

Transfer Pricing and Other Provisions to Check Avoidance of Tax

Some Key Points : Recent Amendments

- (a) Transfer Pricing Officer empowered to examine any international transaction not reported by the assessee [Sections 92CA(2B) & 92CA(2C)]
- (b) Penalty provisions made more stringent in cases where the assessee fails to keep and maintain information and document, etc in respect of an international transaction [Section 271AA]
- (c) Transfer Pricing Regulations to apply to specified domestic transactions [Section 92 & 92BA]

Section 92BA provides the meaning of “specified domestic transaction”. As per section 92BA, for the purpose of sections 92, 92C (Computation of arm's length price), 92D (Maintenance and keeping of information and documents) and 92E (Furnishing of report from an accountant), in case of an assessee the specified domestic transaction shall mean any of the following transactions, not being an international transaction, namely,-

- (1) any expenditure in respect of which payment has been made or is to be made to a related person referred to in section 40A(2)(b);
- (2) any transaction referred to in section 80A i.e., inter-unit transfer of goods and services by an undertaking or unit or enterprise or eligible business to other business carried on by the assessee or vice versa, for consideration not corresponding to the market value on the date of transfer;
- (3) any transfer of goods or services referred to in section 80-IA(8) i.e., inter-unit transfer of goods or services between eligible business and other business, where the consideration for transfer does not correspond with the market value of goods and services;
- (4) any business transacted between the assessee carrying on eligible business and other person as referred to section 80-IA(10);
- (5) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of section 80-IA(8) or section 80-IA(10) are applicable; or
- (6) any other transaction as may be prescribed,

(d) Meaning of International transaction amplified [Section 92B]

Explanation to section 92B amplifies the scope of the terms “international transaction” and “intangible property”.

(e) Permissible variation between ALP and Transfer Price to be notified by the Central Government not to exceed 3% [Section 92C]**(f) Introduction of Advance Pricing Agreement**, being an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time in future [Sections 92CC & 92CD]. The CBDT has prescribed rules specifying the Advance Pricing Scheme.**(g) Safe Harbour Rules** – Section 92CB provides that the determination of Arm’s length price under section 92C or section 92CA shall be subject to safe harbour rules. As per the *Explanation* to section 92CB, the term “safe harbour” means circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee. In exercise of the powers conferred by section 92CB, the CBDT has notified the safe harbour rules.**Question 1**

RV Ltd., an Indian company, exports grapes to DK Inc for an amount of ₹ 30 Lacs. DK Inc. is located in a Notified Jurisdictional Area (NJA).

RV Ltd. charges ₹ 38 lacs and ₹ 40 lacs for sale of similar goods to CC Inc and MM Inc, respectively, which are not located in NJA and both of them are not associated enterprises of RV Ltd.

Assuming that permissible variation notified by Central Government for such class of international transactions is 3% of the transaction price, state the tax implications under section 94A in respect of the above transaction by RV Ltd. to DK Inc.

Answer

As per section 94A, in case an assessee enters into any transaction where one of the parties thereto is located in the Notified Jurisdictional Area (NJA) then the parties to the transaction shall be treated as associated enterprises and the transaction shall be deemed to be an international transaction. The transfer pricing provisions would, therefore, be attracted in such a case. However, the benefit of permissible variation between the transfer price and the arm’s length price, as notified by the Central Government, shall not be available in such a case.

Since DK Inc. is located in a NJA, the transaction of export of grapes by the Indian company, RV Ltd., would be deemed to be an international transaction and DK Inc. and RV Ltd. would be deemed to be associated enterprises. Therefore, the provisions of transfer pricing would be attracted in this case.

The prices of ₹ 38 lakhs and ₹ 40 lakhs charged for sale of similar goods to CC Inc. and MM Inc., respectively, being independent entities located in a non-NJA country, can be taken into

consideration for determining the arm's length price (ALP) under Comparable Uncontrolled Price (CUP) Method.

