

Domestic Transfer Pricing – A Bird’s Eye View

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The concept of transfer pricing was introduced in the IT Act through Finance Act 2001 in order to make sure that appropriate amount of income is subject to tax in India and to curb the practice of tax avoidance. The Honourable Finance Minister in his budget speech for the year 2001 has stated as under:

176. The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions has made the issue of transfer pricing a matter of serious concern. I had set up an Expert Group in November 1999 to examine the issues relating to transfer pricing. Their report has been received, proposing a detailed structure for transfer pricing legislation. Necessary legislative changes are being made in the Finance Bill based on these recommendation¹

As mentioned above, a new set of regulations from Section 92 to Section 92F have been introduced in the IT Act with effective from April 01, 2002. Further, transfer pricing regulations have been made effective only with regard to international transactions entered into by the tax payer.

However, the Honourable Supreme Court, while deciding the matter in the case of **CIT v. Glaxo Smith Kline Asia (Private) Limited²**, has recommended the Government to amend certain provisions of the Act viz. Section 40(2), Section 80 -IA (10) etc. to empower the assessing officer to extend transfer pricing regulations to such transactions between related parties in India.

By following the above recommendations, Central Government, through the Finance Act 2012, has amended transfer pricing regulations to bring-in certain transactions between the related parties within India under the purview of transfer pricing regulations. In this regard, Section 92 of IT Act has been suitably amended to provide that allowance for an expenditure, interest or cost or income in relation to specified domestic transactions (for brevity ‘SDT’) shall be computed having regard to arm’s length principle.

For the purpose of transfer pricing regulations, the expression ‘specified domestic transactions’ has been defined under Section 92BA. Presently, after excluding the transactions covered under Section 40A(2) from the ambit of Section 92BA, domestic transfer pricing provisions are made applicable to transactions covered under section 80-IA (8), section 80-IA (10) and any other transaction under chapter -VI-A and section 10AA in respect of which provisions of section 80-IA (8) or section 80-IA (10) are applicable.

Further, Government, in order to promote manufacturing industry in India, vide Taxation Laws (Amendment) Act, 2019, has inserted Section 115BAB into the IT Act. Section 115BAB of the IT Act provides that the income of domestic manufacturing companies which are covered under section 115BAB may be computed at the option of the assessee at the rate of 15%. Further, section 115BAB provides that once the option is validly exercised by the assessee by filing Form 10-ID, same cannot be withdrawn in subsequent assessment years. Section 115BAB also provides similar provisions as stated in Section 80-IA to expand transfer pricing provisions to transactions covered under Section 115BAB.

With this introduction, let us proceed further to understand the applicability of domestic transfer pricing regulations and procedure for compliance thereunder.

¹ Budget Speech for Finance Bill 2001.

² [2010] 195 TAXMAN 35 (SC).

Applicability of Domestic Transfer Pricing:

Section 92 of the IT Act provides that where in a SDT, two or more AEs enter into a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any 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, the cost or expense allocated or apportioned to, or, as the case may be, contributed by, any such enterprise shall be determined having regard to the ALP of such benefit, service or facility, as the case may be.

Section 92 of the IT Act further provides that 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 ALP. However, it is further provided that transfer pricing regulations do not apply in a case where, by applying the transfer pricing regulations, there is a reduction of income or increase in loss to the assessee. Given the above, domestic transfer pricing is broadly applicable to specified domestic transactions in relation to:

- ✚ Allocation of expenditure, which is incurred for services or facility availed, between two/more AEs.
- ✚ Computation of income from such specified domestic transactions.
- ✚ Allowance of any interest or any other expense with regard to such specified domestic transactions.

Having said that the domestic transfer pricing is applicable to specified domestic transactions between AEs, let us proceed to understand the phrases, specified domestic transaction and associated enterprise would mean.

Meaning of Specified Domestic Transaction:

Section 92BA of the Act defines the expression 'specified domestic transaction' to mean following transactions not being an international transaction:

- ✚ any transaction referred to in section 80A
- ✚ any transfer of goods or services referred to in Section 80-IA(8)
- ✚ any business transacted between assessee and other person as referred to in Section 80-IA (10)
- ✚ any transaction, referred to in any other section in Chapter VI-A /Section 10AA, to which provisions 80-IA (8) or (10) are applicable
- ✚ any business transacted between the persons referred to in Section 115BAB(6)
- ✚ 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 twenty crore rupees.

In other words, in order to consider a transaction as specified domestic transaction, such transaction shall not be covered under the definition of 'international transaction' as defined under Section 92B and the aggregate value of transactions as referred above shall exceed INR 20 Crore in the year.

