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INDIAN TRANSFER PRICING - SPECIFIC ISSUES: EVIDENCE FROM CORPORATE RESPONDENTS

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ABSTRACT

Transfer Pricing plays pivotal role in international trade and commerce when a transaction is between two or more associated enterprises based in multiple tax jurisdictions. Transfer Pricing mechanism facilitates the tax jurisdictions to levy tax on the relevant amount of income to which they are rightfully entitled. Though Transfer Pricing is of recent origin it has been greatly influencing the international tax aspects of the day. When the tax authority of one country adjusts the profit of a member of the MNE group, this may have an effect on the tax base of another country. As a result Transfer Pricing has become a major tax issue for the companies. In other words, cross-border tax situations involve issues related to jurisdiction, allocation of income and valuation.



KEYWORDS: WTransfer Pricing , international trade and commerce , Base Erosion and Profit Shifting (BEPS)‘.

INTRODUCTION:

In the arena of international taxation several developments are taking place across the world. These developments primarily indicate efforts of each tax jurisdiction to contain revenue leakages in cross border transactions and to ensure legitimate tax collections. In this direction, OECD recently released their report on ‘Base Erosion and Profit Shifting (BEPS)’. This has thrown great challenges to tax administrations in

research scholars have carried-out their doctoral work in the field of Transfer Pricing. Those reviewed by the researchers are as under:

capturing taxable transactions at the right time at the right place. OECD in its BEPS report gave a very meticulous action plans for various administrations for achieving objectives . India is a late starter in structuring the Transfer Pricing policy but it has been seriously following the foot prints of developed countries.

REVIEW OF LITERATURE

Before embarking upon the present research study the researchers reviewed the following recent research works in the area of Transfer Pricing:

DOCTORAL THESES

A good number of

Researcher	Country	Year	Outcome of the study
<u>Simeon Ogbulafor Okpechi</u> ³	USA	1976	Reviews the Transfer Pricing mechanism in relation to criteria such as divisional autonomy, objective performance evaluation and goal congruence.
<u>Sabri Abdel-Hamid-El-Segini</u> ⁴	England	1992	Identifies factors influencing Transfer Pricing strategies which represent a motive to shift profits.
Jamie Elliott ⁵	UK	1999	Longitudinal grounded theory case studies can provide some variable insights into our understanding about how MNEs manage International Transfer Pricing.
Ashok Kumar ⁶	India	2002	Evaluates Transfer Pricing policy in India with special reference to pharmaceutical industry.
<u>Rajab Abdulla Rajab Al-Esmail</u> ⁷	UK	2003	Shows the discretion provided under both OECD (TNMM) and US IRS (CPM) methods.
<u>Lowaiyee Agnes</u> ⁸	China	2004	The more important the management perceives the interest of local partners and the maintenance of a good relationship with host government the more likely it is that the Foreign Investment Enterprises (FIE) will adopt a market-based Transfer Pricing method.
<u>Jian Li</u> ⁹	New Zealand	2005	Provides an insight into International Transfer Pricing practices and audits across New Zealand, Australia and China, providing MNEs and other business, which already operate or intend to operate between these three markets, with guidance in complying with the Transfer Pricing regulations of the three Asia-Pacific national economic regimes involved.
<u>Ren Linghui</u> ¹⁰	China	2010	The study analyses China's special interests in regulating Transfer Pricing and thus revealing and critiquing its unique features.
<u>Yeni Mulyani</u> ¹¹	Australia	2010	Along with adequate Transfer Pricing provisions, the overall tax regime plays an important role in improving Transfer Pricing compliance.
<u>Gupta Pradeep</u> ¹²	India	2010	Explores the Transfer Pricing practices of MNCs in India.
<u>Rasmus Steineses</u> ¹³	Denmark	2012	Focuses on the effectiveness of relationship between two related parties on the pricing of inter-company loans.

