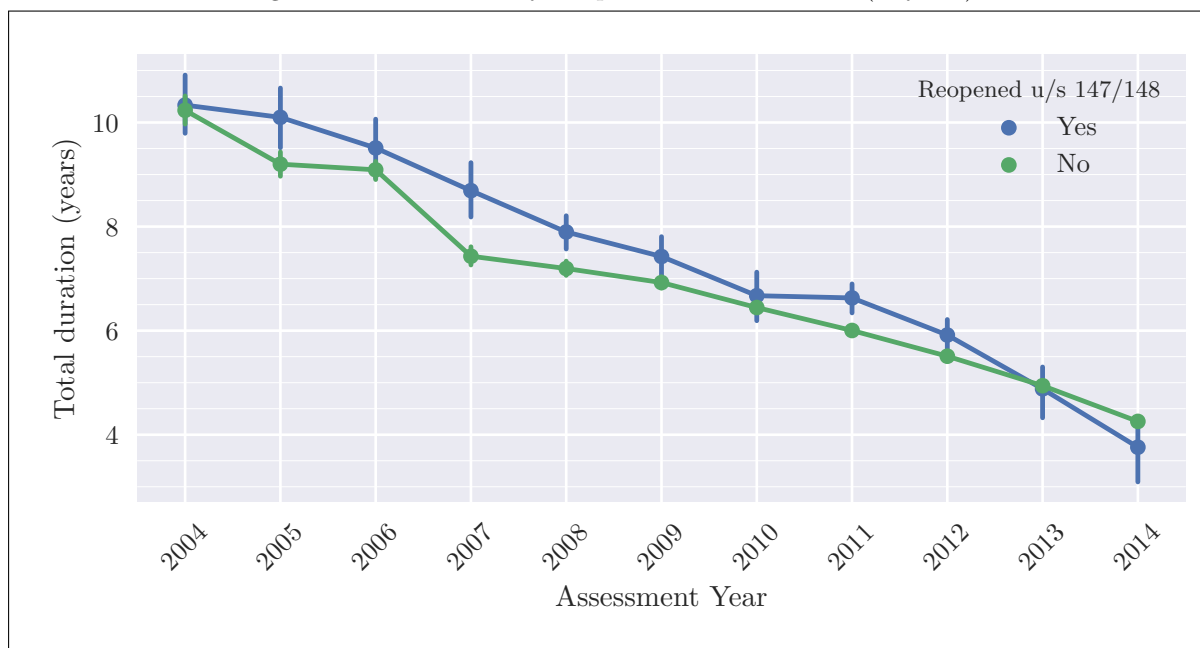
However, the instance of the matter being sent back to AO has been higher for cases that went through the DRP than those for CIT(A). With the exception of assessment years 2003–04 and 2010–11. Thus even though the DRP was to be a part of the process, the fact that many such cases are sent back to the AO means that having DRP as part of the process has not imparted certainty and may in fact have increased it.<sup>28</sup>

Income Tax Act<sup>29</sup> allows the assessing officer to re-open the past completed assessments. This is time barred, i.e. the returns relating to up to 4 previous assessment years can be re-assessed. It is also seen that in some cases the AO re-opened the return already assessed earlier. As is expected, the estimated duration of cases that were re-opened is greater than those that weren't.

<sup>28</sup>The ITAT is also seen to send the matter back to the DRP to give a speaking order. Identifying cases as those where it mentions that the matter is sent back to DRP is important to ensure that our results are not biased. Only 0.72 of the cases are such cases.