Since more than one price is determined by the CUP Method, the ALP would be the arithmetical mean of such prices.

Therefore, ALP = ₹ 39,00,000 i.e., $[(₹ 38,00,000 + ₹ 40,00,000)/2]$

Transfer Price = ₹ 30,00,000

Since the ALP is more than the transfer price, the ALP of ₹ 39 lakhs would be considered for computing the income from the international transaction between RV Ltd. and DK Inc.

Question 2

State the consequences that would follow if the Assessing Officer makes adjustment to arm's length price in international transactions of the assessee resulting in increase in taxable income. What are the remedies available to the assessee to dispute such adjustment?

Answer

In case the Assessing Officer makes adjustment to arm's length price in an international transaction which results in increase in taxable income of the assessee, the following consequences shall follow:-

- (1) No deduction under section 10AA or Chapter VI-A shall be allowed from the income so increased.
- (2) No corresponding adjustment would be made to the total income of the other associated enterprise (in respect of payment made by the assessee from which tax has been deducted or is deductible at source) on account of increase in the total income of the assessee on the basis of the arm's length price so recomputed.

The remedies available to the assessee to dispute such an adjustment are:-

- (1) In case the assessee is an eligible assessee under section 144C, he can file his objections to the variation made in the income within 30 days [of the receipt of draft order by him] to the Dispute Resolution Panel and Assessing Officer. Appeal against the order of the Dispute Resolution Panel can be made to the Income-tax Appellate Tribunal.
- (2) In any other case, he can file an appeal under section 246A to the Commissioner (Appeals) against the order of the Assessing Officer within 30 days of the date of service of notice of demand.
- (3) The assessee can opt to file an application for revision of order of the Assessing Officer under section 264 within one year from the date on which the order sought to be revised is communicated, provided the time limit for appeal to the Commissioner (Appeals) or the Income-tax Appellate Tribunal has expired or the assessee has waived the right of such an appeal. The eligibility conditions stipulated in section 264 should be fulfilled.

Question 3

Can the Transfer Pricing Officer accept use of multiple-year data for determination of Arm's Length Price in an international transaction?

Answer

Rule 10B of the Income-tax Rules, 1962, has prescribed the methods of determining Arm's Length Price under section 92C.

As per Rule 10B(4), the data to be used in analyzing the comparability of an uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into. However, data relating to a period of maximum 2 years prior to such financial year may also be considered if such data reveals the facts which could have an influence on the determination of transfer prices in relation to the transactions being compared.

In effect, the transfer pricing officer can use the data of maximum 2 years prior to the relevant financial year for determination of arm's length price in an international transaction provided the same influence the determination of transfer price in the relevant financial year.

Question 4

Discuss whether adjustment is required in the context of transfer pricing provisions where the transfer price adopted for an international transaction of sale of goods by an Indian company during the financial year 2013-14, is ₹50 lacs whilst the Arm's Length Price determined using the most appropriate method are ₹48 lacs and ₹56 lacs. Assume that the rate of permissible variation prescribed by the Central Government is 2% of the transfer price for this class of international transaction.

Answer

The proviso to section 92C(2) provides that where more than one price is determined by the most appropriate method, the arm's length price (ALP) shall be taken to be the arithmetical mean of such prices.

However, if the arithmetical mean, so determined, is within such percentage of the transfer price notified by the Central Government, then, the transfer price shall be deemed to be the arm's length price and no adjustment is required to be made.

The arithmetical mean of the prices = $(₹ 48 + ₹ 56) / 2 = ₹ 52$ lacs.

The rate of permissible variation prescribed by the Central Government is 2% i.e. ₹ 1 lacs (₹ 50 lacs x 2%).

Since the variation between the arm's length price of ₹ 52 lacs and the transfer price of ₹ 50 lacs is not within the limit of 2% of TP (i.e., ₹ 1 lacs), the arm's length price shall be ₹ 52 lacs.

