

**B S R & Co.**

# **Domestic Transfer Pricing**

**9 October 2012**

**Manoj Pardasani**

**Partner – Transfer**

**PriManoj Pardasani**

**Partner – Transfer Pricing**

***ANY TAX ADVICE IN THIS COMMUNICATION IS NOT INTENDED OR WRITTEN BY B S R & Co. TO BE USED, AND CANNOT BE USED, BY A CLIENT OR ANY OTHER PERSON OR ENTITY FOR THE PURPOSE OF (i) AVOIDING PENALTIES THAT MAY BE IMPOSED ON ANY TAXPAYER OR (ii) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY MATTERS ADDRESSED HEREIN.***

***You (and your employees, representatives, or agents) may disclose to any and all persons, without limitation, the tax treatment or tax structure, or both, of any transaction described in the associated materials we provide to you, including, but not limited to, any tax opinions, memoranda, or other tax analyses contained in those materials.***

# Glaxo Smithkline Asia (P) Ltd. (Supreme Court) [2010]

In the Finance Act 2012, Supreme Court's recommendations in the case of Glaxo Smithkline Asia (P) Ltd. have been taken into consideration and certain 'Specified Domestic Transactions' were brought into the ambit of the Indian Transfer Pricing regulations.

## Facts

- Main issue for determination was whether the taxpayer and its service provider were related companies in terms of Section 40A(2) of the Indian tax laws? If yes, whether the allocation of cross charges by the taxpayer was correct
- The Supreme Court held that a larger issue was whether the Indian Transfer Pricing regulations should be limited to cross-border transactions or extended to domestic transactions

## Supreme Court Suggestions

- Provisions of the Act such as Sections 40A(2) and 80IA(10) need to be amended empowering the AO to make adjustments to income based on the arm's length price available
- Also, it merits consideration whether:
  - the law should be amended to make it compulsory for the taxpayer to maintain books of accounts and other documents as required under the Indian TP laws, **in respect of domestic transactions which are not revenue neutral**; and
  - the taxpayer may be required to obtain an audit report from a Chartered Accountant certifying that transactions between related entities are at arm's length

# Scope of Domestic Transfer Pricing

- any expenditure in respect of which payment has been made or to be made to a specified person [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 taxpayer and other person as referred to in sub-section (10) of section 80-IA;
- 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; or
- any other transaction as may be prescribed

## **Applicability**

- Applicable where aggregate amount of exceeds INR 5 crores (approximately USD 1 million) in a year.
- Applicable from Financial Year (FY) 2012-13 onwards

## **Compliance Requirement**

- Preparation of Transfer Pricing Documentation (TP Report)
- Accountant's Report in Form 3CEB
- Transfer Pricing Assessment