Now, let us proceed to understand each transaction specified above in detail:

i. any transaction referred to in section 80A:

Section 80A of IT Act provides various conditions for claiming deduction under chapter VI-A of IT Act. Section 80A(6), which deals with transfer of goods between in connected persons, provides that in respect of section 10A, section 10AA, section 10B or section 10BA or any other provisions of Chapter VI-A under the heading C i.e., section 80H to 80RRB, where any good or services are held for the purpose of the undertaking or unit or

enterprise or eligible business are transferred to any other business carried out by the assessee or vice-versa, the consideration shall be computed having regard to ALP.

ii. any transfer of goods or services referred to in Section 80-IA(8):

Section 80-IA provides exemption from profits earned from eligible business of the assessee being industrial undertaking. As assessee is claiming deductions from profits, section 80-IA (8) provides that where *goods or services are held for the purpose* of eligible business are transferred to any other business carried on by the assessee or vice-a-versa, the consideration for such goods or services shall be at Fair Market Value (for brevity 'FMV'). FMV under this section to mean price that such goods or services would ordinarily fetch in the open market or ALP where such transaction is considered as SDT.

iii. any business transacted between assessee and other person as referred to in Section 80-IA(10):

Section 80-IA (10) provides that where owing to close connection between the assessee carrying on eligible business and any other person, the course of *business transaction between them* is so arranged which produces more than ordinary profits to such assessee carrying eligible business, the assessing officer can take profits which may be reasonably deemed to have been derived therefrom for the purpose of providing deduction.

iv. any transaction, referred to in any other section under Chapter VI-A/section 10AA, to which provisions of Section 80-IA(8) or (10) are applicable:

In simpler words, it means that any other section under Chapter VI-A or section 10AA which provides similar condition as referred to in section 80-IA (8) or section 80-IA (10), such transaction shall also cover under SDT. Following sections under chapter VI-A, important sections among the others, provides that provisions of section 80-IA(8) and section 80-IA(10) are applicable while computing the deduction allowed under respective sections:

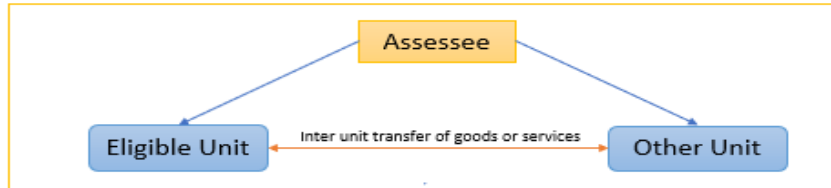
| Section | Nature of business |
|-----------------------|--|
| Section 80-IA | Profits or gain from Industrial undertaking or Infrastructure development. |
| Section 80-IAB | Profits or gains from development of SEZ. |
| Section 80-IAC | Profits or gains of eligible start-up. |
| Section 80-IB | Profits or gains from certain industrial undertaking other than industrial undertakings. |
| Section 80-IBA | Profits or gains from development of certain housing projects. |

v. any business transacted between the persons referred to in Section 115BAB(6):

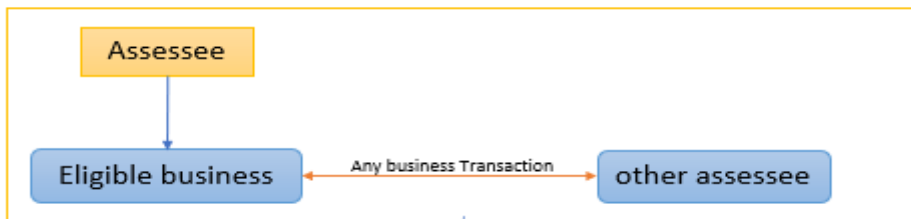
Section 115BAB is inserted with lower tax rate of 15 percent for companies which are engaged in manufacturing of certain goods in India. As the tax rate applicable to manufactured companies covered under section 115BAB is 15%, there is involved a risk of shifting profits from other persons to companies covered under 115BAB and thereby avoidance of tax to the revenue. In order to tackle this issue, section 115BAB read with section 92 and section 92BA provides that such transactions between related parties shall be computed having regard to arm's length principle.

Further, if such transaction is not entered at ALP, such excess income as determined having regard to arm's length principle shall be deemed to be the income in the hands of the assessee covered under section 115BAB and such excess income shall be subject to tax in the hands of such assessee at the rate of 30%. Given the above consequences, it is very much required to comply with transfer pricing regulations by the company covered under section 115BAB in order to avoid any undesirable consequences.