The Assessing Officer may compute the total income of the Indian company having regard to the arm's length price of ₹ 52 lacs so determined. No deduction shall be allowed under Chapter VI-A or section 10AA in respect of ₹ 2 lacs, being the amount of income by which the total income of the Indian company is enhanced after application of the arm's length price of ₹ 52 lacs.

Note: It is assumed that the assessee has not entered into an Advance Pricing Agreement and has also not opted to be subject to Safe Harbour Rules.

Question 5

I. Limited, an Indian Company supplied billets to its holding company, U. Limited, UK during the previous year 2013-14. I. Limited also supplied the same product to another UK based company, V. Limited, an unrelated entity. The transactions with U. Limited are priced at Euro 500 per MT (FOB), whereas the transactions with V. Limited are priced at Euro 700 per MT (CIF). Insurance and Freight amounts to Euro 200 per MT. Compute the arm's length price for the transaction with U. Limited.

Answer

In this case, I. Limited, the Indian company, supplied billets to its foreign holding company, U. Limited. Since the foreign company, U. Limited, holds more than 26% shares in I. Limited, I. Limited and U. Limited shall be deemed to be associated enterprises within the meaning of section 92A.

As I. Limited supplies similar product to an unrelated entity, V. Limited, UK, the transactions between I. Limited and V. Limited can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between I. Limited and U. Limited Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

Transactions with U. Limited are on FOB basis, whereas transactions with V. Limited are on CIF basis. This difference has to be adjusted before comparing the prices.

	Amount (in Euro)
Price per MT of billets to V. Limited	700
Less: Cost of insurance and freight per M.T.	<u>200</u>
Adjusted Price per M.T.	<u>500</u>

Since the adjusted price for V. Limited, UK and the price fixed for U. Limited are the same, the arm's length price is Euro 500 per MT. Since the sale price to related party (i.e., U. Limited) and unrelated party (i.e., V. Limited) is the same, the transaction with related party U. Limited has also been carried out at arm's length price.

Question 6

X Ltd., operating in India, is the dealer for the goods manufactured by Yen Ltd. of Japan. Yen Ltd. owns 55% shares of X Ltd. and out of 7 directors of the company, 4 were appointed by

them. The Assessing Officer, after verification of transactions of ₹ 300 lacs of X Ltd. for the relevant year and by noticing that the company had failed to maintain the requisite records and had also not obtained the accountants report, adjusted its income by making an addition of ₹ 30,00,000 to the declared income and also issued a show cause notice to levy various penalties. X Ltd seeks your expert opinion.

Answer

The facts of the case indicate that X Ltd. and Yen Ltd. of Japan are associated enterprises since Yen Ltd. holds shares carrying more than 26% of the voting power in X Ltd. and has appointed more than half of the board of directors of X Ltd. Since Yen Ltd. is a non-resident, any transaction between X Ltd. and Yen Ltd. would fall within the meaning of “international transaction” under section 92B. Therefore, the income arising from such transactions have to be computed having regard to the arm's length price.

The action of the Assessing Officer in making addition to the declared income and issuing show cause notice for levy of various penalties is correct since X Ltd. had committed defaults, as listed hereunder, in respect of which penalty, as briefed hereunder, is imposable -

- (i) Since X Ltd. has entered into an international transaction as defined in section 92B, any amount added or disallowed in computing the total income under section 92C(4), shall be deemed to represent income in respect of which particulars have been concealed or inaccurate particulars have been furnished which makes it liable for penalty under section 271(1)(c) read with Explanation 7. The penalty would be 100% to 300% of the amount of tax sought to be evaded.
- (ii) Failure to maintain the requisite records as required under section 92D in relation to international transaction makes it liable for penalty under section 271AA which will be 2% of the value of each international transaction.
- (iii) Failure to furnish report from an accountant as required under section 92E makes it liable for penalty under section 271BA i.e., a fixed penalty of ₹ 1 Lac.

