

Overview of Transfer Pricing Provisions with reference to its applicability to Specified Domestic Transactions



BCA

Vispi T. Patel

Vispi T. Patel & Associates

Chartered Accountants

Glossary

- ❖ AO – Assessing Officer
- ❖ ALP – Arm's length Price
- ❖ CIT – Commissioner of Income Tax
- ❖ DTA – Domestic Tariff Area
- ❖ FAR – Functional, Assets, Risks Analysis
- ❖ FMV – Fair Market Value
- ❖ MAM – Most Appropriate Method
- ❖ MNEs- Multi National Enterprises
- ❖ SDT – Specified Domestic Transaction
- ❖ TPO – Transfer Pricing Officer
- ❖ TPR – Transfer Pricing Regulations

Brief History & Background of Indian TPR

- ❖ Liberalization of trade and foreign exchange policy started in India in the year 1991
- ❖ This created huge increase in interest of MNEs in India
- ❖ Several Indian companies also steadily emerged as global players by either making offshore acquisitions or by setting up overseas subsidiaries
- ❖ The Standing Committee in March 1991 observed that provisions of Income Tax Act, 1961(Act) were inadequate to curb transfer pricing among MNEs

Brief History....

- ✧ The Expert Group constituted by Central Board Of Direct Taxes (CBDT) recommended complete revision of existing section 92 of the Act
- ✧ The Finance Act, 2001 introduced TPR in India by substituting existing Section 92 of the Act and introducing new sections 92A to 92F w.e.f April, 2001
- ✧ The Finance Act, 2012 amended TPR for domestic transactions w.e.f AY 2013-14. This was an outcome of suggestions given by Honorable SC in **CIT v Glaxo SmithKline Asia (P) Ltd. (236 CTR 113)**

Tax Evasion through Transfer pricing as one of the major areas of generation of black money

- Former FM Pranab Mukherjee



Intent behind introducing Domestic Transfer Pricing

- ✧ To discourage tax abuse by shifting of profits by undertakings having huge accumulated losses /enjoying tax holidays/ differential tax rates
- ✧ To shift from FMV / ordinary profit to ALP

TPR in India

- ✧ Section 92 - Income arising to “Associated Enterprises” from “International Transactions” or expenditure / income in relation to the Specified Domestic Transactions (w.e.f AY 2013-14) shall be computed having regard to the “Arm’s Length Price”
- ✧ OECD TP Guidelines lays the foundation of the Transfer Pricing Regulation in India
- ✧ Interplay of Domestic law and DTAA
- ✧ Preconditions:
 - ✧ Two or more associated enterprises;
 - ✧ Enter into an international transactions
 - ✧ Specified Domestic Transaction (w.e.f AY 2013-14)
- ✧ Consequence:
 - ✧ Income to be computed having regard to the arm’s length price

Arm's Length Price

✧ Section 92F(ii) of the Indian TPR

“arm's length price means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions”

✧ Under Rules 10A to 10E of Income Tax Rules, 1962 (Rules)

“Uncontrolled transaction” – transaction between enterprises other than associated enterprises, whether resident or non-resident

Specified Domestic Transactions

- ✧ The Finance Act, 2012 has introduced TPR for specified domestic transactions
- ✧ SDTs to include :
 - ✧ Any payment to a person referred in section 40A(2)(b)
 - ✧ Any transaction referred in section 80A
 - ✧ Any transfer of goods or services referred to in Section 80IA(8)
 - ✧ Any business transacted with the person as referred to in Section 80-IA (10)
 - ✧ Any transaction referred to in any other section under Chapter VI-A/10AA to which 80-IA (8)/(10) are applicable
 - ✧ Any other transaction as may be prescribed
 - ✧ And where the aggregate value of above transactions exceeds INR 50 mn

TP Provisions applicable to SDTs

Section 92	:Computation of income having regard to ALP
Section 92BA	: Specified Domestic Transaction
Section 92C	: Methods of computation of ALP
Section 92CA	: Reference to TPO
Section 92D	: Maintenance and keeping of information and documents
Section 92E	: Report from an accountant (CA)

Methods for benchmarking Arm's Length Pricing

- ✧ The Act prescribes selection of the MAM from the five specified methods; having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe – Rule 10C
 - ✧ Comparable uncontrolled Price Method (CUP)
 - ✧ Resale Price Method (RPM)
 - ✧ Cost Plus Method (CPM)
 - ✧ Profit Split Method (PSM)
 - ✧ Transactional Net Margin Method (TNMM)
 - ✧ Such other Method as may be prescribed by the board

**Whether the methods as stated in Rule 10AB and Rule 10B
will be applicable to SDT
(Can delegated legislation override substantive law?)**

