

## SECONDARY ADJUSTMENTS TO BECOME A REALITY

### UNDER INDIAN TRANSFER PRICING REGIME

Since introduction of transfer pricing (TP) provisions almost a decade and a half back, Indian TP landscape has been constantly evolving in order-to keep pace with the economic realities of the world as well as the international best practices.

The tax authorities' earlier attempt to carry out secondary adjustments was prevented by the higher appellate and judicial bodies for there was no express provision under the existing TP regulations to permit such secondary adjustments.

This is no longer the position now and secondary TP adjustments are all set to become a reality very soon. Union Budget 2017 proposes to introduce a new provision in the Income-tax Act, 1961, namely section 92CE, which permits secondary adjustments in situations enumerated there under, with effect from April 1, 2018 (assessment year 2018-19).

### What is secondary adjustment?

In transfer pricing parlance, a secondary adjustment, with the express sanction of law, is carried out pursuant to the primary TP adjustment. This can be better understood by way of the following **illustration:**

An Indian Company, I Co, sells certain products to its associated enterprise (AE), F Co, for Rs 100, whereas the arm's length price (ALP) of such sale transaction is Rs 150. Given the difference between the transfer price (Rs 100) and the ALP (Rs 150), an upward (primary) TP adjustment will be carried out to the extent of INR 50, which will be taxed in the hands of the I Co. Subsequently, for the purpose of carrying out secondary adjustment, it would be deemed

25.05.2017

as if F Co. owes Rs 50 to the I Co. (being the difference between ALP and actual transfer price), which will be deemed to be a loan or an advance by I Co to F Co. As such, an interest would be imputed on such advance and an adjustment/addition to income will be carried out in the hands of the I Co on account of such interest. This adjustment/addition on account of a notional interest is termed as secondary adjustment.

Secondary adjustment, therefore, is carried out in the following manner:

- (a) making a primary adjustment;
- (b) assuming/deeming a transaction based on such primary adjustment, and;
- (c) Imputing a notional income to such assumed/deemed transaction.

Since, Secondary adjustment deems existence of an international transaction (of a loan or advance), its execution was not possible without the blessing under the IT Act.

#### [Proposed amendment in the budget and analysis](#)

The proposed section 92CE of the IT Act permits secondary adjustment to the following primary adjustments:

- *Suo moto* TP adjustment by the taxpayer in its return of income;
- Adjustment made by ITA and accepted by the taxpayer;
- TP adjustment, in terms of an Advance Pricing Agreement;
- TP adjustment made as per safe harbour rules;
- TP adjustment arising as a-result of resolution under Mutual-Agreement Procedure

---

The transactions, where underlying primary TP adjustment does not exceed INR 1 crore or which are entered up-to financial year 2015-16

25.05.2017

(assessment year 2016-17) have been kept outside the ambit of secondary adjustment.

Deeming fiction is introduced under the new provision whereby, if as a result of the primary adjustment, there is an increase in the total income or reduction in loss of the taxpayer, the excess money (i.e. the difference between ALP and the transfer price) which is available with the AE, and not repatriated to India within the prescribed time, is deemed to be an advance made by the taxpayer to such AE on which an interest would be imputed in accordance with the prescribed methodology.

Secondary adjustment is defined to mean an adjustment in the books of accounts of the taxpayer and its AE to reflect that the total allocation of profits between the taxpayer and its AE are consistent with the transfer price determined as a result of the primary adjustment, thereby removing the imbalance between cash account and actual profit of the taxpayer.

**Prepared by: Lakshman**

**Reviewed by:**

**We are happy to help you,**

**Contact**

**Ankit C Shetty**

**+91 9980731897**

**[ankit@bcshettyco.com](mailto:ankit@bcshettyco.com)**