# Specified Persons - Section 40A(2)(b)

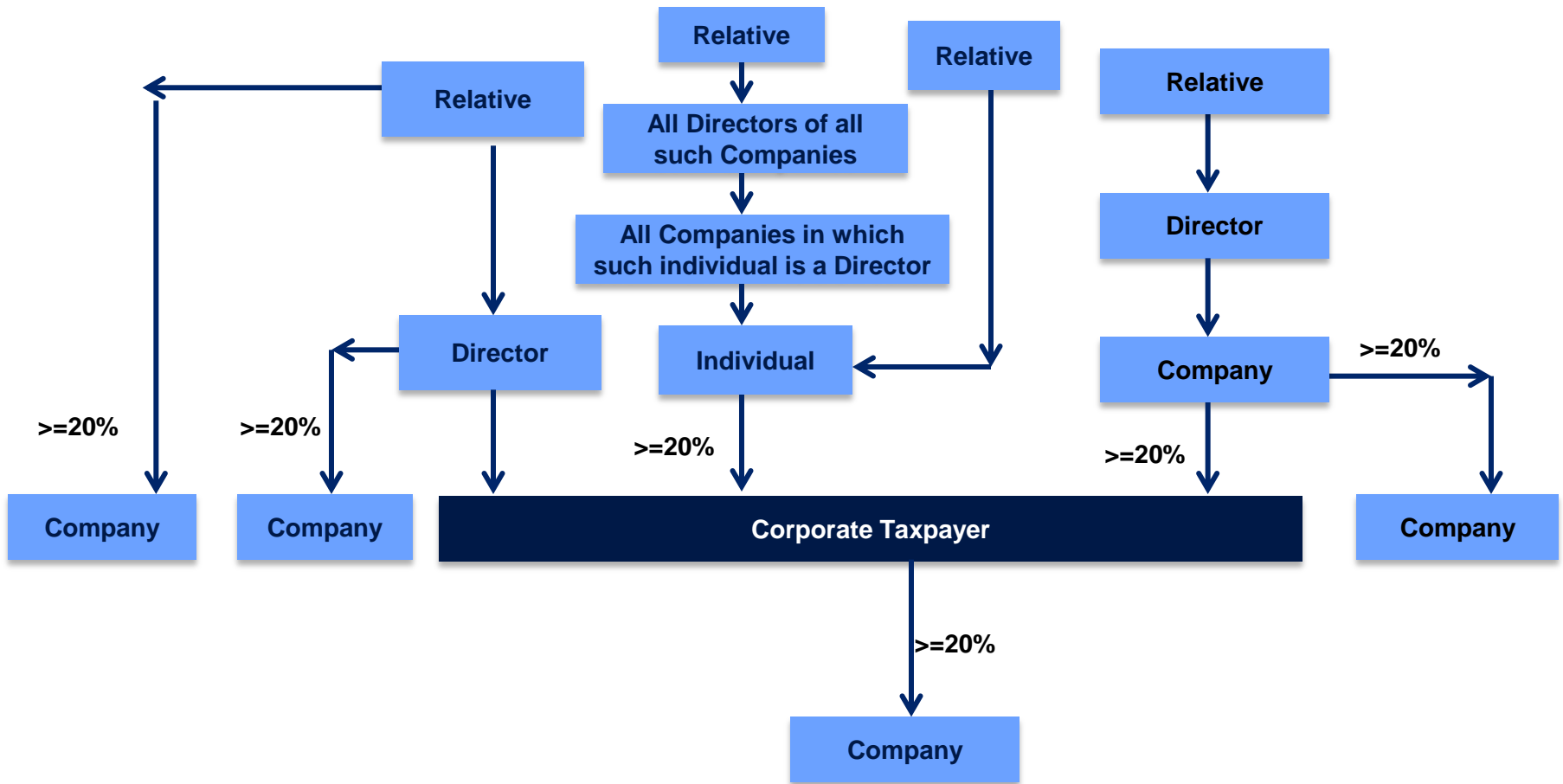
## Section 40A(2)(b) - list of persons/ entities to be treated as related parties/ specified persons

- Specified persons having **substantial interest** ( i.e. more than 20% voting power or share in profits) in taxpayer's business and vice-versa covered
- Scope expanded to include sisters concerns

## Illustrative, list of entities/ persons that may be included for a corporate taxpayer (*not an exhaustive list*):

- a) those holding 20% or more equity in the tax payer;
- b) companies held more than 20% by such a company that holds more than 20% equity in the tax payer;
- c) those companies in which the tax payer holds 20% or more equity;
- d) Directors of tax payer company, and relatives of such Directors;
- e) Directors of companies in category (a) above; and relatives of such Directors;
- f) If an individual holds 20% or more equity in the tax payer, then relatives of such an individual; all other companies where such individual is a Director; all other Directors of such a company, and relatives of all such Directors; etc

