

India's Transfer Pricing Framework: Evolution, Challenges, and Future Directions

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DOI: <https://doi.org/10.51584/IJRIAS.2025.100900005>

Received: 09 Sep 2025; Accepted: 19 Sep 2025; Published: 10 October 2025

ABSTRACT

India's transfer pricing regime, governed by Chapter X of the Income Tax Act, 1961, is a robust framework aligned with OECD guidelines, designed to curb profit shifting and ensure tax base integrity. This white paper provides a comprehensive analysis of the regime's statutory provisions, methodologies, documentation requirements, and dispute resolution mechanisms. It highlights recent developments, including a record 125 Advance Pricing Agreements (APAs) in FY 2023–24, amendments to Safe Harbour Rules, and the innovative Block Transfer Pricing Assessment Scheme introduced in the Finance Act, 2025. Through a SWOT analysis, comparative perspective, case studies, and visual aids (tables, charts, and flowcharts), the paper evaluates strengths like global alignment and challenges such as high compliance costs. Recommendations include digital transformation, simplified thresholds for SMEs, and enhanced global collaboration. This study contributes to tax scholarship by offering insights into India's role in global tax governance.

Preface

Transfer pricing has emerged as a pivotal aspect of global taxation, ensuring fairness in cross-border and domestic transactions while safeguarding national tax bases. In India, the transfer pricing regime, established in 2001, has evolved into a sophisticated framework aligned with international standards, yet tailored to address unique domestic challenges, such as a significant informal economy and tax arbitrage. This white paper synthesizes India's transfer pricing regulations, recent innovations, and their implications for multinational enterprises (MNEs) and policymakers. By integrating statutory analysis, empirical data, case studies, and visual aids, it aims to contribute to advanced tax scholarship and inform global tax governance debates. The paper is intended for academics, tax practitioners, and policymakers seeking to understand India's role in shaping equitable taxation in an era of digital economies and BEPS 2.0.

Keywords: Transfer Pricing, India, Arm's Length Price, Advance Pricing Agreements, Safe Harbour Rules, Block Assessment Scheme, OECD Guidelines, BEPS, Dispute Resolution, Taxation

INTRODUCTION

Transfer pricing regulates the pricing of transactions between associated enterprises (AEs) to ensure they reflect market-based prices, preventing tax base erosion. In India, transfer pricing rules, introduced in 2001 under Chapter X (Sections 92–92F) of the Income Tax Act, 1961, align with the OECD's arm's length principle while addressing domestic priorities like tax arbitrage in an informal economy.^[1] The regime has evolved through legislative amendments, judicial pronouncements, and innovations like APAs and the Block Assessment Scheme.

^[1]: India's informal economy, estimated at 50% of GDP, complicates comparability analysis in transfer pricing (Grant Thornton, 2023).

This white paper aims to:

- Analyze India's transfer pricing framework, focusing on statutory provisions, methods, and dispute resolution.

- Highlight recent developments, including APAs, Safe Harbour Rules, and the 2025 Block Assessment Scheme.
- Critically evaluate the regime's efficacy using a SWOT analysis, comparative lens, and case studies.
- Propose reforms to enhance compliance and global alignment.

The study is relevant to policymakers, practitioners, and academics, offering insights into India's evolving role in international tax governance amid BEPS 2.0 and digital economy challenges.

Key Insight: India's informal economy, contributing nearly 50% of GDP, poses unique challenges in identifying reliable comparables, necessitating tailored benchmarking approaches.

Overview of India's Transfer Pricing Regime

Statutory Framework

India's transfer pricing regulations are codified in Sections 92–92F of the Income Tax Act, 1961, introduced via the Finance Act, 2001. Key provisions are summarized below.

Table 1: Key Statutory Provisions of India's Transfer Pricing Regime

Section	Description	Key Features
92	Computation of Income	Mandates ALP for international transactions; allows AO to recompute if documentation is inadequate.
92A	Associated Enterprise	Defines AEs based on 26% voting power or significant influence (e.g., board control, intangibles).
92B	International Transaction	Covers sales, services, intangibles, and PEs; expanded by Finance Act, 2012.
92BA	Specified Domestic Transaction	Applies to transactions > INR 20 crore under tax holiday regimes (e.g., Section 10AA).
92C	ALP Computation	Prescribes six methods (CUP, RPM, CPM, PSM, TNMM, Other); allows 3% tolerance range.
92CC–92CD	Advance Pricing Agreements	Authorizes APAs for up to 5 years with rollback for 4 prior years.
92CE	Secondary Adjustment	Mandates repatriation of excess income within 90 days or imposes 18% tax.
92D–92E	Documentation & Reporting	Requires contemporaneous documentation and Form 3CEB filing by October 31.