From the above discussion, transactions under domestic transfer pricing can broadly be classified as transactions between



Pic 1: eligible unit and other units of the same assessee



Pic 2: assessee and other enterprise which has close connection

Meaning of Associated Enterprise:

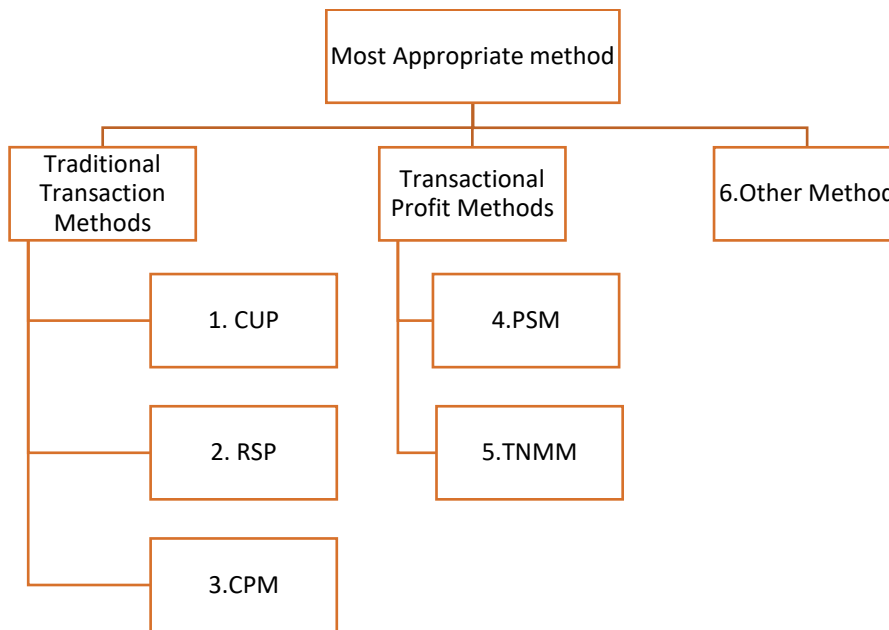
Section 92 states that any specified domestic transaction between AEs shall be computed having regard to the ALP. Hence, it is required to understand the word 'associated enterprise'. Section 92A defines the word 'AE'. However, the definition provided in section 92A is applicable only with respect to 'international transactions' entered into by the assessee. For the purpose of domestic transfer pricing, meaning of AE was provided in Rule 10A which states that in relation to a specified domestic transaction entered into by an assessee, AE means,

- ✚ other units/undertakings/businesses of such assessee in respect of a transaction referred to in section 80A or, as the case may be, section 80-IA(8)
- ✚ any other person referred to in section 80-IA(10) in respect of a transaction referred to therein
- ✚ other units, undertakings, enterprises or business of such assessee, or other person referred to in sub-section (10) of section 80-IA, as the case may be, in respect of a transaction referred to in section 10AA or the transactions referred to in Chapter VI-A to which the provisions of sub-section (8) or, as the case may be, the provisions of sub-section (10) of section 80-IA are applicable.

From the above, it is evident that Rule 10A simply refers to respective specified domestic transactions for the purpose of defining the word 'AE'. Hence, any person having close connection with the assessee is treated as 'AE' for the purpose of domestic transfer pricing. However, the word close connection is not defined under IT Act and any controlling interest with the other entities can be considered as close connection. Which means that having investment to the extent of 20% percent in other enterprises or vice-a – versa, such relation is to be considered as having close connection. Hence, even though a person is not covered under the definition of AE under section 92A, such person may be considered as AE under domestic transfer pricing.

Methods specified for computing the ALP:

Section 92C provides the following methods for computing the ALP which are applicable for both international transactions and SDT.



Maintenance of Documentation:

Section 92D read with Rule 10D states that every person who has entered into specified domestic transactions shall maintain documentation as specified under Rule 10D with respect to specified domestic transaction entered.

Reporting of SDT:

Similar to the international transactions, SDT is also required to be reported Form 3CEB. Part 'C' of Form 3CEB, which covers clause 21 to clause 25, is applicable for domestic transfer pricing.

| Clause | Description of the Clause | Remarks |
|--------|--|---|
| 21 | List of AE with whom the assessee has entered into specified domestic transactions, with the following details: | Provide the details of AE enterprises with whom the assessee entered into SDT. |
| 22 | Particulars in respect of transactions in the nature of transfer or acquisition of any goods or services: Has the eligible unit under section 80-IA (8) or section 10AA has transferred any goods or services to other units of the assessee or vice-a-versa? | Provide the details of transfer of such goods or services viz. i. name and details of the business, ii. description of the goods or services, |

