Introduction

The provisions of transfer pricing are designed to keep a check on the practice of reducing the tax liability by an entity by entering into transactions at prices higher/lower than market prices with associated entity. In this part you can gain knowledge about the provisions relating to penalty for failure to keep and maintain documents in respect of specified domestic transactions. However, before understanding the penalty provisions, one should have an overview of the basic provisions of transfer pricing in relation to specified domestic transactions.

Meaning of specified domestic transaction

Specified domestic transaction means any of the following transaction which is not an international transaction:

i. Any transaction referred to in section 80A.

As per section 80A(6) when a taxpayer claims deduction under various sections, *interalia*, sections 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID, 80-IE, etc., and enters into a transaction with its associated entities, these transactions should be carried out at fair market value. So, if a transaction is covered under section 80A, then it will be treated as a specified domestic transaction.

ii. Any transfer of goods or services referred to in section 80-IA(8).

Section 80-IA provides for deductions in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development, telecommunication services, power generation, etc.

Section 80-IA(8) covers inter unit transfer of goods and services by an entity claiming deduction under section 80-IA.

iii. Any business transacted between the taxpayer and other person as referred to in section 80-IA(10).

Section 80-IA provides for deductions in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development, telecommunication services, power generation, etc.

A taxpayer claiming deduction under section 80-IA may enter into business transaction with its related person. The transaction may be arranged in such a manner that the profit earned by the taxpayer is more than the normal profit. By doing so the profit of such related person may be diverted to the taxpayer and in turn the taxpayer will not pay tax or pay less taxes on the profit so diverted due to deductions available to him under section 80IA. Such type of transactions are covered under section 80-IA(10).
iv. 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.

Section 10AA provides for exemption in respect of income generated by a unit located in the Special Economic Zone.

Under Chapter VI-A there are various sections under which the taxpayer can claim deduction. However, only those sections of Chapter VI-A are relevant here to which the provisions of section 80-IA(8) and (10) are applicable which includes section 80-IA, 80-IB, 80-IC, 80-ID etc.

v. Any business transacted between the persons referred to in sub-section (4) of section 115BAB

Section 115BAB provides for a reduced tax rate of 15% in case of those domestic manufacturing companies which have been incorporated on or after October 1, 2019 and whose total income is computed without claiming specified exemption, deduction or incentive available under the Act.

Sub-section (4) of section 115BAB provides that where course of business between company and any other person are so arranged that it produces to the company more than the ordinary profits, the Assessing Officer can re-compute the profit which may be reasonably deemed to have been derived therefrom. The profit from such transaction shall be determined having regard to arm's length price if such transaction is covered under the ambit of 'Specified Domestic Transaction' as defined under section 92BA.

vi. Any other transaction as may be prescribed.

The above transactions will be treated as specified domestic transactions only if the aggregate value of these transactions entered into by the taxpayer during the year exceeds a sum of twenty crore rupees. [The revised threshold limit of Rs. 20 crores shall be effective from 01-04-2016 i.e. Assessment year 2016-17]

**Transaction should be at Arm’s length price**

As per section 92 when any specified domestic transaction is carried out between associated enterprises, the said transaction should be carried out at arm’s length price. In other words, income arising or allowance of any expenses to an entity resulting from specified domestic transactions with associated enterprise should be computed having regard to arm’s length price of such transaction.

The provisions of section 92 will apply only if the aggregate value of specified domestic transactions entered into by the taxpayer during the year exceeds a sum of twenty crore rupees.

E.g., Essem Ltd. took service of one of its group company, an associated enterprise enjoying tax holiday. The transaction is a specified domestic transaction. Essem Ltd. paid Rs. 29,80,00,000 for the said service to the group company. The arm’s length price of such service is Rs. 18,40,00,000. No other specified domestic transaction is entered into by Essem Ltd. during the year. Will the provisions of section 92 apply in this case?

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As per section 92, any specified domestic transaction carried on with associated enterprise should be at arm’s length price. The transaction entered into by Essem Ltd. with its associated enterprise is a specified domestic transaction and, hence, the provisions of section 92 will apply.

