National Conclave for CA Students- Goa 2014

Paper Presentation
Domestic Transfer Pricing

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Domestic Transfer Pricing

What is Domestic Transfer Pricing?? (What???)

DTP is the rule through which government tries to stop the tax evasion by the entities who try t divert their profit by doing transactions with the sister concerns, inter group under takings, Tax Holiday enterprise etc. Initially transfer pricing provisions were applicable only to cross border transactions (ITP).but seeing the growth of the revenue from international transfer pricing government tried to implement the same rules also to the Specified Domestic Transactions. Supreme in the case of **Glaxo Smithkline Asia (P) Ltd. V/s CIT** it was held that Ministry of Finance should consider appropriate provisions in law to make transfer pricing regulations applicable to such related party domestic transactions.

Income Tax authorities having gained significant experience in transfer pricing related to international transactions, now Finance Act, 2012 has cast wider and deeper net to cover domestic transactions between related parties.

The Finance Act, 2012 came up with number of transfer pricing amendments, most significant among them being the extension of transfer pricing provisions to specified domestic transactions (SDTs).

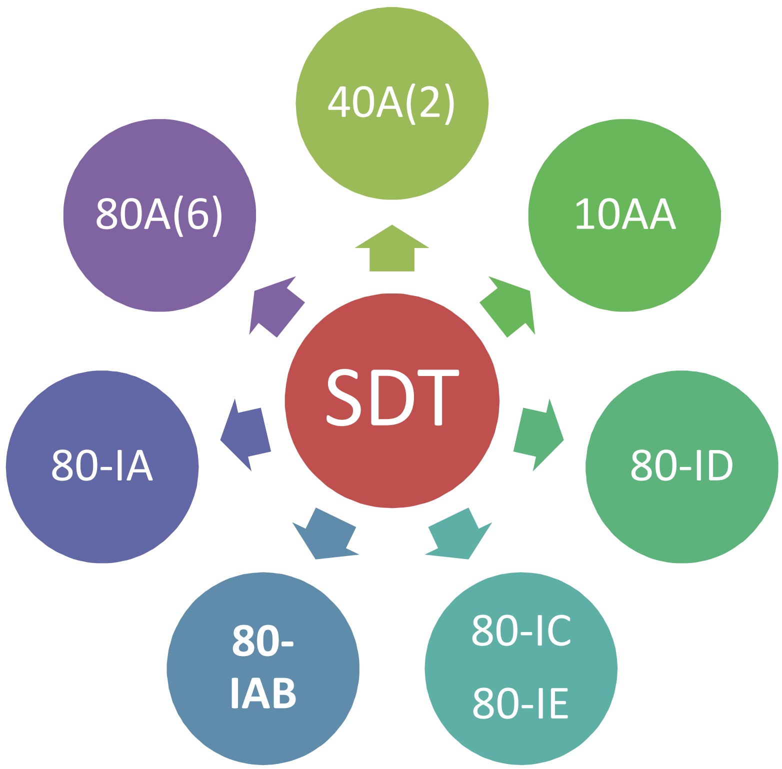
Difference between 'Price' and 'Transfer Price'

Price --> Transaction between two unrelated parties

Transfer Pricing-------------------------------------> Pricing of Domestic Transaction between two related parties

Due to special relationship between related parties, transfer Price may be different than the price that would have been agreed between related parties. A Price between two unrelated parties is known as "Arms Length Price (ALP)"

Section 92BA "Specified Domestic Transaction "is applicable to following (to whom???)



- Any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of Sec. 40A(2),
    - In the case of a corporate taxpayer, (say Company B), payments to the following persons are covered:

Type of Person	When Covered??
Investor Company	Any company (say Company A) which has substantial interest (20% or more holding) in Company B
Sister Company	Any company in which Company A has substantial interest (i.e. Company C)
Investee company	Any company in which Company B has substantial interest (i.e. Company D)
Group company	->Any company of which a director has substantial interest in Company B. ->Any company in which a director of Company B has substantial interest. ->Any relative of such directors.

