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Determinants of Transfer Pricing Disputes in India

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Abstract:
This study explores the financial determinants associated with transfer pricing (TP) disputes in India, focusing exclusively on cases that have entered litigation. Utilizing case law data from Taxmann and financial information from the Prowess database, the research examines how specific financial metrics relate to disputed TP assessments. Given the non-normality of financial data (confirmed by Shapiro–Wilk tests), Spearman's rank-order correlation was employed to uncover key associations. The analysis reveals strong relationships between related party transactions (RPTs), sales, and foreign exchange earnings, suggesting these areas often trigger disputes. Conversely, weak correlations between royalties and operational metrics point to potential issues in documentation or misalignment with the arm's length principle. As the findings are based on litigated cases, they highlight characteristics commonly present in contentious scenarios, providing targeted insights for risk assessment and compliance. The study contributes to both academic discourse and policy formulation by identifying dispute-prone financial indicators in the Indian TP landscape.

Keywords
Transfer Pricing, Tax Disputes, Related Party Transactions, Royalties, Thin Capitalization, Effective Tax Rate, Forex Exposure, TP Documentation, Advance Pricing Agreements (APA), Multinational Corporations (MNCs), Judicial Precedents, Profit Shifting, Indian Tax Litigation, Financial Correlation Analysis, TP Compliance, Royalty Adjustments,

Introduction

Transfer pricing (TP) has become a pivotal focus in international taxation, especially in economies like India, where multinational enterprises (MNEs) play a significant role in cross-border trade. Ensuring compliance with the arm's length principle while balancing revenue authorities' expectations and global best practices presents a multi-faceted challenge. India's transfer pricing regime has evolved significantly since its inception, underpinned by legal frameworks, judicial precedents, and international guidelines like the OECD Transfer Pricing Guidelines. However, this evolution has also led to a sharp increase in disputes, making India one of the most litigious TP jurisdictions globally as envisaged in (Sikka and Willmott (2010)).

This research paper is determinant-based analysis of transfer pricing disputes in India with the objective to find relationships between financial metrics and disputes.

Literature Review

Transfer pricing (TP) practices within multinational corporations (MNCs) are influenced by a variety of determinants, broadly classified into tax-related motivations, firm-specific characteristics, internationalization strategies, corporate governance structures, and regulatory factors.

1. Tax Motivations- A primary determinant of transfer pricing aggressiveness is the desire to

minimize global tax burdens. Clausing (2003) demonstrates strong evidence of tax motivated intra-firm price manipulation among US firms, confirming that lower tax rates are associated with altered intra-firm prices to shift profits. Similarly, Hadmoko and Irawan (2022) show that effective tax rates (ETR) mediate the relationship between tax haven utilization, operational complexity, and TP aggressiveness among Indonesian manufacturing MNCs.

Other studies also highlight how corporate tax strategies drive TP. Winarto and Daito (2021) find that both thin capitalization and transfer pricing practices significantly reduce firms' effective tax rates, and that institutional ownership further strengthens these tax avoidance strategies. Furthermore, Taylor et al. (2018) demonstrate that transfer pricing aggressiveness and foreign tax rate differentials are positively associated with uncertain tax benefits, particularly in firms with specialized auditors.

Taxes and tunneling incentives are frequently identified as important drivers of TP, while bonus mechanisms exert limited influence Farkhah Elfa et al. (2022). This suggests that profit-shifting motivations often override personal incentive schemes in shaping transfer pricing strategies.

2. Firm-Specific Characteristics - Firm characteristics significantly influence the likelihood and extent of TP practices. Larger firms are generally less inclined to engage in aggressive transfer pricing, as found by Herdianova et al. (2022). They conclude that larger company size and higher tax rates both negatively affect TP activities.

Profitability, in contrast, tends to magnify the relationship between tax motivations and transfer pricing. Baroroh et al. (2021) notes that highly profitable firms are more likely to engage in transfer pricing when foreign ownership concentration is high, enhancing the impact of tax expenses on TP decisions. Meanwhile, Mukundhan and Cordeiro (2019) reveals that firms with high liquidity (financial slack) are more likely to invest in tax havens for both tax and strategic purposes, while firm size, profitability, and age do not significantly impact such decisions.

3. Internationalization Strategies - International presence and operations complexity are crucial determinants of TP aggressiveness. Taylor et al. Taylor et al. (2015) establish that multinationality, tax haven usage, and the ownership of intangible assets all contribute significantly to more aggressive TP practices. These factors often operate jointly to intensify transfer pricing behavior.

