GLOSSARY
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Advance ruling: The advance ruling means the determination by Authority for Advance Rulings of a question of law or fact in relation to a transaction, which has been undertaken or is proposed to be undertaken by a non-resident applicant or a resident applicant with such non-resident.

Advance pricing Agreement/Arrangement: It is an arrangement that determines in advance of controlled transactions, an appropriate set of criteria for determination of the transfer pricing for those transactions over a fixed period of time. It is arrangement “before the fact” that determines an appropriate set of criteria such as method and comparables for the determination of transfer pricing over

Arm’s Length Principle: A controlled transaction is considered to be as per arm’s length principle if the results of the transactions are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances. The principle provides broad parity of tax treatment for MNE’s and independent enterprises. It avoids the creation of tax advantages or disadvantages that would otherwise distort the relative competitive positions of either type of entity.

Arm’s Length Price: Arm’s length price may be defined as a price, which is applied in a transaction between persons other than associated enterprises in uncontrolled conditions. It is therefore a price, which is ordinarily determined by market forces and would be charged in transactions between independent enterprises that deal with each other

Arm’s Length Range: The OECD guidelines defines it as range of figures that are acceptable for establishing whether the conditions of a controlled transactions are at arm’s length and that are derived either by applying the same transfer pricing method to multiple comparable data or from applying different transfer pricing methods.

Associated Enterprise: An associated Enterprise includes an enterprise, which has direct or indirect participation in the management, control or capital of another enterprise. It also includes the situations where the same person directly or indirectly participates in the management, control or capital of both the enterprises. The law may also provide certain other conditions like dependence on raw materials, advancing of loans by one enterprise to another etc wherein two enterprises may be deemed to be associated enterprises. The expression is defined in Article 9 of the OECD model Convention as an enterprise, which participates directly or indirectly in the management control or capital of another enterprise, and imposes commercial or financial conditions, which differ from those, which would be made between independent enterprises.

Accountant Report: A report from a Chartered Accountant or any other person qualified to be appointed as an auditor certifying that in his opinion the international transactions undertaken by taxpayer and reported in form 3CEB are at arm’s length as per records maintained by the assessee. The report is to be furnished to the authority on or before the specified date in the prescribed from duly verified by such accountant and setting forth such particulars as may be prescribed.
Adjustment: Transfer pricing adjustment means any adjustment made to the taxpayer’s transfer price or profit if the transactions between associated enterprises are below or above the arm’s length price is called primary adjustment. But if the adjustment is made to allocate profits consistent with primary adjustment it would be secondary adjustment. Adjustments to the profits of an enterprise are considered necessary when the conditions made or imposed between associated enterprises differ from those which would have been made between independent enterprises.

Arithmetic Mean: A statistical tool based on the principle of arithmetic average where the price or any other measurement is influenced by extreme figures which may be very high or low. The concept is unique to Indian transfer pricing regulations. When more than one price is obtained by the most appropriate method the arm’s length price is taken as arithmetic mean of such prices.

Balancing payment: A payment normally from one or more participants to another, at adjust participants, proportionate share of contributions, that increases the value of the contributions of the payer and decreases the value of the contributions of the payee by the amount of the payment.

Berry Ration: It is one of the profit level indicators. It is the ratio of gross profit to operating expenses, or the ratio of operating profit to operating expenses plus 100%. An expert witness in Dupont case first and used the ratio as a profit level indicator.

Benefit Test: Benefit test is applied in transfer pricing transactions to determine whether specific service or intangible asset transferred to associated enterprise directly results in a reasonably identifiable increment of economic or commercial value that enhances the recipient’s commercial position.

Best method rule: A rule requiring the taxpayer to use transfer pricing method that results in the most reliable measure of arm’s length price. The rule determines choice of transfer pricing method in US. The best method rule is similar to the rule of the ‘most appropriate method’ under Indian regulations. Both rules require choice of most suitable method, given the facts and the circumstances of a case, instead of following any hierarchy in the choice of methods.

Burden of Proof: the principle of law of evidence as per which burden to prove a certain fact lies on a party. Under Indian transfer pricing regulations the primary burden to prove that price charged in international transaction is at arm’s length and method selected is the most appropriate method lies on the assessee.

Control: The word control means power to take decisions regarding the management and operation of the two enterprises. The two enterprises are treated as related entities if an individual controls one enterprise and that individual or his relatives also control other enterprise.

Controlled Transaction: It is a transaction between two enterprises that are associated enterprises with respect to each other.

Commercial intangible: An intangible that is used in commercial activities such as the production of a good or the provision of a service, as well as an intangible right
that is itself a business asset transferred to customers or used in the operation of business

**Comparable Uncontrolled price method** : This is the method wherein the price charged for the property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances. An uncontrolled transaction is comparable to a controlled transaction if none of the differences between the transaction being compared or between the enterprises could materially effect the price in the open market or if reasonable accurate adjustments could be made to eliminate the material effects of such differences. The method can be applied for determining transfer prices of tangible and intangible property, interest rate, or fees for services provided or acquired.