Reference to TPO

- ✧ If AO considers it necessary or expedient, he may refer domestic transaction to TPO with prior approval of CIT - 92CA(1)
- ✧ TPO can not suo moto apply TP provisions to the specified transaction (other than transaction referred by AO) which comes to the notice of the TPO during the course of assessment proceedings – Section 92CA(2A) & (2B) not applicable
- ✧ In cases of payment to related party as mentioned u/s 40A(2)(b) and income in relation to SDT, whether AO has to first form opinion or burden is on taxpayer to demonstrate the transaction are at ALP
- ✧ Further, one needs to factor in the provisions of 92CA(4)

Compliance

- ✧ Taxpayers having Specified Domestic Transactions would have to maintain documentation as prescribed under section 92D
- ✧ Documentation contain
 - ✧ Shareholding Structure
 - ✧ Group Structure
 - ✧ Industry Analysis
 - ✧ Nature of Specified domestic transaction
 - ✧ FAR Analysis
 - ✧ Selection and application of MAM
 - ✧ Comparability Analysis
 - ✧ Determination of ALP

Compliance...

- ✧ Taxpayers having Specified Domestic Transactions would have to obtain and furnish a prescribed report from an Accountant in Form 3CEB – Section 92E
- ✧ Form 3CEB needs to be submitted with the tax authorities before the due date of filing annual return of income



Penal Consequences in case of non-compliance

- ✧ If the adjustment is treated as concealment of income: penalty will be 100 to 300% of tax on adjustment
- ✧ Failure to maintain required set of documents: 2% of value of transactions
- ✧ Failure to report transaction in Accountant's report: 2% of value of transactions
- ✧ Failure to furnish documentation: 2% of value of transactions
- ✧ Failure to furnish Accountant's report by due date: INR 100,000

Section 40A(2)(a) & (b)



Payment to Relative or Associate – Section 40A(2)(a)

- ✧ Any payment to related parties as mentioned under section 40A(2)(b)
- ✧ If AO finds it *necessary and expedient* he may refer such transaction to TPO with prior approval of CIT
- ✧ TPO shall determine ALP of such transactions

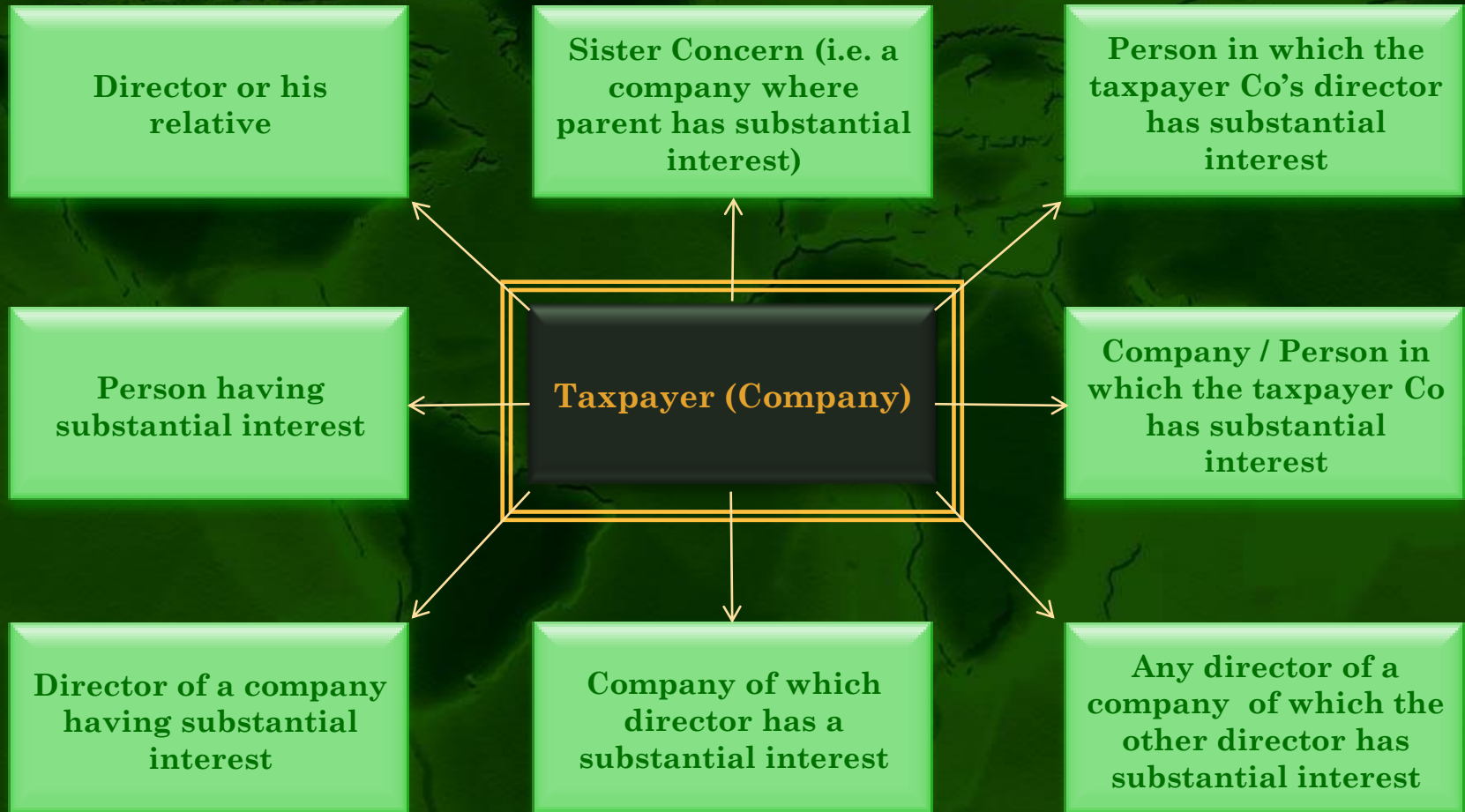
Related Parties covered under section 40A(2)(b)