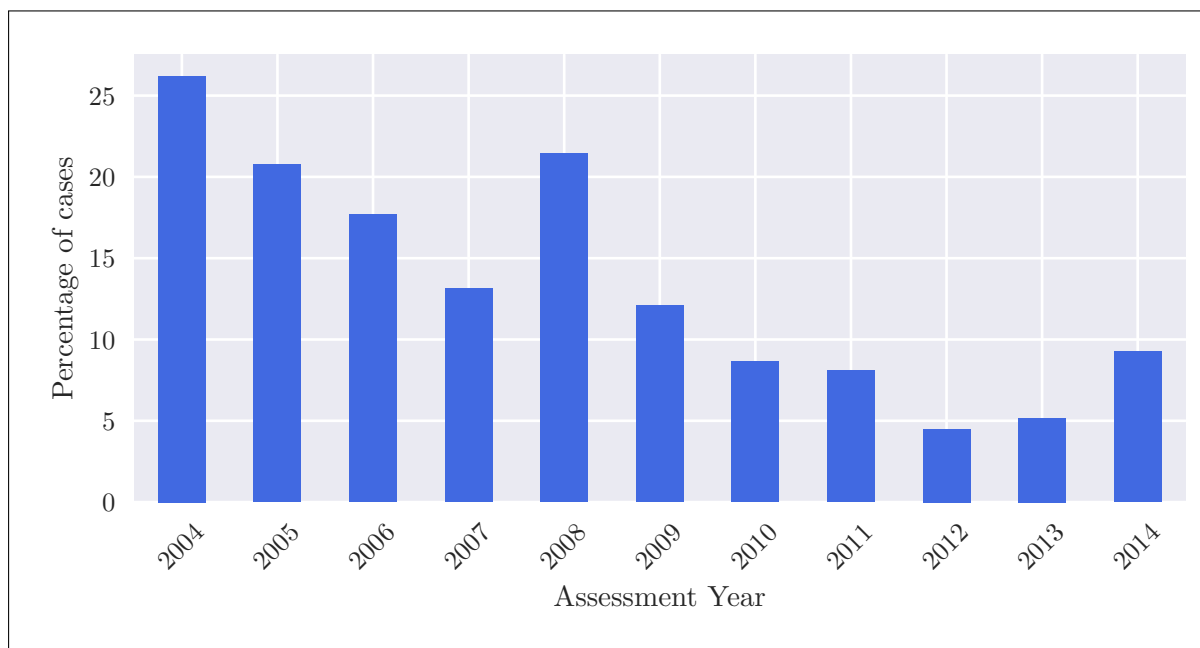
<sup>29</sup>Section 147

Figure 12: Time taken by re-opened cases vs. others (in years)



Another positive feature has been the significant decline in the proportion of re-opened cases.

