Domestic Transactions in TP - What is “Specified”

Intent Of Specified Domestic Transactions Provisions In Indian Transfer Pricing Regulations:

Transactions between related parties have always been suspected as a tool to shift profits and thereby reduce the overall tax liability of a company or a group operating from multiple locations having different tax laws. In order to mitigate tax arbitrages in transactions entered into between domestic companies, the concept of Specified Domestic Transactions was introduced in the Income-tax Act, 1961 by Finance Act, 2012.

Concept Of Tax Arbitrage

Tax arbitrage refers to the practice of profiting because of the difference in ways in which income and expenses are treated for the purpose of calculating taxes. The tax impact changes where one of the parties to such a transaction is either loss-making or is liable to pay taxes at a lower rate. In such cases, profits can be deliberately shifted to such an entity to reduce the overall tax burden of the group or company.

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Definition Of Specified Domestic Transaction:

Following are the specified conditions that are required to classify transactions as a specified domestic transaction under section 92BA of the Income-tax Act, 1962 ('the Act'):

- The transaction should not be an international transaction;
- Any transaction as referred in Sections 80A, 80IA(8), 80IA(10) of the Act;
- Any business transacted between the assessee and other person as referred to in section 80-IA(10) of the Act;
- Any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of section 80-IA(8) and 80IA(10) of the Act are applicable;
- The aggregate of such transactions entered into by the taxpayer should exceed the threshold limit of **INR 20 crores** (from the assessment year 2016-17).

As per the provisions of the Act, once a transaction falls under Specified Domestic Transaction, all the compliance requirements relating to transfer pricing documentation, accountant's report, etc. shall apply to it in the same manner as they apply for international transactions.

Transfer Pricing Scrutiny Assessment of Specified Domestic Transactions:

In the recent past, there has been increased focus of the tax authorities on Specified Domestic Transactions in India. The most common Specified Domestic Transactions challenged by the tax authorities include the following:

- Transfer of goods and services between the tax holiday unit/ company and domestic tariff area unit/company;
- Cost allocation for common human resources between tax holiday unit and domestic tariff area unit;
- Sale or purchase of goods or services from head office to branches.

It is pertinent to note that the power of the AO/ the officer from NeAC to refer the Specified Domestic Transactions to the Transfer Pricing Officer comes into play when the reason to believe that there is a tax arbitrage in case of Assessee only when it is recorded in writing.

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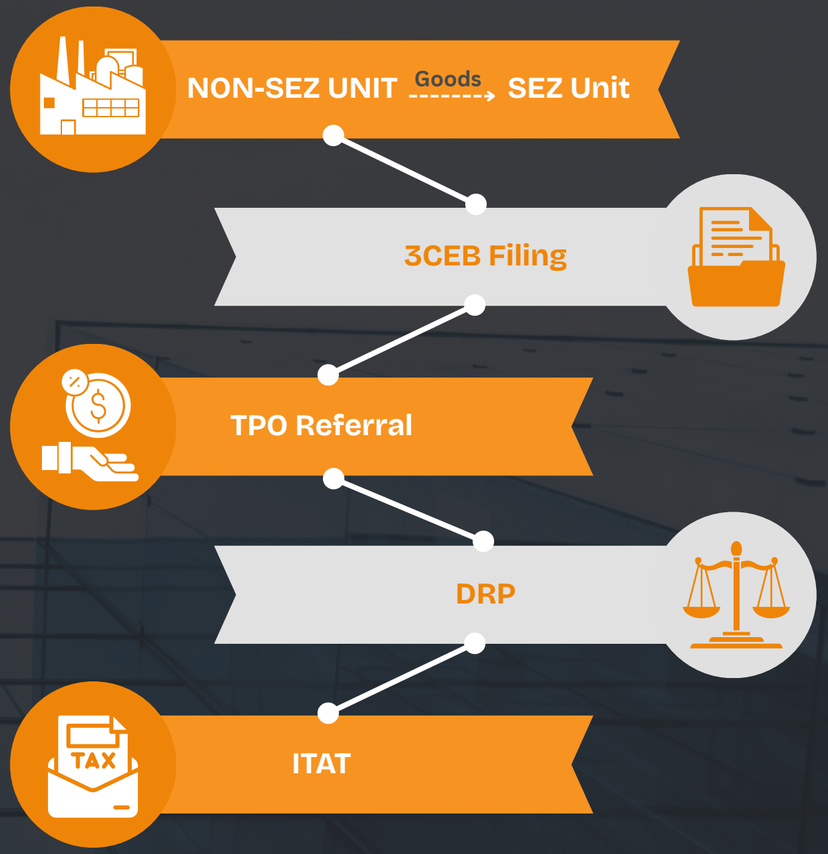
The following recent Ruling in case of KBS Creations Vs Deputy Commissioner of Incometax,Circle-24(1) [ITA No. 6477/MUM/2024 (A.Y-2021-22)] from Mumbai Income Tax Appellate Tribunal clearly brings out the intent of the Specified Domestic Transactions provisions in the context of the jurisdiction of AO/ TPO to conduct the scrutiny assessment:

