

CROSS-HAIRS BETWEEN FEMA & TRANSFER PRICING

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Why Cross-Hairs?

FEMA regulates **permissibility, pricing, reporting and timelines** of foreign exchange transactions.

Transfer Pricing ensures that **international transactions** with AEs are conducted at **Arm's Length Price (ALP)**.

Both apply simultaneously to cross-border dealings \Rightarrow **FEMA pricing \neq TP pricing**.

Results in regulatory conflict, dual valuation requirements, and compliance risks.

Transactions Covered

- Both (FEMA & TP) apply simultaneously to below transactions:

- 1) Overseas Direct Investment (ODI) transactions
- 2) Foreign Direct Investment (FDI) transactions
- 3) External Commercial Borrowings (ECB)
- 4) Royalty Payment
- 5) Export of goods/services (export receivables)
- 6) Import of goods/services (import payables)

1) ODI Transactions

S. No	Transaction	Legal Extract	Legal provision
1.	Issue or transfer of equity Shares of foreign Company	Rule 16 of ODI Rules. Pricing guidelines.–	The transaction must be done a price arrived on an arm's length basis taking into consideration the valuation as per any internationally accepted pricing methodology for valuation.
2.	Issue of Debts Instruments	Regulation No. 4 of ODI regulations: Financial commitment by Indian entity by way of debt	Debt instruments issued by a foreign entity subject to the condition that such loans are duly backed by a loan agreement where the rate of interest shall be charged on an arm's length basis.
3.	Corporate Restructuring	Rule 18 of ODI Rules. Pricing guidelines.–	If the original overseas investment exceeds USD 10 million, or the diminution in value is more than 20% of the total outstanding dues owed to the Indian investor, then such diminution must be certified at arm's length value by: a Registered Valuer under the Companies Act, 2013, or a corresponding registered valuer / CPA in the foreign (host) jurisdiction.

Legal Provision: ODI Framework

Under Foreign Exchange Management (Overseas Investment) Regulations, 2022

Regulation No. 4: Financial commitment by Indian entity by way of **debt**.—

An Indian entity may lend or invest in any debt instruments issued by a foreign entity subject to the condition that such loans are duly backed by a loan agreement where the rate of interest shall be charged on an arm's length basis.

Explanation.— For the purpose of this regulation, the expression “arm's length” means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

Legal Extract: Source

Foreign Exchange Management (Overseas Investment) Rules, 2022


<https://rbidocs.rbi.org.in/rdocs/content/pdfs/GazetteRules23082022.pdf>



Meaning of Debt instruments

Rule 5. Foreign Exchange Management (Overseas Investment) Rules, 2022

A. Debt instruments:

- (i) Government bonds;
 - (ii) corporate bonds;
 - (iii) all tranches of securitisation structure which are not equity tranche;
 - (iv) borrowings by firms through loans; and
 - (v) depository receipts whose underlying securities are debt securities;
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2) FDI Transactions

S. No	Transaction	Legal Extract	Legal provision
1.	Issue or transfer of equity Shares of Indian Company	Rule 21 of NDI Rules. Pricing guidelines.–	<p><u>Issue/ Transfer to a person resident outside India shall not be less than :</u></p> <p>the valuation derived using any internationally accepted method on an arm's length basis, certified by a CA, SEBI-registered Merchant Banker, or Practising Cost Accountant.</p> <p><u>transferred by a person resident outside India to a person resident in India shall not exceed</u></p> <p>the valuation derived using any internationally accepted method on an arm's length basis, certified by a CA, SEBI-registered Merchant Banker, or Practising Cost Accountant.</p>
2.	Investments by Foreign Portfolio Investors	SCHEDULE II(See rule 10(1)) of NDI Rules	<p><u>in case of issue by private placement, the price is not less than:</u></p> <p>Fair price must be determined using any internationally accepted valuation method on an arm's length basis and certified by a SEBI-registered Merchant Banker, CA, or Practising Cost Accountant.</p>

3) ECB

As per the current *FED Master Direction No. 5/2018-19 dated March 26, 2019*, there is no concept of Arm's Length Pricing (ALP) in ECB. ECB interest is governed strictly by the prescribed interest rate maximum ceiling limit, namely:

- ❑ Benchmark rate plus 500 bps spread: FCY denominated ECB
- ❑ Benchmark rate plus 450 bps spread in INR denominated ECB

Benchmark rate: Benchmark rate in case of FCY ECB/TC refers to any widely accepted interbank rate or ARR of 6-month tenor, applicable to the currency of borrowing. Benchmark rate in case of Rupee denominated ECB/TC will be prevailing yield of the Government of India securities of corresponding maturity

Source: <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/5MD2603201979CA1390E9E546869B2A9A92614DEDBF.PDF>

Accepted Inter-Bank Rates

Currency	Old benchmark (IBOR)	New ARR (Alternate Reference Rate)
USD	LIBOR	SOFR (Secured Overnight Financing Rate)
GBP	GBP LIBOR	SONIA (Sterling Overnight Index Average)
EUR	EURIBOR/EONIA	€STR (Euro Short-Term Rate)
JPY	JPY LIBOR/TIBOR	TONA (Tokyo Overnight Average Rate)
CHF	CHF LIBOR	SARON (Swiss Average Rate Overnight)
India	MIBOR (being reformed)	ARR based on CCIL transaction data (for derivatives)

Introduction of ALP in ECB

RBI issued Draft ECB Framework under Foreign Exchange Management (Borrowing and Lending) Regulations, 2018 on Oct 03, 2025:

Draft ECB Framework is available on the RBI website for public response (till October 24, 2025).

One of the main objectives of the draft ECB framework is that ECBs are proposed to be raised at market-determined interest rates.

AS per Regulation 9:

9. Arm's length principle – ECB from a related party, group entity or otherwise connected lender shall be carried out on an arm's length basis.

2(1)(b)“arm's length basis” means a transaction that is conducted as if the transacting parties were unrelated, so that there is no conflict of interest.

Source: https://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=61351&fn=5&Mode=0



4) Royalty

- ❑ A.P. (DIR Series) Circular No.5 dated July 21, 2003 (superseded by RBI) Press Note on December 16, 2009.
- ❑ Which permitted on the automatic approval route to make royalty payments at 8% on exports and 5% on domestic sales without any restriction on the making the royalty payments.
- ❑ After withdrawn of above said circular, there is no limit to make the royalty payment.

Source: <https://rbidocs.rbi.org.in/rdocs/Notification/PDFs/37974.pdf>

5) Export-Receiveable

Under FED Master Direction No. 16/2015-16 dated January 1, 2016 the exporter under obligation to repatriate of export proceeds shall be nine months from the date of export.

AD Category – I banks may extend the period of realization of export proceeds up to a period of six months.

<https://rbidocs.rbi.org.in/rdocs/notification/PDFs/11MDEGS1205163428383952204B77831A3A086E82FDDF.PDF>

But such period of nine months has been extended to fifteen months through RBI circular on **Reserve Bank of India (Trade Relief Measures) Directions, 2025** via circular no. RBI/2025-26/96, DOR.STR.REC.60/21.04.048/2025-26 dated November 14, 2025. Relevant extract is reproduced below: -

“B. Extension of tenor for Export Credit

10. A RE eligible to undertake export financing business may permit an enhanced credit period of up to 450 days for pre-shipment and post-shipment export credit disbursed till March 31, 2026.”

https://www.rbi.org.in/scripts/bs_circularindexdisplay.aspx/BS_CircularIndexDisplay.aspx?Id=12921

6) Import-Payable

Under FED Master Direction No. 17/2016-17 dated January 1, 2016 the importer should make the payment within six months from the date of shipment.