RESEARCH ARTICLES

Significant contributions to the body of knowledge have been made by the researchers in the subject of Transfer Pricing by way of research articles. Among the studies conducted, the following works have been reviewed:

Researcher	Year	Outcome of the study
Turner ¹⁴	1996	Summarizes the Transfer Pricing guidelines issued by OECD in 1995, provides an overview of the tax rules applying to related party transactions in various countries, and compared those approaches to the ones found in Canada.
Cravens and Shearon ¹⁵	1996	Shows that the experience of international Transfer Pricing while useful in building the blocks of Transfer Pricing understanding may not suffice as a platform for dealing with domestic issues.
Connie Rae Bateman and et al ¹⁶	1997	Stages in Transfer Pricing decision process along-with critical factors directly affect sales and Transfer Pricing audit.
Karen S. Cravens ¹⁷	1997	Executives of US based MNEs perceive that Transfer Pricing does influence measures of corporate performance.
K. Hung Chan and Lynne Chow ¹⁸	1997	Tax audits on Transfer Pricing are confined mainly to medium and small-sized foreign investments, lower-technology companies and transfer of tangible goods, and tend to focus on certain nationality and forms of foreign investment.
Thomas A. Gresik ¹⁹	2000	Needed is a policy that seeks to achieve arm's-length prices in consistent with broader welfare objectives when the multinational's home country adopts a commensurate-with-income standard (ruling out repatriated losses) and when the multinational prefers pre-tax operating profit over post-tax Transfer Pricing profit.
Teresa L. Conover and Nancy B. Nichols ²⁰	2000	Smaller and/or distressed firms are less likely to shift income through Transfer Pricing than larger firms.
Dawson and Miller ²¹	2000	Profit-maximizing multinational corporations used transfer price to shift profit to the relatively lower-tax country in order to maximize their global after-tax or else equal.
Borkowski ²²	2001	There is greater agreement among MNCs on their Transfer Pricing methods for intangible property compared to tangible goods. Also, there was no significant difference in the methods used to value intangible property for cross-border intangible transfers.
Swenson ²³	2001	Reported prices increased when the combined effect of taxes and tariffs provided an incentive for firms to overstate their prices.
Reeb and Hansen ²⁴	2003	Tax minimization schemes were more aggressively pursued in small firms.
Eric J. Bartelsman ²⁵	2003	Provides evidence of income shifting in response to differences in corporate tax rates for a large section of OECD countries.
Srivatsan ²⁶	2004	By adopting tax/profit shifting from higher tax jurisdictions to lower tax jurisdictions, the firm could go on building the profits and multiplier concept would hold true for Transfer Pricing. Further, the multiplier would be limited and dependent on tax rates prevailing in each shift; and the quantum of corpus that is shifted each time.
Ki Ho and Lau ²⁷	2005	Market price and full cost plus are the most commonly used ITP methods. The results of this study also reveal that there are no significant differences in the perceived frequency of use of various ITP methods by U.S. MNCs for transactions with their affiliates in the People's Republic of China (PRC) and the UK.

