

Finance Bill 2012 - Transfer Pricing Norms Extended to Domestic Transactions

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Pre – Budget 2012 Scenario

Existing Provisions

- Provisions for domestic transfer pricing existed even prior to Budget 2012
- Section 40A(2) – focus on **‘reasonableness’** of expenditure to **‘related party’**
- Tax holiday/ deduction provisions – **ss10A, 10AA, 80I, 80IA** etc enforce concept of **‘fair market value’**/ for transactions involving **‘close connection’**

Short Comings

- Provisions **open-ended** and **ambiguous**
- **No prescribed methods** for determining **‘reasonableness’/‘fair market value’**
- **‘Close connection’** not defined

Supreme Court Decision in GlaxoSmithKline

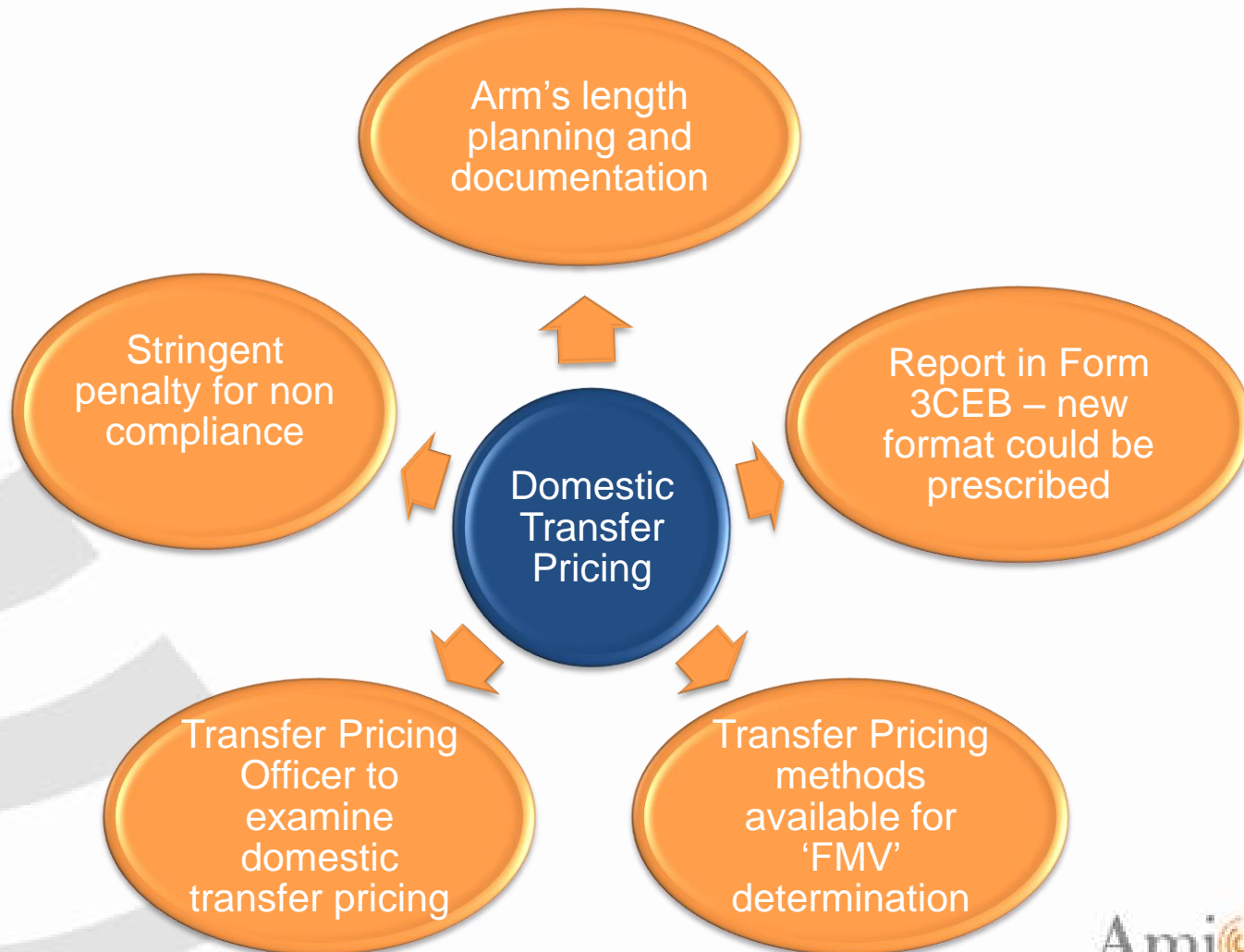
[SLP (Civil) No(s).18121/2007]

