



Mulund CPE Study
Circle of ICAI

Domestic Transfer
Pricing –
Applicability &
Overview

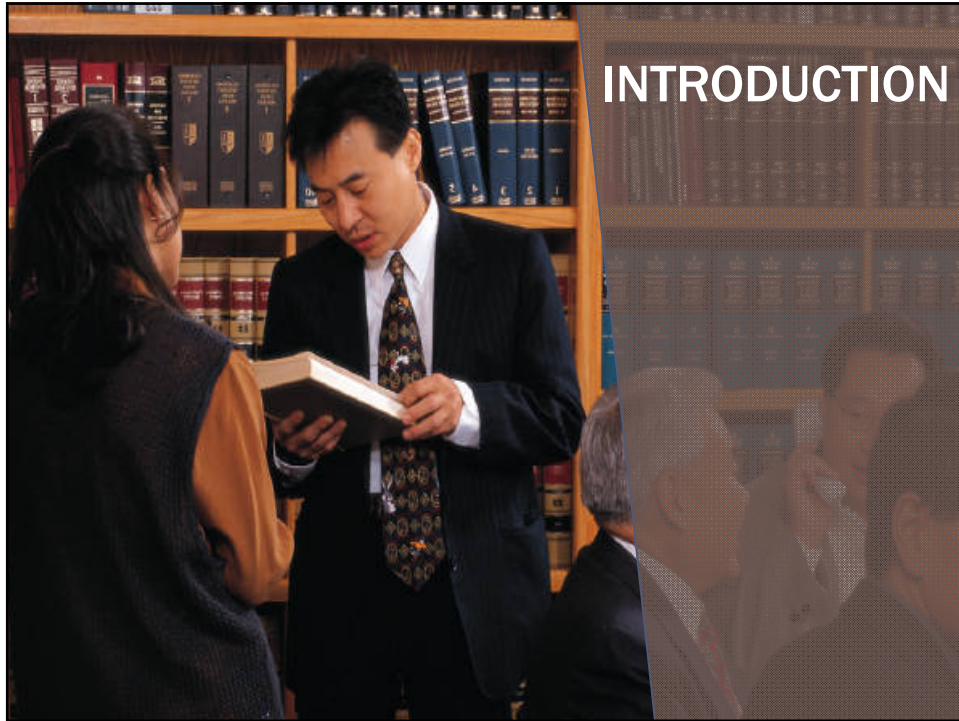
15/6/2013

CA Paras K Savla

CONTENT

- Introduction
- Specified domestic transactions
- Illustrations
- Procedures
- ALP under other Acts
- Appendix





BACKGROUND

- Supreme Court in case of Glaxo Smithkline Asia (P.) Ltd. [2010] 195 Taxman 35 (SC) while dealing with the allowability of the allocation of cross charges has raised the issue whether Transfer Pricing Regulations should be limited to cross-border transactions or be extended to domestic transactions?
- It observed that in the case of domestic transactions, the under-invoicing of sales and over-invoicing of expenses ordinarily will be revenue neutral in nature, except in two circumstances having tax arbitrage—
 - If one of the related Companies is loss making and the other is profit making and profit is shifted to the loss making concern; and
 - If there are different rates for two related units (on account of different status, area based incentives, nature of activity, etc.) and if profit is diverted towards the unit on the lower side of tax arbitrage.



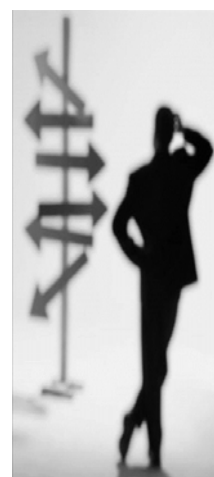
BACKGROUND

- It further observed that complications arise in cases where fair market value is required to be assigned to the transactions between related parties in terms of section 40A(2).
- It opined that in order to reduce litigation,
 - Certain sections like S. 40A(2) & S. 80-IA(10), be amended for empowering the Assessing Officer to make adjustments to the income declared by the assessee having regard to the fair market value of the transactions between the related parties.
 - The Assessing Officer may apply any of the generally accepted methods of determination of arm's length price, including the methods provided under Transfer Pricing Regulations.
 - The taxpayer may compulsorily required to maintain books of account and other documents on the lines prescribed under rule 10D, obtain an audit report from Chartered Accountant