Chan Agnes and Lai Lan ²¹	2006	Tax audit adjustments for respondents that have autonomy in setting transfer prices or sourcing from outsiders are smaller than those that have their transfer transactions dictated by parent companies.
Bernard ²²	2006	Export prices for intra-firm transactions were significantly lower than the prices for the same good sent to an arm's length customer. The price wedge between arm's length and intra-firm prices responds to differences in market structure, taxes, and tariffs.
Feinschreiber and et al ²⁰	2007	The well-accomplished tax auditors are making Transfer Pricing more difficult for both Korean-based and foreign-based taxpayers. As a result, Advance Pricing Agreements are becoming more important for cost contribution agreements.
Wagdy M. Abdallah and Ahmed S. Maghrabi ²¹	2009	Most effective Transfer Pricing should include; tax and non-tax strategies to manage global earnings of the company; objectives behind the system; potential global income tax consequences; selection of the best Transfer Pricing methods; and key issues to help in avoiding tax audits in the future.
Ching – Wen Lin and Hsiao – Chen Change ³²	2010	Tax minimisation is no longer the focus of Transfer Pricing manipulation strategies of Taiwanese MNEs and their real concerns are winning maximum economic profits, enhancing the competitiveness of the enterprise, and effectively repatriating profits to parent companies in order to facilitate greater economic profits.
Christian Plesner Rossing and Carsten Rohde ³³	2010	Implementation of a Transfer Pricing tax compliance strategy gives rise to a number of changes to the overhead cost allocation system design.
S P Singh and et al ³⁴	2011	A well-structured APA regime in India would signal the beginning of an era that is reformist in nature and forward looking in its implementation.
S P Singh and Abhay Kumar ³⁵	2012	Both taxpayers and tax authorities should be sanguine in considering berry ratio as a good Profit Level Indicator (PLI) under the TNMM if the requisite conditions for its application are found satisfied.
Amit Singhania and Ankur Goel ³⁶	2012	Over a period of time, the Indian tax authorities have identified payment of management charges as one of the soft targets for making Transfer Pricing adjustment.
Gyaneshwanath (Garry) Gowrea ³⁷	2012	Multinational companies seek to conduct business where it is more cost effective and tax efficient.
Christian Plesner Rossing ³⁸	2013	Functional tax strategy impacts the management control system (MCS) in a multinational enterprise (MNE) facing Transfer Pricing tax risks. It is argued that the MCS in a multinational setting is contingent upon the MNE's response to its tax environment.
Anshu Khanna ³⁹	2013	The Transfer Pricing litigations are bound to increase many-fold over future years on account of domestic Transfer Pricing compliance.
K. Hung Chan and et al ⁴⁰	2015	Chinese tax authorities have significantly reduced their focus on auditing wholly foreign-owned enterprises, and placed more focus on western multinationals and larger companies in the late 2000s as compared with the audits in the early 1990s. The findings show that changes in the business environment, regulations and the audit expertise of tax officials can lead to a shift in the focus of tax audits of international transfer pricing.

OBJECTIVES OF THE STUDY

The main objectives of the present study are to :

1. Analyse the Indian Transfer Pricing mechanism,
2. Examine Corporates' view on Indian Transfer Pricing, and
3. Suggest measures for improvement of Transfer Pricing regime in India.

SCOPE OF THE STUDY

One hundred fifty sample companies spreading across India and belonging to both manufacturing and service sectors have been covered. The study is restricted to Transfer Pricing issues only.

METHODOLOGY

I. Sources of Data:

The data for the present study has been gathered from primary as well as secondary sources. The primary data, in the form of respondents' opinion, has been collected from the corporate business houses. Questionnaire using Likert Scale (using Highly Satisfied, Satisfied, Neither Satisfied nor Dissatisfied, Dissatisfied, and Highly Dissatisfied as parameters) and multiple choice responses (with 'Yes/No' as parameters) has been used. Publications of the Government, Professional and Academic Journals, Prominent websites dealing with tax matters, and other literature pertaining to the subject have been used as secondary sources.

II. Sample Size for the Study:

The sample size adopted for the study consists of 150 corporate enterprises. The profile of the respondents include Directors, Executive Directors, and Senior Managers (Taxation) of the respondent companies.

Table-1:
Sector – Wise Distribution of Sample Corporate Undertakings

Sl. No.	Sector	Frequency	In Percent
1.	Manufacturing Sector	86	57.34
2.	Service Sector	64	42.66
Total		150	100.00

Source: Field Study.

HYPOTHESES OF THE STUDY

The following hypotheses were formulated on the basis of overall and sector – wise corporate respondents.

