



# Domestic Transfer Pricing

## -Laws and Practices an Intro

This article covers the implications and nuances of domestic transfer pricing provisions and practices followed

### Prelude

Transfer pricing regulations was introduced with regard to International transactions (Cross Border Transactions) with associated enterprises in 2001. The Ministry of Finance honoring the judgment of Apex Court in CIT vs. M/S Glaxo Smithkline Asia (P) Ltd. (Special Leave to Appeal (Civil) No(s).18121/2007) expanded the ambit of Transfer pricing to Specified domestic transactions by Finance Bill 2012.

The Honorable Supreme court held that

“The larger issue is whether Transfer Pricing Regulations should be limited to cross-border transactions or whether the Transfer Pricing Regulations to be extended to domestic transactions. In domestic transactions, ordinarily under-invoicing of sales and over-invoicing of expenses will be revenue neutral in nature; except in two circumstances having tax arbitrage such as where one of the related entities is

- (i) Loss making or
- (ii) Liable to pay tax at a lower rate and the profits are shifted to such entity.

The CBDT should examine whether Transfer Pricing Regulations can be applied to domestic transactions between related parties under section 40A(2) by making amendments to the Act. The Assessing Officer can be empowered to make adjustments to the income declared by the assessee having regard to the fair market value of the transactions between the related parties and can apply any of the generally accepted methods of determination of arm's length price, including the methods provided under Transfer Pricing Regulations.”

Earlier to afore mentioned regulatory norms and requirements, The Income tax Act, 1961 gave wide powers to Assessing officer to circumvent the expenses raising above the fair market value for transactions between the related parties. However, the said system was providing colossal amount of disputes and litigations between the tax payers and revenue as no specific method to determine the fair market value was in existence.

This judgment laid foundation to channelize the method in determination of Arm's length price and led to the introduction of Domestic transfer pricing. The fact is acknowledged in the Memorandum to Finance Bill 2012.

## Meaning of Specified Domestic transactions

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:-

- any expenditure in respect of which payment has been made or is to be made to a person referred to in section 40A(2)(b);
- any transaction referred to in section 80A;
- any transfer of goods or services referred to in sub-section (8) of section 80-IA;
- any business transacted between the assessee and other person as referred to in section 80-IA (10);
- any transaction, referred to in any other section under Chapter VIA or section 10AA, to which provisions of section 80-IA(8) or section 80-IA(10) are applicable; or any other transaction as may be prescribed. (no other transactions are prescribed)

## Determination of Arm’s length Price

In commercial parlance, an arm’s length price is the price at which independent enterprises deal with each other, where the conditions of their commercial and financial relations ordinarily are determined by market forces. Section 92F(ii) of the Act, however, defines the arm’s length price as a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions.

Section 92C(1) stipulates that the arm’s length price is to be determined by adopting any one of the following methods, being the most appropriate method:

- Comparable Uncontrolled Price method (CUP method)
- Resale Price Method (RPM)
- Cost plus Method (CPM)
- Profit Split Method (PSM)
- Transactional Net Margin Method (TNMM)
- Other Method (OM) as prescribed by the Board and provided in Rule 10AB

i.e. 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 facts.

If more than one price is determined by the most appropriate method, the ALP shall be taken to be arithmetical mean of such prices. Further as per notification no 30/2013 dated April 15, 2013, Actual transaction price of Specified Domestic Transaction shall be deemed to be at Arm’s Length, if the variation between the ALP so determined and the actual transaction price does not exceed 3% of the actual transaction price.

## Qualms and Challenges

Although the Domestic transfer pricing is an opt method to deter profit shifting and minimizing the loss to the revenue, there are few reservations that are listed below

- No distinction/exclusions on Revenue neutral transactions between different assessee
- Coverage of payments made towards Revenue and capital expenditure is a subject view on which decisions are expected from apex courts.
- Sharing of common costs such as administration, management, and human resources in computing the arm's length price is widely disputed by the revenue and tax payers.
- Single Sided adjustments - if excessive or unreasonable expenses are disallowed in the hands of tax payer at time of the assessment then corresponding adjustment to the income of the recipient will not be allowed in the hands of recipient of income. Hence, it would lead to double taxation in India.
- Financing, including utilization of cash pools or group borrowings and lending with incurrance of interest expense at lower rates for the interest of subsidiary by the holding would be quizzed.
- Following challenges are bound to occur during the determination of arm's length price
  - (i) **Salary and Bonuses paid to the partners:**  
**Benchmarking** – Comparing two firms even in similar industry for bonus and salary would be irrational. Whether the limit as mentioned in section 40 (b) would be the ALP?
  - (ii) **Directors Remuneration**  
**Benchmarking** - Remuneration paid by one company cannot be compared with other companies. Whether regulatory/ corporate governance approvals can be considered as an evidence of arm's length conditions? Whether the limit as mentioned in Schedule XIII would be the ALP?
  - (iii) **Transfer of Land**  
**Benchmarking** – Whether the guide line value of the lands accepted as ALP or valuation from Officer is accepted as ALP
  - (iv) **Allocation of expenses between the same taxpayer having an eligible unit and non-eligible unit**  
**Benchmarking**- Whether allocation of expenses between a Tax Holiday unit and a nontax holiday unit would be SDT – Sec 80-IA(10)?

## Final Précis

| Before Domestic Transfer Pricing           | Vs | After Domestic Transfer Pricing                         |
|--|----|---|
| No method prescribed for computing FMV     | To | Six methods prescribed for computing ALP                |
| No documentation required to be maintained | To | Contemporaneous documentation required to be maintained |
| Assessment done by the AO                  | To | Assessment done by the TPO                              |
| Reporting under Tax Audit Report           | To | Accountant's Report in Form 3CEB                        |



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