**Comparability Analysis** : The analysis concerns the application of the arm’s length rule based on a comparison of the condition in a controlled transaction with the conditions in uncontrolled transactions.

**Compensating adjustment** : An adjustment in which the taxpayer reports a transfer price for tax purposes that is, in the taxpayer’s opinion, an arm’s length price for a controlled transaction, even though this price differs from the amount actually charged between the associated enterprises. This adjustment would be made before the tax return is filed.

**Contract manufacturer** : A contract manufacturer is an enterprise that enters into arrangement that enters into arrangement with the developer of the product and agrees to produce the product in accordance with developer specifications. It is a manufacturing service provider that faces little risk and does not own intangible other than basic know-how in regard to manufacturing.

**Contribution analysis** : An analysis used in the profit split method under which the combined profits from controlled transactions are divided between the associated enterprises based upon the relative value of the functions performed (taking into account assets used and risks assumed) by each of the associated enterprises participating in those transactions, supplemented as much as possible by external market data that indicate how independent enterprises would have divided profits in similar circumstances.

**Cost Plus Method** : The cost plus method begins with the cost incurred by the supplier of property, service in controlled transaction to which an appropriate mark-up is added to account for an appropriate profit considering the function performed. Assets involved and risks assumed. The price arrived at after adding the cost plus mark up to these costs can be considered as arm’s length price of the controlled transaction. Under this method the seller’s cost plus mark up is bench marked against that of comparable enterprises.

**Cost Plus mark-up** : The cost plus mark up is normally the gross profit of the transaction, which covers the general administrative and selling expenses and allows an appropriate net profit.
Cost contribution arrangement (CCA): It is an arrangement among the business enterprises to share the costs and risks of developing producing or obtaining asset, services, or rights, and to determine the nature and extent of the interests of each participant in those assets services, or rights.

Copyright: copyright means a right to do or authorize the doing of certain acts including the making of a copy or sell or give on hire a work or any substantial part thereof. There is infringement of a copyright when any person without license or in contravention of conditions of a license permits the performance of work.

Corresponding Adjustment: Corresponding adjustment means an adjustment allowed to mitigate or eliminate double taxation in a case where tax authority of one country increase the taxable income applying the arm’s length principle to transactions involving associated enterprises. The corresponding adjustment can be by way of downward adjustment of tax liability or decrease in the quantum of primary adjustment.

Cost plus mark-up: Cost plus mark-up means gross profit margin charged over the cost of the transaction relating to supply of goods and services. The mark-up charged is sufficient to cover the general, administrative and selling expenses and appropriate net profit margin of the supplier of goods and services.

Contemporaneous data: The term used by OECD guidelines and under Indian regulations in the context of documentation requirement. The general rule under Rule 10D (4) of the Income Tax Rules, 1962 (Rules) is that the information and documents should as far as possible be ‘contemporaneous’ However, the term is not defined in the regulations. OECD guidelines also do not define the same. OECD comparability draft notes issued on May 10th 2006 define it as “during the same period of time, though not necessarily during the same tax year”. Thus, where an international transaction is entered into in financial year 2006-2007, data relating to April 2007 may be regarded as contemporaneous even though it does not strictly pertain to the same financial year.

Double Taxation: It occurs when a resident of one country has a source of income situated in another country resulting in tax being imposed by both countries on same income. OECD defines it as the imposition of comparable taxes in two or more states on the same taxpayer in respect of the same subject matter for identical products.

Documentation: Documentation means information and documents maintained by a taxpayer in respect of international transactions entered into between associated enterprises. Documentation requirements generally cover information relating to ownership structure of the enterprise, profile of the multinational group, broad description of the business operations of the enterprise, nature and terms of international transactions, functional analysis, transfer pricing methods considered and economic analysis carried out by the enterprise for determining arm’s length price.

Direct-charge method: A method of charging directly for specific intra-group services on a clearly indentified basis
**Direct costs** : Costs that are incurred specifically for producing a product or rendering service, such as the cost of raw materials.

**Economic Analysis** : The analysis consists of selection of most appropriate method for transfer pricing on the basis of functions and risks undertaken and availability of comparable data.

**Electronic Commerce** : It refers to electronic transaction involved in buying and selling of goods and services over the Internet.

**Embedded intangible** : Intangible property affixed to tangible property. An example is a trademark that is associated with tangible property. MNEs may try to pass valuable intangibles as part of tangible property without specifically charging any price for the same. Embedded intangibles may give rise to significant transfer pricing issues.