The Assessing Officer shall give an opportunity of hearing to the assessee with a notice as to why the arm's length price should not be determined on the basis of material or information or document in the possession of the Assessing Officer.

Note: It is assumed that X Ltd. has not entered into an APA and has also not opted to be subject to Safe Harbour Rules.

Question 7

EF Limited, an Indian company, is engaged in manufacturing electronic components. 74% of shares of the company are held by EF Inc., incorporated in USA. EF Limited has borrowed funds from EF Inc. at LIBOR plus 150 points. The LIBOR prevalent at the time of borrowing is 4% for US \$. The borrowings allowed under the External Commercial Borrowings guidelines issued under Foreign Exchange Management Act are LIBOR plus 200 basis points. Discuss

whether the borrowing made by EF Limited is at arm's length ('LIBOR' means London Inter-Bank Offer Rate).

Answer

One of the methods for determination of arm's length price in an international transaction is Comparable Uncontrolled Price method (CUP). Under the CUP method, the price charged or paid for property transferred or services rendered in a comparable uncontrolled transaction, or a number of such transactions, is identified. Such price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions, which could materially affect the price in the open market. The adjusted price so arrived at is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction.

EF Inc., USA and EF Limited, the Indian company shall be deemed to be associated enterprises since the former holds more than 26% voting power in the latter.

The arm's length rate of interest can be determined by using CUP method having regard to the rate of interest on external commercial borrowing permissible as per guidelines issued under Foreign Exchange Management Act. The interest rate permissible is LIBOR plus 200 basis points i.e., $4\% + 2\% = 6\%$, which can be taken as the arm's length rate. The interest rate applicable on the borrowing by EF Limited, India from EF Inc., USA, is LIBOR plus 150 basis points i.e., $4\% + 1.5\% = 5.5\%$. Since the rate of interest, i.e. 5.5% is less than the arm's length rate of 6%, the borrowing made by the EF Ltd. is not at arm's length. However, in this case, the taxable income of EF Ltd., India, would be lower if the arm's length rate is applied. Hence, no adjustment is required since the law of transfer pricing will not apply if there is a negative impact on the existing profits.

Question 8

In the context of transfer pricing provisions in relation to international transactions, what are the factors to be considered while selecting the most appropriate method?

Answer

Rule 10C deals with the determination of the most appropriate method. Under this Rule, the method which is best suited to the facts and circumstances of each particular international transaction, and which provides the most reliable measure of an arm's length price in relation to the international transaction will be considered as the most appropriate method.

For the purpose of selecting the most appropriate method, the following factors should be taken into account -

- (i) the nature and class of the international transaction;
- (ii) the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;

- (iii) the availability, coverage and reliability of data necessary for application of the method;
- (iv) the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;
- (v) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;
- (vi) the nature, extent and reliability of assumptions required to be made in application of a method.

Question 9

Anush Motors Ltd., an Indian company declared income of ₹ 300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2014:

- (i) *10,000 cars sold to Rida Ltd. which holds 30% shares in Anush Motors Ltd. at a price which is less by \$ 200 each car than the price charged from Shingto Ltd.*
- (ii) *Royalty of \$ 1,20,00,000 was paid to Kyoto Ltd. for use of technical know-how in the manufacturing of car. However, Kyoto Ltd. had provided the same know-how to another Indian company for \$ 90,00,000.*
- (iii) *Loan of Euro 1000 crores carrying interest @ 10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31.3.2014. The total book value of assets of Anush Motors Ltd. on the date was ₹ 90,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was EURO 100 crores.*

Explain in brief the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for A.Y.2014-15 keeping in mind that the value of 1\$ and of 1 EURO was ₹ 63 and ₹ 84, respectively, throughout the year.

Answer

Any income arising from an international transaction, where two or more “associated enterprises” enter into a mutual agreement or arrangement, shall be computed having regard to arm’s length price as per the provisions of Chapter X of the Act.