Certain individuals	->Any director of Company B ->Any director of Company A ->Any individual who has substantial interest in Company B ->Any relative of the above individuals

Parties Covered	Yes/ No
A & B	Yes
A & C	Yes
B & C	Yes
A & D	No
A & E	No
D & E	No

- Any transaction referred to in Sec.80A, This section cover the enterprise claiming deductions from total income under Chapter VI-A,
- Any transfer of goods or services referred to in Sub-Sec.(8) of Sec.80-IA, This section covers the enterprises with an eligible enterprise close connections with any other person. E.g. Infrastructure Developers, Telecommunication Service Providers, Developers of Industrial Parks, Producers or Distributors of powers etc.
- Any business transacted between the assessee and other person as referred to in sub-section (10) of Sec.80-IA, This section includes Developers of SEZ, SSI engaged in cold storage plant, Industrial undertakings in industrially backward state as mentioned in VII Schedule,
- 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, Any other transaction as may be prescribed, 80IA includes person having from the SEZ units.

Conditions for the SDT (When???)

- As per Domestic TP provisions, the transaction between two related parties shall be at "Arm Length Price" The fair market price can be established using market evidence.
- Arm length price can be determined by use of methods prescribed under international transfer pricing.
- Transaction with all the related parties during the year exceeds Rs. 5 Crores then DTP is applicable.

Which types of the payments are included?

1. **Payment of Expenditures**

DTP provisions covered the payment of expenditures. Expenditure means capital and revenue expenditure. In the case of **CIT v. Plasmac Machine Mfg. Co. Ltd. [1993] 201 ITR 650 (Bombay HC)** it was held that capital expenditure payments eligible for depreciation are not covered under section 40A(2) of the Act. Further, depreciation is not a deduction but an allowance. Relying on the intent to apply DTP provisions to expenditure covered under section 40A(2), capital expenditures eligible for depreciation may be excluded by taxpayers.

Such payments of expenditures in excess of the reasonable amount may be disallowed as per the rule of SDT. Such expenditures should be at the arms length amount.