Background Of The Assessee:

The Assessee [KBS Creations] is a firm, engaged in business of Gems and Jewellery, primarily manufacturing and export of diamond studded Jewellery. The assessee is having one of its units located in Santacruz Electronics Export Processing Zone-Special Economic Zone(SEEPZ - SEZ) Andheri (East), Mumbai. The assessee has another unit located outside of SEZ, which mainly supplied diamonds to manufacturing unit in SEZ. The assessee reported certain Specified Domestic Transaction (SDT) with its related party/associated enterprises in the Form 3CEB and maintained all the required documentation out of abundant caution.

The assessing officer (AO) made reference under section 92CA (1) was made to Transfer Pricing Officer (TPO) for computation of Arm Length Price as the Assessee reported the sale transaction in the 3CEB. TPO made an adjustment of Rs.11.62 crores to sales transaction, thereby reducing profit of undertaking to that extent for the purpose of computation of deduction under section 10AA. Consequently, the AO made addition /adjustment of Rs.11.62 crores in draft assessment order. The Assessee filed its detailed objections before the Dispute Resolution Panel (DRP), and the DRP has rejected most of the objections of the Assessee. Consequently, the Assessee filed its appeal before the ITAT.



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Important Issue Under Consideration:

Amongst other issues, the Assessee mainly contended on the following issues:

1. AO has erred in making reference to TPO by invoking provisions of section 80IA(10) without determining and establishing existence of an arrangement between the concerned parties which results in more than ordinary profit and therefore, whole proceedings initiated under transfer pricing provisions is bad in law.
2. The assessee by refereeing sub-section (10) of section 80IA submitted that such section casts responsibilities upon the AO to demonstrate that business affairs of the assessee with the closely connected entity have been so arranged even raised to more than ordinary profit to the assessee, which is missing in the assessment and TP proceedings, and determine what is normal profit.

Findings of the Income Tax Appellate Tribunal

The ITAT opined that a careful reading of definition of SDT prescribed in section 92BA makes it clear that there must be a transaction, it is not an International Transaction within meaning of 'International Transaction' defined in section 92B, and it should be covered under one of the six transactions mentioned in the subsection and aggregate value of transactions in the previous year exceed a sum Rs. 20 Crore.

The ITAT has opined that the TPO has not considered the above contentions/ submissions of the Assessee from the beginning of the assessment proceedings and proceeded to determine the arm's length nature of the transactions under consideration.

Relying on the Hon'ble Jurisdictional High Court in CIT Vs. Schmetz India Private Limited (2012) 26 taxmann.com 336 (Bom), the ITAT has opined that the existence of arrangement between the deduction seeking unit and other AE is a pre-condition for invoking rigor of section 80IA(10). Higher profit per se cannot lead to the conclusion that there is arrangement between the parties. The concept of PLI cannot per se be applied to hold that assessee has earned higher profit. The TPO has no occasion to make any comparative data analysis unless condition of pre-arrangement is satisfied.

Other Rulings Relied Upon By The Assessee and Discussed By The ITAT:

- Rajasthan High Court PCIT Vs. Vedansh Jewels Private Limited (2018) 97 taxmann.com 521 (Raj).
- Karnataka High Court in CIT Vs. H.P. Global Soft Ltd. 342 ITR 263 (Kar)
- Delhi Tribunal in Mankind Pharma Limited Vs. DCIT in ITA No. 2313/Del/2022
- DCIT Vs. Halliburton Technology Industries Pvt. Ltd. in ITA No. 277/Pun/2021

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About VSTN

VSTN Consultancy Private Ltd is a boutique Transfer pricing firm with extensive expertise in the field of international taxation and transfer pricing. VSTN Consultancy has been awarded by International Tax Review (ITR) as Best Newcomer in Asia Pacific – 2024 and is recognized as one of the finest performing transfer pricing firms.

Our offering spans the end-to-end Transfer Pricing value chain, including design of intercompany policy, drafting of Interco agreement, ensuring effective implementation of the Transfer Pricing policy, year-end documentation and certification, Global Transfer Pricing Documentation, BEPS related compliances (including advisory, Masterfile, Country by Country report), safe harbor filing, audit defense before all forums and dispute prevention mechanisms such as Advance Pricing agreement.

We are structured as an inverse pyramid where leadership get involved in all client matters, enabling clients to receive the highest quality of service.

Being a specialized firm, we offer advice that is independent of an audit practice and deliver it with an uncompromising integrity.

Our expert team brings in cumulative experience of over Six decades in the transfer pricing space having worked with multiple Multinational Companies across sectors/industries in the Big 4 and have cutting edge knowledge and capabilities in handling complex TP engagements.

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