

TransPrice Times-Special Edition

'Range vs Arithmetic Mean'

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The CBDT has recently rolled out a draft frame work of the range concept and multiple year data that finds mention in the budget speech of Hon. Finance Minister while introducing Finance Bill, 2014.

In Global Transfer Pricing arena, the concept of range and multiple year data is widely accepted. India since inception of Transfer Pricing (i.e. year 2001) has been following the concept of 'Arithmetic Mean / Average' to arrive at an Arm's length Price (ALP). One may indicate that 'Arithmetic Mean' or 'average' could give fair results to determination of ALP, however the ALP then has a tendency to be skewed towards either high profit making companies or loss making companies, which may not give appropriate results. Hence, following the median ideology made a lot of sense in the transfer pricing world while determining the ALP.

While India is converging with the global standards with an aim towards accepting the global best practices and simplifying the legislation, it often gets trapped in a self-woven net of complexity. However, we highly appreciate the release of such draft scheme of proposal for public consultation before such new legislation takes the form of an Act/ Rules. Our observations on the proposed scheme are as follows:

Adoption of range concept:

1. The concept of range has been restricted only in the case of determination of ALP by using Transactional Net margin Method (TNMM), Resale Price Method (RPM) or Cost Plus Method (CPM). The principle in practice could also apply to Comparable Uncontrolled Price (CUP) Method or Any Other Method where more than one prices are determined. If the board wants to apply only to the above mentioned proposed method, an appropriate justification could be provided as to why the same is not applicable to CUP or Any other method. Alternatively, the range concept should also be made available to CUP and Any Other Method.

2. A minimum of 9 entities are required to be selected as comparable entities. In practice, many a times only 4-5 comparable entities are available. By incorporating such condition, the taxpayer may seek to take an advantage of range concept by artificially adding comparable companies. By following such approach one could foresee increase in litigation revolving around such number of companies. Hence, it is suggested to bring down the number to minimum 4 comparable entities.

3. The data points lying within 40th to 60th percentile to be considered as range. Our suggestion would be to bring it closer to the international practices by considering data points lying within 25th to 75th percentile to be construed as range.

4. There could be practical difficulty to apply range as a concept when required numbers of comparable entities are not available at the time of contemporaneous maintenance of documentation; however the same are made available at the time of assessment. This would add to increase in the litigation over adoption of range as a concept. A clear guidelines needs to be issued covering such practical aspects and insisting on contemporaneous documentation and not documentation at the time of audits/ assessments.

5. Applicability of range to the roll back provisions for Advance Pricing Agreements needs to be highlighted and directed.

6. It is suggested that range as a concept to be introduced and should replace the arithmetic mean concept as keeping both in place would contribute to increased litigation at later years. This would mean complicating law and not simplifying the procedures.

Use of Multiple year data:

1. As per the proposed scheme, 3 year multiple data could be used including the current year to which the analysis is undertaken. Also 2 out of 3 years could be considered if the data of current year is not available due to non updation in the public domain, quantitative filter failure in any one out of three years or comparable entity has commenced operations only in last two years. As per the proposed scheme, it has to be clarified that the use of multiple year data is allowed while using the range concept or a arithmetic mean concept. Also it has to be clarified what would be the position if the comparable company finds it place in the current year only due to the first year of operation or updation in the public domain

2. The data of current year is allowed to be used by the revenue authorities as well as taxpayers if the same becomes available at the time of audit. This would take away the relevance of maintenance of transfer pricing documentation on a contemporaneous basis.

3. Use of multiple year data to be clarified for the roll back provisions of APA

As per our view, although the move of the revenue authorities to adopt globally accepted principles is appreciated, implementation of the same along with interpretation of the statue would play a key role in success of the initiatives. We would be making a representation covering above mentioned points to the CBDT, we would request you to provide your inputs on the draft proposal before 28th May 2015, so that we can incorporate your views in the representation too. You may reply on akshaykenkre@transprice.in with your recommendations.