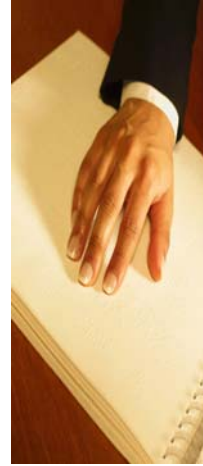
NEW PROVISIONS

- S. 92(2A) – Computation provision
- S. 92BA – Meaning of Specified Domestic Transaction (SDT)
- S. 92C – Computation of Arm's Length Price (ALP)
- S. 92CA – Reference to TPO
- S. 92D – Maintenance and keeping of information / documents for SDT
- S. 92E – Report of Accountants for SDT
- S. 80A(6) Explanation (iii) – Meaning of market value
- S. 80IA(8) & (10) – Meaning of market value
- S. 40A(2)(a) Proviso – No disallowance of expenses if such expense is at ALP



MEMORANDUM TO FINANCE BILL 2012

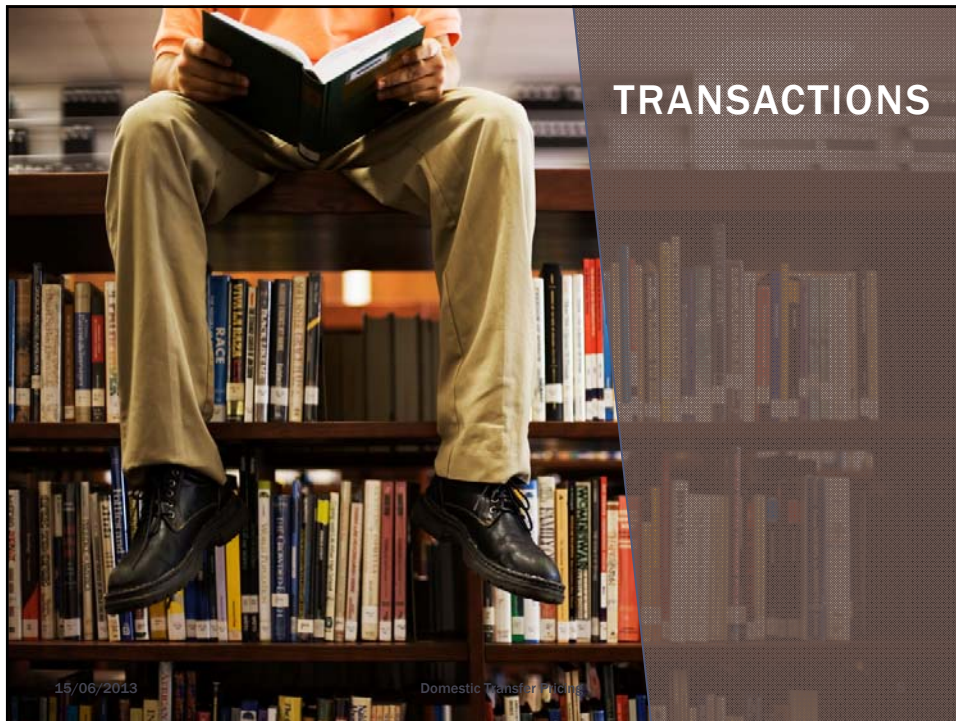
- No specific method to determine reasonableness of expenditure or fair market value to re-compute the income under specified sections
- extending the transfer pricing requirements to all domestic transactions will lead to increase in compliance burden on all assesseees which may not be desirable.
- Therefore, the transfer pricing regulations extended to the transactions entered into by domestic related parties or by an undertaking with other undertakings of the same entity for the purposes of S. 40A, Chapter VI-A and section 10AA.



