

Transfer Pricing Compliance FY 2025-26 - Essential Focus Areas for Businesses

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I. Introduction

Form 3CEB takes its final bow in AY 2026-27, as this marks the last assessment year in which the form will be filed. The curtain not only falls on "Form 3CEB" but also to the decades old concept of "Assessment Year", paving the way for the simpler and more intuitive "Tax Year" regime.

With the advent the New Income Tax Act 2025 read with the Income Tax Rules 2026, businesses undertaking international transactions or specified domestic transactions will transition to filing Form 48 (new form replacing Form 3CEB) beginning with Tax Year 2026-27.

As transfer pricing continues to evolve from a compliance exercise to a strategic business imperative, organisations must focus not only on meeting current regulatory obligations but also on anticipating the expectations of the future. This article outlines the key transfer pricing considerations for FY 2025-26 that businesses should focus on and analyses the emerging trends and developments that are set to influence the next phase of transfer pricing compliance starting from Tax Year 2026-27. In an environment characterized by increasing transparency, data-driven tax administration, and heightened regulatory scrutiny, proactive preparedness today will be instrumental in ensuring sustainable compliance and effective risk management in the years ahead.

II. Financial Year 2025-26/ Assessment Year 2026-27 - Key aspects of consideration for businesses from Transfer Pricing perspective

1. Key aspects to be considered by businesses prior to book close

a. True up/ True down Adjustments

One of the key transfer pricing considerations before closing the books of accounts is ensuring that the actual results or margins achieved by an entity are aligned with the arm's length outcome contemplated under its intercompany pricing policy and supported through a benchmarking analysis.

In practice, many companies evaluate the need for transfer pricing true-up or true-down adjustments only at the end of the financial year, immediately prior to book closure, rather than monitoring their results periodically throughout the year. A more proactive approach involving quarterly reviews can help identify potential deviations early and mitigate year-end surprises.

Year-end true-down adjustments may result in excess payment of advance tax during the year, thereby creating a working capital burden until the corresponding refund is received upon filing the tax return. Conversely, true-up adjustments lead to additional taxable income, potentially resulting in a shortfall in advance tax payments and consequent exposure to interest liabilities.

Therefore, it is not sufficient for businesses to merely establish a robust intercompany pricing policy. The real challenge, and indeed the key to effective transfer pricing compliance, lies in the timely monitoring, consistent implementation, and periodic review of the policy throughout the financial year to ensure that actual outcomes remain aligned with the intended arm's length position. Adoption of technology tools for effective implementation of the TP policy is going to be the way forward for corporates.

b. Segmentation for Transfer Pricing purposes

In certain circumstances, business may not be required to draw out their segmental financials as per the applicable accounting standards however may be required to provide segmental financials for the purposes of transfer pricing. Therefore, it may be essential that business also prepare the segmental financials before year end to ensure that the margins/ actual results of such segments align with the arm's length results.

Further it should be ensured that the allocation key used is appropriate and is consistent over the years. It is generally observed that segmentation prepared solely for transfer pricing purposes tend to attract greater scrutiny from the Transfer Pricing Officer (TPO), particularly in cases where third-party segments reflect losses while related-party segments continue to earn profits.

Therefore, it is imperative for businesses to ensure that their segmental reporting framework is robust so that it significantly strengthens a taxpayer's transfer pricing position and mitigate potential disputes during assessments.

c. Scenarios where the company is into losses-Proactive approach!

There might be instances where a company would have incurred losses during the financial year due to various reasons. Defending transfer prices using profitability analysis could prove challenging in such circumstances. In such cases, Taxpayers generally resort to adopting Other Method to determine the arm's length price, as against net profit ratios using Transactional Net Margin Method (TNMM). However, in majority of the cases, they are not backed by robust supporting to approve the application of Other method, & the defence in the TP documentation is done referencing prevailing industry rates. Such ad hoc basis would not stand the test of time during TP assessments.

A robust Functions, Assets and Risk Analysis (FAR) assumes significant importance in such loss scenarios. Based on FAR, where it is possible to characterise the counterparty as the least risk entity, then a flip side benchmarking approach whereby the margins of the counter party is evaluated may be adopted to justify that the international transactions are at arm's length instead of adopting an ad-hoc CUP/ Other Method. However, where the counterparty is an entrepreneur and owns intangibles and the Taxpayer is the normal risk bearing entity, then carrying out the below adjustments may be explored.