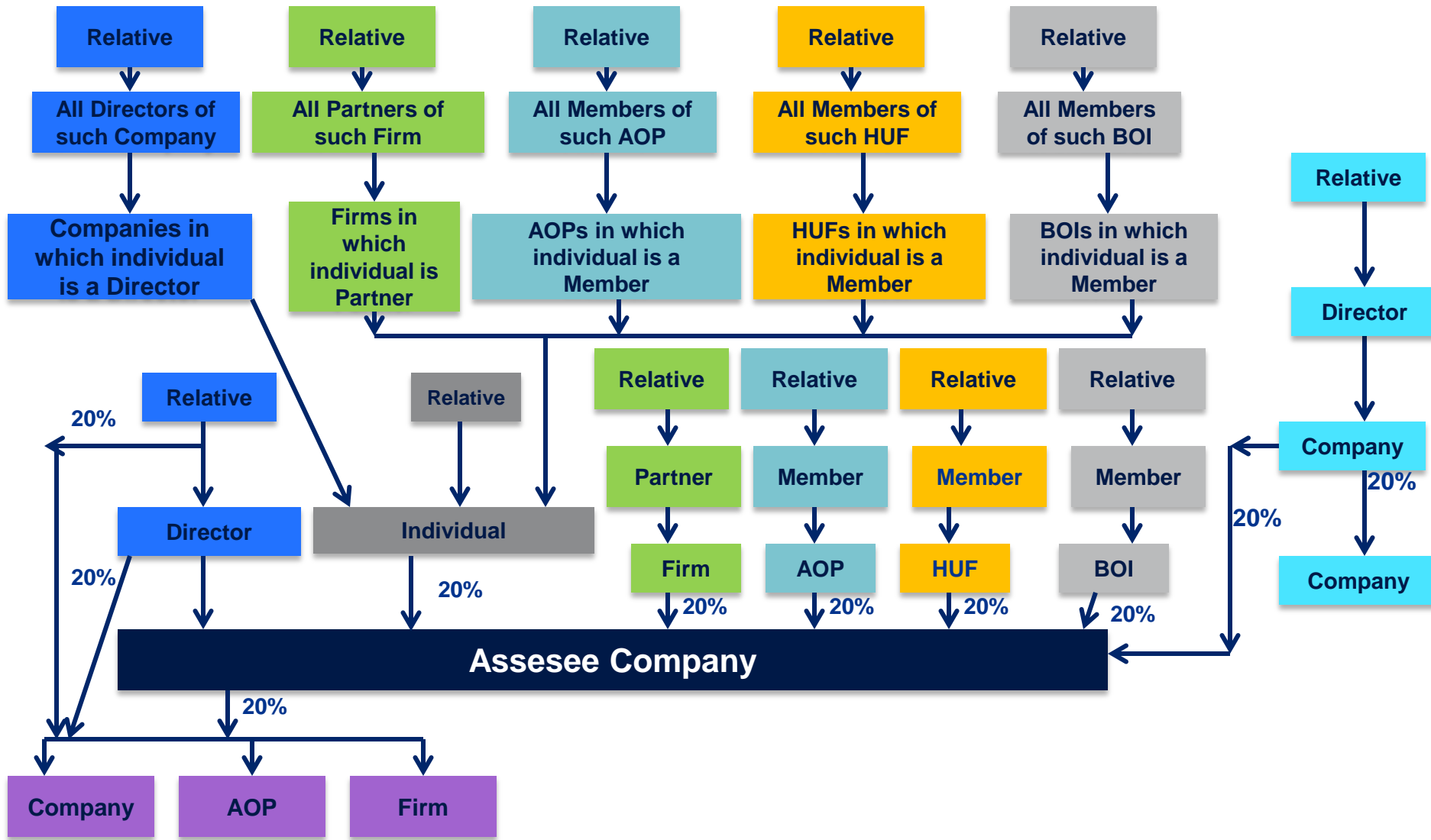
# Section 40A(2)(b) – Illustrative chart



*Circular No. 6-P, dated 6 July 1968 also refers to direct and indirect relationship*

*“Relative” - in relation to an individual, the husband, wife, brother or sister or any lineal ascendant or descendant of that individual*

# Section 40A(2)(b) – Illustrative chart



# Section 40A(2)(b) – Expenditure transactions

- Refers to 'expenditure' incurred in payments made or to be made
- Does not refer to any 'income'
- Expenditure by one group entity is income for another group entity - arms length analysis will consider both transacting parties
- Only the entity incurring the expense will need to complete the prescribed compliances.

## Transactions (illustrative only)

Expenditure on buying goods  
Expenditure on procurement of services  
Expenditure on interest payments  
Expenditure on salary, training services,  
marketing expenses

## Transactions (illustrative only)

Expenditure on purchase of tangible and  
intangible property  
Group charges  
Reimbursements  
Guarantee fees

Capital Expenditure and Transactions without consideration – To discuss



# Tax Holiday Transfer Pricing Test

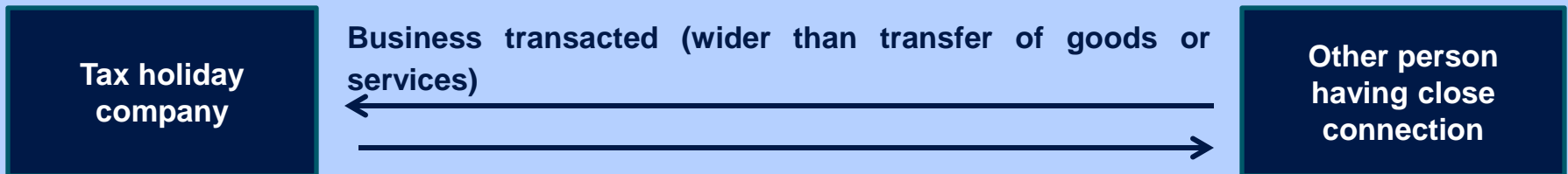
Sub-section (8) of section 80-IA (and similar such provisions in 10AA, 80IA, 80IB, 80IC, 80ID)



**Not corresponding to market value (adherence to ALP proposed)**

**Appropriate allocation keys to be used to allocate costs and overheads for computation of tax holiday  
Revenue will challenge use of ad-hoc allocation keys**

Sub-section (10) of section 80-IA (and similar such provisions in 10AA, 80IA, 80IB, 80IC, 80ID)