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TRANSACTIONS

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SPECIFIED DOMESTIC TRANSACTION MEANS ...

- Any payment for expenditure made to persons specified u/s 40A(2)(b)
- Any transactions referred u/s 80A – transfer to another units of the same assessee
- Transfer of goods & services amongst the business of assessee as referred u/s 80-IA(8)
- Transactions between the assessee and any other person, in the opinion of AO is arranged to generate extra-ordinary profits as referred u/s 80-IA(10)
- Any transactions referred to u/c VI-A (i.e. S. 80-IAB, 80-IB, 80-IC, 80-ID, 80-IE) or S. 10AA to which S. 80-IA(8) / (10) applies.
- Any other prescribed transaction
- Provisions are applicable only if aggregate value is exceeds Rs. 5 Crs.



RELATED PARTIES FOR AN INDIVIDUAL

Type of Assessee	Payment made to
Individual	To a relative or any entity in which the individual or any relative of individual has a substantial interest



- Payment for any kind of expenditure is covered under the ambit of this provision. Eg: Payment made for purchase of goods, services or facilities enjoyed, interest on loans obtained etc.
- Relative u/s 2(41) means husband, wife, brother or sister or any lineal ascendant or descendant of that individual

RELATED PARTIES IN CASE OF COMPANY

Type of Assessee	Payment made to
Company	<ul style="list-style-type: none">• Any director of the company or any relative of any director or to any entity in which the director or relative of director holds a substantial interest;• Any individual / company / firm / HUF / AOP having substantial interest in the company or a relative of such individual or director of such company or partner of such firm or member of such AOP / HUF;• Any entity in whose business the company or director of company or relative of director holds a substantial interest

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SUBSTANTIAL INTEREST

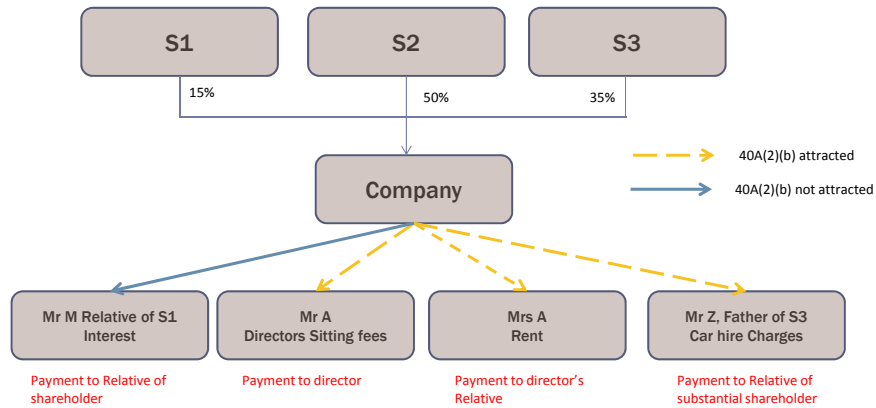
- Substantial interest means
 - Company : beneficial owner of shares(excluding preference shares) at any time during the year carrying 20% or more voting rights
 - Any other case : beneficially entitled (at any time during the year) for 20% or more profits of such business or profession

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ILLUSTRATION OF COMPANY MAKING PAYMENT