Legislative Intent: These provisions aim to curb profit shifting by MNEs and domestic entities exploiting tax incentives, aligning with OECD standards.^[^2]

^[^2]: OECD Transfer Pricing Guidelines (2022) emphasize the arm's length principle as the global standard.

Transfer Pricing Methods

Section 92C, read with Rule 10B, prescribes six methods for ALP determination, as illustrated below.

Table 2: Comparative Analysis of Transfer Pricing Methods

Method	Applicability	Advantages	Challenges
CUP	Standardized goods (e.g., commodities)	High reliability; direct market comparison	Difficult to find comparable uncontrolled transactions
RPM	Distributors with minimal value addition	Simple when resale prices available	Inapplicable for significant value-added activities
CPM	Manufacturing, contract services	Reflects supplier costs	Complex cost base determination
PSM	Integrated operations, intangibles	Equitable profit allocation	Subjective contribution analysis
TNMM	Services, manufacturing, distribution	Flexible; uses public data	Profit indicator selection critical
Other	Unique transactions	Flexible for bespoke models	Lack of clear guidelines

Practical Insight: TNMM is widely used (e.g., 80% of APAs in FY 2023–24) due to its adaptability and data availability.^[^3]

Documentation Requirements

Rule 10D mandates a three-tier documentation framework per BEPS Action 13, as shown below.

Table 3: Three-Tier Documentation Requirements

Tier	Description	Threshold	Filing Deadline	Form
Local File	Transaction-specific details, FAR analysis	Intl: > INR 1 crore; SDT: > INR 20 crore	October 31	3CEB
Master File	Group-wide overview, intangibles, financing	MNE turnover > INR 5 billion	November 30	3CEAA/3CEAB
CbCR	Global income, tax allocation	MNE revenue > INR 64 billion	Within 12 months	3CEAC–3CEAE

^[^3]: CBDT Annual Report, FY 2023–24, notes TNMM’s dominance in APA methodologies.

Challenges: High compliance costs (2–5% of MNE budgets) and data scarcity in India’s emerging market context increase the burden on MNEs.^[^4]

Dispute Resolution

India’s multi-tiered dispute resolution includes:

- **MAP:** Resolves double taxation under DTAA’s (24-month target).
- **DRP:** Handles adjustments for foreign companies (Section 144C).
- **ITAT:** Final fact-finding authority.
- **APAs:** Proactive certainty mechanism.

Penalties: Non-compliance attracts penalties (e.g., 2% of transaction value under Section 271AA, INR 100,000 for Form 3CEB failure).

Case Study: *SAP Labs India Pvt. Ltd. v. Income Tax Officer* (Supreme Court, 2023) clarified the treatment of marketing intangibles, emphasizing the need for consistent judicial guidance to reduce uncertainty.

Recent Developments

Advance Pricing Agreements

In FY 2023–24, the CBDT signed 125 APAs (86 unilateral, 39 bilateral), covering 224 transactions—a record high.

Insight: APAs reduce litigation, with 420 APA years and 56 rollback years resolved in FY 2023–24.^[^5]

Safe Harbour Rules

The 2025 amendment expanded Safe Harbour Rules, increasing the threshold to INR 300 crore and adding lithium-ion batteries.

Table 4: Safe Harbour Margins (AY 2022–23)

Transaction	Threshold	Margin Requirement
Software/ITES	≤ INR 1 bn	≥ 17% operating margin
KPO	≤ INR 2 bn	≥ 18–24% (based on employee cost)
Intra-group Loan (INR)	≤ INR 1 bn	425 bps over SBI MCLR
Corporate Guarantee	—	≥ 1% p.a. commission
Auto Components	—	≥ 12% (core); ≥ 8.5% (non-core)

^[^4]: Grant Thornton (2023) estimates documentation costs at 2–5% of MNE compliance budgets.