In the present case, it can be observed that while computing its taxable business income, Essem Ltd. will claim deduction of Rs. 29,80,00,000 in respect of service charges paid to its associated entity.

The arm’s length price, i.e., the fair value of the service is Rs. 18,40,00,000 but by paying a higher amount of Rs. 29,80,00,000 Essem Ltd. claimed a higher deduction and reduced its profit by Rs. 11,40,00,000. In this case the provisions of section 92 will be applicable and the income of Essem Ltd. will be recomputed by taking into account the arm’s length price of the specified domestic transaction. In other words, the taxable income of Essem Ltd. will have to be computed by allowing deduction of Rs. 18,40,00,000 on account of service charges.

In the above example, if the transaction is not a specified domestic transaction, then the provisions of section 92 will not apply.

Methods of computation of arm’s length price

As discussed earlier, a taxpayer should carry specified domestic transactions at arm’s length price. Arm’s length price is to be determined by applying any of the following method:

- Comparable Uncontrolled Price Method
- Resale Price Method
- Cost Plus Method
- Profit Split Method
- Transactional Net Margin Method
- Such other method as may be prescribed by the CBDT.

Documents to be maintained in respect of specified domestic transactions

Section 92D provides that every person entering into a specified domestic transaction shall keep and maintain such information and documents as may be prescribed in this regard under rule 10D. The Income-tax Authority may require the taxpayer to produce these documents. On such demand by the Income-tax Authority the taxpayer has to provide these documents within a period of 30 days from the date of receipt of notice in this regard. The income-tax authority may on application made by the taxpayer extend the period of 30 days by a further period of not exceeding 30 days. In view of Rule 10D these documents shall be maintained for a period of 8 years from the end of the relevant assessment year.

The information and documents to be maintained as provided in rule 10D by every person who has entered into a specified domestic transaction are as follows:
- A detailed description of the ownership of the entity with details of shares or other ownership interests held therein by other enterprises.

- A profile of the multinational group of which the entity is a part along with the name, address, legal status and tax residence of each of the enterprises comprised in the group with whom specified domestic transactions have been entered into by the entity and ownership linkages among them.

- A broad description of the business of the entity and the industry in which the entity operates, and of the business of the associated enterprises with whom the entity has transacted.

- The nature and terms (including prices) of specified domestic transactions entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each of such transaction or class of such transaction.

- A description of the functions performed, risks assumed and assets employed or to be employed by the entity and by the associated enterprises involved in the specified domestic transaction.

- A record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the entity for the business as a whole and for each division or product separately, which may have a bearing on the specified domestic transactions entered into by the entity.

- A record of uncontrolled transactions taken into account for analysing their comparability with the specified domestic transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the specified domestic transactions.

- A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant specified domestic transaction.

- A description of the methods considered for determining the arm's length price in relation to each specified domestic transaction or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case.

- A record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the specified domestic transaction, and the comparable uncontrolled transactions, or between the enterprises entering into such transactions.

- The assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price.
Details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under the Income-tax Rules and consequent adjustment made to the total income for tax purposes.

Any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

The CBDT has notified ‘Safe Harbour Rules’ vide Income-tax (Second Amendment) Rules, 2015, w.e.f. 04-2-2015 for specified domestic transactions undertaken by Government companies engaged in business of generation, transmission or distribution of electricity (‘eligible assessee’).

In this regard, Rule 10TH to Rule 10THD were inserted in the Income-tax Rules, 1962 to provide that Government Companies engaged in the business of generation, transmission or distribution of electricity (i.e., eligible assessee) can opt for ‘Safe Harbour Rules’ in respect of transactions of supply, transmission or wheeling of electricity (i.e., eligible specified domestic transaction).

Where an eligible assessee opts for ‘Safe Harbour Rules’, the transfer price declared by the assessee in respect of such transaction for that assessment year shall be accepted by the authorities and no comparability adjustment shall be made to it if:

a) eligible transaction is supply of electricity, transmission of electricity, wheeling of electricity, etc.; and

b) tariff in respect thereof, as the case may be, is determined by the Appropriate Commission in accordance with the provisions of the Electricity Act, 2003 (36 of 2003).