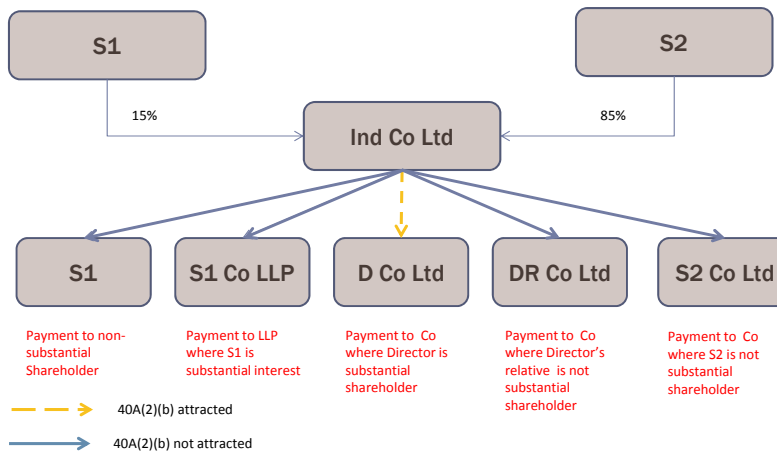


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ILLUSTRATION OF COMPANY MAKING PAYMENT

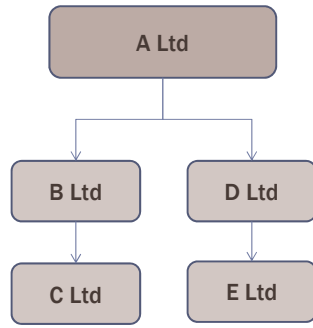


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RELATED PARTIES IN CASE OF COMPANY



→ Holding

Transactions	Whether in ambit of 40A(2)(b)	Reason
A Ltd – B Ltd.	Yes	A Ltd being the holding company holds a substantial interest in B Ltd
A Ltd – C Ltd	No	C Ltd is a step down subsidiary and A Ltd does not have substantial interest in C Ltd.
B Ltd – D Ltd	Yes	B Ltd does not have any substantial interest in D Ltd and vice versa
B Ltd – E Ltd	No	B Ltd does not have any substantial interest in E Ltd
D Ltd – C Ltd	No	D Ltd does not have any substantial interest in C Ltd
E Ltd – A Ltd	No	A Ltd does not directly have any substantial interest in E Ltd.

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RELATED PARTIES IN CASE OF FIRM / HUF / AOP

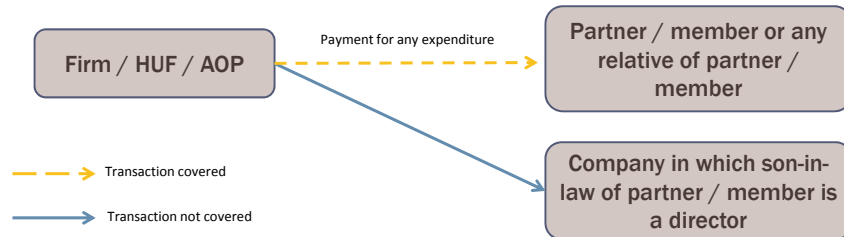
Type of Assessee	Payment made to
Firm / AOP / HUF	<ul style="list-style-type: none"> Any partner of firm / member of AOP / HUF or any relative of any partner / member or to any entity in whose business the partner / member holds a substantial interest Any entity in whose business the firm / AOP / HUF or any relative of partner or member holds a substantial interest

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RELATED PARTIES IN CASE OF FIRM / HUF / AOP



- Relative of partner / member will only include relatives as defined u/s 2(41), i.e. husband, wife, brother or sister or any lineal ascendant or descendant of the partner / member

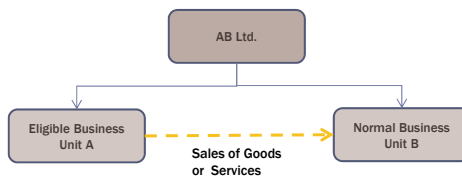
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UNITS ENJOYING TAX HOLIDAY

- Applicable 80IA-(8) - where any goods or services held by the
 - eligible units and transferred to any other business carried on by the assessee or
 - any other business carried on by the assessee and transferred to eligible business
- Such transfer to be recorded in the books of eligible business at market value or such price which is at arm's length price
- DTP provisions are applicable in respect of transfer amongst different units of same assessee



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COMPANY ENJOYING TAX HOLIDAY

- Applicability – S. 80IA(10) – when it appears to the AO that due to close connection between the assessee carrying eligible business and any other business are arranged in such a manner with generates more than ordinary profits
- AO to compute deduction considering profits as may be reasonably deemed to be derived.
- Amount of profit from such transaction to be determined having regards to arm's length price
- 'Close connection' not defined. Hence it is subjective and also subject to litigation.
- Trigger point for this provision is when it appears to the AO Hence would create practice difficulties.