Taxpayer	Related Party
Individual – 40A(2)(b)(i)	Any relative
Company – 40A(2)(b)(ii)	any director or his relative
Firm – 40A(2)(b)(ii)	any partner or his relative
AOP – 40A(2)(b)(ii)	any member or his relative
HUF – 40A(2)(b)(ii)	any member or his relative
Any Taxpayer – 40A(2)(b)(iii)	any individual having substantial interest in the taxpayer's business or his relative,
Any Taxpayer – 40A(2)(b)(iv)	A company, firm, AOP, HUF having substantial interest in the taxpayer or any director, partner, member, of such company, firm, AOP, HUF or relative of such director, partner or member (also refer slide no 21)

Related Parties covered under section 40A(2)(b)

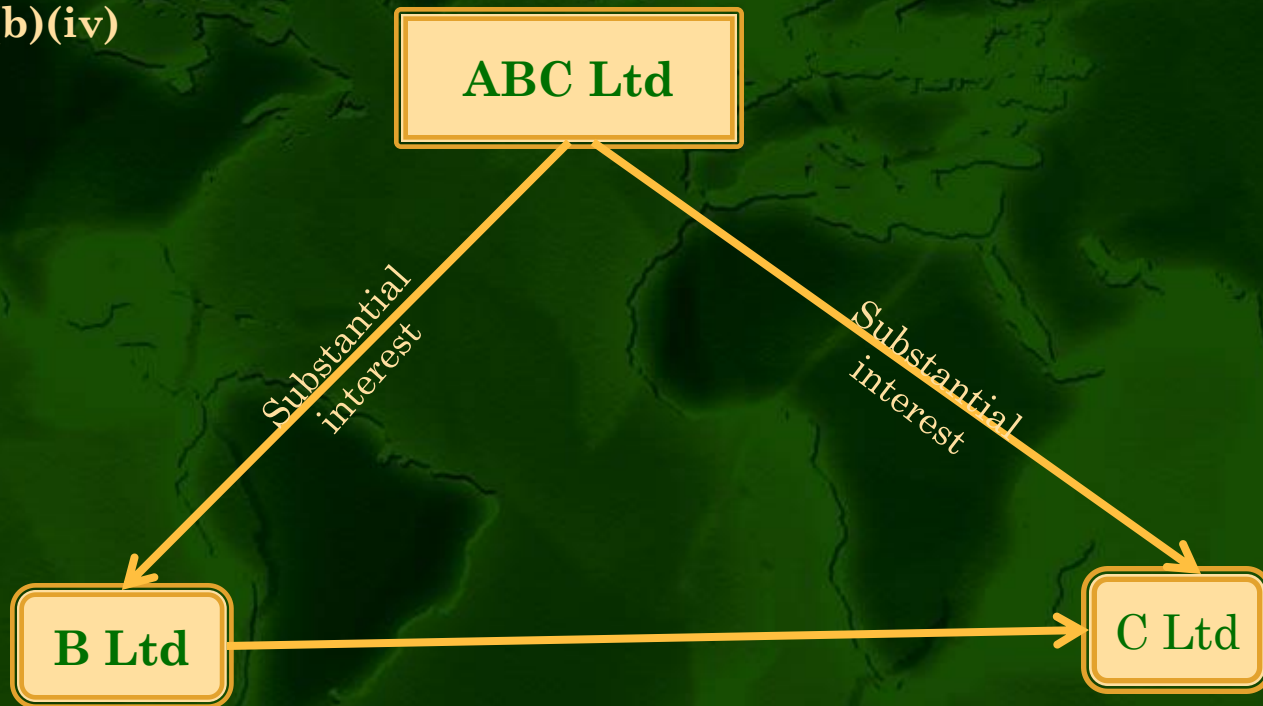
Taxpayer	Related Party
Any Taxpayer – 40A(2)(b)(v)	a company, firm, AOP, HUF of which a director, partner, member having substantial interest in the taxpayer or any director, partner, member, of such company, firm, AOP, HUF or relative of such director, partner or member
Any Taxpayer – 40A(2)(b)(vi)	a person in which taxpayer / any director, partner, member of taxpayer / relative of such individual, director, partner or member has substantial interest