Section 92A defines an “associated enterprise” and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts, it is clear that “Anush Motors Ltd.” is associated with :-

- (i) Rida Ltd. as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Anush Motors Ltd.;
- (ii) Kyoto Ltd. as per section 92A(2)(g), since this company is the sole owner of the technology used by Anush Motors Ltd. in its manufacturing process;

- (iii) Dorf Ltd. as per section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of total assets of Anush Motors Ltd.

The transactions entered into by Anush Motors Ltd. with different companies are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2014-15.

	Particulars	₹ (in crores)
	Income of Anush Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter – X	300.00
Add:	Difference on account of adjustment in the value of international transactions:	
(i)	Difference in price of car @ \$ 200 each for 10,000 cars (\$ 200 x 10,000 x 63)	12.60
(ii)	Difference for excess payment of royalty of \$ 30,00,000 (\$ 30,00,000 x 63) [See Note below]	18.90
(iii)	Difference for excess interest paid on loan of EURO 1000 crores (84*1000*1/100)	840.00
	Total Income	<u>1,171.50</u>

The difference for excess payment of royalty has been added back presuming that the manufacture of cars by Anush Motors Ltd is wholly dependent on the use of know-how owned by Kyoto Ltd.

Note: It is presumed that Anush Motors Ltd. has not entered into an Advance Pricing Agreement or opted to be subject to Safe Harbour Rules.

Question 10

What is the legislative objective of bringing into existence the provisions relating to transfer pricing in relation to international transactions?

Answer

The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions prompted the Government to set up an Expert Group to examine the issues relating to transfer pricing.

There is a possibility that two or more entities belonging to the same multinational group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction which is tax haven or where the tax liability is minimum. This may adversely affect a country's share of due revenue. The increasing participation of multinational groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the

prices charged and paid in such intra-group transactions, which may lead to erosion of tax revenue. Therefore, transfer pricing provisions have been brought in by the Finance Act, 2001 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises.

Question 11

US Ltd., a US company has a subsidiary, IND Ltd. in India. US Ltd. sells computer monitors to IND Ltd. for resale in India. US Ltd. also sells computer monitors to CMI Ltd., another computer reseller. It sells 50,000 computer monitors to IND Ltd. at ₹ 11,000 per unit. The price fixed for CMI Ltd. is ₹ 10,000 per unit. The warranty in case of sale of monitors by IND Ltd. is handled by IND Ltd. However, for sale of monitors by CMI Ltd., US Ltd. is responsible for the warranty for 3 months. Both US Ltd. and IND Ltd. offer extended warranty at a standard rate of ₹ 1,000 per annum. On these facts, how is the assessment of IND Ltd. going to be affected?

Answer

US Ltd., the foreign company and IND Ltd., the Indian company are associated enterprises since US Ltd. holds not less than 26% voting rights in IND Ltd. (being a subsidiary of US Ltd., more than 50% of its voting rights would be held by US Ltd.). US Ltd. sells computer monitors to IND Ltd. for resale in India. US Ltd. also sells identical computer monitors to CMI Ltd., which is not an associated enterprise. The price charged by US Ltd. for a similar product transferred in comparable uncontrolled transaction is, therefore, identifiable. Therefore, Comparable Uncontrolled Price (CUP) method for determining arm's length price can be applied.

While applying CUP method, the price in comparable uncontrolled transaction needs to be adjusted to account for difference, if any, between the international transaction (i.e. transaction between US Ltd. and IND Ltd.) and uncontrolled transaction (i.e. transaction between US Ltd. and CMI Ltd.) and the price so adjusted shall be the arm's length price for the international transaction.