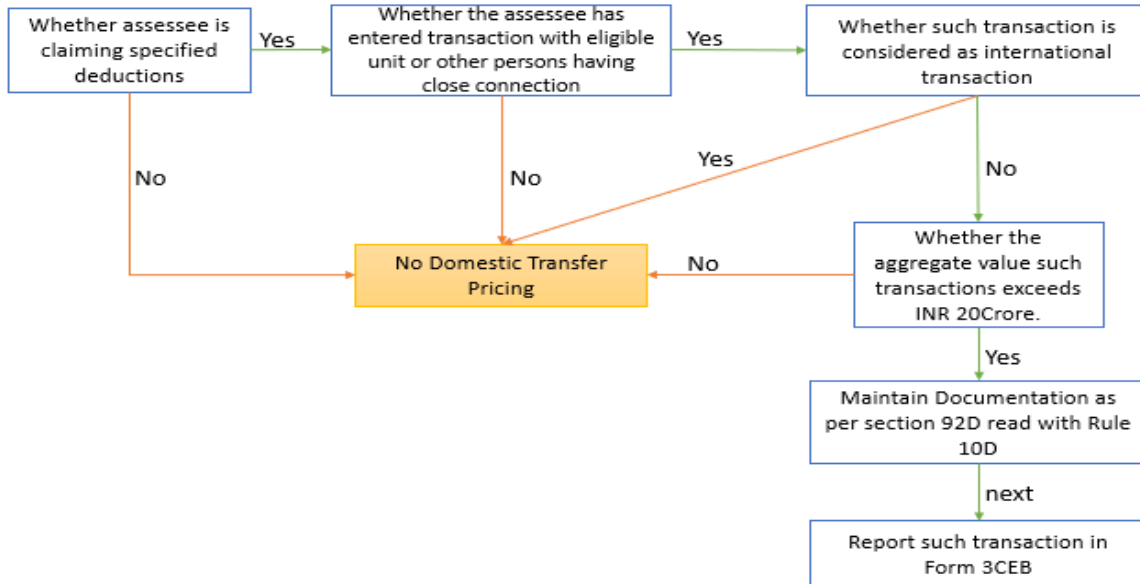
| | | |
|----|---|---|
| | | <p>iii. amount paid or received as per books of account and corresponding ALP, and</p> <p>iv. method used for determining such ALP.</p> |
| 23 | Particulars in respect of specified domestic transaction in the nature of any business transacted: Has the assessee entered into any business transaction with other entities which has resulted in more than ordinary profits to the assessee? | Unlike other clause in Form 3CEB, these clauses pose a question 'whether transaction with the other entities has resulted in more than ordinary profits?' |
| 24 | Particulars in respect of specified domestic transaction in the nature of any business transacted between the persons referred to in sub-section (6) of section 115BAB: Has the assessee entered into any business transaction with other entities which has resulted in more than ordinary profits to the assessee? | <p>If one chooses 'yes' to this question, it may imply that the assessee has earned more than ordinary profits and has to make adjustment.</p> <p>It may be practically viable to select 'No' to these clauses, if assessee has not earned more than ordinary profits.</p> <p>However, owing to stringent and onerous penalties, it is advisable to report such transaction in residuary clause 25.</p> |
| 25 | Particulars in respect of any other transactions: Has the assessee entered into any other specified domestic transaction(s) not specifically referred to above, with an AE? | Provide details of any other SDT which are not specifically referred in above clauses. |

Penalties for non-compliance:

| Section | Nature of Failure | Amount of Penalty |
|---------|---|---|
| 271AA | Failure to report any transaction in report. i.e., in Form 3CEB. | 2 percent of the value of specified domestic transaction. |
| | Failure to maintain documentation as specified under section 92D. | |
| | Furnishes incorrect information or documentation. | |
| 271BA | Failure to furnish report under section 92E. i.e., Form 3CEB | Rs.1,00,000. |
| 271G | Failure to furnish documentation to AO. | 2 percent of the value of specified domestic transaction. |

Note: The above penalties are in addition to penalty leviable under section 270A for under reporting of income.

A flow chart of determining the domestic transfer pricing is provided below for ease of understanding:



In this part, we have dealt with a broad overview on the provisions of domestic transfer pricing. In the next part, we shall be dealing with certain case studies on domestic transfer pricing.

Glossary:

| Term | Description |
|------------|--------------------------------------|
| AE | Associated Enterprise |
| ALP | Arm’s Length Price |
| CPM | Cost Plus Method |
| CUP Method | Comparable Uncontrolled Price Method |
| FMV | Fair Market Value |
| Government | Central Government of India |
| IT Act | Income Tax Act, 1961 |
| PSM | Profit Split Method |
| RPM | Resale Price Method |
| SDT | Specific Domestic Transaction |
| TNMM | Transactional Net Margin Method |