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ILLUSTRATION

- X Ltd. enjoying tax holiday, sold goods to A LLP
- It appears to the AO that though transaction is between unrelated parties, but they both have close connection and also generated more than ordinary profit



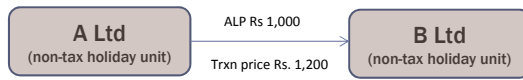
- ALP as per the comparable company – OP/TC is 18% (arithmetic mean) and mark-up charged by the X Ltd is 25%.

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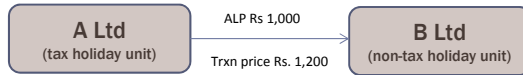
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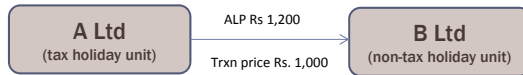
IMPLICATIONS



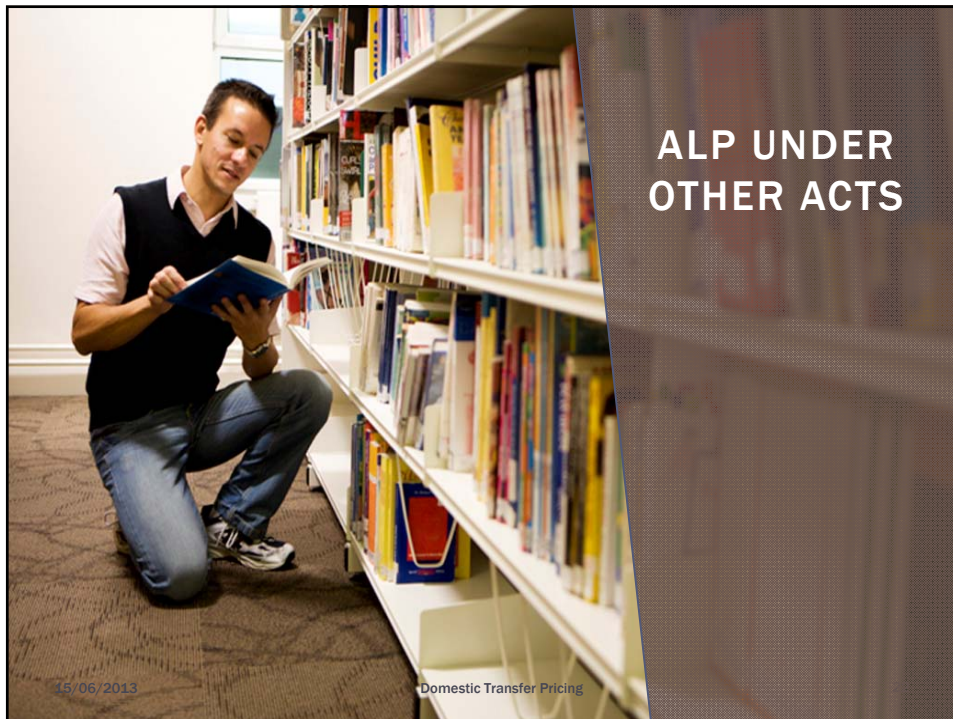
Disallowance of expenditure by Rs.200 in case of A Ltd u/s 40A(2)(b) without corresponding adjustment



Disallowance of deduction by Rs.200 in case of A u/s 80IA(10) & disallowance of expenditure of Rs.200 u/s 40A(2)(b)



Allowance of deduction u/s 80IA(8) is lower by Rs.200



ALP UNDER OTHER ACTS

COMPANIES BILL 2012

- Clause 188 of the Companies Bill 2012 (as passed by Lok Sabha) has mandated company to obtain permission of the board or members in respect to the Related Party Transactions
- However no such permission is required in case such transaction are entered during ordinary course of business and are at Arm's Length Price.
- Bill does not prescribes method for computation of Arm's Length Price.