Figure 13: Percentage of cases that were re-opened assessments

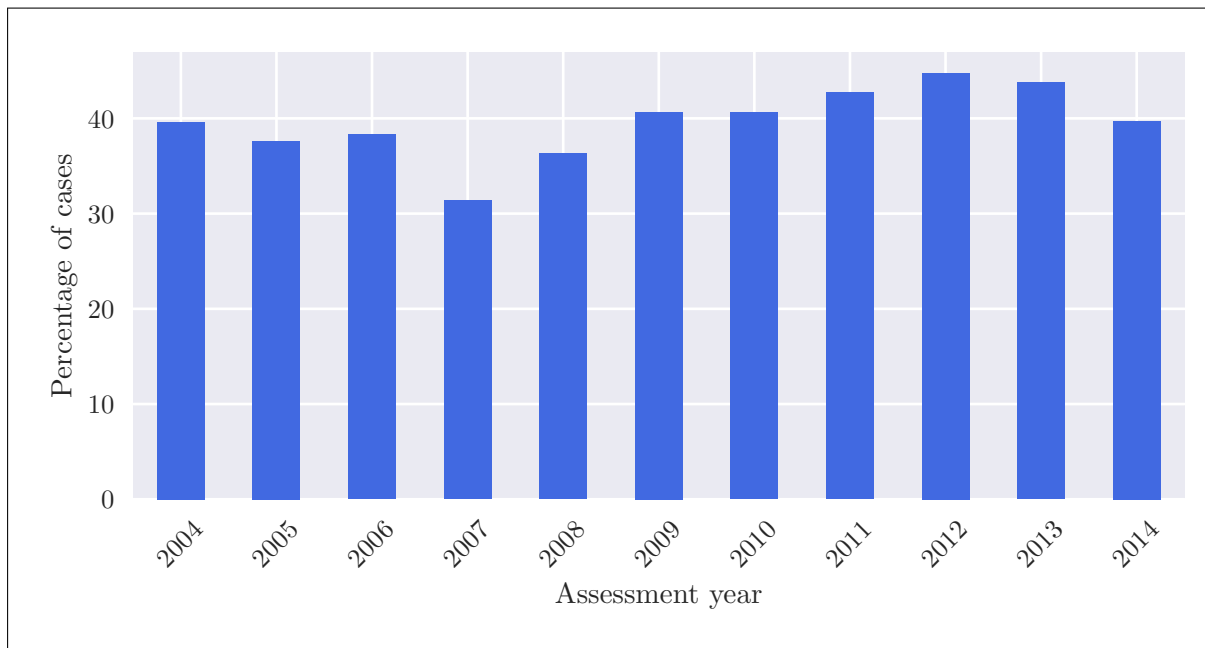


Therefore a transfer pricing assessment may not be final in case the AO re-opens a case or where the final fact finding authority pronounces in its decision that the matter be sent back to AO for fresh calculation. The trends observed here have been positive, since the instances of remand and re-opening, in case of transfer pricing disputes, have declined since the inception of transfer pricing regime.

#### 4.4.2 Similar issue

In our sample of case orders, we observed orders in 2647 out of the total 6731 cases (i.e. 39 per cent) make a reference to an earlier order in a similar case, involving the same assessee. Although, it is possible that the facts in the earlier case may not be exactly similar to the present case. Nevertheless, the contention arises for an *identical* reason. This indicates an unresolved issue which may clog the dispute resolution system. In fact, the proportion of these cases in the sample have remained steady across assessments years. While a dip was observed in 2007–08, the increasing trend resumed. It remains to be seen if the decline in 2014 will be sustained.

Figure 14: Reference to assessee’s own case



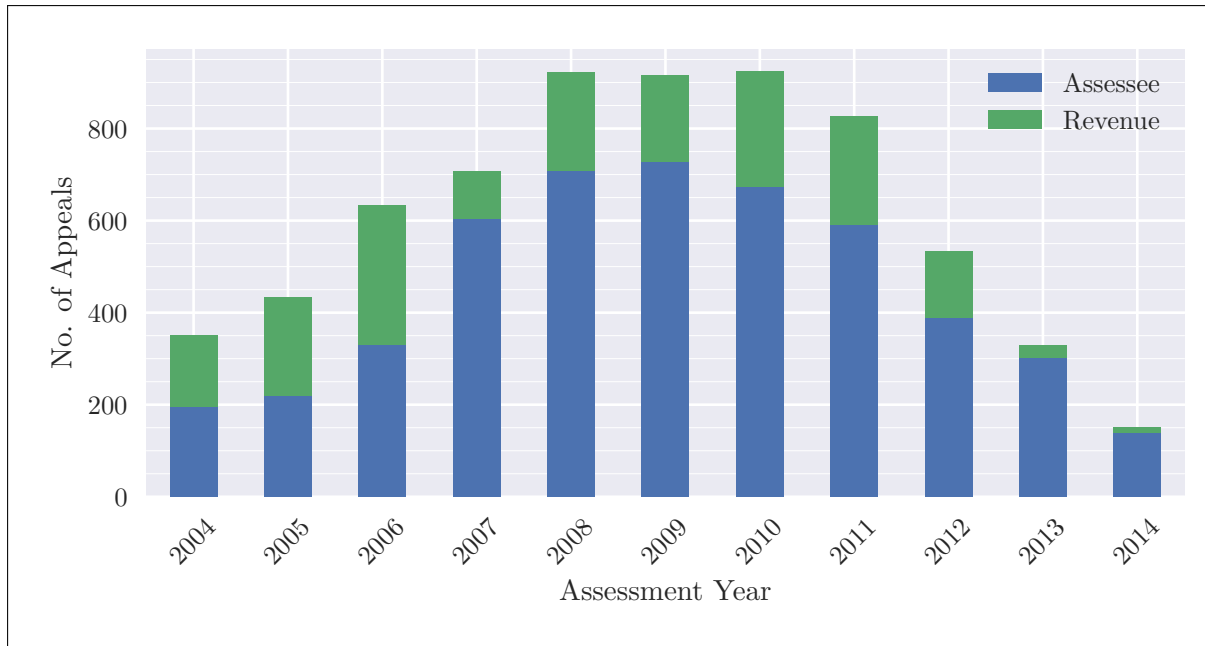
One solution to such a problem is the introduction of measures such as the APAs, which might reduce the incidence of repeated disputes on similar matters. However, no structural shift is visible in the trend except for the last assessment year. With the introduction of the rollback provision in 2014, it is possible that there may be an augmented demand for APAs. This will require addressing the shortage of competent manpower.<sup>30</sup> Another solution can be the introduction combined audits for multiple years, as is the practice in UK.