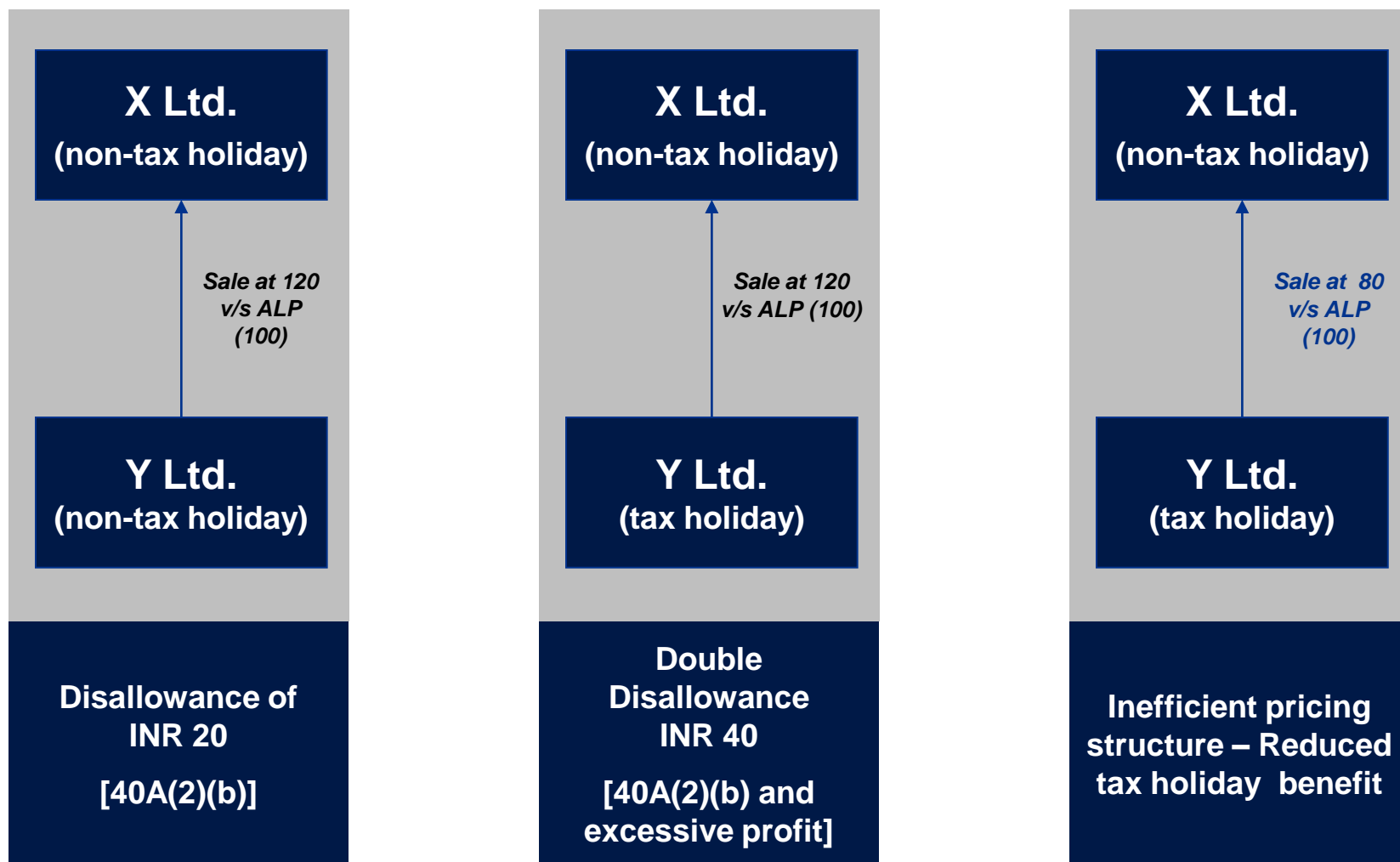


**More than ordinary profits earned by business unit claiming deduction (adherence to ALP proposed)**

**Corresponding provisions to the above would be covered in Chapter VI-A and Section 10AA**

**Transactions to be reported in Accountant's Report and their arms' length nature to be substantiated  
in the TP Documentation**

# Possible Tax Leakages – If ALP Not Followed (Illustrations)



# Penalties

<u>Default</u>	<u>Penalty</u>
In case of a post-inquiry adjustment, there is deemed to be a concealment of income	100-300% of tax on the adjusted amount
Failure to maintain documents	2% of the value of each specified domestic transaction
Failure to furnish documents	2% of the value of each specified domestic transaction
Failure to furnish accountant's report	INR 100,000
Failure to report a transaction in accountant's report	2% of the value of each specified domestic transaction
Maintaining or furnishing incorrect information or documents	2% of the value of each specified domestic transaction

Maintenance of Transfer Pricing documentation is the key to avoid penalties

**Thank You**