

TAX FLASH NEWS

CBDT rolls-out the final rules for 'range' concept and multiple year data prescribed under Transfer Pricing regulations

Background

On 21 May 2015, the Central Board of Direct Taxes (CBDT) issued the draft scheme of the proposed rules for computation of the Arm's Length Price (ALP) of international transactions or Specified Domestic Transactions (SDT) undertaken on or after 1 April 2014. The proposed rules were relating to the availability of range and use of multiple year versus single year data. Comments and suggestions from stakeholders and the general public were sought, which was a very inclusive and transparent move of the government. We at KPMG in India had provided our comments and suggestions based on internal consultations and discussions with our clients.

On 19 October 2015, the CBDT published a notification¹ releasing the final rules for the use of range and multiple year data (the Rules). These Rules have provided clarifications on various areas as well as bring into play, areas that may result into disputes.

Key Highlights/Amendments of the Rules

The key highlights/amendments of the Rules are as under:

- I. **Amendment to existing Rule 10B** pertaining to the determination of ALP based on selection of the Most Appropriate Method (MAM)

Use of multiple year data

The data to be used for a comparability analysis was required to be data related to the 'financial year' in which the international transaction or the SDT was entered into or data relating to a period not more

than two years prior to such a financial year. The term 'financial year' has been replaced by the term 'current year' in order to avoid disputes arising from the use of the term 'financial year'.

The above amendment will be applicable for only those international transactions or SDTs, entered into on or after 1 April 2014.

Further, it has been mentioned, that where the Resale Price Method (RPM), Cost Plus Method (CPM) or Transactional Net Margin Method (TNMM) is used as the MAM for the determination of the ALP of international transactions or SDT entered on or after 1 April 2014, comparability will be conducted based on

- data relating to the current year; or
- data relating to the financial year immediately preceding the current year, if the data relating to the current year is not available at the time of furnishing the return of income

However it has also been provided that, during the assessment proceedings, if the current year data becomes available, the same shall be considered irrespective of the fact that such current year data was not available at the time of furnishing of return of income.

- II. **New Rule 10CA.** Determination of the ALP where application of the MAM results in more than one price

In cases where the application of any of the methods result in more than one price, the ALP shall be computed as follows:

- A dataset shall be constructed by placing the prices/data in an ascending order.

¹ CBDT Notification No. 83/2015, dated 19 October 2015

- If a comparable has been identified on the basis of data relating to:
 - a) **Current year**, then the data for the immediately preceding two financial years can be considered, provided the comparable has undertaken the same or similar comparable uncontrolled transaction in those preceding two years.
 - b) **Financial year immediately preceding the current year**, then the data for the immediately preceding two years can be considered provided the comparable has undertaken the same or similar comparable uncontrolled transaction in that preceding year.

Enterprises may not be considered as comparables, if they have not undertaken comparable uncontrolled transaction in the current year. An enterprise shall be rejected from the comparable data set even if, such an enterprise had undertaken comparable uncontrolled transaction in either or both of the financial years immediately preceding the current year.

Use of the weighted average to compute the ALP

The price in respect of comparable uncontrolled transactions shall be determined using the **weighted average** of the prices/data for;

- 1) the current year and preceding two financial years; or
- 2) two financial years immediately preceding the current year (but not including the current year as the same may not have been available)

in accordance to the following:

- Where the prices have been determined using RPM, the weighted average of the prices shall be computed with weights being assigned to the quantum of sales.
- Where the prices have been determined using CPM, the weighted average of the prices shall be computed with weights being assigned to the quantum of costs.
- Where the prices have been determined using TNMM, the weighted average of the prices shall be computed with weights being assigned to the quantum of costs incurred or sales effected or assets employed or to be employed, or as the case may be.

Application of the range concept

- A minimum of six comparables would be required in the dataset for applying the concept of range.
- An arm's length range beginning from the thirty-fifth percentile of the dataset (arranged in ascending order) and ending on the sixty-fifth percentile will be considered.

The concept of range will not be applicable in cases where the MAM is selected to be the profit split method or the 'other method'.

If the price at which the international transaction or SDT is undertaken is within the thirty-fifth percentile to sixty-fifth percentile of the dataset, the transaction shall be deemed to be at the ALP.