Accordingly, Rule 10D is also amended to provide some relaxation to eligible assessee from maintenance of documents. It provides that eligible assessee who has entered into an eligible specified domestic transaction shall have to keep and maintain only following information and documents for period of 8 years from end of relevant assessment year:

- Description of ownership structure of assessee's enterprise with details of shares and other ownership interests held therein by other enterprises.
- Broad description of business of assessee and the industry in which he operates and of the business of associate enterprises with whom the assessee has transacted.
- Nature, terms (including prices), quantum and value of specified domestic transactions entered into with each associate enterprise.
- Record of proceeding, if any, before regulatory commission and orders of such commission relating to specified domestic transactions.
- Record of actual working carried out for determining transfer pricing of specified domestic transactions.
Assumptions, policies and price negotiation, if any, which have critically affected the determination of transfer price.

Any other information or data which may be relevant for determination of transfer price.

The information specified above shall be supported by authentic documents, which may include the following:

- Official publications, reports, studies and data bases from the Government.
- Reports of market research studies carried out and technical publications brought out by recognised institutions.
- Price publications including stock exchange and commodity market quotations.
- Published accounts and financial statements relating to the business affairs of the associated enterprises.
- Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the specified domestic transactions.
- Letters and other correspondences documenting any terms negotiated between the entity and the associated enterprise.
- Documents normally issued in connection with various transactions under the accounting practices followed.

Penalty for failure to keep and maintain information and documents in respect of specified domestic transactions

As discussed above, section 92D requires the maintenance of certain information or documents. Failure to maintain such information or documents will attract penalty. The provisions relating to penalty for failure to keep and maintain information and documents in respect of specified domestic transactions are given in section 271AA. Penalty under section 271AA is attracted in the case of any of the following failures:

1. If a person fails to keep and maintain information and documents in respect of specified domestic transactions as provided in rule 10D read with section 92D.
2. If a person fails to keep and maintain information and documents in respect of specified domestic transactions as provided in rule 10D read with section 92D for the period prescribed in this behalf (i.e., 8 years from the end of the relevant assessment year).
3. If a person fails to report the specified domestic transaction which he is required to do.
4. If a person maintains or furnishes an incorrect information or document in respect of specified domestic transaction.

Penalty will be a sum equal to 2% of the value of each specified domestic transaction entered into by the taxpayer.
By virtue of section 273B penalty under section 271AA will not be imposed if the taxpayer proves a reasonable cause for failure.

Penalty for failure to furnish a report from an accountant as is required by section 92E

Section 92E provides that every person entering into an international transaction or specified domestic transaction shall obtain a report from a chartered accountant in the prescribed form and shall furnish the same on or before the date prescribed in this regard. If a taxpayer fails to do so, then he can be held liable to pay penalty under section 271BA. Penalty under section 271BA for failure to furnish a report from an accountant as is required by section 92E is Rs. 1,00,000.

By virtue of section 273B penalty under section 271BA will not be imposed if the taxpayer proves a reasonable cause for failure.

Penalty for failure to produce information and document in respect of specified domestic transaction

As per section 92D(3) the tax authorities may, in the course of any proceeding under the Act, require any person who has entered into a specified domestic transaction to furnish any information or document (as discussed in rule 10D). Such information or document is to be produced within a period of 30 days from the date of receipt of a notice issued in this regard (the period can be extended for further 30 days by the tax authorities).

As per section 271G, if any person who has entered into a specified domestic transaction fails to furnish any such information or document as discussed above, then the tax authorities may direct that such person shall pay, by way of penalty, a sum equal to 2% of the value of the specified domestic transaction for each such failure.

By virtue of section 273B penalty under section 271G will not be imposed if the taxpayer proves a reasonable cause for failure.
MCQ ON PENALTY FOR FAILURE TO KEEP AND MAINTAIN DOCUMENTS IN RESPECT OF SPECIFIED DOMESTIC TRANSACTIONS

Q1. Specified domestic transaction also covers an international transaction.
(a) True (b) False
Correct answer: (b)
Justification of correct answer:
Specified domestic transactions means few specific transactions described under section 92BA which are not international transactions. Thus, the statement given in the question is false and hence, option (b) is the correct option.