- Decision in context of **section 40A(2)** and allocation of cross-charges
- Court decided not to interfere in view of '**revenue-neutrality**' of outcome
- Noted circumstances (where possibility of tax arbitrage exists) in which Transfer Pricing regulations should extend to domestic transactions
 - One unit makes **loss** while other makes **profit**
 - Transactions with **tax holiday** units
- Recommended extension of Transfer Pricing regulations (including documentation requirements) to cover such circumstances

Scope of Specified Domestic Transactions

- Finance Bill 2012 extends Transfer Pricing Regulations to **'specified domestic transactions'** (**'SDT'**)
- Amendment applies **prospectively** from Financial Year ('FY) 2012-13 and onwards
- SDT include transactions covered under:
 - Section 40(A)(2)
 - Section 80A
 - Sub-section (10) of 80IA
 - Chapter VI -A and section 10AA [to the extent sub-sections (8) and (10) of section 80IA apply]
 - Any other transaction as may be prescribed
- Transfer Pricing compliance requirements apply if **cumulative value** of SDT exceeds **INR 5 crores (INR 50 million)**

Compliance and Procedural Requirements



Concept of Related Party under SDT

Section 40A(2)

- Wide Definition
 - Individuals – includes ‘relative’
 - Companies, firms etc – includes directors, partners & members
 - Persons having substantial interest ie beneficial ownership of shares with not less than 20 percent voting power (‘beneficial ownership’ not defined)

Section 80A, Section 80-1A, 80IB, 80IC, 80ID, 80IE, 10A, 10AA, 10B, 10BA

- ‘any other business carried on by assessee’/ ‘close connection’ (‘close connection’ not defined)

Section 35AD – deductions in case of specified businesses (cold storage, warehousing etc)

- Refers to ‘Associated Person’ – includes:
 - Person who participates directly or indirectly in management or control or capital (no clear guidance provided)
 - Hold shares with not less then 26% of voting power
 - Guarantees not less than 10% of total borrowings
 - Appoints more than half of the Board of directors or members of the governing board

Snapshot - International Vs Domestic Transfer Pricing

Issue	International	Domestic
Can taxable income be reduced?	No - arm's length principle applies only to increase taxable income	Same principle applied to domestic transactions
Related party concept	One of Thirteen conditions for association in s92A should apply	Each SDT clause provides its own definition - concept of 'close connection' vague and open ended
Existence of Tax Arbitrage	Normally exists as different countries have different tax rates	May apply regardless [eg section 40A(2)]
Corresponding Adjustment	Available through tax treaties under Article 9(2)	Not available (resulting in economic double taxation)
Availability of APA	Yes (prospectively)	No

Comparative View – Key Jurisdictions

Particulars / Country	 U.S.	 U.K.	 Canada	 Japan
Applicability to Domestic Transactions	Theoretically yes – practically seldom applied	Yes	No	No
Exemptions	No	Yes (for SMEs)	No	No
Availability of corresponding adjustment	Yes	Yes	Not Applicable	Not Applicable
Related party definition	Same as for international transactions	Same as for international transactions	Not Applicable	Not applicable

Policy Issues

- Law makers should enable corresponding adjustments for domestic transactions – thereby avoid economic double taxation
- Transfer Pricing law should cover only situations with tax arbitrage possibility [whereas scope of section s40A(2) is wider]
- Terms such as ‘close connection’, ‘beneficial ownership’ and ‘participation in control and management’ require clarity
- Extension of Advance Pricing Agreements to SDT – currently APA available only for international transactions
- Unduly harsh penalty for non compliance - 2 percent of value of transaction (even for incorrect reporting in Form 3CEB)
- Domestic Transfer Pricing may be another ‘blood bath’ for taxpayers – 8.5 billion dollars of adjustment in last Transfer Pricing audit (international transactions)

Way Forward

Time to put house in order – identify domestic related party transactions

Evaluate ex-ante whether prices are arm's length

Transfer Pricing planning and documentation hygiene

Avoid adjustment true-ups/ embarrassment at year end

How Amicus can help?

- Identify transactions covered by domestic Transfer Pricing
- Benchmarking / planning for provision of goods/ services and financial transactions (including guarantee fee, management fee and intangibles' analysis)
- Review of inter-division / inter-company cost allocation
- Transfer Pricing impact evaluation and risk mitigation for domestic business re-structuring
- Assistance in Transfer Pricing documentation/ Form 3CEB filing

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