If the price at which the international transaction or the SDT is undertaken is outside the arm's length range (thirty-fifth percentile to sixty-fifth percentile of the dataset), the ALP of the transaction shall be taken to be the median of the dataset.

Continued use of the arithmetic mean

In a case where the dataset consists of less than six comparables, or the MAM considered for determination of the ALP is profit split method or 'other method', the ALP will be determined based on the arithmetical mean of all the prices/data included in the dataset. Further, the benefit of a three percent variation which was earlier permissible while adopting the arithmetic mean, continues to be available.

Illustrations

The notification has provided three illustrations on the following:

- Illustration 1 depicts a sample computation of the weighted average, computation of the range using the thirty-fifth and sixty-fifth percentile and the adjustment to the median using seven comparables.
- Illustration 2 depicts that during an assessment, if the Revenue Authorities identify new comparables, they can include them based on the availability of current year data and remove those comparables which do not clear the quantitative and qualitative filters for the current year data.

- Illustration 3 depicts the manner in which range can be arrived when the results of analysis of thirty-fifth and sixty-fifth percentile are whole numbers.

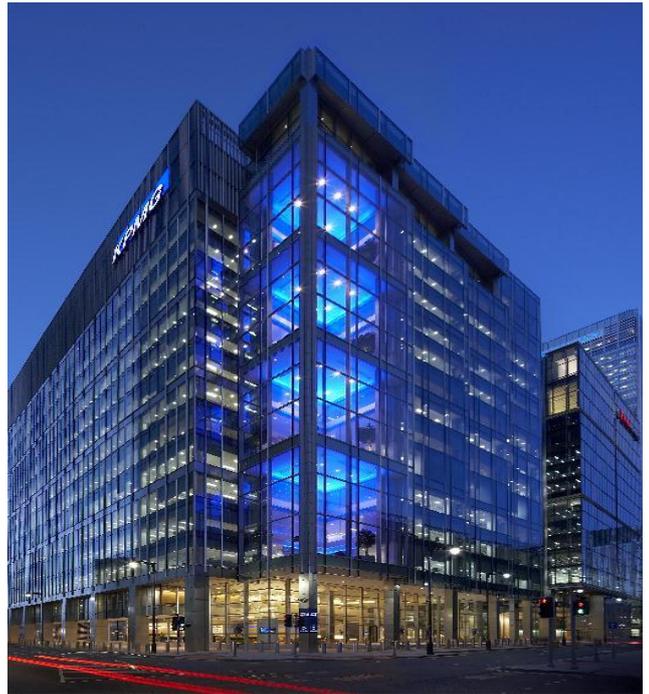
Our comments

Transfer pricing has been a major area of litigation over the years. Many TP adjustments take place in India on account of a comparability analysis, undertaken using the arithmetic mean and single year or current year data. The introduction of range concept and the use of multi-year analysis is expected to have a significant impact on TP compliance and litigations. Though these Rules and the guidance are not completely in sync with globally accepted norms and practices, it may still help in reducing litigation. It may also help in closing Advance Pricing Agreements and applications under Mutual Agreement Procedures going forward.

The Rules have provided many prerequisites for the use of the range as well as multi-year analysis which may require substantial deliberations. Though, use of the thirty-fifth to sixty-fiftieth percentile is not completely in line with global practices, however, the CBDT has broadened the range from the proposed fortieth to sixtieth percentile and reduced the minimum number of comparables from nine to six, which is a positive move in aligning with international standards. In cases where the arithmetic mean is to be used, an allowance of a deviation up to three percent is also a welcome move.

The illustrations provided in the notification are self-explanatory and crisp with respect to the methodology for application of range and multiple year data.

A challenge that taxpayers may continue to face during assessment proceedings could be related to the use of comparables data that will become available subsequent to the date of filing the Accountant's Report or return of income. A provision of this nature may not be considered fair as it leads to an impossibility of performance. There are still certain areas where clarifications may be required, such as, where the Revenue Authorities remove comparables from a data set at the time of assessment proceedings, rendering an existing set to less than six, which may lead to a question whether the arithmetic mean be used instead of the range or vice versa.



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