

Red Herrings in TP penalty – correction needed?

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Finance Act 2012 ushered a number of significant amendments to Indian Transfer Pricing regulations ranging from introduction of APA mechanism to tightening of penalty provisions for Transfer Pricing non-compliance. Amongst others, Finance Act 2012 sought stringent compliance with reporting norms by introducing ad-valorem penalty^[1] for non-reporting of international and domestic related party transactions.

Penalty provisions are a critical component of enforcement policy spelling out dire consequences for non-conforming taxpayers. In this context, emphasis on clarity is as important as stringency for successful deterrence. With few months remaining in another round of Transfer Pricing compliance, this article examines the existing penalty provision(s) for non-filing / erroneous filing of Form 3CEB – the statutorily mandated Accountant's Certificate for reporting international and domestic related party transactions. The author is of the opinion that there appears to be a mis-match between legislative intent and enactment regarding penalty provision for filing of Form 3CEB – a gap that could possibly work in favour of taxpayers unless plugged by legislative corrective action.

Background

Indian Transfer Pricing regulations mandate filing of Form 3CEB for every taxpayer entering into international transaction or Specified Domestic Transaction ('SDT'). Under the extant laws pre-Finance Act, 2012 the penalty for non-furnishing Form 3CEB was Rs 1 lakh. The amount was certainly meager compared to the value of international transactions generally entered into by taxpayers. The legislature sought to remedy this situation by introducing stricter ad-valorem penalty (of 2 percent of value of transaction) for failure to report related party transactions in Form 3CEB. The legislative intention for stricter enforcement of reporting norms comes across clearly in the Memorandum to Finance Bill, 2012. Relevant extract is re-produced below for ready reference.

Section 271BA of the Income Tax Act provides a penalty of Rs. 1 lakh in cases where any person fails to furnish a report from an accountant as required by Section 92E. Section 271AA provides penalty for failure to keep and maintain information and document in respect of International Transaction. Section 271G provides penalty for failure to furnish information or document under Section 92D which requires maintenance of certain information and documents in the prescribed proforma by persons entering into an International Transaction.

*The above scheme of penalty provisions allows for misuse of provisions due to lack of effective deterrent. In order to suppress information about international transactions, some taxpayers may not furnish the report or get the Transfer Pricing audit done. **The meager penalty of Rs. 1 lakh as compared to the quantum of international transactions is not an effective deterrent. There is presently no penalty for non-reporting of an international transaction in report filed under section 92E or maintenance or furnishing of incorrect information or documents. Therefore, there is need to provide effective deterrent based on transaction value to enforce compliance with Transfer Pricing regulations. It is, therefore, proposed to amend Section 271AA to provide levy of a penalty at the rate of 2% of the value of the international transaction, if the taxpayer.-***

- (i) fails to maintain prescribed documents or information or;*
- (ii) fails to report any international transaction which is required to be reported, or;*
- (iii) maintains or furnishes any incorrect information or documents.*

This penalty would be in addition to penalties in section 271BA and 271G.

This amendment will take effect from 1st July, 2012.

A reference to the Memorandum of Finance Bill, 2012 clearly demonstrates the intention to introduce penalty equivalent to 2% of value of international transaction or SDT in the event of non-reporting of such a transaction in Form 3CEB. Interestingly, the corresponding amendment has been introduced in section 271AA i.e. the penalty provision for non-maintenance and non-furnishing of Transfer Pricing documentation. Section 271BA dealing with penalty for non-filing of Form 3CEB remains untouched and continues to stipulate a penalty of Rs. 1 lakh for non-filing of Form 3CEB.

Implications

The Courts have held that not only should penal provisions be construed strictly^[2] but wherever two interpretations are possible the interpretation that is favorable to assessee should be adopted^[3]. In the above backdrop following questions arise:

- (i) What is the current penalty for Form 3CEB non-filing? Is it One Lac Rupees or is it 2 percent of the value of related party transactions given that section 271AA makes absolutely no reference to 'Form 3CEB' other than deploying the word 'report'?
- (ii) What is the meaning of 'report' as used in section 271AA?
- (iii) Where a taxpayer fails to report a transaction in Form 3CEB but reports the same in Transfer Pricing Documentation is he liable for ad-valorem penalty since technically the taxpayer has still 'reported' the transactions to tax authorities?
- (iv) While there is an ad-valorem penalty for maintaining or furnishing incorrect information or document, is there any ad-valorem penalty for erroneous filing of Form 3CEB?
- (v) While construing penalty provisions how far can Courts rely on purposive interpretation based on Memorandum to Finance Bill when the plain language of penalty provisions indicates otherwise?

Given the manner in which the penalty provisions are currently drafted there may not be unequivocal answers to above questions leaving floodgates open to litigation. Legal battles on these questions would ensue few years down the line as cases pertaining to Transfer Pricing non-compliance for financial year 2012-13 and onwards land-up in Courts.

While the legislature may have expressed its intention clearly in the Memorandum to Finance Bill, 2012 it may not be sufficient given historic jurisprudence surrounding strict and literal construction of penal statutes and liberal stance towards taxpayers. If legislature really intends to impose an ad-valorem penalty for non-filing or erroneous filing of Form 3CEB, it would augur well if clear and specific amendment(s) are carried out. The coming budget gives just the opportunity to plug this loophole and avoid unnecessary litigation on what could be yet another Transfer Pricing controversy.

^[1] Applicable prospectively from FY 2012-13 and onwards.

^[2] MotibhaiFulabhai Patel & Co. vs. R. Prasad and Ors. [1970 AIR 829].

^[3] CIT vs. Vegetables Products Ltd. [1973 AIR 927].