AD Category – I banks can consider granting extension of time for settlement of import dues up to a period of six months at a time (maximum up to the period of three years)

<https://rbidocs.rbi.org.in/rdocs/notification/PDFs/12MDFB8AD1B34BCB4D0A8F6869DA4A53082E.PDF>

FEMA vs TP – Objectives

FEMA Focus

Ensures forex transactions follow pricing caps, valuation norms, timelines

Regulatory compliance with RBI

Concerned with macro-economic stability

Transfer Pricing Focus

Ensures cross-border transactions with AEs are at ALP

Income-tax ALP compliance

Concerned with profit shifting & tax base erosion

Common Objective: Both focus on repatriation of forex in India

FEMA= Section 8

TP: Section 92CE read Rule 10CB

FEMA VS TP Definition

Aspect	FEMA	Transfer Pricing
Applicability	To all foreign transactions, irrespective of whether the entities are associated or not	Applicable only to transactions between Associated Enterprises (AEs) and transactions must be on ALP.
Meaning of Associated Enterprises	No such concept is inherently required for general taxability of foreign transactions.	Definition is explicitly given under Section 92A of the Income Tax Act.
Control	10% or more of voting rights or in any other manner in the entity.	one enterprise holds, directly or indirectly, shares carrying not less than 26% of the voting power in the other enterprise. <i>(This is one of many tests in Section 92A).</i>
Transactions	Current and capital Transactions	All transactions covered

Cross-Hairs transactions

ODI Equity Transactions

Aspect	FEMA	Transfer Pricing	Reconciliation
Objective	Prevent overvaluation of the foreign company	Ensure the transaction does not artificially shift taxable income out of India.	Adhere to the Stricter Price: The price must be FEMA Valuation and TP ALP.
Pricing Rule	Price must be using internationally accepted method on ALP.	The price must be within the Arm's Length Range.	If FEMA Floor less than TP ALP: Use the FEMA price for the transaction to ensure FEMA compliance, but document the reason in the TP report.
Valuation	Performed by a CA, SEBI Merchant Banker, or Registered Valuer. By using internationally accepted method	Determined by benchmarking using one of the prescribed TP Methods (CUP, TNMM, etc.) to arrive at the ALP.	Use Same Valuation Inputs: If for FEMA, the underlying assumptions (projections, discount rate) should be consistent with the economic reality

Aspect	FEMA	Transfer Pricing	Reconciliation
Documentation	Form FC along with the Valuation Certificate and other documents.	Form 3CEB reporting the transaction, supported by the Local File with the detailed ALP computation.	-

ODI loan Transactions

Aspect	FEMA	Transfer Pricing	Reconciliation
Objective	FEMA ensures that cross-border loans are priced fairly and not used for disguised capital transfers.	TP ensures that the interest rate between AE and Indian entity reflects the Arm's Length Price (ALP).	Both frameworks aim to avoid profit shifting and ensure fair pricing of related-party financial transactions.
Interest rate	the rate of interest shall be charged on an arm's length basis.	The interest must be within the Arm's Length Range.	Both require ALP
Repatriation of Interest	Interest must be repatriated within 90 days from the due date.	TP does not prescribe timelines, but delayed receipt may be considered a deemed loan, requiring ALP interest based on industry norms .	If interest is delayed, under FEMA, it is contravention and under TP adjustment is required.

FDI Transactions

Aspect	FEMA	Transfer Pricing	Reconciliation
Objective	Prevent undervaluation of the Indian company	Ensure the transaction does not artificially shift taxable income out of India.	Adhere to the Stricter Price: The price must be FEMA Valuation and TP ALP.
Pricing Rule	Price must be NOT LESS THAN the fair value (as per the prescribed method, typically DCF). FEMA sets the floor.	The price must be within the Arm's Length Range.	If FEMA Floor > TP ALP: Use the FEMA price for the transaction to ensure FEMA compliance, but document the reason in the TP report.
Valuation	Performed by a CA, SEBI Merchant Banker, or Registered Valuer. By using internationally accepted method	Determined by benchmarking using one of the prescribed TP Methods (CUP, TNMM, etc.) to arrive at the ALP.	Use Same Valuation Inputs: If for FEMA, the underlying assumptions (projections, discount rate) should be consistent with the economic reality

Aspect	FEMA	Transfer Pricing	Reconciliation
Documentation	FC-GPR (for fresh issue) or FC-TRS (for transfer) filed on the FIRMS portal with AD Bank, along with the Valuation Certificate.	Form 3CEB reporting the transaction, supported by the Local File with the detailed ALP computation.	-

Inter-Company Loans (ECB)

