

Circular

F. No. 134/11/2015-TPL

Government of India

Ministry of Finance

Department of Revenue

Central Board of Direct Taxes

May 21, 2015

Subject: - Draft scheme of the proposed rules for computation of Arm's Length Price (ALP) of an International Transaction or Specified Domestic Transaction undertaken on or after 01.04.2014.

Section 92C of the Income Tax Act, 1961 (the "Act") provides for computation of Arm's Length Price (ALP) of an international transaction or specified domestic transaction.

2. The Finance Minister in his Budget speech, while introducing the Finance (No. 2) Bill 2014, had made an announcement that "range concept" for determination of ALP would be introduced in the Indian transfer pricing regime however, the arithmetic mean concept will continue to apply where the number of comparables is inadequate. Further, it was announced that use of multiple year data would be permitted for undertaking comparability analysis. Consequent to the announcement, section 92C (2) of the Act was amended by the Finance (No. 2) Act, 2015 to provide that where more than one price is determined by application of the most appropriate method, the arm's length price in relation to an international transaction or specified domestic transaction undertaken on or after the 1st day of April, 2014 shall be computed in such manner as may be prescribed.

3. Therefore, the manner of computation of ALP is proposed to be provided through the amendment of Income-tax Rules. The proposed mechanism and conditions under which the multiple year data and 'range' concept would be used for determination of ALP shall be as under:-

A. Adoption of the Range Concept

i. The 'Range' concept shall be used only in case the method used for determination of ALP is Transactional Net Margin Method (TNMM), Resale Price Method (RPM) or Cost Plus Method (CPM).

ii. The following steps would be required to construct the range: -

a) A minimum of 9 entities are required to be selected as comparable entities of the tested party, based on the similarity of their functions, assets and risks (FAR) with that of the tested party;

b) 3-year data of these 9 entities (or more) would be considered and the weighted average of such 3-year data of each company would be used to construct the data set. In certain circumstances, data of 2 out of 3 years could also be used. Thus, the data set or series would have a minimum of 9 data points;

c) For calculating the weighted average, the numerator and denominator of the chosen Profit Level Indicator (PLI) would be aggregated for all the years for every comparable entity and the margin would be computed thereafter; and

d) The data points lying within the 40th to 60th percentile of the data set of series would constitute the range.

iii. If the transfer price of the tested party falls outside the range as constructed above, the median of the range would be taken as ALP and adjustment to transfer price shall be made. If the transfer price is within the range no adjustment shall be made. There shall not be two different data sets – one for testing and one for making adjustments.

B. Use of Multiple Year Data

i. The multiple year data would be used only in case determination of ALP is by Transactional Net Margin Method (TNMM), Resale Price Method (RPM) or Cost Plus Method (CPM);

ii. The multiple year data should comprise three years including the current year i.e. (year in which transaction has been undertaken) and its use for above mentioned methods shall be mandatory;

iii. In case of non-availability of data for 3 years for any of the following reasons: -

- Data of the current year of the comparables may not be available on the databases at the time of filing of returns of income by taxpayers;
- A comparable may fail to clear a quantitative filter in any one out of the three years; and
- A comparable may have commenced operations only in the last two years or may have closed down operations during the current year.

the use of data of two out of relevant three years shall be permitted.

iv. The data of the current year, however, can be used during the transfer pricing audit by both the taxpayer and the department if it becomes available at the time of audit.

C. Continued use of Arithmetic Mean

In cases where 'range' concept does not apply, the arithmetic mean concept shall continue to apply in the same manner as it applied before the amendment to section 92C (2) by the Finance (No. 2) Act 2014 along with benefit of tolerance range. Further, in cases where multiple year data is to be used, the same would apply whether "range" concept is used or arithmetic mean is used for determining the ALP. Therefore, in such cases the arithmetic mean of the multiple year data of comparable will be considered for computation of ALP.

4. The comments and suggestion of stakeholders and general public on the above draft scheme are invited. The comments and suggestions may be submitted by 31st May, 2015 at the email address (dirtp11@nic.in or by post at the following address with “Comments on draft transfer pricing rules” written on the envelop:

Director (Tax Policy & Legislation)-I

Central Board of Direct Taxes,

Room No. 147-D,

North Block,

New Delhi – 110001