Even in loss making situations it is still possible to adopt TNMM to defend transfer price, if these losses were incurred due to genuine business reasons (Economic downturn, capacity underutilisation etc), the impact of which could be quantified in the form of suitable economic adjustments.

The Indian regulations, OECD guidelines, judicial pronouncements recognise the need to undertake economic adjustments to enhance comparability between tested party & uncontrolled transactions. Few adjustments which can be performed under TNMM are:

1. Capacity utilisation adjustment – It is performed to neutralize the impact of under absorption of a company's fixed costs vis-a-vis comparables, in years where company has not operated at the optimal installed capacity. Currently there is no statutory requirement to publish capacity details in financials, hence obtaining capacity details would pose difficulties. However, there are alternative approaches such as industry capacity, depreciation adjustment/Fixed cost adjustment or Breakeven point analysis

2. Working capital adjustment – It factors time value of money where there are differences in working capital levels between the tested party & comparables

3. Forex adjustment – In light of rupee depreciating heavily against foreign currencies, a forex fluctuation adjustment would be appropriate to substantiate dip in margins, in cases the tested party has significant imports in comparison with comparables. This is different from forex loss resulting on account of translation exposure appearing in the financials

4. Customs duty adjustment – This eliminates impact of higher customs duty incurred by the taxpayer while importing goods vis-à-vis comparables who might predominantly make local purchases

However, one needs to bear in mind that any adjustment which can be claimed depends on the functional, asset and risk (FAR) profile & characterisation of the taxpayer. Hence these cannot be randomly applied without it being in coherence to the FAR profile. Accordingly, businesses should proactively evaluate potential transfer pricing risks and build contemporaneous documentation. A well-thought-out strategy, backed by robust supporting evidence, can significantly strengthen the defence of transfer prices in loss-making years and help substantiate the arm's length nature of the transactions during transfer pricing assessments.

2. Key aspects to be considered by businesses post book closure

a. Post audit adjustments

In case where audit is completed and finalised, however the results are not at arm's length, then

Businesses may need to consider making relevant Suo-moto adjustments in the tax return. In such cases impact of secondary adjustment should also be factored. Where such adjustment is made, the excess income should be repatriated on or before 90 days from the due date of filing of the return of income. Where such amount is not repatriated within the said period, the same shall be considered as an advance provided by the taxpayer to the associated enterprise and interest at a prescribed rate may be charged accordingly. However the taxpayer may opt to pay additional income tax on the unrepatriated amount @ 18% and upon exercising this option, the excess amount may not be considered as deemed advance.

b. Safe Harbour application under current regulations

An eligible taxpayer may opt for safe harbour by submitting Form 3CEFA prior to the due date of filing the tax return. Where the Taxpayer decides to opt for safe harbour and the books of account have already been closed, the taxpayer may undertake the necessary Suo motu transfer pricing adjustment and reflect the same in the return of income which must be filed on or before the filing of Form 3CEFA.

III. Filing of Form 3CEB- Points for consideration

While the foregoing paragraphs outline the key considerations during the book-close phase the following sections highlight the critical transfer pricing aspects that taxpayers should evaluate prior to filing Form 3CEB.

1. **Identification of AEs** – Form 3CEB requires certification that information is true and correct. Therefore, reliance solely on Ind AS 24/ AS 18 disclosures may not be adequate. AE identification should be assessed based on the cumulative conditions under Sections 92A(1) and 92A(2). PEs in India should also evaluate TP compliance obligations.
2. **Deemed International Transactions** – Evaluate the applicability of Section 92B(2) by reviewing pricing and key contractual terms with third parties.
3. **Foreign Entity Compliance** – Foreign entities earning income in India may be required to file Form 3CEB and maintain separate TP documentation, subject to applicable exemptions.
4. **FOC Assets** – Many at times, assets may be provided free of cost by AEs, such as software licences. The same should not alone be disclosed but there are other implications which needs to be evaluated like considering it as a notional cost in cost base while arriving at the arm's length mark-up.
5. **Corporate Guarantees** – Evaluating whether guarantees provided without consideration constitute a chargeable service or qualify as a shareholder activity.
6. **ESOP granted by AEs to Indian Taxpayers employees-** Time and again Indian courts have upheld that ESOP costs are neither charged to nor borne by the Indian entity and hence no adjustments may be warranted for not including such notional costs in cost base of the Indian taxpayer. However, the Indian Revenue's position in certain APAs, has generally been to include SBC costs in the tested party's cost base. The safe harbour regulations also when defining operating costs refer ESOP as operating expenses to be included in the cost base.
7. **Interest-Free Loans** – Given these are highly litigated, such loans require disclosure and arm's length assessment, including consideration of whether they can be characterised as quasi-equity.
8. **Business Restructuring** – Changes in FAR profile, characterisation or operating models should be evaluated from a business restructuring perspective, with reference to OECD guidance where relevant. Third-party valuation reports for: Intangibles (IP transfers, brand valuation), Share transfers & Business restructuring arrangements should be obtained.
9. **Services vs Reimbursements** – Characterisation should be based on the substance of the transaction. Cost recoveries may, in substance, represent services rather than reimbursements which need proper evaluation.
10. **Management Charges** – Evidence of service receipt, benefit derived, pricing support and allocation methodologies should be adequately documented. Evaluate the management fee safe harbour if conditions are met.
11. **Royalty Payments** – The commercial need, computation basis and benchmarking approach for royalty arrangements should be appropriately substantiated.
12. **Year End Outstanding balances-** Year end outstanding balances are not considered as transactions and this has also been clarified in the ICAI institute guidance on Section 92E- Transfer Pricing. However, taxpayers as an abundant caution may include a disclosure note detailing the year outstanding payables and receivables. However, where the outstanding receivables exceed pertain to overdue receivables beyond the normal credit period, then the same may be challenged by the TPO's deeming it to