THE COMPANIES (COST AUDIT REPORT) RULES, 2011

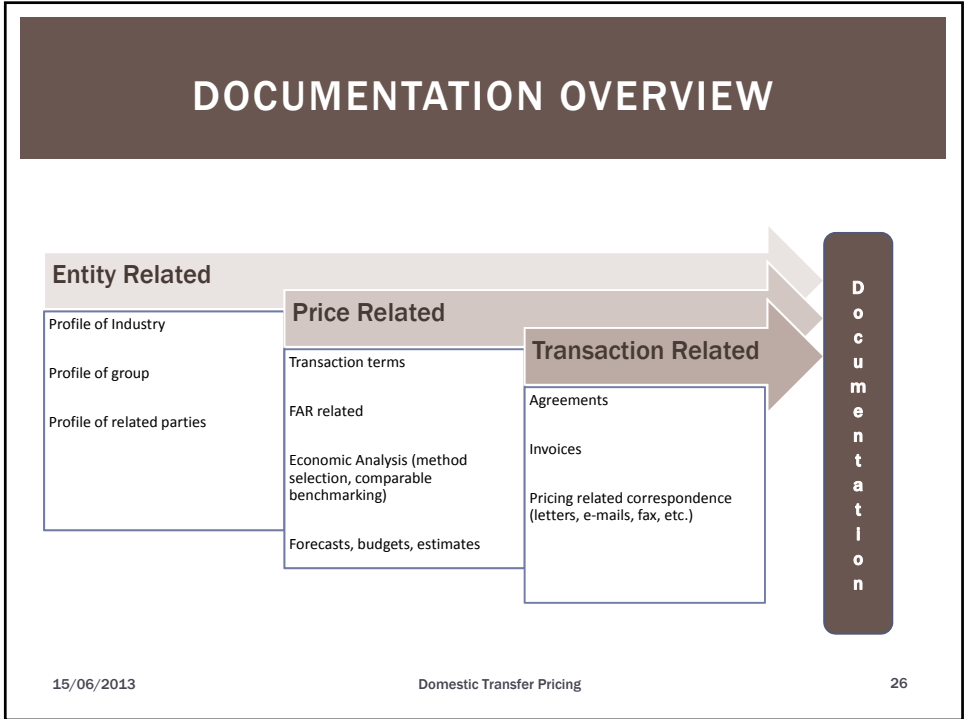
- The Companies (Cost Audit Report) Rules, 2011 required to disclose Methodology for valuation of Inter-Unit/Inter Company and Related Party transactions
- It further states that details of Related Party transactions without indicating the Normal Price and the basis thereof shall be considered as incomplete information.
- Further cost audit report to contain information in following format

10. RELATED PARTY TRANSACTIONS (for the company as a whole)

Sno.	Name & Address of the Related Party	Name of the Product / Service Group	Nature of Transaction (Sale, Purchase, etc.)	Quantity	Transfer Price	Amount	Normal Price	Basis adopted to determine the Normal Price
1								
2								



PROCEDURES & COMPLIANCES



BENCHMARKING METHODS

- Comparable uncontrolled price method
- Resale Price Method
- Cost plus method
- Profit Split Method
- Transactional Net Margin Method
- Other methods of determining arm's length price
 - In relation to an international transaction or specified domestic transaction shall be any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts

