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### Section 92B(2) not applicable to transactions between domestic entities

#### In brief

Swarnandhra IJMII Integrated Township Development Company Pvt Ltd[1] (the taxpayer) is a joint venture (JV) company, with Andhra Pradesh Housing Board (APHB) and an Indian company, *viz.*, IJM (India) Infrastructure Ltd (IJMII), as JV partners. IJMII in turn is a part (a subsidiary) of a foreign group of companies, *viz.*, IJM Group (AE). During the year, the taxpayer entered into transactions with IJMII, which the revenue held to be deemed international transactions under section 92B(2) of the Income-tax Act, 1961 (the Act), as it believed that the terms were, in substance, determined between the taxpayer and the AE.

The Hyderabad bench of the Income-tax Appellate Tribunal (the Tribunal) ruled in favour of the taxpayer and held that the transaction under dispute does not fall under section 92B(2) of the Act, for the following reasons:

a) As both parties are residents, the transaction between them is not an international transaction, and thus the basic premise for invoking section 92B(2) does not arise.
b) It was a direct transaction between IJMII and the taxpayer and not with the AE by using IJMII as an intermediary.

[1] Swarnandhra IJMII Integrated Township Development Co. Pvt. Ltd. *v.*DCIT [TS-762-ITAT-2012 (HYD)]

c) Owing to the active participation of a government body (APHB) in the functioning of the taxpayer, it cannot be said that the AE influenced the terms of the transaction.

In addition, the Tribunal clarified that section 92A(1) of the Act provides broad parameters for defining 'associated enterprise', while section 92A(2) of the Act lists specific situations in this regard. The deeming fiction created by section 92B(2) is in addition to the one created under section 92A(2). Section 92B(2) is thus to be read as an extension of section 92A(2) and not as an extension of section 92B(1). Further, the fiction embodied in section 92B(2) is transaction specific and does not apply to all transactions between the enterprise and the unrelated person.

## Facts

The taxpayer is a JV company, with APHB and IJMII as JV partners, whose shareholding in the taxpayer is in the ratio of 49:51, respectively. IJMII, is an Indian Company and a subsidiary of IJM Corporation, Berhad (hereinafter along with its affiliates referred to as AE).

During the year, the taxpayer entered into transactions with IJMII. The transfer pricing officer (TPO) held that those transactions were deemed international transactions under section 92B(2) of the Act. The TPO believed that the terms of those transactions were determined in substance between the taxpayer and the AE. The taxpayer opposed the TPO's view, whereas the Dispute Resolution Panel upheld the same. Aggrieved, the taxpayer appealed before the Tribunal.

## Tribunal ruling

The Tribunal held as follows:

- Section 92A of the Act defines the term 'associated enterprise'. Section 92A(1) of the Act provides the broad parameters in this regard, while section 92A(2) of the Act lists specific situations. The deeming fiction created by section 92B(2) is in addition to the one created under section 92A(2), as the former travels beyond the parameters set under the latter.

  Section 92B(2) embodies a legal fiction – it deems a transaction to have been entered into between two associated enterprises. Though section 92B(2) is a part of section 92B of the Act, with the heading 'Definition of international transaction', it is to be read as an extension of section 92A(2) of the Act and not as an extension of section 92B(1) of the Act.

- The fiction embodied in Section 92B(2) is transaction specific and does not apply to all transactions between the enterprise and the unrelated person. This is unlike section 92A of the Act, whereby two or more enterprises once determined to be 'associated' remain so for the entire financial year.

- Section 92B(2) of the Act was enacted for all cases where two AEs intend to have an international transaction but want to avoid TP provisions by interposing a third party as an intermediary (who is generally not the ultimate consumer of services/goods, and facilitates their transfer from one enterprise to its associate enterprise with no value addition or insignificant value addition). The intermediary is used to break a transaction, which when viewed in isolation would not satisfy the requirements of section 92A of the Act. In these circumstances, the legal form of such transactions is ignored, and substance is given effect to.