Aspect	FEMA	Transfer Pricing	Reconciliation
Objective	Regulate quantum and terms of foreign debt, setting limits on borrowing cost (All-in-Cost) and minimum maturity.	Ensure the interest rate is at ALP to prevent profit shifting through excessive interest expense deduction	The interest rate must comply with both the FEMA All-in-Cost ceiling and the TP ALP.
Pricing Rule	All-in-Cost: Sets a maximum interest rate (ceiling) based on a benchmark rate	The interest rate must be determined using the CUP Method (e.g., comparing to independent loans of similar credit rating and tenure).	If TP ALP > FEMA Ceiling: Use the FEMA Ceiling rate for the transaction to comply with the RBI, and document the regulatory constraint in the TP report.
Documentation	Monthly ECB-2 Return filed with the AD Bank, along with the Loan Agreement terms.	Form 3CEB reporting the loan amount and interest, supported by the Local File with the detailed benchmarking of the interest rate.	

Royalty

Aspect	FEMA	Transfer Pricing	Reconciliation
Limit	There is no FEMA cap on royalty payments abroad. Payments are permitted under the automatic route subject to bonafide business purpose.	Royalty must be benchmarked at Arm's Length Price (ALP) using CUP or other TP methods. Excessive or unsubstantiated royalty can be disallowed.	FEMA focuses on permissibility, TP focuses on pricing justification.
Benchmarking Requirement	No specific valuation or benchmarking required under FEMA. Only bona fide purpose and documentary evidence needed.	Detailed TP documentation required:	FEMA documentation is minimal, TP documentation is extensive
Documentation	Basic agreements + AD Bank compliance + invoices + proof of services/IP use.	3CEB reporting, Mandatory maintenance of TP study report, inter-company agreement, benchmarking analysis	

Export-Receivable

Aspect	FEMA	Transfer Pricing	Reconciliation
Objective	Ensure timely realisation of export proceeds and prevent diversion of foreign exchange.	Ensure export transactions with AEs are priced at Arm's Length and income is not shifted out of India.	FEMA focuses on timelines, TP focuses on pricing.
Primary & Secondary Adjustment	FEMA does not recognise the concepts of primary adjustment or secondary adjustment and ALP in export.	<p>If export transaction was not made at arm's length → the difference between the actual price and ALP is the primary adjustment.</p> <p>If the AE does not bring the primary adjustment amount into India, it is treated as: Deemed advance, and Interest is imputed on that amount.</p>	exporters must align invoice value with ALP to avoid TP adjustments
Timeline	Export proceeds must be realised within 15 months (extendable by 6 months by AD Bank).	TP does not prescribe any timeline but delayed realisation from an AE can be treated as deemed loan, requiring ALP interest. And it has lot of subjectivity.	Delay beyond FEMA timelines → FEMA non-compliance.

Import-Payable

Aspect	FEMA	Transfer Pricing	Reconciliation
Objective	Ensure timely payment of import dues and prevent the creation of unregulated cross-border financing arrangements.	Ensure that delayed payment to AEs does not result in shifting profits out of India by providing interest-free credit beyond arm's length terms.	FEMA focuses on timeliness of payment; TP focuses on pricing of credit period
Deemed ECB	If import dues remain unpaid for more than 3 years , the outstanding amount is treated as a deemed loan , and is governed by ECB regulations.	TP adjustment cannot be downward.	FEMA deems long outstanding payables (> 3 years) as ECB; TP deems any excessive delay , even less than 3 years, as a loan.
Payment Timeline	Payment for imports must be completed within 6 months from shipment date. AD Banks can extend by 6 months at a time, up to 3 years total.	No prescribed timeline, as per industry norm and it has lot of subjectivity.	Delay creates :FEMA violation and TP interest adjustment

Penalty Exposure

Aspect	Under FEMA	Under TP
Section	Section 13 of FEMA 1999	270A(9), 270A(9), 271G and 271AA of Income Tax Act, 1961
Penalty	Leads to Penalties (up to 3 times the amount involved)	severe Penalties 200% of the tax payable on under reported income 1laks Failure to furnish report (i.e. Form 3CEB) from an accountant as required under section 92E 2% of the value of each international transaction for documentation failure, or penalties on underreported income
	Compounding (voluntary settlement with RBI)	Leads to Income Tax Adjustments (addition to taxable income, leading to higher tax.

Thank You