^[^5]: CBDT Press Release, April 2024, highlights APA milestones.

Impact: By 2017, 200 taxpayers adopted safe harbours, but conservative margins limit uptake.^[^6]

Policy Note: Conservative safe harbour margins discourage adoption, particularly for SMEs, suggesting a need for industry-aligned thresholds.

Block Transfer Pricing Assessment Scheme

Introduced in the Finance Act, 2025, this scheme enables a three-year block assessment from April 1, 2026.

Features:

- Lead year ALP methodology applies to two subsequent years if transactions are consistent.
- TPO assessment for FY 2022–23 due by January 31, 2026.

Income Tax Bill, 2025

The bill retains core provisions, clarifies terms (e.g., “tax year”), and codifies block assessments, effective April 1, 2026.

Critical Analysis

SWOT Analysis

Table 5: SWOT Analysis of India's Transfer Pricing Regime

Aspect	Description
Strengths	Robust legislation, OECD alignment, APA success
Weaknesses	High compliance costs, litigation backlog, limited TPO expertise
Opportunities	Digital tools, BEPS Pillar Two, block assessment efficiency
Threats	Litigation delays, global competition, digital economy challenges

Challenges

- **Compliance Costs:** SMEs face annual costs of INR 1–5 million, disproportionate to their scale.^[^7]
- **Litigation:** ITAT appeals average 2–3 years, delaying resolutions.
- **Informal Economy:** 50% of GDP complicates comparability.
- **Judicial Uncertainty:** Conflicting rulings on marketing intangibles and intra-group services (e.g., *Morgan Stanley & Co. v. Director of Income Tax*, 2007) create ambiguity.

Key Insight: India's high litigation volume, with thousands of unresolved TP disputes, underscores the need for faster dispute resolution and clearer judicial precedents.

[^6]: *Taxsutra* (2018) notes limited adoption due to market misalignment.

[^7]: *Cleartax.in* (2024) estimates SME compliance costs.

Opportunities

- **Digital Tools:** AI and blockchain can streamline audits.
- **Block Assessments:** Offer a scalable global model.
- **BEPS 2.0:** Enhances tax equity.

Case Study: *Morgan Stanley & Co. v. Director of Income Tax* (2007) highlighted India's strict approach to intra-group services, contrasting with more flexible OECD peers like the US, suggesting a need for nuanced guidelines.

Comparative Perspective

Table 6: Comparative Analysis with Key Jurisdictions

Jurisdiction	Strength	Weakness	Lesson for India
USA	Flexible "best method" rule	Less prescriptive documentation	Simplify SME requirements
EU	Robust arbitration under EU Convention	Complex coordination	Adopt arbitration in DTAAs

China	Strict enforcement on intangibles	Limited flexibility	Develop digital transaction guidelines
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Key Insight: India’s structured documentation surpasses the US but lags in arbitration compared to the EU, highlighting the potential for adopting arbitration mechanisms.[^8]

Future Directions

1. **Digital Transformation:** Implement AI-driven audits and blockchain for transparent documentation.
2. **Capacity Building:** Train 500+ TPOs by 2027 to handle complex domains like digital transactions.
3. **Simplified Thresholds:** Introduce tiered documentation for SMEs (< INR 50 crore).
4. **Global Collaboration:** Lead OECD/G20 discussions on digital taxation.
5. **Export Block Assessments:** Promote the scheme as a model for emerging economies.
6. **Stakeholder Engagement:** Refine safe harbour margins via industry consultation.

Policy Note: Exporting the Block Assessment Scheme to other emerging economies could position India as a leader in innovative tax governance.

[^8]: OECD BEPS Action 14 (2022) recommends arbitration for effective dispute resolution.

CONCLUSION

India’s transfer pricing regime is a sophisticated, OECD-aligned framework that balances global and domestic priorities. Innovations like APAs, Safe Harbour Rules, and the Block Assessment Scheme enhance tax certainty. However, high compliance costs, litigation delays, and capacity constraints require reform. By adopting digital tools, simplifying SME requirements, and deepening global collaboration, India can solidify its leadership in transfer pricing governance, fostering a fair tax environment.

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