Related parties in cases of taxpayer being company



Examples showing transactions covered under section 40A(2)(b)

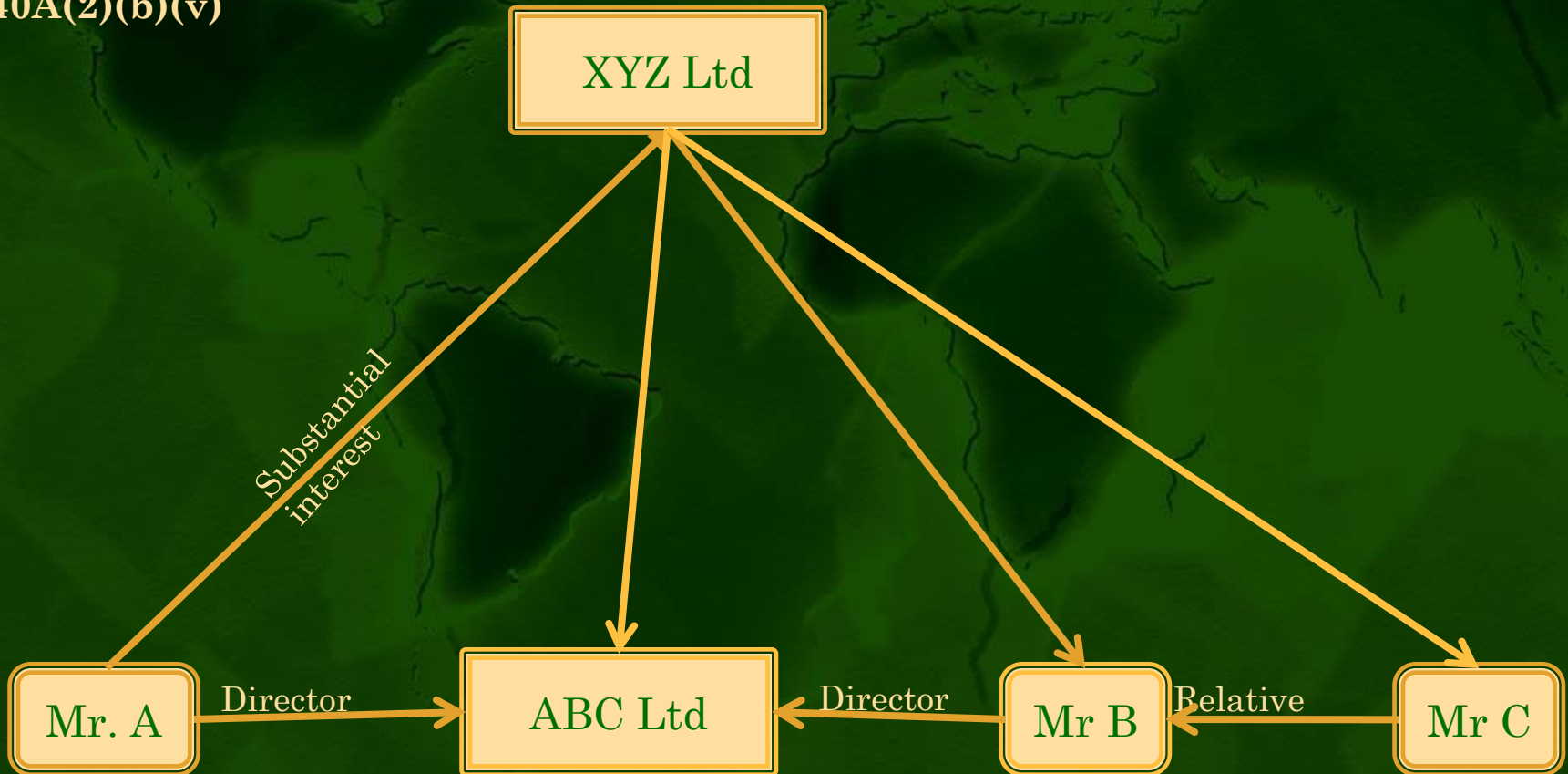
Section
40A(2)(b)(iv)