**Enterprise** : The term enterprise covers every type of business or activity in which normally be engaged including tangible asset, intangible asset, services, investments, loans and shares/securities. An entity would also be considered an enterprise if it is, or has been, or is proposed to be engaged in, specified categories of activities or business even if such specified category of activity was carried on directly or through a subsidiary.

**Functional Analysis** : An analysis of the function performed taking into account the assets used and risks assumed by the associated enterprises in controlled transaction and by independent enterprises in uncontrolled transactions.

**Global formulary apportionment** : It is method that attempts to allocate profits within a controlled group according to a predetermined formula. The formula for apportionment may include global methods, profit splits unitary methods, and worldwide combined reporting.

**Gross Profits** : The Gross profits from a business transaction are the amount computed by deducting from the gross receipts of the transaction the allocable purchases or production costs of sale, with due adjustment for increases or decreases in inventory or stock–in-trade, but without taking account of other expenses.

**Independent enterprises** : Two enterprises are independent enterprises with respect to each other if they are not associated enterprises with respect to each other.

**Indirect-charge Method** : A method of charging for intra-group services based upon cost allocation and apportionment methods.

**Intra group services** : It relates to transaction of services between associated enterprise of a multinational enterprise. The services may be of different types such as administrative, technical, financial and commercial.

**Intentional set-off** : A benefit provided by one associated enterprise to another associated enterprise within the group that is deliberately balanced to some degree by different benefits received from that enterprise in return.
**International Transaction**: It means any transaction between associated enterprises, where one or both of the enterprises are nonresident, including sale and lease of tangible, and intangible property; provision of services, financing cost sharing, and cost contribution arrangements. It also includes certain transaction with third parties, where a prior arrangement exists, and transaction between the associated enterprise routed through a third party. It is essentially a cross border transaction between associated enterprises in any sort of property, whether tangible or intangible or in the provision of services, lending of money etc. The definition also covers the transaction between two non-residents, where for example one of them has a permanent establishment whose income is taxable in India.

**Know-how**: Know-how is defined in OECD model convention as all undivulged technical information whether capable of being patented, or not that is necessary for the industrial reproduction of a product or process. It may include secret service/processes or formulae or other secret information concerning industrial, commercial or scientific experience that is not covered by patent.

**Mutual agreement procedure**: The mutual agreement procedure is a means through which competent authorities of the countries consult to resolve disputes regarding the application of double taxation conventions. The procedure permits a taxpayer to seek a mutual agreements where it considers that action of the contracting states may result in taxation not in accordance with the provisions of the treaty.

**Most Appropriate Method**: The Most appropriate method is a method that is best suited to the facts and circumstances of a particular transaction, and which provides the most reliable measure of an arm’s length price in relation to the international transaction. In choosing the most appropriate method one must consider the nature and class of the international transaction, the class or classes of associated enterprises entering into the transaction and the availability, coverage and reliability of data necessary for application of the method.

**Manufacturing Intangible**: Manufacturing intangible is an intangible property created or developed by the owner as a result of research and development activities, such as patents, designs, inventions, formulae and technical know-how.

**Marketing intangible**: Marketing intangible means an intangible property such as, trade-mark, brand or trade name that is helpful to commercially exploit a product or service because of their interface and recognition by markets.

**Multinational Enterprise group (MNE group)**: A group of associated companies with business establishments in two or more countries.

**Multinational enterprise (MNE)**: A company that is part of an MNE group.

**Non-Discrimination**: Non-Discrimination is a principle of tax treaty as per which subject to principle of reciprocity the nationals of a contracting State cannot be less favorably treated in other Contracting State than the nationals of other State in the same circumstances.
**OECD** : The Organization for Economic Cooperation and Development is an international organization that develops an international consensus on tax treaties, transfer pricing and other international economic issues.

**Permanent Establishment** : The expression permanent establishment means a fixed place of business with a specific site. The place of business would include any premises, facilities or installations used for carrying on the business of the enterprise. The permanent establishment would exist only if the place has a certain degree of permanence.

**Profit Split Method (PSM)**: Under this method the arm’s length price is determined through a division of the consolidated profits of the associated enterprises. The combined profit accruing to the associated enterprises involved in a controlled transaction is determined and then the profit is split among the enterprises according to an economically valid basis.

**Property** : Property includes both tangible and intangible articles, goods and assets that can be traded in open market. The intangible assets included in the definition consist of patents, designs, drawings, inventions, formulae, trade-marks, trade names, brands etc.,

**Resale price method** : The resale price method refers to the arm’s length price for transfers to associated enterprises who resell or distribute the product to unrelated parties without significant value addition. The transfer price in this case in the resale price less applicable gross profit margin earned by the distributor or reseller. The method begins with the price at which a product purchased from an associated enterprise is resold to an independent enterprise. The resale price is then reduced by appropriate gross margin representing the amount out of which the reseller would seek to cover its selling and other operating expenses.

