



# Central Board of Direct Taxes issued draft of the proposed rules for computation of arm's length price

Transfer Pricing Alert  
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## Central Board of Direct Taxes ('CBDT') proposes draft scheme for computation of arm's length price

The Finance Minister, Mr. Arun Jaitley in his maiden 2014 budget speech with the objective of reducing transfer pricing litigation, had announced the introduction of the 'Range concept' and 'use of multiple year data' for determination of arm's length price.

In this context, the CBDT has issued the draft of the proposed rules [F. No. 134/11/2015-TPL], for computation of the arm's length price of international and specified domestic transactions between related entities undertaken on or after April 1, 2014 (relevant for AY 2015-16). The rules once finalized, will provide for the mechanism of adopting the Range concept and also use of multiple year data to compute the arm's length price.

The key concepts are:

Sr. No.	Particulars	Proposed mechanism and conditions
1	Adoption of Range concept	<ul style="list-style-type: none"><li>Range concept shall be used only in cases where the method adopted for the determination of arm's length price is:<ul style="list-style-type: none"><li>➤ Transactional Net Margin Method ('TNMM'), OR</li><li>➤ Resale Price Method ('RPM'), OR</li><li>➤ Cost Plus Method ('CPM').</li></ul></li><li>The Range concept shall apply only where a <u>minimum</u> of 9 comparable companies are selected based on the similarity of their functions, assets and risks with that of the tested party.</li><li>To determine the weighted average for computing the Range (for 9 or more comparable companies), the ratio of the aggregate of the numerator and denominator of the chosen Profit Level Indicator would be computed for all the years for each comparable company. The weighted average of minimum 2 out of 3 years of data would be considered to construct the data set. Accordingly the data set would have a minimum of 9 data points.</li><li>Data points lying within the 40<sup>th</sup> to 60<sup>th</sup> percentile of the data set of the comparable companies would constitute the Range.</li><li>If the transfer price of the tested party falls outside the Range, the median of the Range would be taken as the arm's length price for making an adjustment to the transfer price. If the transfer price is within the Range, no adjustment shall be made.</li></ul>
2	Use of multiple year data	<ul style="list-style-type: none"><li>Multiple year data shall be used only in case the determination of arm's length price is by:<ul style="list-style-type: none"><li>➤ TNMM, OR</li><li>➤ RPM, OR</li><li>➤ CPM.</li></ul></li><li>Multiple year data should comprise of 3 years including the current year (i.e. year in which the transaction has been undertaken). Use of multiple year data for the aforementioned methods shall be mandatory.</li><li>In case of non-availability of 3 years data, use of 2 out of the relevant 3 years shall be permitted in any of the following cases:<ul style="list-style-type: none"><li>➤ Unavailability of current year data at the time of filing return of income;</li></ul></li></ul>

		<ul style="list-style-type: none"> <li>➤ Comparable fails to clear a quantitative filter in any 1 out of the 3 years;</li> <li>➤ Comparable may have commenced operations only in the last 2 years or may have closed down operations in the current year.</li> <li>• The CBDT has also proposed that if at the time of transfer pricing audit, the data of the current year (i.e. year in which the transaction has been undertaken) becomes available, then it can be used during audit by the taxpayer and the Department.</li> <li>• Multiple year data shall apply in both cases where arm's length price is computed based on Range or arithmetic mean.</li> </ul>
3	Continued use of arithmetic mean	<ul style="list-style-type: none"> <li>• Where the number of comparable companies is <i>inadequate (i.e. less than 9 comparables)</i> the arithmetic mean concept shall continue to apply in the same manner as it applied earlier along with the benefit of the tolerance range as prescribed in the Income-tax Act, 1961 and Notification No. 45/2014/F.No.500/1/2014-APA-II.</li> </ul>

## ELP COMMENTS

The proposed rules issued by the CBDT, once finalized, will align the Indian transfer pricing regulations with the global best practices.

Application of the Range concept and the use of multiple year data is a welcome move and considers certain anomalies facing taxpayers / views adopted by the tax Department and will go a long way in reducing transfer pricing litigation in India. However, the draft scheme, in its proposed form, has the following ambiguities and practical difficulties that need clarity.

- Selecting a minimum of 9 data points for the application of the Range concept may be difficult to apply, leading to hardships. For instance, if the taxpayer chose 9 (or more) comparable companies at the time of determining the arm's length price or developing the transfer pricing policy, however at the time of transfer pricing audit, the tax Department disputed the comparable companies selected by the taxpayer and reduced the set to less than 9 comparable companies. Such situations could create significant uncertainty and hardships from the perspective of determining the arm's length price.
- The proposed range of 40th to 60th percentile is different from the globally practiced inter-quartile range concept (i.e. 25th to 75th percentile).
- In certain circumstances 2 out of 3 years data can be used. However, during transfer pricing audit, the taxpayer and the Department can use the data of the current year (i.e. year in which the transaction has been undertaken), if it becomes available. Thereby bringing about uncertainty in determining the arm's length price.
- No reasoning has been provided on the exclusion of the balance 2 methods of analysis, i.e. Comparable Uncontrolled Price Method and Profit Split Method.

Industry and taxpayers should make appropriate representation to address/resolve their concerns and make suggestions to iron out any grey areas.

**Disclaimer:** The information provided in this update is intended for informational purposes only and does not constitute legal opinion or advice. Readers are requested to seek formal legal advice prior to acting upon any of the information provided herein. This update is not intended to address the circumstances of any particular individual or corporate body. There can be no assurance that the judicial/ quasi judicial authorities may not take a position contrary to the views mentioned herein.

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