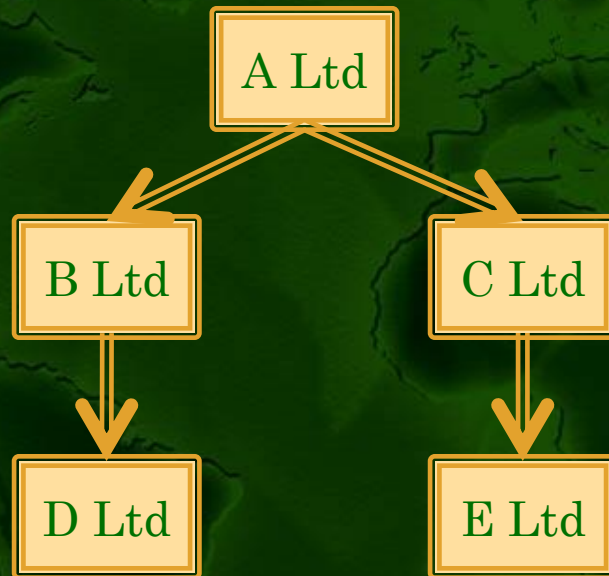
Section 40A(2)(b)(iv) also covers cases of transaction between B Ltd and C Ltd

Examples showing transactions covered under section 40A(2)(b)

Section
40A(2)(b)(v)

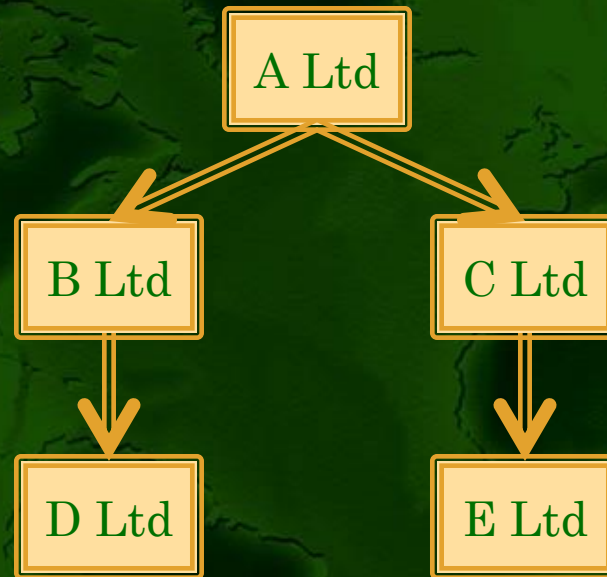


Whether Indirect holdings are covered under section 40A(2)(b)



In this scenario A&B / A&C are related parties; however whether can it be said that A has substantial interest in D & E??

Whether Indirect holdings are covered under section 40A(2)(b)



Transaction between B Ltd and C Ltd are covered under section 40A(2)(b)(iv), however, whether transaction between D Ltd and E Ltd can be treated as related party transactions??

Whether section 40A(2)(a) attracts income?



Taxability:

X I Ltd – Income arising from transaction with related parties are not covered under section 40A(2)

X II Ltd:

Since no interest paid by X II Ltd, provision of Section 40A(2) will not be applicable

Whether AO/TPO can attribute notional income??

Issues which may arise...

- ✧ Whether provisions will be applicable if both assessee are falling under same tax bracket?
- ✧ In case of upward adjustment – whether benefit of corresponding adjustment is available?
- ✧ If TPO accepts the ALP of the domestic transaction whether AO can still trigger business expediency and benefit test?
[provision of section 40A(2)(a)]
- ✧ Can AO step into shoes of businessman?
- ✧ What is the impact on capital expenditure transactions??

Section 80IA(8) & (10)



Applicability of Domestic TP provisions to eligible business under 80IA

✧ *Transactions referred u/s 80-IA(8)*

» *transfer of goods or services between resident undertakings / division of the same taxpayer i.e. intra unit transfer*

» *If transfer is not at market value*

» *Onus is on AO*

Applicability of Domestic TP provisions to eligible business under 80IA

- ❖ *Transfer of goods and services as referred in section 80-IA(10)*
 - » *transaction with any other person generates more than ordinary profits*
 - » *with whom taxpayer has close connection or due to any other reason*
 - » *Onus is on AO*

Issues w.r.t. Section 80IA(10)

- ✧ What is the meaning of close connection?? What can be other reasons which can lead to formation of opinion by AO that the assessee is earning more than ordinary profit?
- ✧ Whether definition of AE under section 92A points to close connection?
- ✧ Whether transactions between two eligible undertakings / company needs to benchmarked?

Issues w.r.t. Section 80IA(10)