PENALTY

S. 271AA 2% of each transaction value for:

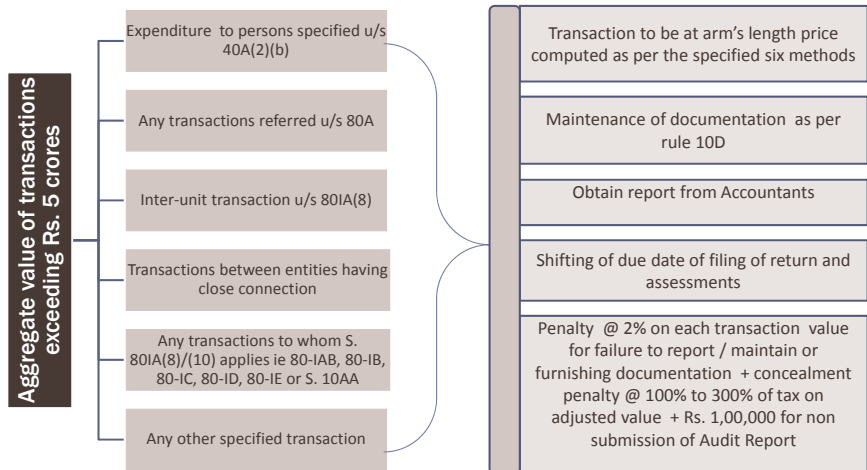
- failure to maintain prescribed documents or information.
- failure to report any specified domestic transaction which is required to be reported.
- maintaining/ furnishing incorrect information/ documents.

S. 271G failure to furnish each information:
2% of transaction value for failure to furnish information/ documents as required u/s 92D(3)

S. 271BA
Rs. 1 lakh for failure to furnish accountant's report u/s 92E

S. 271(1)(C)
Between 100%-300% of tax sought to be evaded on SDT

SUMMARY



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LET'S TALK



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THANK YOU



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APPENDIX

SECTION 40A(2)(b)

(b) The persons referred to in clause (a) are the following, namely :—

- (i) where the assessee is an individual any relative of the assesseee;
- (ii) where the assessee is a company, firm, association of persons or Hindu un-divided family any director of the company, partner of the firm, or member of the association or family, or any relative of such director, partner or member;
- (iii) any individual who has a substantial interest in the business or profession of the assessee, or any relative of such individual;
- (iv) a company, firm, association of persons or Hindu undivided family having a substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family, or any relative of such director, partner or member 93[or any other company carrying on business or profession in which the first mentioned company has substantial interest];

SECTION 40A(2)(b)

(v) a company, firm, association of persons or Hindu undivided family of which a director, partner or member, as the case may be, has a substantial interest in the business or profession of the assessee; or any director, partner or member of such company, firm, association or family or any relative of such director, partner or member;

(vi) any person who carries on a business or profession,—

(A) where the assessee being an individual, or any relative of such assessee, has a substantial interest in the business or profession of that person; or

(B) where the assessee being a company, firm, association of persons or Hindu undivided family, or any director of such company, partner of such firm or member of the association or family, or any relative of such director, partner or member, has a substantial interest in the business or profession of that person.

SECTION 40A(2)(b)

Explanation.—For the purposes of this sub-section, a person shall be deemed to have a substantial interest in a business or profession, if,—

(a) in a case where the business or profession is carried on by a company, such person is, at any time during the previous year, the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) carrying not less than twenty per cent of the voting power; and

(b) in any other case, such person is, at any time during the previous year, beneficially entitled to not less than twenty per cent of the profits of such business or profession.

MEANING OF SPECIFIED DOMESTIC TRANSACTION

92BA. For the purposes of this section and sections 92, 92C, 92D and 92E, "specified domestic transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely:—

- (i) any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;
 - (ii) any transaction referred to in section 80A;
 - (iii) any transfer of goods or services referred to in sub-section (8) of section 80-IA;
 - (iv) any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;
 - (v) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or
 - (vi) any other transaction as may be prescribed,
- and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of five crore rupees.

SECTION 92 (2A)

CHAPTER X

SPECIAL PROVISIONS RELATING TO AVOIDANCE OF TAX

Computation of income from international transaction having regard to arm's length price.

92. (2A) Any allowance for an expenditure or interest or allocation of any cost or expense or any income in relation to the specified domestic transaction shall be computed having regard to the arm's length price.