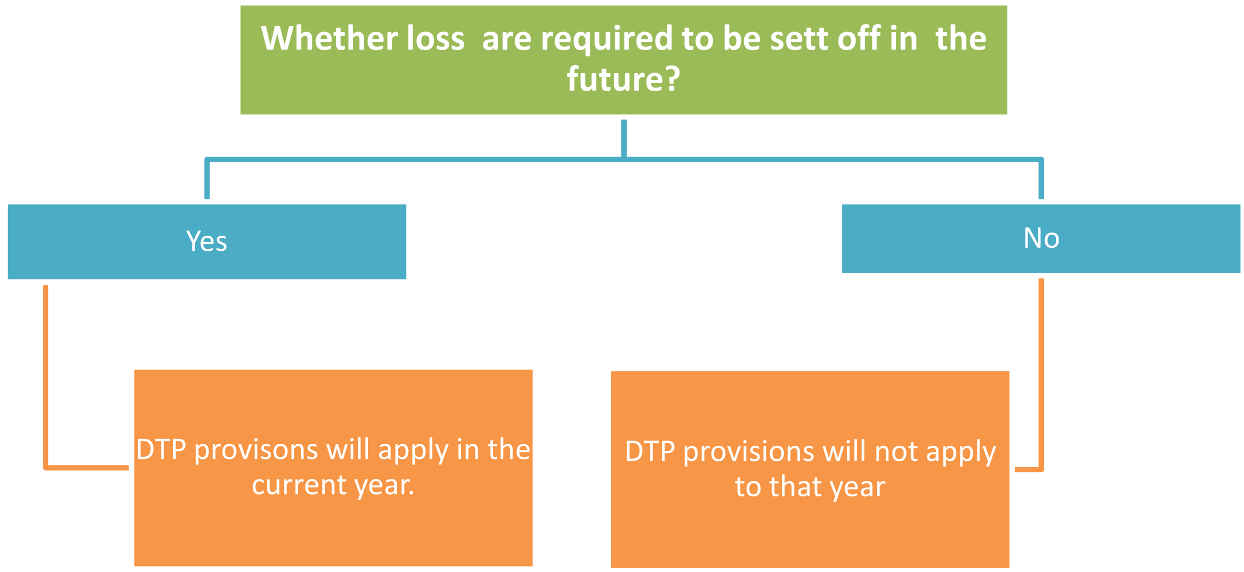
2. **Payments to Directors**

Payments to directors include the director's remuneration, Commission, Sitting Fees, Perquisites etc. Here Director includes any director of the company irrespective of nature of Directorship

The Quantum of the Directors remuneration depends upon the various factors same was clarified the case of **CIT Vs. India Thermit Corporation (Delhi),** where the quantum was decided based on the Compliance of The Companies Act, 1956, General Remuneration policy of the company, Cost of other person involved in the recruitment of another personnel with same qualification, experience, Skill Levels etc. So based on this factors it can be decided whether there is any excess payments or not.

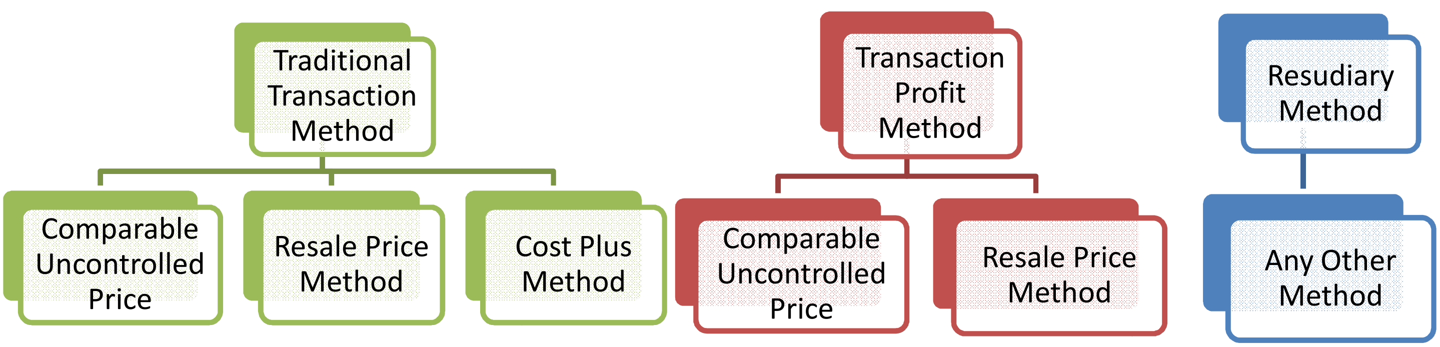
3. **Transactions with Tax Holiday undertakings**

The transactions with tax holiday undertakings prescribed above are included i.e undertakings claiming industry based tax holiday, industries in backward areas, etc. Transfer of Goods and Services with undertakings should be at arm's length price computed in accordance with specified Methods. If the transaction are with the loss making undertakings covered under section 80-IA(8) or 80-IA(10) then applicability of the DTP will depend upon whether loss is required to set off in future or not.



Methods for determining Arm's Length Price (How???)

The Arm's Length Price has to be determined applying any of the prescribed methods



Ordinary Profit & Arms Length Profit

Under section 80-IA(10), ordinary profits for tax holiday undertakings will need to be determined by using prescribed transfer pricing methods. The challenges likely to be faced by taxpayers in this regard have been illustrated below:

Particulars	Profit Calculation
Total Income	120
Cost (Operating Cost)	20
Profit (Operating Profit)	100
OP/TC	**20%**

Companies	OP/TC
Company P	10%
Company Q	20%
Company R	30%
Company S	10%
Company T	-10%
Average OP/TC	**12%**

As per TNMM Method profits in excess of ALP are not ordinary profit and deny tax holiday on such excessive profits shown by the company i.e 20%-12% = 8%

If any other cost based method is selected then profit derived from that method should be selected as "Ordinary Profit". In the case of **M/s Visual Graphics Computing Services (India) Pvt. Limited V/s ACIT** it was held that onus is on the AO to prove that excess profit the that holiday undertaking is not 'ordinary'. Here it is to be noted that ±3% Tolerance level is allowed to get complied with ALP compliance.