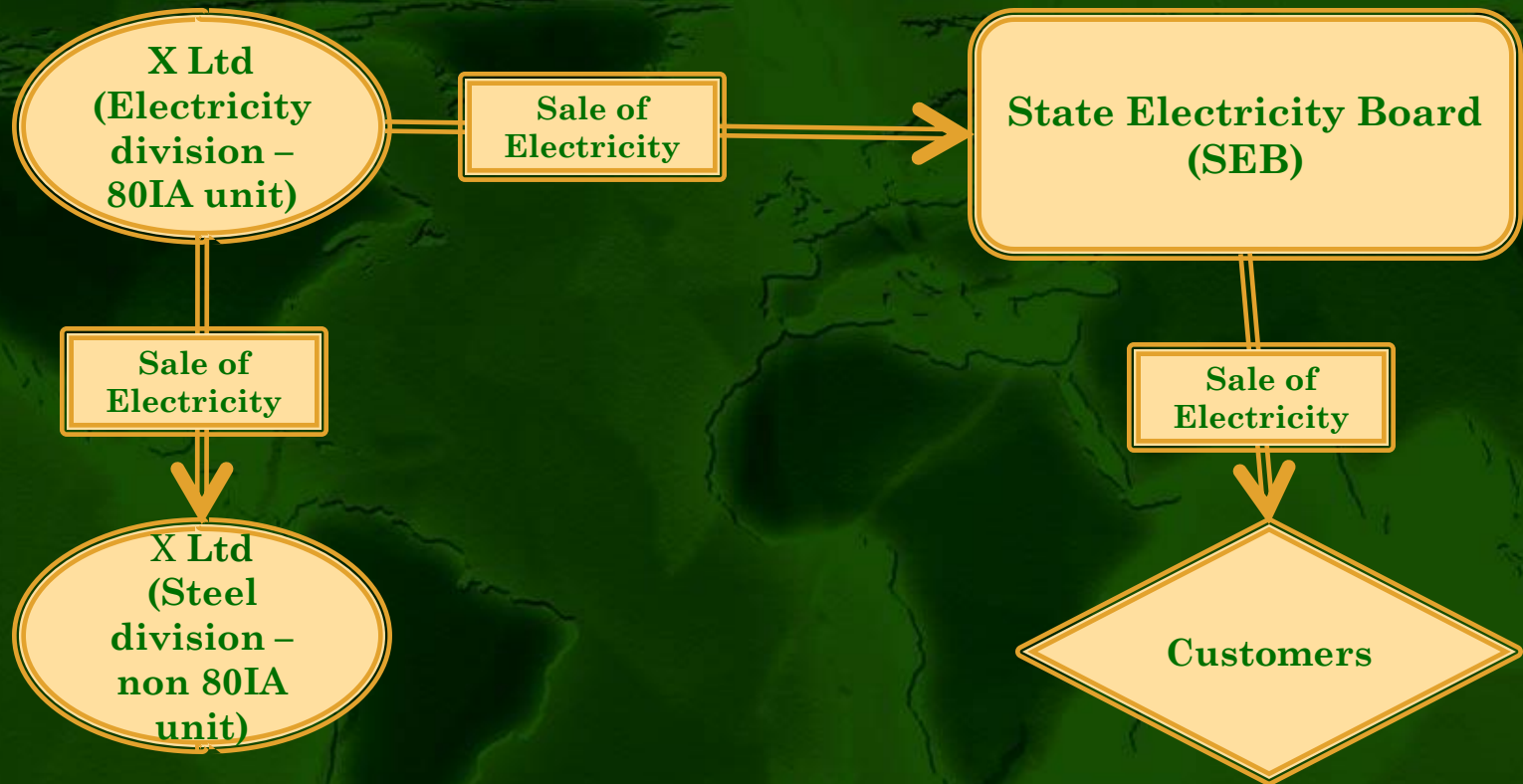
- ✧ Identification of transactions
- ✧ Onus is on whom; whether on TPO or on taxpayer to report the transactions?