I. Hypothesis for Overall study of Corporate Respondents

Transfer Pricing Issues	Respondents	Statement (H _a – Alternative Hypothesis)
Documentation procedure	All Corporate Respondents	The corporate respondents have significant relationship for specific issues of Transfer pricing
Stages of Clearance		
Methods adopted in deciding arm's length price for Transfer Pricing		
Audit procedure		
Penalties under Transfer Pricing provisions		
Cooperation of Transfer Pricing authorities		
Transfer Pricing provisions and rules		
Overall system of Transfer Pricing		

II. Hypotheses for Sector-Wise Study of Corporate Respondents

Transfer Pricing Issues	Respondents	Statements (H _a – Alternative Hypotheses)
Documentation procedure	Sector-Wise Corporate Respondents	There is significant relationship between sector-wise response towards documentation procedure applicable to Transfer Pricing.
Stages of Clearance	Sector-Wise Corporate Respondents	There is significant relationship between sector-wise response towards stages of clearance applicable to Transfer Pricing.
Methods adopted in deciding arm's length price for Transfer Pricing	Sector-Wise Corporate Respondents	There is significant relationship between sector-wise response towards Transfer Pricing Methods adopted in deciding arm's length price for Transfer Pricing.
Audit procedure	Sector-Wise Corporate Respondents	There is significant relationship between sector-wise response towards audit procedure under Transfer Pricing.
Transfer Pricing Issues	Respondents	Statements (H _a – Alternative Hypotheses)
Penalties under Transfer Pricing provisions	Sector-Wise Corporate Respondents	There is significant relationship between sector-wise response towards penalties under Transfer Pricing provisions.
Cooperation of Transfer Pricing authorities	Sector-Wise Corporate Respondents	There is significant relationship between sector-wise response towards cooperation of Transfer Pricing authorities in Transfer Pricing process.
Transfer Pricing provisions and rules	Sector-Wise Corporate Respondents	There is significant relationship between sector-wise response towards Transfer Pricing provisions and rules.
Overall system of Transfer Pricing	Sector-Wise Corporate Respondents	There is significant relationship between sector-wise response towards overall system of Transfer Pricing.

TOOLS AND TECHNIQUES USED FOR DATA ANALYSIS

Hypotheses were tested using one sample t-test statistic at 5% level of significance. Percentage method and graphs have been used to analyse the data.

ANALYSIS AND INTERPRETATION OF CORPORATES' VIEW ABOUT INDIAN TRANSFER PRICING

The primary data gathered through questionnaire from the said 150 companies, between Jan-2014 and June-2015, have been tabulated and analysed by classifying the information as 'Specific Issues' of Transfer Pricing. The hypotheses have been tested by using one sample t-test.

Specific Issues:

The researchers studied eight specific issues concerning the Transfer Pricing practices in India. The response of the corporate sector towards these issues have been summarised in table-7.

Table-2:
Respondents' Opinion about Specific Issues of Transfer Pricing in India

Sl. No	Specific Issues of Transfer Pricing	Sector	Opinion					Total
			HS	S	NSNDS	DS	HDS	
1.	Documentation procedure	M	35	41	05	02	03	86
		S	13	43	03	05	00	64
		Total	48	84	08	07	03	150
		In %	(32)	(56)	(5.34)	(4.66)	(02)	(100)
2.	Stages of clearances	M	06	68	08	04	00	86
		S	05	50	07	01	01	64
		Total	11	118	15	05	01	150
		In %	(7.34)	(78.66)	(10)	(3.34)	(0.66)	(100)
3.	Methods applied in deciding Arm's Length Price	M	01	55	14	12	04	86
		S	01	37	13	11	02	64
		Total	02	92	27	23	06	150
		In %	(1.33)	(61.33)	(18)	(15.34)	(04)	(100)
4.	Audit procedure	M	00	20	24	35	07	86
		S	01	21	09	27	06	64
		Total	01	41	33	62	13	150
		In %	(0.66)	(27.33)	(22)	(41.35)	(8.66)	(100)
5.	Penalties for non - compliance of Transfer Pricing provisions	M	01	66	07	10	02	86
		S	00	47	07	10	00	64
		Total	01	113	14	20	02	150
		In %	(0.66)	(75.33)	(9.34)	(13.34)	(1.33)	(100)
6.	Cooperation of Transfer Pricing authorities in Transfer Pricing decision process	M	02	06	20	41	17	86
		S	02	18	09	23	12	64
		Total	04	24	29	64	29	150
		In %	(2.66)	(16)	(19.33)	(42.67)	(19.34)	(100)
7.	Transfer Pricing Provisions and Rules	M	02	72	07	02	03	86
		S	02	51	07	02	02	64
		Total	04	123	14	04	05	150
		In %	(2.67)	(82)	(9.34)	(2.66)	(3.33)	(100)
8.	Overall system of Transfer Pricing	M	01	75	05	02	03	86
		S	03	47	09	05	00	64
		Total	04	122	14	07	03	150
		In %	(2.66)	(81.34)	(9.34)	(4.66)	(02)	(100)