## 5 Appellant and case outcomes

In recent times it has been suggested that the Income tax Department has been relatively litigious. To examine if this is in fact the case, the orders can be classified on the basis of appellant. That is for each assessment year we compute what proportion of appeals are filed by tax department.

<sup>30</sup>Page 7 of the Central Board of Direct Taxation 2018.

Figure 15: Appeals filed by revenue and assessee



The appeals by the tax department have declined over the period of analysis. In 2005–06, the tax department appealed before the ITAT in equal number of cases. However, the proportion of cases filed by the Revenue declined over time. With particularly sharp reduction in the years 2009–10. This decline was reversed in 2012–13. This may, in part, be associated with Revenue being allowed to appeal against the order of DRP. After a brief increase, there was renewed decline and the share of appeals filed by Revenue.

Assessee not only file more appeals, the data show that they also have a higher success rate than the Revenue Department. Table 5 shows the distribution of cases by appellant and outcome.

Table 5: Cases in sample by appellant and outcome

Appellant	Result of appeal				Total
	Allowed	Dismissed	Partly Allowed	N/A	
Assessee	1852	412	2151	463	4878
Revenue	178	1137	391	147	1853
<b>Total</b>	<b>2030</b>	<b>1549</b>	<b>2542</b>	<b>610</b>	<b>6731</b>

As the table shows, the assessee accounts for majority of the appeals across assessment years.<sup>31</sup> The table shows, that on average 61.4 per cent of the Revenue Department’s appeals are dismissed, while 9.6 per cent are allowed. In contrast on average 8.4 per cent of the appeals filed by the assessee are dismissed, and 38 per cent appeals are allowed. As figures 13 and 14 show these trends hold over time. The dismissal rates for appeals filed by the Revenue Department have consistently been around or above 60 per cent. In contrast the dismissal rates for appeals filed by the assessee have consistently been below 20 per cent.

<sup>31</sup>In 610 cases, the meta-data for the case provided by the ITAT website did not report the result.