Transactions in other provisions to which s.80-IA(8)/(10) apply

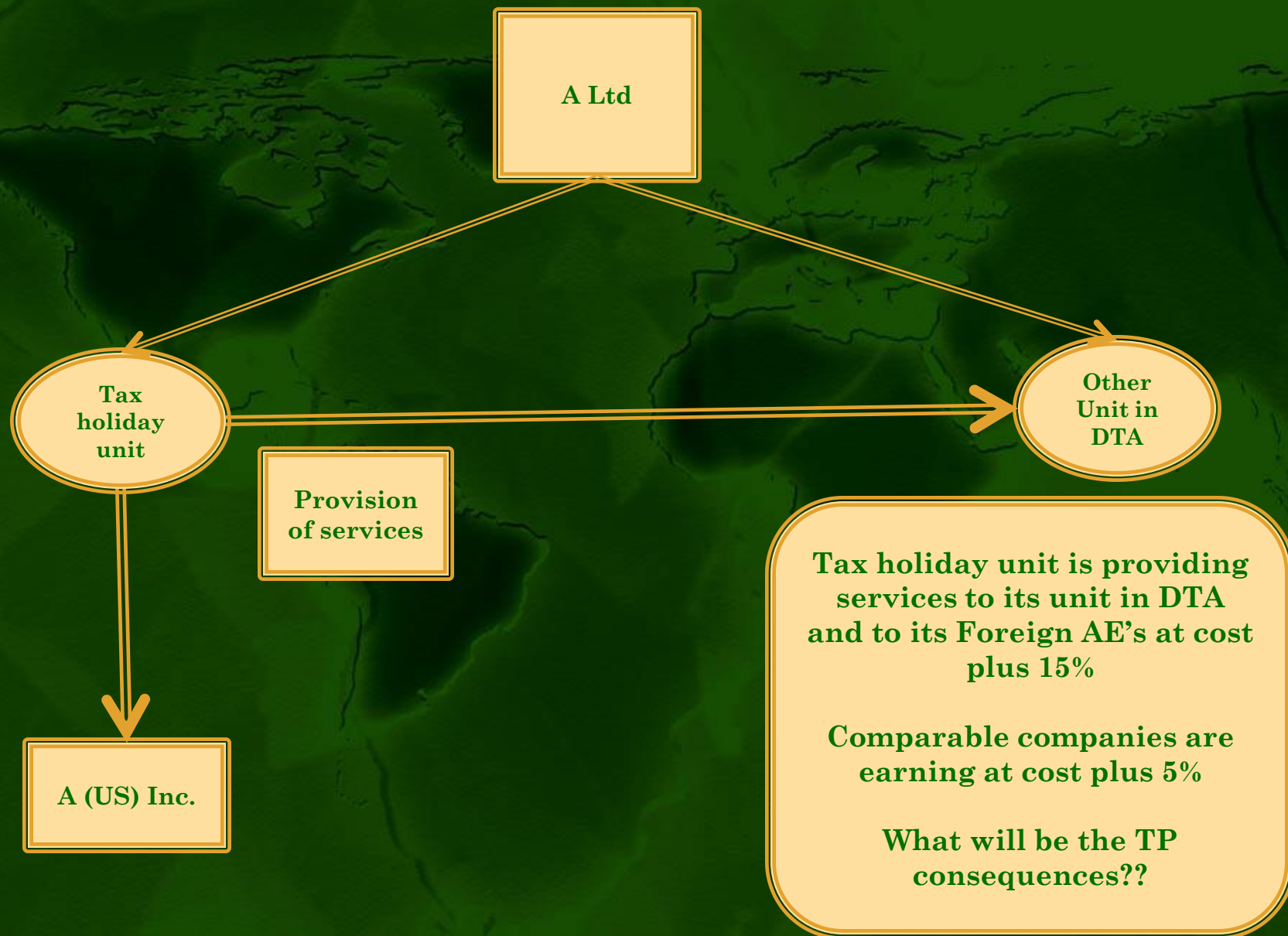
- ❖ 80-IA - Income from Infrastructure, Telecommunication, Industrial Park & Power sector etc.
- ❖ 80-IAB- Income of an undertaking or enterprise engaged in development of SEZ
- ❖ 80-IB- Income from certain industrial undertakings other than infrastructure development undertakings
- ❖ 80-IC- Income of certain undertakings or enterprises in certain special category States
- ❖ 80-ID- Income of hotels and convention centres in specified area
- ❖ 80-IE- Income of certain undertakings in North-Eastern States

Intra unit transfer – section 80-IA(8)



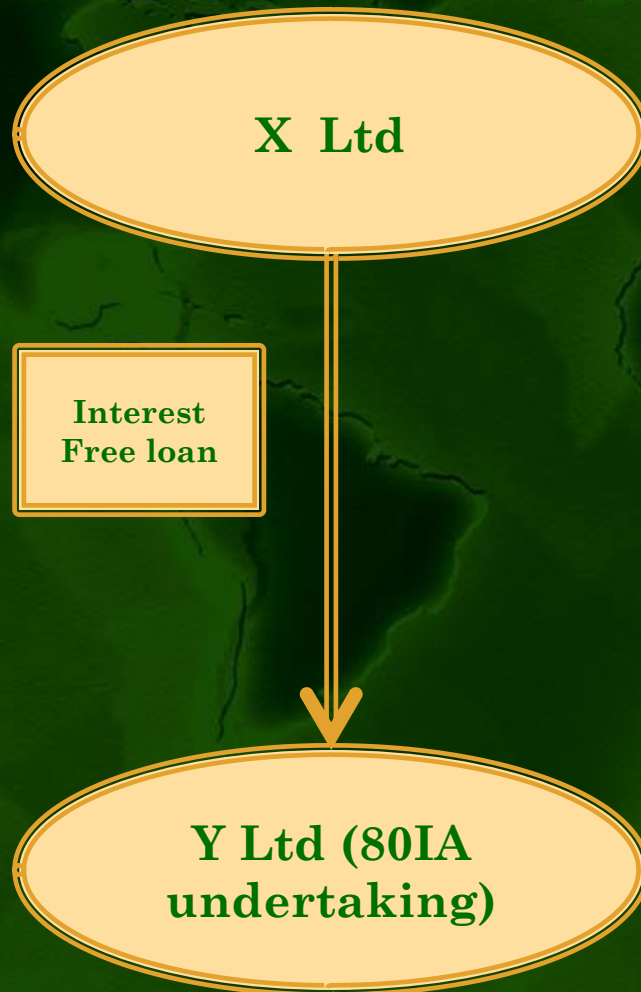
Price at which SEB supplied electricity to its customer shall be consider as market price for intra unit transfer