Source: Field Survey.

Note: 1. Figure in parenthesis are percentage to the total.

2. HS – Highly Satisfied, S – Satisfied, NSNDS – Neither Satisfied nor Dissatisfied, DS – Dissatisfied, HDS – Highly Dissatisfied. * M – Manufacturing Sector and S – Service Sector.

Table-7 reveals that the documentation procedure prescribed under Indian Transfer Pricing provisions has been accepted by more than 88 percent of the respondents, so also the stages of clearance involved in deciding the arm's length price, which is accepted by more than 86 percent of the respondents. Majority of the corporates have expressed their satisfaction regarding Transfer Pricing provisions and Transfer Pricing system as a whole. However, as regards to audit procedure and the cooperation of Transfer Pricing authorities in Transfer Pricing decision process the corporate participants expressed their reservations.

The outcome of the results is that majority of the respondent-corporate houses are satisfied about six issues considered for the study and the other two issues have not been accepted, (since majority of the respondent-corporates are dissatisfied about them).

RESULTS AND DISCUSSION

The research data has been analysed by using one sample t-test as a tool to test the hypotheses. The results of the test are as under:

I. Specific Issues of Transfer Pricing –

For the purpose of testing the relationship between all the corporate respondents vis-a-vis specific issues of Transfer Pricing in India the researchers applied one sample t-test to test the following alternative hypothesis.

Table-3:
Testing the difference in overall Respondents' Opinion towards Specific Issues of Transfer Pricing

Statistical Tool	Hypothesis on Specific Issues of Transfer Pricing based on overall corporate respondents' opinion		one sample t-test			Decision
			Test Value = 0			
			t	df	p-value	
one sample t-test	H _o	The Corporate respondents have no significant relationship for 'Specific Issues' of Transfer Pricing.	35.21	149	0.070	Null rejected
	H _a	The Corporate respondents have significant relationship for 'Specific Issues' of Transfer Pricing.				

Source: Primary Data using SPSS v.20.

It can be observed from table-3 that t-value 35.21, with 149 degree of freedom (df), has a p-value of 0.070, which is greater than 0.05. The null hypothesis is thus rejected and the alternative is accepted. Thus, it is inferred that the corporate respondents have significant relationship for specific issues of Transfer Pricing.

Sector-Wise Specific Issues -

The following hypotheses have been drawn to test the difference in opinion of sector-wise (Manufacture and Service) respondents' opinion towards specific issues of Transfer Pricing.