be in the nature of loan.

13. Specified Domestic Transactions (SDTs) – Transactions involving tax holiday or concessional tax regime units, including cross-charges of common costs, should be reviewed for disclosure.

Care should be taken to ensure alignment between transactions in TP documentation/Form 3CEB with financial statements and tax audit report (Form 3CD). Further agreements for all intercompany transactions should be maintained, with the terms (pricing, services, deliverables) of contract reflecting the actual conduct

Timely compilation of supporting documentation (e.g. invoices for all related party transactions, detailed related party ledgers with clear narrations to establish audit trail, email correspondence, contracts, and relevant proofs where relevant), during the TP documentation process can significantly streamline the Form 3CEB audit and facilitate efficient responses to queries from the tax authorities.

IV. Key Developments 2026

Pillar 2 Compliances

With Pillar Two becoming effective from FY 2024-25 across many jurisdictions, in-scope multinational groups are now entering their first compliance cycle. The initial GloBE Information Return (GIR) filing is generally due within 18 months from the end of FY 2024-25, with several jurisdictions requiring filings and related compliance actions during 2026.

India has not yet enacted domestic legislation implementing the Pillar Two GloBE Rules. Accordingly, Indian entities are presently not required to undertake Pillar Two tax filings under Indian tax law. However, the MCA has amended AS 22 through the Companies (Accounting Standards) Amendment Rules, 2026 (G.S.R. 169(E) dated 10 March 2026) has introduced mandatory exception that dictates that enterprises must neither recognise nor disclose deferred tax assets (DTAs) or deferred tax liabilities (DTLs) arising from international tax reforms under the OECD Pillar Two Model Rule. Similar amendment has also been made to IND AS 12 applicable for Listed Companies.

Accordingly based on the above temporary mandatory exemption Indian Companies are not required to recognise and disclose deferred taxes arising from the implementation of the Pillar Two model rules.

V. What lies ahead for Tax year 2026-27

The Income-tax Rules, 2026 have replaced the relatively simple Form 3CEB with a far more comprehensive Form 48, which will apply from the next compliance cycle, i.e., Tax Year 2026-27. The new Form 48 requires taxpayers to disclose significantly more information than was previously required, including details such as the arm's length range for each reported international transaction and the number of comparable companies used in determining that range.

Although transfer pricing regulations have always required taxpayers to maintain contemporaneous documentation, in practice, transfer pricing documentation has often been prepared as a post facto exercise, primarily to support disclosures made in Form 3CEB. The enhanced disclosure requirements under Form 48, however, demand a much higher degree of preparedness and may necessitate the completion of transfer pricing documentation well before the filing of the form itself. This is critical as all relevant datapoints from the TP report needs to be updated in the form and the CA must certify that the TP document is maintained.

Consequently, businesses can no longer afford to view transfer pricing documentation as a year-end compliance exercise. Instead, they may need to adopt a more proactive approach, ensuring that benchmarking analyses and supporting TP documentation are prepared on a contemporaneous basis. In this regard, the current year provides an ideal opportunity for companies to undertake a "dry run" of the new requirements, identify potential data gaps, strengthen internal processes, and ensure a smooth transition to the more rigorous transfer pricing compliance regime that lies ahead.