In Korea, Kang and Kim (2021) finds a positive association between international diversification (measured by entropy index) and tax avoidance, especially among Chaebol firms. Similarly, Rini et al. (2022) find that Indonesian firms with links to tax havens exhibit greater tax avoidance, although thin capitalization does not appear to significantly influence tax behavior in these industries.

Moreover, Dischinger and Riedel (2008) highlight that European MNCs systematically allocate intangible assets to subsidiaries located in low-tax countries, facilitating profit shifting and reducing global tax liabilities.

4. Corporate Governance and Internal Incentives- Corporate governance structures and ownership incentives also shape TP behaviors. Komarudin et al. (2022) show that good corporate governance (GCG) strengthens the influence of taxes on transfer pricing, whereas

larger firm size weakens this effect. Ardillah and Vanesa (2022) further explore the interplay between corporate governance and tax aggressiveness, finding that independent boards and audit committees have different impacts depending on the proxy used (CETR vs. BTD), while political connections do not significantly affect tax aggressiveness or TP.

Tunneling incentives, which represent the motive of controlling shareholders to divert resources, are also positively linked to transfer pricing behavior. Tarmidi et al. (2023) finds that higher tunneling incentives increase TP activity, although transfer pricing does not directly mediate the relationship between tunneling incentives and corporate tax policies.
Executive characteristics can further moderate the impact of transfer pricing on tax avoidance, as shown by Amanda and Carolina (2021), emphasizing the role of top management in shaping corporate tax strategies.

5. Regulatory Environment and Audit Oversight - The regulatory environment and audit specialization have been shown to moderate the determinants of TP. Taylor et al. (2018) illustrate that firms with specialized auditors exhibit a stronger link between TP practices, foreign tax rate differences, and uncertain tax benefits.

Thin capitalization strategies, often implemented alongside TP, significantly reduce tax liabilities, and institutional ownership reinforces these strategies among Indonesian manufacturing firms Winarto and Daito (2021).

However, transfer pricing alone does not always directly lead to tax aggressiveness. Hasanudin et al. (2022) find that while tax incentives and thin capitalization contribute strongly to tax aggressiveness, transfer pricing itself does not significantly impact effective tax rates unless accompanied by other mechanisms.

In some sectors, such as consumer goods, TP has been shown to have no significant impact on tax avoidance, although firm size can moderate the effects of capital intensity and sales growth Khamisan and Astuti (2023).

There exists a solitary exception—a working paper authored by Tandon (2019). However, this paper's focus was confined primarily to a review of dispute resolution mechanisms and the proposal of alternative measures such as Advance Pricing Agreements (APAs). Research has indicated that there are increasing numbers of complexity and controversies in the application of TP methods. Despite adopting various alternate measures like Safe Harbour Rules and DRP, APA and various amendments to smoothen the application of methods, the disputes are increasing and the time taken to resolve them is never decreasing. Comparatively, research endeavors scrutinizing case laws related to TP have surfaced in other countries like China, Indonesia, and Malaysia. Nevertheless, India, despite its significant role in the global economy and its intricate TP landscape, remains uncharted territory in this regard.

The determinants are essential factors that significantly influence how multinational corporations (MNCs) formulate and execute their transfer pricing strategies. Understanding these determinants is pivotal as they shape the very essence of transfer pricing practices and outcomes.

Filling this gap is imperative as it can provide profound insights into how MNCs navigate the

Indian transfer pricing landscape, offering unique perspectives on the determinants that guide their decision-making processes. Such research would not only contribute to the academic field but also provide valuable inputs for policymakers and tax authorities in India, aiding them in refining tax regulations and ensuring equitable tax practices. There exists a solitary exception—a working paper authored by (Tandon (2019)). However, this paper's focus was confined primarily to a review of dispute resolution mechanisms and the proposal of alternative measures such as Advance Pricing Agreements (APAs). Research has indicated that there are increasing numbers of complexity and controversies in the application of TP methods. Despite adopting various alternate measures like Safe Harbour Rules and DRP, APA and various amendments to smoothen the application of methods, the disputes are increasing and the time taken to resolve them is never decreasing. Comparatively, research endeavors scrutinizing case laws related to TP have surfaced in other countries like China, Indonesia, and Malaysia. Nevertheless, India, despite its significant role in the global economy and its intricate TP landscape, remains uncharted territory in this regard. In essence, the study of TP case laws in India has the potential to catalyze seminal research and contribute significantly to both academia and the broader domain of tax regulation and practice. Thus, objective is to analyze and derive insights from Indian transfer pricing (TP) case laws to address the existing academic gap, enhance understanding of TP practices in India.