Assessment/Audit

A separate cell consisting of transfer pricing officers will now perform the assessment of Specified Domestic Transactions instead of assessing officers. Taxpayer need to prepare and maintain specified books, registers, reports in accordance with the method used to determine ALP. Such record includes agreement, invoices, transaction terms, Economic analysis etc.

Moreover Taxpayer need to obtain Chartered Accountants certificate in Form No 3CEB providing detils like List of related Parties, Nature and value of SDT, Method used to determine ALP etc.

It is also mandatory to e-file form No 3CEB before due date of filing of return.

Due Dates for Compliance

Activity	Due Date
Maintenance of detailed transfer pricing documentation	Maintain by 30th November of respective AY and submit during assessment proceedings.
Form 3CEB	30th November of respective AY.

Statute of limitation for completion of assessment

The time limit for completion of audit is at present will be 48 months from the end of the relevant tax year. If 3CEB filed on 30th Nov- 2014 then assessment should be completed within 4 years i.e up to 30th Nov- 2014

DTP and Companies Act, 2013

The amended provisions of the Companies Bill, 2012 (Clause 188) prescribe that a consent of the board is required to be given at the meeting of the board for entering into prescribed transactions with the related parties. If the paid-up capital of the company exceeds the prescribed limits, prior approval of the shareholders is also required by a special resolution. Every related party transaction which is not at arm's length is required to be reported in the board's report to the shareholders, along with a justification for entering into such a transaction. In the event of a non-compliance of the aforementioned requirements, the following consequences shall follow:

1. The Contract or arrangement can be redered void by the board of directors or shareholder of the company.
2. Wheretransaction is with the director's related party or authorised by the director, then the director shall indemnifythe company against any loss.
3. The company can recover its loss from the director or employee involved in the transaction.
4. Any director or employee involved can be imprisoned (in the case of a listed company) or fined (in the case of a listed as well as unlistedcompany).

So as per the Companies Act, 2013 Directors and Board need to more vigilant to mitigate the stringent provisions of the DTP. They should undertake ALP valuation for every transaction with related parties.

Penal Consequences (if not then what??)

A stringent penalty regime has been prescribed:

- Failure to maintain documents - 2% of the value of the transaction
- Failure to furnish documents – 2% of the value of the transaction
- Failure to report a transaction in Accountant's report – Rs. 1,00,000 /-

•Maintaining or furnishing incorrect information or documents – 2% of the value of the transaction

•Adjustment for incorrect pricing – 100% to 300% of the additional tax payable

Final verdict

DTP provision has created so many problems for the entities. Threshold limit of Rs. 5 Crore is also very less. There are point of Double Taxation also like if the Profit of the Tax Holiday undertaking is not ordinary then it is disallowed by the TPO but at the same time there is no provision for reduction of income of the other entity. There is no provision for entity who is receiving the income. So, to that extent there cascading effect which requires amendment. On the other hand there are lots of challenges for the entities which are involved in such type of transaction. Compliance of these provisions may not be feasible for all organization.

Thanks & Regards

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Reference:-

- **Various articles on DTP**
- **Income Tax Provisions**
- **Article on DTP by WIRC of ICAI, PWC, KPMG.**
- **Business- Standard**
- **Article FICCI on transfer Pricing Provision**
- **Reference of www.icaiahmedabad.com**
- **Reference of www.Moneycontrol.com**
- **My own Knowledge…**