- The legal fiction embodied in Section 92B(2) of the Act can be used only for the purpose of examining whether such transaction constitutes an 'international transaction' under section 92B(1) of the Act. In case section 92B(1) is not attracted, the fiction under section 92B(2) ceases to operate. The transaction under dispute does not fall under section 92B(2) of the Act, for the following reasons:

a) As both the parties are residents, the transaction between the taxpayer and IJMII do not constitute an international transaction. The basic premise for invoking section 92B(2) does not arise. Further, transfer pricing provisions are not applicable to transactions between domestic related parties. Had that been so, there would have been no need to bring about the amendment in this regard in the Finance Act, 2012.
b) The transaction in question involved direct rendering of services by IJMII to the taxpayer and not to the AE by using IJMII as an intermediary.
c) APHB's policies are directly controlled by the Andhra Pradesh government. In view of the active participation of the government in the functioning of the taxpayer, it cannot be said that the AE would influence the entering into the contract by the taxpayer or its terms and conditions.

## PwC observations

This is undoubtedly a significant ruling which addresses a controversial legal transfer pricing issue which has been often debated since the time the transfer pricing regulations were enacted. In the past, there have been different views taken on whether the application of section 92B(2) of the Act is restricted to international transactions only, or whether it also applies to transactions between domestic entities. In this regard, the Tribunal has categorically held that section 92B(2) of the Act does not apply to transactions between domestic entities, and the pre-condition of there being an international transaction has to be satisfied if section 92B(2) is to be applied. One of the reasons stated by the Tribunal for drawing this conclusion is the amendment introduced *vide* the Finance Act 2012 for prospective applicability of transfer pricing provisions to domestic transactions. However, this reasoning does not seem appropriate as the scope of the said domestic transactions is very specific and does not really cover a section 92B(2) scenario. Also, the underlying objective of the respective provisions is not exactly the same.

While arriving at its conclusion, the Tribunal has also provided clarity and insight on certain pertinent matters. The Tribunal has elucidated that the applicability of section 92B(2) is for particular transactions only, and such transactions do not make the transacting entities 'associated' for the entire financial year. Further, the Tribunal has ruled out the possibility of external influence when a government body actively participates in the functioning of an organization – this is certainly useful guidance when evaluating 'determined in substance' for the purpose of section 92B(2).

In another observation, the Tribunal has established a link between section 92A(2) of the Act and section 92B(2) which is quite insightful. As per the Tribunal, Section 92B(2) defines a parameter for an 'associated enterprise relationship', which is over and above the parameters outlined in section 92A(2), and hence section 92B(2) has been regarded as an extension of section 92A(2), rather than section 92B(1).

Further, in the instant case, the Tribunal has considered the disputed transaction to be a 'direct' transaction which is between the taxpayer and the other entity, and is not carried further with the AE. Applicability of section 92B(2) has thus been ruled out in case of 'direct' transactions, where there is no 'intermediary'. The entity inter-posed between the taxpayer and the AE has been considered to be an 'intermediary' by the Tribunal, which essentially acts as a 'pass-through' entity between the taxpayer and its AE, adding little or no value. In this regard, although not clarified by the Tribunal, it may nonetheless be inferred that not all 'pass-through' arrangements would fall prey to the applicability of section 92B(2), as there could be certain arrangements which are so structured for genuine business reasons and not just to avoid tax. On the other hand, even if the inter-posed entity is not characterized as a 'pass-through' entity it does not mean that section 92B(2) would not apply.

On a separate note, it may be worth highlighting that section 92B(2) requires the taxpayer transacting with an unrelated person ('a person other than an associated

enterprise'). In the present case, IJMII cannot be said to be 'unrelated' to the taxpayer, as it had a majority and significant shareholding of 51% in the taxpayer. However, this aspect has not been discussed in the instant ruling. This is possibly because the Tribunal upfront dismissed application of section 92B(2) on the premise that IJMII and the taxpayer were both domestic entities, and it did not, therefore, need to traverse beyond that.

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