This study employs a mixed methods approach, combining qualitative analysis of relevant literature and case studies and quantitative data analysis of transfer pricing trends.

1. Access data of case laws on the Taxmann Offline Research Platform. 2. Filter cases using the transfer pricing and timeline. 3. Study case-laws one by one qualitatively and extract data for the identified variables. 4. Analyze data using statistical measures, e.g. summation, correlation, and regression. 5. Conclude

The data is compiled from Taxmann.com, a case law repository, to analyze judicial precedents and trends in transfer pricing disputes across various industries, focusing on methodologies, adjustments, procedural compliance, and judicial outcomes. This data provides a solid foundation for examining patterns, industry-specific challenges, and regulatory adherence in transfer pricing litigation. The available data in the case laws was populated in an excel table. The dataset representation is tabulated as per Table 1 appended. The corresponding financial data of selected companies were extracted from the Prowess database. The final data-set of 87 companies was achieved through availability pertaining to the financial year 2016-17. The analysis was carried out on this database for simplicity. The mapping of proxies is as under :-

Conceptual Variable (Theory)	**Related Financial Variables (Dataset)**	**Linkage / Proxy Measurement**
Effective Tax Rate (Tax Motivation)	Provision for Direct Tax, Total Income	ETR = Provision for Tax / Pre-tax Income

Thin-Capitalization (Proxy via Borrowings /Assets)	Borrowings (Old Sch. VI), Total Assets	Borrowings-to-Total Assets Ratio (Borrowings / Total Assets)
Foreign Tax Rate Differential	Total Forex Earnings, Total Forex Spending	Presence of high foreign transactions implies exposure, but tax rates need external data
Use of Tax Havens	Royalties, Technical Know-How Fees, Forex Spending	Payments for royalties, fees often routed via tax havens
Multinationality / International Diversification	Total Forex Earnings, Total Forex Spending	High forex activity = multinational operations
Intangible Assets and Transfers	Royalties, Depreciation/Amortisation	Payment for use of intangibles, amortization of intangible assets
Profitability	Total Income, Total Expenses, Sales of Goods	Profit Margin = (Total Income – Total Expenses) / Total Income
Liquidity (Financial Slack)	Current Assets, Current Liabilities	Liquidity = Current Assets / Current Liabilities
Company Size	Total Assets, Total Income, Sales of Goods	Size proxy by Total Assets or Revenue
Tunneling Incentives	Related Party Transactions (RPTs)	Volume/value of RPTs indicates tunneling risk
Forex Exposure	Total Forex Earnings, Forex Spending, Forex Loss	High forex movement shows exposure
Related Party Transactions (Direct TP Risk)	RPTs	Higher RPT volume = higher TP risk

The above linkages signify the use of gathered data for further analysis. The extracted variables were made base for analysis.

