

Range Concept and Multi-year data

Introduction:-

Since the time the transfer pricing (TP) provisions were first introduced in India in 2001 and the concept of the arm's length price introduced, taxpayers have been grappling with issues arising from the requirement to use the arithmetic mean to defend the arm's length nature of their transactions.

This approach leads to the single point of ALP instead of a range and did not provide any flexibility to the taxpayers.

So, Arun Jaitley in the Budget 2014, introduced range concept and allowed the use of multiple year data in order to align the transfer pricing practices to the transfer pricing practices followed in the developed economies like U.S, Australia, UK etc.

The rules are applicable for both international transactions and specified domestic transactions (SDT).

So let's understand how Range concept is flexible to the taxpayers

Range Concept:-

Previously when we calculate the ALP, we will be using Arithmetic Mean of the comparables and then we arrive at the ALP. This allows the prices or margins to be compared with the point rather than a range.

The Range concept is applicable for all the transactions including international transactions and specified transactions from Apr 2014.

The range concept is used for all the methods except the Profit Split Method (PSM) and the "other method".

In other words, Arithmetic Mean concept has to be used for calculating the Arms Length Price (ALP) under PLM or other method.

There should be a minimum of 6 comparables for applicability of Range concept.

If the number of comparables less than 6 then arithmetic concept is applicable.

The arms length range is defined as 35th percentile and the 65th percentile of the dataset arranged in the ascending order.

If the transaction falls within this range, then it is deemed to be arms length price.

If the transaction doesn't fall between this, then the median of the dataset has to be calculated.

In case the provisions of sub-rule (4) of Rule 10CA are not applicable (i.e. if there are less than 6 comparables, or if the MAM is calculated in accordance with PSM or 'other method' then the rule 10CA is not applicable)

In those cases, arithmetic mean has to be calculated.

Rule 10B:-

The newly introduced sub-rule (5) of the Rule 10B allows taxpayers to use multi-year data instead of single year data.

So, the taxpayers can use previous financial year data for comparability analysis only when the current year data is not available to the taxpayer at the time of filing of return.

However, if the current year data becomes available during the course of transfer pricing proceedings, then the same needs to be taken into account even if the current year data is not available at the time of the filing of return of income.

Computation of Arm's Length Price (Rule 10CA):-

During the assessment proceedings, if the data relating to the current year is available, then the same needs to be considered irrespective of the fact that current year data was not available at the time of the furnishing of the return of income.

Multiple year data will be considered for the Computation of ALP irrespective of the fact that range concept is applicable or not.

Where the application of the MAM results in more than one uncontrolled price, then the ALP has to be calculated as below:-

Data for the current year in which the transaction has been undertaken and two years preceding the financial has to be taken.

The dataset has to be arranged in the ascending order.

Then the weighted average of the prices for three years has to be calculated, which is being depicted in the rules and also in the Illustration 1.

Data for the current year should be compulsorily taken. The data for the previous years can be taken only if passes through qualitative/quantitative filters.

In case where the company is found incomparable for the current year in which the transaction is undertaken by the taxpayer, the company cannot be acceptable as comparable for the earlier years even if it is found to be comparable for the earlier years.

The arm's length range will constitute of the values falling between 35th and the 65th percentile of the comparable entries that are arranged in the ascending order.

35th Percentile = Total no. Of Entries * 35/100 (Lowest value in the dataset)

65th Percentile = Total no. Of Entries * 65/100 (Highest value)

If the price as calculated in the 35th Percentile is a whole number, then the 35th percentile shall be the arithmetic mean of such value and the value immediately succeeding in the dataset.

If the value derived from the formula is not a whole number, then the comparable entry in the next data place should be considered as the 35th percentile.

The same has to be followed for the 65th percentile and the 50th percentile (Median).

If the price at which an international transaction or specified domestic transaction has actually been undertaken is within the range, the price at which the

international or specified domestic transaction is undertaken, it is deemed to be the arm's length price as per section 92C (1).