**Resale Price margin** : A margin representing the amount out of which a reseller would seek to cover its selling and other operating expenses and, in the light of the functions performed (taking into account assets used and risks assumed) make an appropriate profit.

**Residual Analysis** : An analysis used in the profit split method which divides the combined profit from the controlled transactions under examination in two stages. In the first stage, each participant is allocated sufficient profit to provide it with a basic return appropriate for the type of transactions in which it is engaged. Ordinarily this basic return would be determined by reference to the market returns achieved for similar types of transactions by independent enterprises. Thus the basic return would generally not account for the return that would be generated by any unique and valuable assets possessed by the participants. In the second stage, any residual profit (or loss) remaining after the first stage division would be allocated among the parties based on an analysis of the facts and circumstances that might indicate how this residual would have been divided between independent enterprises.

**Safe Harbour Rules** : The rules provide the circumstances in which the tax authorities would automatically accept transfer prices. The requirement of safe harbor may vary from a relief from the obligation to comply with a country’s transfer pricing regulation to the obligation to comply with various procedural rules.
Secondary transaction: A constructive transaction that some countries will assert under their domestic legislation after having proposed a primary adjustment in order to make the actual allocation of profits consistent with the primary adjustment. Secondary transactions may take the form of constructive dividends, constructive equity contributions, or constructive loans.

Service Cost method: A transfer pricing method used in USA that allows the arm’s length charge for a controlled service transaction to be determined by reference to total cost of services without a mark-up. The types of services included for applying this method are accounting; budgeting tax and audit; payroll; human resource functions; public relations; general clerical treasury; computer support; legal and insurance.

Simultaneous tax examinations: A simultaneous tax examination, as defined in Part A of the OECD Model Agreement for the Undertaking of simultaneous Tax examinations, means an “arrangement between two or more parties to examine simultaneously and independently, each on its own territory, the tax affairs of a taxpayers in which they have a common or related interest with a view to exchanging any relevant information which they so obtain”

Tested party: The related party in a controlled transaction whose operating profit attributable thereto can be verified using the reliable data.

Thin Capitalization: Thin capitalization means an abnormally high debt to equity ration of a company, where the debt finance comes from a foreign affiliated contributor of capital. It is used in cases where there is excessive use of debt finance compared to equity finance. It may also occur in the situation of back to back financing, where the visible contributor of capital is not directly a shareholder but is an associated enterprise of multinational group. A company is therefore considered as thinly capitalized if the debts owned by a company are disproportionately high in relation to its equity capital.

Toll Manufacturer: Toll manufacturer means a contract manufacturer or service provider who does not bear any market risk because of guaranteed volume of orders and does not own any valuable intangible asset.

Trade-Mark: Trade mark is a distinctive sign used by an enterprise or legal entity to identify the product or service provided to customers and which distinguishes it from the products or services of other entities. It is an intangible property that generally consists of a name, word phrase, logo symbol, design image or combination of these elements.

Trade Name: Trade name means any name under which an enterprise carries out the business for commercial purposes and which has substantial promotion value. It can be legally registered by the owner because of its brand recognition value.

Transaction: Transaction includes an arrangement, understanding or action in concert, whether or not such arrangement, understanding or action is formal or in writing, or whether or not such arrangement, understanding or action is intended to be enforceable by legal proceeding.
**Transaction Value**: The expression is used under customs valuation rules in respect of price paid or payable for the goods sold for export to India.

**Transfer price**: Transfer pricing means determination of price of goods, services and intangibles transacted between associated enterprises that belong to the same business group. It refers to the price charged by one enterprises to an associated enterprise for supply of goods, services and intangibles like know-how etc. The Organization of Economic Cooperation and Development defines it as “prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises”

**Traditional transaction methods**: The comparable uncontrolled price method, the resale price method, and the cost plus method.

**Transactional Net Margin Method**: Under this method the net profit margin that a taxpayer realizes from a controlled transaction is compared with net margin earned to comparable uncontrolled transactions. The net margin of the transactions so compared forms the basis of determining arm’s length price. The net margin is calculated with reference to appropriate base say costs, sales or assets. The method is used where the data available is inadequate or unreliable to apply traditional transaction methods.

**Transactional profit method**: A transfer pricing method that examines the profits that arise from particular controlled transactions of one or more of the associated enterprises participating in those transactions.

**Uncontrolled Transaction**: A transaction between two or more enterprises that are not members of the same controlled group. Uncontrolled transactions are undertaken in open market conditions and are not influenced by any special relationship between the parties.

**Unspecified Method**: Unspecified method is a residuary transfer pricing method which is not specified in transfer pricing regulations of a country. Transfer pricing rules allow use of unspecified method if it provides the most reliable measure of the arm’s length standard and methods prescribed in rules cannot be used in a particular case.