Intra company transfer and transaction with foreign AE



Transaction between to unrelated parties – section 80-IA(10)

Interest free loan given to 80IA unit



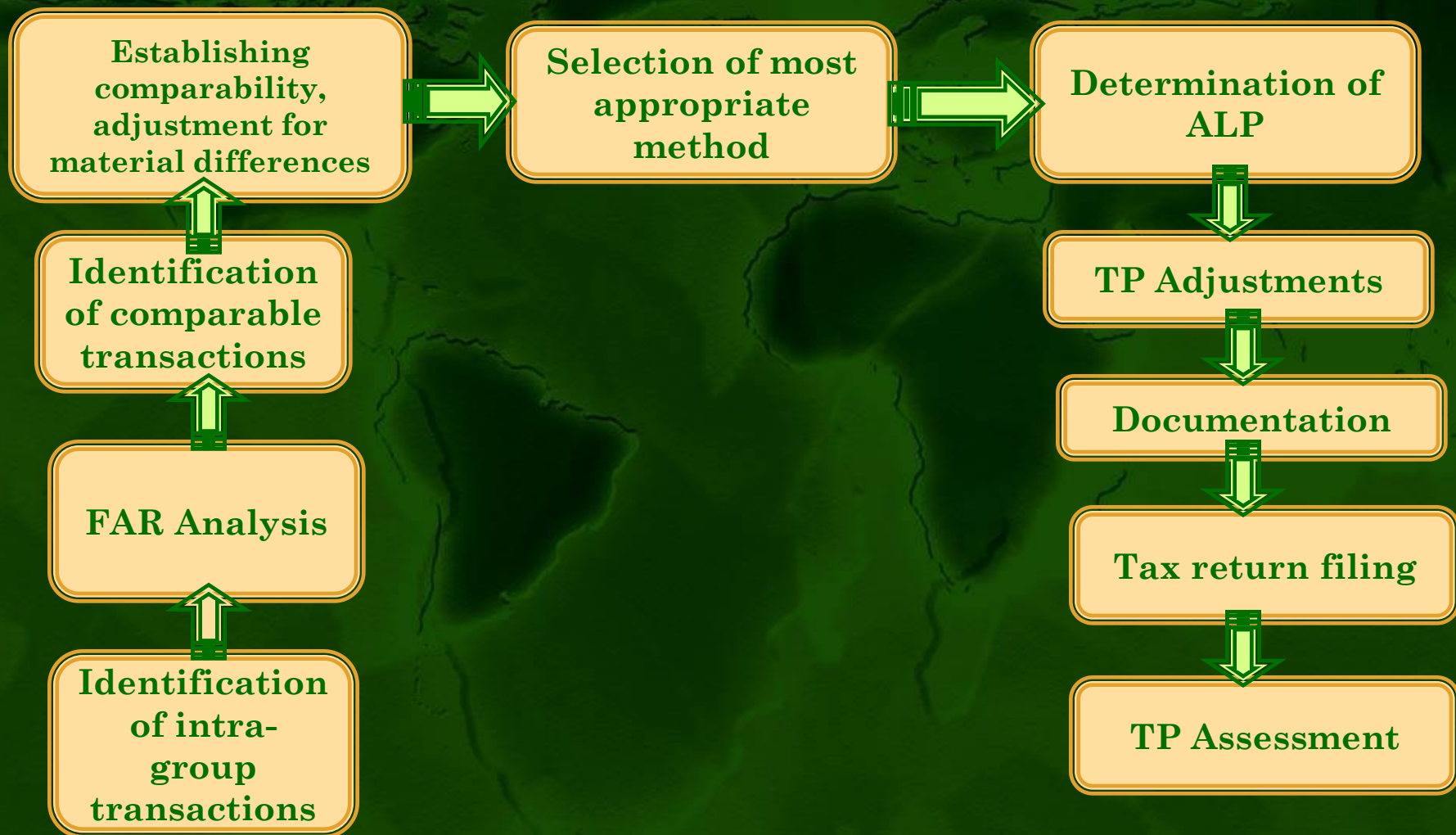
Taxability:

X Ltd – Income arising from transaction with related parties are not covered under section 40A(2)

Y Ltd:

Can AO make addition in the books of Y as this transaction may enable Y to earn more than ordinary profit??

Transfer Pricing Process w.r.t Specified Domestic Transactions





THANK YOU

Vispi T. Patel

Vispi T. Patel & Associates

Chartered Accountants

Contact no : +91 22 2288 1091/1092

+91 -98 6763 5555

Email id : vispitpatel@vispitpatel.com