

# Transfer Pricing and Corporate Taxation Issues

**Shraddha Shelke**

LL.M / II Semester Corporate and Commercial Law  
School of Law, Sandip University, Nashik.

**Abstract:** *Transfer pricing has become a critical area of international taxation due to globalization and the rise of multinational enterprises (MNEs). MNEs often engage in cross-border transactions involving goods, services, and intellectual property between associated enterprises. Because these entities are under common control, there is a risk of price manipulation to shift profits to low-tax jurisdictions. Transfer pricing regulations mandate the Arm's Length Principle (ALP), requiring related-party transactions to reflect prices that would occur between independent entities. This paper examines the evolving framework for corporate taxation issues and the transformative role of Indian regulations. The determination of the Arm's Length Price (ALP) involves complex methods such as the Comparable Uncontrolled Price (CUP) method, Resale Price Method (RPM), Cost Plus Method (CPM), Profit Split Method (PSM), and Transactional Net Margin Method (TNMM).*

**Keywords:** *Transfer Pricing, Corporate Taxation, Arm's Length Principle (ALP), BEPS, DEMPE Framework, Equalisation Levy, Pillar One and Two, Income Tax Act 1961*

## I. INTRODUCTION

India's modern transfer pricing and international corporate tax regime is primarily enshrined in the Income Tax Act, 1961 (as amended), which underwent a monumental shift via the Finance Act, 2001. Prior to this expansion, India's international tax framework lacked specialized, comprehensive anti-avoidance documentation and compliance mechanisms to tackle complex cross-border intra-group pricing. Transactions were loosely monitored under basic provisions that lacked rigorous economic benchmarking, structural comparability parameters, or sophisticated economic analysis. The 2001 amendments ushered in a radical paradigm shift toward an objective, effects-based regime designed to protect the domestic tax base, prevent base erosion, ensure fair profit allocation, and provide tax neutrality for multinational enterprises (MNEs).

The Central Board of Direct Taxes (CBDT), along with dedicated Transfer Pricing Officers (TPOs), constitutes the primary administrative and regulatory enforcement apparatus. Initial statutory objections and disputes are channeled through the quasi-judicial Dispute Resolution Panel (DRP), with subsequent appeals escalating to the Income Tax Appellate Tribunal (ITAT), and eventually to the High Courts and the Supreme Court of India. While the core transfer pricing architecture (Sections 92 to 92F) was established in 2001, the regime has continuously adapted to global shifts. The introduction of the Advance Pricing Agreement (APA) scheme in 2012 and Safe Harbour Rules in 2013 brought structural evolution. More recently, the implementation of the OECD/G20 Base Erosion and Profit Shifting (BEPS) action plans has introduced transformative transparency requirements, including the three-tiered documentation structure: Master File, Local File, and Country-by-Country Reporting (CbCR). Furthermore, statutory amendments introducing thin capitalization rules (Section 94B), the Equalisation Levy, and the Significant Economic Presence (SEP) test have broadened India's tax net over the digital and financial operations of global enterprises.

## II. LITERATURE REVIEW

From an international standpoint, foundational works such as Reuven S. Avi-Yonah's International Tax as International Law evaluate how source and residence rules clash within multinational networks, illustrating the vulnerability of developing host nations to sophisticated profit-shifting maneuvers. On algorithmic and digital corporate presence,



scholars like Richard M. Bird have examined how cross-border data flows challenge traditional brick-and-mortar permanent establishment principles.

Articles within the Journal of International Taxation and the International Transfer Pricing Journal frequently analyze rulings from the ITAT and Indian High Courts, evaluating how closely domestic interpretations of the DEMPE framework align with global standards. Furthermore, periodic reports and working papers published by the OECD, the United Nations Tax Committee, and the International Bureau of Fiscal Documentation (IBFD) offer empirical baselines regarding the effectiveness of unilateral levies versus multilateral solutions like Pillar One and Pillar Two in checking base erosion.

### **III. DISCUSSION**

#### **Transfer Pricing and the Arm's Length Principle (Section 92C)**

Section 92C of the Income Tax Act, 1961 mandates that any income arising from an international transaction between associated enterprises must be computed having regard to the arm's length price. The statute strictly delineates five primary transfer pricing methods, supplemented by an "Other Method" rule to handle unique transactions.

**Traditional Transactional Methods:** The Comparable Uncontrolled Price (CUP) method compares the price charged for property or services transferred in a controlled transaction to the price charged in a comparable uncontrolled transaction. Though highly reliable when exact matches exist, its use is restricted due to strict product and market comparability requirements. The Resale Price Method (RPM) measures the arm's length nature of a transaction by evaluating the gross profit margin realized by a distributor or reseller. It is typically applied to inbound distribution operations where the reseller does not add substantial value to the product. The Cost Plus Method (CPM) focuses on the gross mark-up achieved by a manufacturer or service provider over direct and indirect production costs. It is extensively utilized in contract manufacturing and routine back-office service operations.

**Transactional Profit Methods:** The Profit Split Method (PSM) allocates the combined operating profit or loss generated by interrelated transactions based on the relative economic value added by each entity. It is increasingly applied to highly integrated business models or where both AEs own valuable, unique intangibles. The Transactional Net Margin Method (TNMM) examines the net profit margin relative to an appropriate base (e.g., costs, sales, assets) that an enterprise realizes from a controlled transaction. TNMM remains the most widely used method in Indian transfer pricing audits due to its flexibility against minor product differences, though it requires strict functional, asset, and risk (FAR) alignment.