Table-4:
Testing the difference in sector-wise respondents' opinion towards Specific Issues of Transfer Pricing

Statistical Tool	Hypotheses on Specific Issues of Transfer Pricing based on Sector-wise corporate respondents' opinion		one sample t-test				Decision
			t	df	p-value	Mean Difference	
one sample t-test	H _o	There is no significant relationship between sector-wise response towards documentation procedure applicable to Transfer Pricing.	27.00	149	.000	1.987	Null rejected
	H _a	Documentation procedure applicable to Transfer Pricing.					
	H _o	There is no significant relationship between sector-wise response towards stages of clearance applicable to Transfer Pricing.	43.36	149	.000	2.113	Null rejected
	H _a	Stages of clearance applicable to Transfer Pricing					
	H _o	There is no significant relationship between sector-wise response towards methods adopted in deciding arm's length price for Transfer Pricing.	35.07	149	.000	2.593	Null rejected
	H _a	Methods adopted in deciding arm's length price for Transfer Pricing.					
	H _o	There is no significant relationship between sector-wise response towards audit procedure under Transfer Pricing.	40.90	149	.000	3.300	Null rejected
	H _a	Audit procedure under Transfer Pricing.					
	H _o	There is no significant relationship between sector-wise response towards penalties under Transfer Pricing provisions.	37.82	149	.000	2.400	Null rejected
	H _a	Penalties under Transfer Pricing provisions.					
one sample t-test	Hypotheses on Specific Issues of Transfer Pricing based on Sector-wise corporate respondents' opinion		one sample t-test				Decision
			t	df	p-value	Mean Difference	
	H _o	There is no significant relationship between sector-wise response towards cooperation of Transfer Pricing authorities in Transfer Pricing process.	41.77	149	.000	3.600	Null rejected
	H _a	Cooperation of Transfer Pricing authorities in Transfer Pricing process.					
	H _o	There is no significant relationship between sector-wise response towards Transfer Pricing Provisions and Rules.	39.18	149	.000	2.220	Null rejected
	H _a	Transfer Pricing Provisions and Rules.					
	H _o	There is no significant relationship between sector-wise response towards overall system of Transfer Pricing.	40.93	149	.000	2.210	Null rejected
	H _a	Overall system of Transfer Pricing.					

Source: Primary Data using SPSS v.20.

Note: df – Degree of Freedom, H₀ – Null Hypothesis, H₁ – Alternative Hypothesis.

From the analysis of the hypotheses stated in table-4 it can be observed that the one sample t-test value lies in the rejected region for all the null hypotheses pertaining to specific Transfer Pricing issues viz., documentation procedure, stages of clearance, methods adopted in deciding arm's length price, audit

procedure, penalties for non-compliance, cooperation of Transfer Pricing authorities in Transfer Pricing process, Transfer Pricing provisions and rules, and overall system of Transfer Pricing. The t-value for the above said issues are 27.00, 43.36, 35.07, 40.90, 37.82, 41.77, 39.18, and 40.93 respectively, with degree of freedom (for all specific issues of Transfer Pricing) being 149, p-value being .000 and mean difference being greater than 0.05 (+1.96) level of significance the null hypotheses are rejected. Consequently, it is concluded that there is significant relationship between sector-wise responses of the respondents towards specific issues of Transfer Pricing. A critical evaluation of test results makes the point also clear that the corporates are comfortable and happy in dealing with the 'Specific Issues', of Indian Transfer Pricing covered under the study.

CONCLUSION:

Transfer Pricing is order of the day and its increasing relevance needs no exaggeration thanks to globalisation policies of the countries around the globe. However, it is necessary that the Transfer Pricing policies and system of any tax jurisdiction should not be a hindrance in the efficient play of global economic partners. The study has revealed that Indian Transfer Pricing policies and system are not wholly rejected by the corporates. In fact most of the Indian Transfer Pricing regulatory provisions have been approved by the corporates. Never the less as a sequel to the analysis of corporates' it is desired that the Indian Government should initiate proper measures to ensure that the frequency in amendments to Transfer Pricing provisions is reduced, undue aggressiveness of the Transfer Pricing authorities is tapered, documentary compliance requirements are eased, appeals are disposed timely and cooperation of authorities is enhanced. It is necessary that Indian Transfer Pricing system is leveled-up to international benchmarks like OECD regulations. These measures will go a long way in improving the Transfer Pricing regulation for the benefit of both the corporates as well as the Government.



Dr. Jabiulla
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