For sale of monitors by CMI Ltd., US Ltd. is responsible for warranty for 3 months. The price charged by US Ltd. to CMI Ltd. includes the charge for warranty for 3 months. Hence arm's length price for computer monitors being sold by US Ltd. to IND Ltd. would be:

Particulars	No.	₹
Sale price charged by US Ltd. to CMI Ltd.	50,000	10,000
Less: Cost of warranty included in the price charged to CMI Ltd. (₹ 1,000 x 3 /12)		250
Arm's length price		9,750
Actual price paid by IND Ltd. to US Ltd.		11,000
Difference per unit		1,250
No. of units supplied by US Ltd. to IND Ltd.	50,000	
Addition required to be made in the computation of total income of IND Ltd. (1,250 × 50,000)		6,25,00,000

No deduction under chapter VI-A would be allowable in respect of the enhanced income of ₹ 6.25 crores.

Note: It is assumed that IND Ltd. has not entered into an advance pricing agreement or opted to be subject to Safe Harbour Rules.

Question 12

Discuss the concept of Arm's length price as envisaged in section 92C of the Income-tax Act, 1961. What are the methods under which the arm's length price, relating to an international transaction, is determined under section 92C?

Answer

"Arm's length price" is defined in section 92F(ii) to mean price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions. Section 92C deals with the method to be adopted for determining the arm's length price and the factors to be considered for applying a particular method.

Section 92C provides that the arm's length price in relation to, *inter alia*, an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of the 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, namely:-

- (a) comparable uncontrolled price method;
- (b) resale price method;
- (c) cost plus method;
- (d) profit split method;
- (e) transactional net margin method;
- (f) such other method as may be prescribed by the Board. Accordingly, the Board vide *Notification No. 18/2012 dated 23.05.2012* has prescribed that the other method for determination of the arms' length price in relation to an international 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.

Out of the above, the most appropriate method shall be selected in the manner as may be prescribed by the Rules. However, if more than one price is determined by the most appropriate method, then the arithmetical mean of such price shall be taken as arm's length price.

If the variation between the arm's length price determined and the price at which the transaction was actually undertaken does not exceed such percentage not exceeding 3% of the latter (i.e. the actual transaction price) as may be notified by the Central Government in

the Official Gazette, then the price at which the international transaction was undertaken shall be deemed to be the arm's length price.

Question 13

- (a) *When shall a transaction be considered as an international transaction?*
- (b) *In what circumstances shall a transaction entered into with a person other than an associated enterprise be deemed as a transaction between two associated enterprises?*

Answer

- (a) As per section 92B, an international transaction is one which satisfies the following criteria -
 - (i) A transaction between two or more associated enterprises, either or both of whom are non-residents;
 - (ii) It is in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, lending/borrowing money or any other transaction having a bearing on the profits, income, losses or assets of such enterprises;
 - (iii) It includes a transaction in the nature of a mutual agreement, or arrangement between two or more associated enterprises for the allocation or apportionment of any contribution, cost or expense incurred (or to be incurred) in connection with a benefit, service or facility provided (or to be provided) to any one or more of such enterprises.
- Note: Please refer to Chapter 16 in Volume-II of the Study Material for understanding the scope of international transaction.*
- (b) As per the provisions of section 92B(2), a transaction entered into by an enterprise with a person other than the associated enterprise, shall for the purposes of sub-section (1), be deemed to be a transaction entered into between two associated enterprises if
 - (i) there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise; or
 - (ii) the terms of the relevant transaction are determined in substance between such other person and the associated enterprise.

Question 14

R, an individual resident in India, bought 1,000 equity shares of ₹ 10 each of A Ltd. at ₹ 50 per share on 30.5.2013. He sold 700 equity shares at ₹ 35 per share on 30.9.2013 and the remaining 300 shares at ₹ 25 per share on 20.12.2013. A Ltd. declared a dividend of 50%, the record date being 10.8.2013. R sold on 1.2.2014, a house from which he derived a long-term capital gain of ₹ 75,000.

Compute the amount of capital gain arising to R for the assessment year 2014-15.