**ALP Assessment Factors:** The evaluation relies on a detailed analysis of Functions performed, Assets employed, and Risks assumed (FAR Analysis). TPOs scrutinize contractual terms, geographic market variations, economic conditions, business strategies, and internal/external comparable data gathered from commercial databases.

**Key Developments and Enforcement Trends:** Key structural updates include the implementation of the range concept and multiple-year data usage, which replaced the rigid arithmetic mean rule for specific transaction counts, aligning India with global standards. The deployment of the Safe Harbour Rules offers predefined profit margins or mark-ups, which, if adopted, shield eligible taxpayers from transfer pricing audits. Furthermore, the Advance Pricing Agreement (APA) scheme allows corporations to negotiate upfront pricing methodologies with the CBDT for up to nine consecutive years (including roll-back years), significantly boosting tax certainty. However, compliance remains complex due to data availability limits in public databases, intensive corporate documentation mandates, and frequent adjustments by authorities regarding marketing intangibles and location savings.

**Corporate Taxation Challenges:** Intangibles, Digital Economy, and Anti-Base Erosion

As corporate assets shift from physical inventory to intellectual capital and digital ecosystems, the traditional mechanisms of corporate taxation face systemic structural challenges.

**Valuation of Intangibles and the DEMPE Framework:** One of the most contentious areas in Indian corporate taxation is the treatment of intangible assets (such as trademarks, patents, and proprietary software). To determine which corporate entity is entitled to intangible-related returns, India applies the international DEMPE framework, tracking



Development, Enhancement, Maintenance, Protection, and Exploitation. Indian tax authorities look beyond legal ownership to ensure that profits match the entities executing these physical functions. This has led to major adjustments for local contract R&D centers (captives) and large-scale marketing intangible spend, where local advertising expenses by a subsidiary are interpreted as building value for a foreign parent brand.

#### **SUGGESTIONS FOR STRENGTHENING THE REGIME**

\* **Enhance Predictability through Detailed Valuation Guidelines:** The CBDT should publish exhaustive, sector-specific circulars outlining bright-line tests for the valuation of marketing and trade intangibles under the DEMPE framework. Clear guidance on what qualifies as routine versus non-routine local marketing expenditure will minimize subjective TPO adjustments and subsequent litigation.

\* **Accelerate the Administrative Processing of APAs:** To improve investor confidence, the CBDT needs to expand its institutional resource pool and deploy dedicated economic analysis teams to clear the systemic backlog of unilateral and bilateral APAs. Setting strict internal timelines for processing applications will provide businesses with predictable tax planning timelines.

\* **Seamless Convergence with OECD Pillar Reforms:** As the global minimum tax framework matures, India should systematically align its domestic digital tax framework with the OECD Pillar One and Pillar Two standards. Establishing a clear timeline for phasing out the unilateral Equalisation Levy in favor of a coordinated global approach will prevent retaliatory trade measures and double taxation.

\* **Strengthen Administrative Capacity and Economic Expertise:** Transfer pricing audits require deep financial and economic analysis rather than standard accounting checks. TPOs should receive regular training in advanced data science, forensic corporate accounting, and industrial economics to effectively evaluate complex transaction models like the Profit Split Method (PSM) in digital or pharmaceutical supply chains.

#### **IV. CONCLUSION**

The transfer pricing and corporate taxation regime in India has matured significantly since the milestone enactments of 2001. The regulatory framework has transitioned into a highly structured environment that actively counters base erosion and complex profit shifting through advanced legal mechanisms. However, as noted in international taxation literature (Avi-Yonah, 2021) and Indian tax treatises (Singhania, 2024), structural gaps persist regarding the subjective valuation of high-tech intangibles, long dispute resolution timelines, and alignment with unilateral digital levies.

To sustain a credible, investment-friendly economic landscape, India must transition toward an economically sophisticated, tech-enabled tax framework. Achieving a balance between protecting the national tax base and fostering business certainty requires clear administrative guidelines, a faster APA process, and close integration with emerging multilateral consensus models. These reforms are essential to ensure that profits are taxed where the underlying economic activities occur and where the actual value is created.

#### **Books:**

1. Income Tax Act, 1961 (Sections 92 to 92F, 94B).
2. Finance Act, 2001.
3. OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.
4. OECD Model Tax Convention on Income and on Capital.
5. OECD/G20 Base Erosion and Profit Shifting (BEPS) Project Reports.

#### **Journal Articles and Papers:**

6. Indian Equalisation Levy and Significant Economic Presence (SEP) regulations.
7. Income Tax (21st Amendment) Rules, 2016 (CbCR and Master File Requirements).
8. League of Nations (1920s) Historical Tax Conventions and Reports.
9. Internal Revenue Code Section 482 (United States Corporate Regulations).



10. OECD (2021). Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy.
11. Income Tax Appellate Tribunal (ITAT) Jurisprudence on Comparable Selection.
12. Advance Pricing Agreement (APA) Scheme Rules, 2012.
13. Safe Harbour Rules Notification, 2013.