The price at which an international transaction or the specified domestic transaction has actually been undertaken is outside the arm's length range referred in sub-rule (4) of the rule 10 CA, the arm's length price shall be taken to be the median of the dataset.

If the median is a whole number, it shall be the average of the prices of such value and the next higher value.

If the provisions of the sub-rule (4) of the Rule 10CA are not applicable then the arm's length price shall be the arithmetical mean of all the values included in the dataset, provided the variation between the arm's length price so determined and the price at which an international transaction/specified domestic transaction has actually been undertaken does not exceed 3% .

Illustration 1:-

S.No. (1)	Name of the Company (2)	Year 1 (3)	Year 2 (4)	Year 3 (Current Year) (5)	Aggregation of OC and OP (6)	Weighted Average (7)
1	A	OC= 200 OP =30	OC= 300 OP =35	OC= 450 OP = 40	OC = 950 OP = 105	9.05
2	B	OC= 150 OP =45	OC= 100 OP =40	OC= 150 OP =55	OC = 400 OP = 140	2.86
3	C	OC= 225 OP= 45	OC= 250 OP =25	OC= 180 OP =55	OC = 655 OP = 125	5.24
4	D	OC= 220 OP= 33	OC= 175 OP =45	OC= 200 OP =50	OC= 595 OP = 128	4.65
5	E	OC= 140 OP =10	OC= 150 OP = 12	OC= 165 OP = 28	OC = 455 OP = 50	9.1
6	F	OC= 75 OP =10	OC= 115 OP =15	OC= 155 OP = 30	OC =345 OP = 55	6.27
7	G	OC= 150 OP = 35	OC= 175 OP = 30	OC= 225 OP =45	OC =550 OP = 110	5
8	H	OC= 200	OC= 185	OC= 220	OC = 605	6.05

		OP =15	OP =30	OP =55	OP = 100	
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The dataset shall be constructed as follows:-

S.No	1	2	3	4	5	6	7	8
Values	2.86	4.65	5	5.24	6.05	6.27	9.1	9.05

Total no.of entries = 8

35th Percentile is = $8 * 35 / 100 = 2.8$

Since this is not a whole number, the number succeeding the above no. is considered as the 35th percentile, i.e. 5.

65th percentile is = $8 * 65 / 100 = 5.2$

Since the above no. Is not a whole number, the number succeeding the above no. will be treated as 65th percentile, i.e. 6.27.

Therefore the arms length range is 5 – 6.27.

So if the transaction falls within this range, it is deemed to be the arms length price and no adjustment is required.

If the transaction falls outside this range, say 7.5, then the median has to be calculated.

Median = Total no. of entries * 50/100

$$= 8 * 50 / 100 = 4$$

Since this is a whole number, the average of this value and the value succeeding this value has to be calculated.

I.e. $(5.24 + 6.05) / 2 = 5.645$.

Therefore the arms length price is 5.645 and the necessary adjustment will be made.

Conclusion:-

The major important drawback according to my observation is when the tax payer has taken the comparable for the previous years and didn't take the comparable for the current year. However at the time of the assessment proceedings, the TPO added the comparable for the current year and if the ALP differs significantly, then this rule is not favourable to such assesses who are genuine in calculating the arms length price.

And in the developed economies like U.S use **25%-75%** as the arms length range and it didn't specify the methods in which the arms length range is applicable.

Also the number of prior years has not been specified by the IRS.

However the amended rules provide **clarity and flexibility** in arriving at the arms length price of the transaction. It is a sensible move by the government in bring the transfer pricing practices in align with the practices followed by the developed economies.

The use of range concept, being a statistical tool, enhances the reliability of analysis undertaken for computation of ALP.

Use of inter-quartile range is amongst the globally accepted best practice and also closer to economic realities wherein prices, and or margins, are compared to those within a **range** and not at to a particular **point**.