Figure 16: Share of appeals filed by Revenue and percentage dismissed

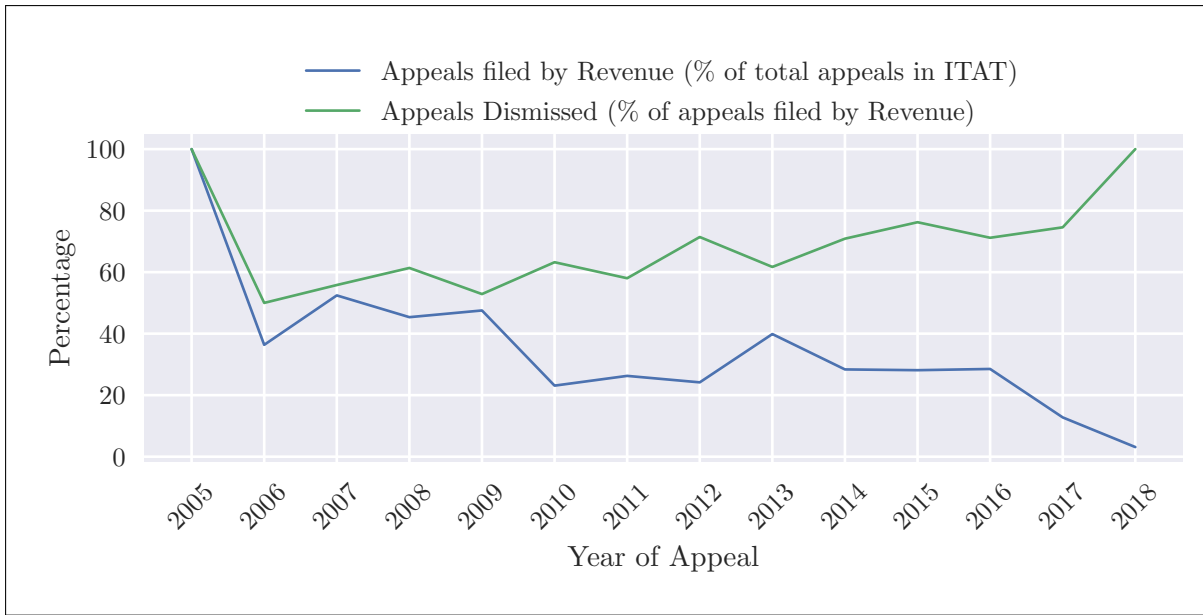
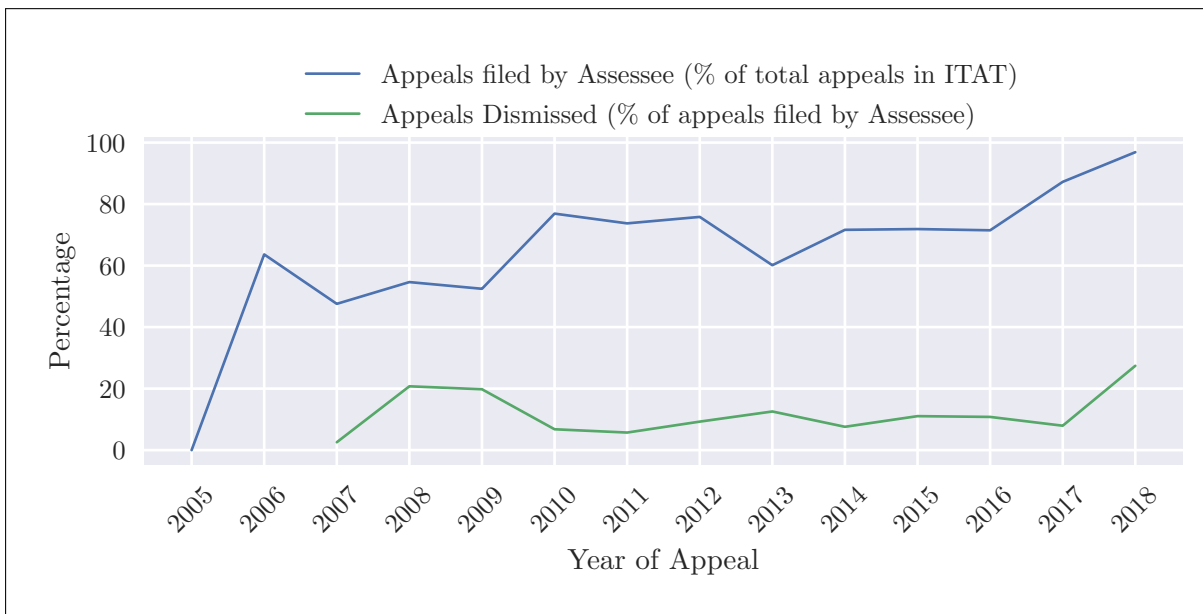


Figure 17: Share of appeals filed by assessee and percentage dismissed



## 6 Conclusion

The information compiled using case orders provides us with a unique overview of the transfer pricing process in India. It is evident from the results presented herein that the transfer pricing regime has evolved. With experience and reforms the duration of cases has declined. In 2013–14 a transfer pricing case took 4 years, including the assessment. To remedy long duration of cases, the [DRP](#) was introduced in 2009. Such reform is expected to speed the process of case disposal. While the [DRP](#) visibly improved the duration at the time of its introduction, this tapered off in the following period.