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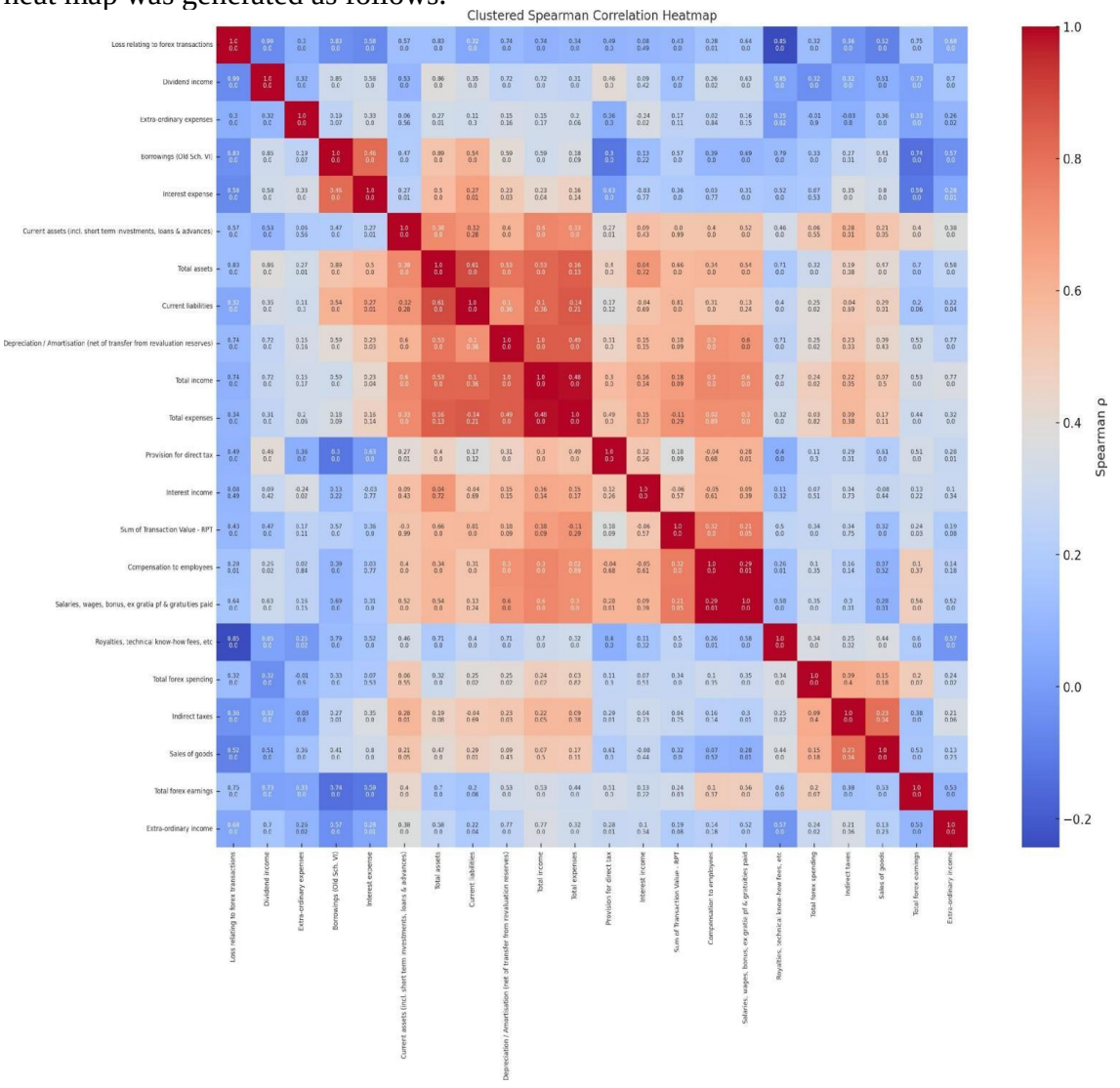
Analysis of Data

A Shapiro–Wilk test was conducted to assess the normality of 22 financial variables in the dataset. Results indicated that none of the variables were normally distributed, as all p-values were less than .001 (W-statistics ranged from .105 to .424). These findings provide strong evidence against the assumption of normality, suggesting that the data violate a key requirement for parametric tests such as Pearson's correlation. Therefore, non-parametric methods, specifically Spearman's rank-order correlation, were deemed more appropriate for subsequent analysis Myšková and Hájek (2017).

The variables were put through Pearson's correlation and the following correlation matrix heat map was generated as follows.



Based on the correlations observed among financial metrics, the analysis can be categorized into four distinct groups to aid in identifying potential transfer pricing disputes: Corrected Interpretation of Spearman Correlation Results for Transfer Pricing Analysis

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(1) Statistically Significant Relationships : That May Require Justification: While many relationships in the data are statistically significant, most are not excessively tight when analyzed using Spearman correlation (a more robust method for non-normal financial data). However, a few still warrant closer review:

* Related-Party Transactions (RPT) and Sales of Goods (˜0.70, p < 0.001): This high correlation suggests that a substantial portion of sales may involve affiliates. This is consistent with related-party trade, but it requires strong transfer pricing documentation and benchmarking to support pricing and substance.
* Interest Income and Sales (˜0.64, p < 0.001): This moderate-to-high correlation is unusual unless the company operates a finance-heavy model (e.g., lending or leasing). If not, it may indicate embedded financing or misclassification of revenue. This relationship may also reflect an indirect dependency through company size or profitability.
* Interest Expense and Sales (˜0.47, p < 0.001): While not excessive, this link suggests potential structured financing of receivables or inventory. Operational justifications should be reviewed. This may be driven by third variables such as working capital needs.
* RPTs and Forex Earnings (˜0.63, p < 0.001): A strong positive relationship exists, suggesting foreign exchange revenue may involve group companies. This could imply centralized treasury functions or revenue shifting, possibly driven by the firm's international structure.