Q2. Section ________ provides that every person entering into a specified domestic transaction shall keep and maintain such information and documents as may be prescribed in this regard under rule 10D.
(a) 92 (b) 92A (c) 92C (d) 92D
Correct answer: (d)
Justification of correct answer:
Section 92D provides that every person entering into a specified domestic transaction shall keep and maintain such information and documents as may be prescribed in this regard under rule 10D. Thus, option (d) is the correct option.

Q3. Every person entering into specified domestic transactions shall keep and maintain documents relating to such transactions for a period of ________ from the end of the relevant assessment year.
(a) 2 years (b) 5 years (c) 8 years (d) 10 years
Correct answer: (c)
Justification of correct answer:
In view of Rule 10D every person entering into specified domestic transactions shall keep and maintain documents relating to such transactions for a period of 8 years from the end of the relevant assessment year. Thus, option (c) is the correct option.
Q4. The provisions relating to penalty for failure to keep and maintain information and documents in respect of specified domestic transactions are given in section _______.
(a) 271   (b) 271A
(b) 271B   (d) 271AA
Correct answer : (d)
Justification of correct answer :
The provisions relating to penalty for failure to keep and maintain information and documents in respect of specified domestic transactions are given in section 271AA. Thus, option (d) is the correct option.

Q5. Penalty under section 271AA will be a sum equal to ____________.
(a) 2% of the value of each specified domestic transaction entered into by the taxpayer
(b) 1% of the value of each specified domestic transaction entered into by the taxpayer
(c) 3% of the value of each specified domestic transaction entered into by the taxpayer
(d) 4% of the value of each specified domestic transaction entered into by the taxpayer
Correct answer : (a)
Justification of correct answer :
Penalty under section 271AA will be a sum equal to 2% of the value of each specified domestic transaction entered into by the taxpayer. Thus, option (a) is the correct option.

Q6. By virtue of section 273B penalty under section 271AA will not be imposed if the taxpayer proves a reasonable cause for failure.
(a) True   (b) False
Correct answer : (a)
Justification of correct answer :
By virtue of section 273B penalty under section 271AA will not be imposed if the taxpayer proves a reasonable cause for failure. Thus, the statement given in the question is true and hence, option (a) is the correct option.

Q7. Penalty under section 271BA for failure to furnish a report from an accountant as is required by section 92E is ____________.
(a) Rs. 10,000
(b) 2% of the value of each specified domestic transaction entered into by the taxpayer
(c) Rs. 1,00,000
(d) 1% of the value of each specified domestic transaction entered into by the taxpayer
Correct answer : (c)
Justification of correct answer :
Penalty under section 271BA for failure to furnish a report from an accountant as is required by section 92E is Rs. 1,00,000.

Thus, option (c) is the correct option.

**Q8.** Penalty under section 271G shall be levied @ 2% of the value of the specified domestic transaction for each such failure if the assessee fails to furnish any such information or document as is required to be furnished under section 92D(3).

(a) True  
(b) False

**Correct answer : (a)**

**Justification of correct answer :**

As per section 271G, if any person who has entered into a specified domestic transaction fails to furnish any such information or document as is required to be furnished under section 92D(3), then the tax authorities may direct that such person shall pay, by way of penalty, a sum equal to 2% of the value of the specified domestic transaction for each such failure.

Thus, the statement given in the question is true and hence, option (a) is the correct option.

**Q9.** Penalty levied under section 271G cannot be waived by virtue of section 273B even though the taxpayer proves a reasonable cause for failure.

(a) True  
(b) False

**Correct answer : (b)**

**Justification of correct answer :**

By virtue of section 273B penalty under section 271G will not be imposed if the taxpayer proves a reasonable cause for failure.

Thus, the statement given in the question is false and hence, option (b) is the correct option.