Even with the introduction of the [DRP](#), [CIT\(A\)](#) remained a preferred route for some companies. Among other reasons, this is because of the benefit that a taxpayer may receive in terms of revised instruction on stay matter. Therefore, the convergence in the duration for [CIT\(A\)](#) and [DRP](#) has been a positive feature



for the taxpayer. Since the taxpayer may choose the CIT(A), yet the time may not vary significantly from that of DRP.

Even though the said changes in the transfer pricing regime have been positive, there are issues that remain to be addressed. For one, the share of assessee in disputes and their success rate in the tribunal require deeper examination. Since they insinuate demands raised by the tax department are not sustainable. A cause for further concern is that more than a third of the cases are similar to an assessee's past case. Therefore, the department and taxpayer are likely getting repeatedly caught in similar disputes. This clogs the dispute resolution system. APAs have been introduced for this reason. Yet the administrative constraints are one of the reasons for their slower adoption. An alternative solution for a system with such constraints is to jointly perform audits for multiple years.

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## A Annexure

This annexure details the specifications for regular expressions based text-mining from the texts of the ITAT orders. We used the Python 3 implementation of regular expressions for this study.

### A.1 Specifications for filtering transfer pricing cases

To pick out the Transfer Pricing disputes we searched each order for the following terms:

- section 92
- associated enterprise
- international transaction
- arm’s length price
- transfer pricing officer
- most appropriate method
- comparable uncontrolled price
- resale price method
- cost plus method
- profit split method
- transactional net margin method

### A.2 Specifications for extracting sections of IT Act

We extensively preprocessed the order of the text to prepare it for regular expression-based extraction. The code can be provided upon request. Two crucial preprocessing steps were to remove all newlines, spaces and full stops, and replacing all instances of “&” and “and” with commas.

We first searched the text for the following patterns:

- `section([0-9]1,3[A-Z],4)(?!ftansferofproperty)`<sup>32</sup>
- `u/s([0-9]1,3[A-Z],4)(?!ftansferofproperty)`
- `sections([0-9A-Z,]+)(?!oftransferofproperty)`<sup>33</sup>
- `u/s([0-9A-Z,]+)(?!oftransferofproperty)`

We then marked each case based on whether the list of sections mentioned contained 147 or 148 (or both).

### A.3 Specifications for extracting route data

#### A.3.1 CIT(A) / DRP

We first split the text of the order into lines based on line-breaks, and limited the search to the first 20 lines.

---

<sup>32</sup>This pattern translates to: *All occurrences of 1 to 3 digits, and up to 4 capital letters when they follow the word “section”, provided they are not followed by another digit or the words “oftransferofproperty”.* This is to only pick up references to the IT Act, and avoid picking up references to sections of the Transfer of Property Act, which is frequently cited in ITAT orders.

<sup>33</sup>This pattern translates to: *All occurrences of sets of 1 to 3 digits, followed by 4 capital letters, so long as the first set is preceded by the word “section” and the last set is not followed by the words “oftransferofproperty”.* This is designed to pick up instances where there is a reference to multiple sections of the IT Act, and avoids picking up references to the Transfer of Property Act.

First we then looked for the following terms:

- CIT
- commissioner
- Commissioner
- COMMISSIONER

We extracted the sentence which contained these terms. If the sentence also contained the following terms we rejected the sentence:

- vs.,5CIT
- vs.,5commissioner
- CIT.,5vs
- Commissioner.,10vs

Sentences which contained the above patterns were references to other cases. If there were any sentences left over, we marked the case as having come through [CIT\(A\)](#).

Next we searched for the following terms:

- DRP
- Dispute Resolution Panel
- section 144C

If these terms were found, we marked the cases as having come through [DRP](#).