Answer

The amount of capital gains arising to R has to be computed applying the provisions of sub-section (7) of section 94, which provides that "where:

- (a) any person buys or acquires any securities or unit within a period of three months prior to the record date; and
- (b) such person sells or transfers -
 - (i) such securities within a period of three months after such date; or
 - (ii) such unit within a period of nine months after such date; and
- (c) the dividend or income on such securities or unit received or receivable by such person is exempted,

then the loss, if any, arising to him on account of such purchase and sale of securities or unit, to the extent such loss does not exceed the amount of dividend or income received or receivable on such securities or unit, shall be ignored for the purpose of computing his income chargeable to tax".

For this purpose, "record date" means such date as may be fixed by a company for the purpose of entitlement of the holder of the securities to receive dividend and "securities" includes stocks and shares.

Computation of capital gains of Mr. R for the assessment year 2014-15

Particulars	₹	₹
Long-term capital gain on sale of building		75,000
Less: Short-term capital loss on sale of shares		
700 shares	7,000	
300 shares	7,500	14,500
Taxable long-term capital gains		60,500

Computation of capital gain on sale of shares of A Ltd. by Mr.R

Date of purchase of shares		30.5.2013
Record date		10.8.2013
Date of sale of shares	30.9.2013	20.12.2013
Number of shares sold	700	300
Sale price per share	₹ 35	₹ 25

Particulars	₹	₹
Sale consideration	24,500	7,500
Less: Cost of acquisition	35,000	15,000
	10,500	7,500

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Less: Dividend income as per section 94(7) [700×10×50%] [See Note below]	3,500	Not deductible
Short-term capital loss on sale of shares	7,000	7,500

Note:

1. 700 shares are sold within 3 months after the record date, hence related dividend income should be deducted from the loss as per section 94(7).
2. 300 shares having been sold after 3 months of record date, section 94(7) is not applicable. So, the dividend income of ₹ 1,500 should not be deducted. Such dividend is exempt under section 10(34).
3. Short-term capital loss can be set-off against long-term capital gains as per the provisions of section 74(1)(a). Therefore, short-term capital loss on sale of shares can be set-off against long-term capital gains on sale of building.

Question 15

What are the "specified domestic transactions" which are subject to transfer pricing provisions?

Answer

The specified domestic transactions, which are subject to transfer pricing provisions, means any of the following transactions, not being an international transaction, namely-

- (1) Any expenditure in respect of which payment has been made or is to be made to a related person referred to in section 40A(2)(b);
- (2) Any transaction referred to in section 80A i.e., inter-unit transfer of goods and services by an undertaking or unit or enterprise or eligible business to other business carried on by the assessee or *vice versa*, for consideration not corresponding to the market value on the date of transfer;
- (3) Any transfer of goods or services referred to in section 80-IA(8) i.e., inter-unit transfer of goods or services between eligible business and other business, where the consideration for transfer does not correspond with the market value of goods and services;
- (4) Any business transacted between the assessee carrying on eligible business and other person as referred to section 80-IA(10);
- (5) Any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of section 80-IA(8) or section 80-IA(10) are applicable; or
- (6) Any other transaction as may be prescribed.

However, the above mentioned transactions shall not be treated as specified domestic transaction in case the aggregate of such transactions entered into by the assessee in the previous year does not exceed a sum of ₹ 5 crore.

Self-examination Questions

1. Discuss the meaning of the term "Arm's length principle" and its significance.
2. What are the practical difficulties in application of arm's length principle?
3. What are the guidelines to be followed while applying the arm's length principle?
4. Discuss the methods for calculating arm's length price, briefing the advantages and limitations of each method.
5. What are the issues involved in applying arm's length principle to -
 - (a) Intangibles
 - (b) Intra-group services.
6. What is the legislative objective of bringing into existence the provisions relating to transfer pricing in India?
7. Discuss the meaning of the following terms -
 - (a) Associated Enterprise
 - (b) International Transaction
8. What is the procedure for making reference to a Transfer Pricing Officer?
9. What are the information and documents prescribed under Rule 10D to be kept and maintained by the assessee?
10. Write short notes on -
 - (a) Bond washing transactions
 - (b) Dividend stripping.