(2) Unexpected or Weakly Justified Correlations: Certain moderate correlations appear between variables that typically would not be closely related, and may indicate structuring, misclassification, or internal policy alignment:
* Dividend Income and Compensation (˜0.28, p = 0.014): This weak correlation is likely coincidental, but if driven by structured profit distribution policies, it may require explanation.
* Dividend Income and Extraordinary Income (˜0.36, p = 0.001): May indicate one-time gains treated similarly to dividends. Though not unusual, classification practices should be reviewed. The correlation may stem from shared sources of income such as investment returns.
* Royalties and Sales of Goods (˜0.36, p = 0.001): This moderate correlation is below expectations. If royalties are based on sales, a higher linkage would be expected. The current weak relationship may point to a formulaic or poorly substantiated royalty model.

(3) Missing or Weak Relationships- That Should Exist: Some expected financial linkages are weak or absent, raising questions about data integrity or alignment with business substance:
* Royalties and Total Income (˜0.30, p = 0.004): Given that royalties are typically tied to revenue or usage, this low correlation suggests weak alignment. This is particularly concerning in loss years, as it may trigger TP scrutiny.
* Royalties and Borrowings/Interest Expense (˜0.19, p = 0.075): Weak correlation implies royalties are not clearly debt-financed, contradicting common intra-group IP financing models.
* RPTs and Royalties (˜0.22, p = 0.045): Weak connection, which is unexpected given that many royalty payments are intra-group. Suggests potential misclassification or bundling of fees.
* RPTs and Interest Income/Expense (<0.20, p > 0.05): Absence of correlation indicates that intercompany loans may not be generating interest or may be poorly documented.

(4) Moderate but Potentially Meaningful Relationships (0.2 < < 0.4): These correlations, while not statistically strong, may still reflect real economic patterns. They merit further functional and segmental analysis:
* Royalties and Borrowings (˜0.22, p = 0.045): May suggest indirect funding of IP payments.

* Interest Expense and Sales (˜0.47, p < 0.001): Could imply financing linked to operations and possibly driven by working capital requirements. * Dividend and Extraordinary Income (˜0.36, p = 0.001): Possibly linked through one-off asset gains or internal events, including shared financial holdings.

(5) Absence of Significant Negative Correlations: The Spearman analysis revealed no statistically significant negative correlations. This suggests that most financial metrics in the dataset move in the same direction, which is typical in operational and financial scaling. However, this also indicates a lack of inverse relationships that could provide diversification, control, or counterbalancing mechanisms.

(6) Clustering of Variables and Pattern Recognition: The clustered heatmap based on hierarchical ordering of variables visually revealed grouping patterns among metrics related to income, expenses, and intercompany transactions. These clusters help validate functional groupings and may support segmentation analysis for transfer pricing benchmarking.

(7) Limitations of Spearman Correlation Analysis: While Spearman correlation is robust and appropriate for non-normal financial data, it has limitations:
* It only captures monotonic (increasing or decreasing) relationships. Strong non-monotonic (e.g., U-shaped or cyclical) relationships may go undetected.
* It does not imply causation, only association.
* Some moderate relationships may reflect indirect dependencies or third-variable effects, such as:
- Interest Income and Sales (˜0.64): May be influenced by company size.
- InterestExpense and Sales (˜0.47): Possibly driven by working capital demands.
- Dividend and Extraordinary Income (˜0.36): Linked by financial holdings.
- RPTs and Forex Earnings (˜0.63): Likely due to international group structures.
- Royalties and Borrowings (˜0.22): May reflect an IP financing strategy.

Spearman correlation reveals a more realistic and statistically appropriate view of financial relationships in this dataset compared to Pearson. It corrects for outliers and nonnormality, reducing the appearance of artificial or inflated relationships. Several links (e.g., RPTs with sales or forex earnings, interest metrics with revenue) remain significant and should be documented and justified. Other weak or missing correlations raise valid concerns and should be explored in more detail during transfer pricing documentation and benchmarking.

Discussion

The findings of this study are derived solely from transfer pricing (TP) cases that escalated to litigation, thereby representing contentious or high-risk scenarios rather than the broader set of all TP filings. This specificity is crucial, as it allows for the identification of financial patterns commonly associated with disputes in the Indian TP environment. A prominent observation is the strong correlation between Related Party Transactions (RPTs) and sales (0.70), underscoring that companies with a high volume of intra-group trade are more likely to face scrutiny. This suggests that RPT-heavy revenue structures require meticulous benchmarking and defensible pricing models to avoid disputes. Likewise, the substantial correlation between RPTs and foreign exchange earnings (0.63) implies that international operations involving group entities are frequently challenged, particularly when cross-border transactions lack transparent pricing mechanisms.