## A.4 Specifications for extracting outcome data

We split the order into sentences, and limited the search to the last ten sentences. We searched for the following patterns:

- restored
- afresh
- fresh (?!cash)<sup>34</sup>
- fresh (?!capital)
- fresh (?!fund)
- opportunity.\*?objections

We marked cases which matched the patterns above as having been remitted to the [AO](#) for a fresh assessment.

### A.4.1 Own case

We searched the order for the following patterns:

- assessee's own case

We marked the cases in which we found a match for the first pattern, as having a reference to “own case”.

---

<sup>34</sup>This means “fresh” not followed by the term “cash”

## A.5 Samples of text of ITAT orders

Figure 18: Snapshot of first page of sample case order

1		
<b>IN THE INCOME TAX APPELLATE TRIBUNAL, DELHI 'I-2' BENCH, NEW DELHI</b>		
<b>BEFORE SHRI N.K. BILLAIYA, ACCOUNTANT MEMBER, AND SHRI SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER</b>		
<b>ITA No. 7574/DEL/2017 [A.Y 2013-14]</b>		
<b>M/s Sennheiser Electronics India Ltd 102-A, First Floor, Time Tower M.G. Road, Gurgaon, Haryana</b>	<b>Vs.</b>	<b>The A.C.I.T Circle - 4(1) Gurgaon</b>
<b>PAN : AAKCS 4629 Q</b>		
<b>[Appellant]</b>		<b>[Respondent]</b>
<b>Date of Hearing</b>	<b>:</b>	<b>10.09.2018</b>
<b>Date of Pronouncement</b>	<b>:</b>	<b>19.09.2018</b>
<b>Assessee by</b>	<b>:</b>	<b>Shri Alok Vasant, Adv</b>
<b>Revenue by</b>	<b>:</b>	<b>Shri H.K. Choudhary, CIT-DR Ms. Anchal Khandelwal, Sr.DR</b>
<b><u>ORDER</u></b>		
<b><u>PER N.K. BILLAIYA, ACCOUNTANT MEMBER,</u></b>		
<p>With this appeal, the assessee has challenged the correctness of the order dated 29.11.2011 framed u/s 143(3) r.w.s 144C of the Income-tax Act, 1961 [hereinafter referred to as 'the Act'].</p>		

Figure 19: Snapshot of page of case order where relevant text "Afresh" is located

*Training to the sales force regarding the operation and mechanism of the product is provided by Sennheiser India. Information on the Products and information and materials to be used in training the employees to perform the Marketing Services are developed by Sennheiser group at the request of Sennheiser India.*

*Administration*

*Sennheiser India is responsible for all its local administrative functions like, human resource,/recounting and IT. It also prepares its own financial statements."*

18. The ld. DR had vehemently contended that since there was no agreement, understanding or arrangement between the assessee and its AEs, respective functions performed cannot be determined. The ld. DR further contended that since the Bright Line Test has been negative by the Hon'ble High Court, let the TPO adjudicate the issue afresh after determining the respective functions and frame de novo assessment.

Figure 20: Snapshot of last page of case order

26

Profit available for set off (H = E-G)	4,45,57,022 -
SBI Base rate plus 300 basis points adopted by TPO for benchmarking AMP expenses (I)	12.75%
Compensation for AMP expenses computed by TPO	4,08,18,553
<b>Adjustment on Account of AMP expenses after set off (K = J-H)</b>	<b>(37,38,469)</b>

23. Considering the facts of the case in totality from all possible legal angles, we do not find any plausible reason for TP adjustment on account of AMP expenses. We, accordingly, direct the Assessing Officer to delete the impugned adjustments.

24. In the result, the appeal filed by the assessee in ITA No. 7574/DEL/2017 is allowed.

**The order is pronounced in the open court on 19.09.2018.**

**Sd/-**

**[SUDHANSHU SRIVASTAVA]  
JUDICIAL MEMBER**

**sd/-**

**[N.K. BILLAIYA]  
ACCOUNTANT MEMBER**

**Dated: 19<sup>th</sup> September, 2018**

vii /

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