The moderate correlations observed between interest income, interest expense, and sale indicate

the likelihood of financial structuring (e.g., intercompany loans, embedded financing) playing a role in triggering disputes. These relationships may not be inherently problematic but likely draw attention in the absence of adequate documentation or economic substance.
Conversely, the unexpectedly weak correlations between royalty payments and total income or sales suggest a potential mismatch in pricing models or contract structures. Given the centrality of intangibles in TP disputes, this disconnect may indicate either non-market pricing or misclassification of payments, both of which raise red flags during audits.
The absence of strong correlations between RPTs and key TP-related elements like interest income or royalties is also noteworthy. This could imply that intra-group financial transactions are either poorly documented or structured in a manner not transparent enough to withstand regulatory examination.
Collectively, these insights emphasize that certain financial profiles—particularly high-volume RPTs, international transactions, and ambiguous royalty arrangements—tend to attract greater scrutiny and litigation.

Conclusion

This study identifies key financial characteristics commonly associated with transfer pricing (TP) disputes in India by analyzing a sample composed entirely of litigated cases. The use of Spearman correlation, suitable for the non-normal financial data, enabled robust pattern recognition within this unique subset.

High RPT exposure, especially involving international transactions, is a consistent feature in disputed cases. Moderate-to-strong associations between financing metrics and sales suggest that intra group financing arrangements are a common point of contention. Weak correlations in expected areas, such as royalties and operational metrics, highlight potential structural weaknesses in TP documentation or policy execution. No significant negative correlations indicate a lack of natural counterbalancing financial activities within these firms, potentially contributing to their dispute risk. These findings, while not generalizable to all TP cases, offer practical insights into the types of financial structures that tend to result in litigation. By focusing on dispute-prone scenarios, this research aids tax professionals, policymakers, and MNEs in identifying high-risk areas that warrant enhanced compliance and documentation.
While this study offers meaningful insights into financial patterns underlying TP disputes, several limitations create avenues for further exploration:

Comparative analysis with non-disputed cases could help isolate the distinguishing features that elevate certain TP arrangements to litigation. Segmental analysis by industry or firm size may reveal unique risk factors within high value sectors such as pharmaceuticals, technology, and manufacturing. Regression analysis using categorical variables (e.g., dispute outcome: taxpayer vs. revenue authority success) could improve predictive modeling of TP audit results. Integration of qualitative data—such as legal reasoning from case law texts—would offer a holistic view of not just what triggers disputes, but why they escalate. Cross-country comparisons could contextualize India's TP disputes within a broader global framework, highlighting jurisdictional nuances in enforcement.

Such extensions would strengthen the empirical basis for TP risk management, especially in jurisdictions like India, where litigation remains a prominent feature of tax administration.

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Table 1
Transfer Pricing Cases by Financial Year and Assessment Year

S.No	Financial Year	Assessment Year	Number of Cases
1	2014–15	2015–16	173
2	2015–16	2016–17	217
3	2016–17	2017–18	170
4	2017–18	2018–19	146
5	2018–19	2019–20	8
6	2019–20	2020–21	37
7	2020–21	2021–22	11
8	2021–22	2022–23	1

Table 2
Shapiro–Wilk Test for Normality of Financial Variables

Variable	W-statistic	p-value	Normally Distributed
Total income	0.2063	< .001	No
Total expenses	0.2097	< .001	No
Royalties, technical know-how fees, etc	0.2441	< .001	No
Total assets	0.1966	< .001	No
Indirect taxes	0.1336	< .001	No
Provision for direct tax	0.1993	< .001	No
Current liabilities	0.1783	< .001	No
Borrowings (Old Sch. VI)	0.2144	< .001	No
Compensation to employees	0.4238	< .001	No
Salaries, wages, bonus etc	0.4070	< .001	No
Total forex earnings	0.1260	< .001	No
Total forex spending	0.1055	< .001	No
Loss relating to forex transactions	0.1248	< .001	No
Interest expense	0.1532	< .001	No
Dividend income	0.2521	< .001	No
Interest income	0.1497	< .001	No

Depreciation/Amortisation	0.1720	< .001	No
Extra-ordinary expenses	0.1077	< .001	No
Extra-ordinary income	0.1358	< .001	No
Sales of goods	0.1235	< .001	No
Current assets	0.1528	< .001	No
Sum of Transaction Value - RPT	0.3407	< .001	No