

Date: 31st May 2015

Kind Attn:

Director (Tax Policy & Legislation)-I
Central Board of Direct Taxes,
Room No. 147-D,
North Block,
New Delhi – 110001.

By email

Subject: Comments to the ‘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’.

Dear Sir,

We are grateful for the opportunity to comment and provide suggestions on the ‘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’.

The proposed rules which have been drafted for the adoption of the range concept for determination of arm’s length price as well as for allowing the use of multiple year data is a positive step in bringing the Indian legislation on Transfer Pricing closer to the international best practices. On an analysis of the proposed rules, however, there are some concerns - as listed in the following paragraphs - which we request you to address:

❖ Adoption of the Range Concept:

- 1) Restriction to application of certain methods: We are unable to comprehend the reason for the restriction of adoption of the range concept only for the application of methods - Transactional Net Margin Method (TNMM), Resale Price Method (RPM) or Cost Plus Method (CPM). The range concept is in one way a reiteration of the fact that transfer pricing is not an exact science. The differences in the figures that comprise the range may be caused by the fact that, in general, the application of the arm’s length principle only produces an approximation of conditions that would have been established between independent enterprises¹. Alternatively, it is also possible that the different points in a range represent the fact that independent enterprises engaged in comparable transactions under comparable circumstances may not establish exactly the same price for the transaction². Since the range concept is accepted as a superior measure of central tendency when compared to the

¹ OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, para. 3.55.

² Ibid.

arithmetic mean, in the absence of any preference in the legislation for adoption of a particular method for the determination of an arm's length price, it is suggested that the range concept should be extended to the application of other methods like Comparable Uncontrolled Price Method (CUP) too.

- 2) Minimum requirement of 9 entities: Mathematically, the range concept can be applied even to a data set consisting of two comparables to the least since the value returned by application of the percentile formula need not necessarily be a member of the data set. Although it is acknowledged that a reasonable number of observations forming part of the data set is desirable for a rational outcome by application of measures of central tendency, First Proviso r.w. Second Proviso to Section 92C(2) of the Income tax Act, 1961 does not either prescribe the requirement of a minimum number of entities for the operation of the tolerance band when calculating the arithmetical mean and/or calculating the arithmetical mean itself. We therefore request you to remove the requirement of presence of minimum number of entities in the data set for application of the range concept.

In the alternative – as a measure of good governance - we request you to make public the empirical evidence which may have led you to the introduction of such minimum requirement criteria.

❖ **Use of Multiple Year Data:**

- 1) Mandatory application in case of TNMM, RPM, CPM: As per our understanding of the proposed rules dealing with the application of range concept along with the use of multiple year data, the possible scenarios as arising out of the proposed rules can be presented as below:

Number of comparables	Availability of data for a particular number of years	Result
> 9 entities	> 2 out of 3 years	Range concept
< 9 entities	> 2 out of 3 years	Arithmetical mean
> 9 or < 9 entities	< 2 out of 3 years for any of the comparables	Such comparable cannot be included in application of either Range concept or Arithmetical mean. Therefore, reject such comparable itself?

The mandatory application of multiple year data consideration could therefore result in inconsistent outcomes which can be demonstrated below:

Entity	Availability of financial data					
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
A Ltd	√	X	√	X	√	√
Result	Reject	Reject	Accept	Reject	Accept	Accept

(Note: It is assumed that the entity under consideration otherwise passes through all the other necessary quantitative and qualitative filters.)

The above illustration shows the same entity can result in becoming a comparable for some of the years under review whereas it would fail to become a comparable in some other years under consideration. It may be noted that the acceptance or rejection of such an entity as a comparable is solely influenced by the availability of financial data³ even when it would otherwise have passed the comparability analysis test involving comparison of the economic parameters.

We therefore request that the application of the multiple year data usage in principle may be made non-mandatory.

In the alternative, correspondingly the tested party too may be allowed to use the multiple year data concerning its own financial statements for the purpose of determining the arm's length price.

- 2) Usage of current year data at the time of assessment: We request that it may be explicitly stated that the use of current year data at the time of assessment for determination of the arm's length price should not be allowed either by the tax payer or the tax administration based on the following reasons:
 - (a) It goes against the tax policy of levying penalty for non-maintenance of information and documentation latest by the date of return filing as enforced under Section 271AA of the Income Tax Act, 1961;
 - (b) It may violate grounds of natural justice since the taxpayer would be precluded from making any compensating adjustment in the case of availability of data subsequently at the time of assessment which was not available at the time of filing the return;
 - (c) It may result in an exercise akin to data mining.
- 3) General: The allowance for use of multiple year data is contradictory to the tax policy of using contemporaneous information and documents for the determination of an arm's length price. The use of contemporaneous information and documents is advocated since such information and documents may ensure a high degree of comparability⁴. Whereas, the use of

³ The non-availability of financial data may be due to genuine reasons such as non-updation by the database software company, non-filing by the entity itself under reasons beyond their control, etc.

⁴ The United Nations Practical Manual on Transfer Pricing for Developing Countries, para. 10.4.3.4.

multiple year data is advocated so as to be useful in providing information about relevant business and product life cycles of the comparables as well as to improve the process of selecting third party comparables⁵. The confrontation between the two contrasting economic rationales may be put to rest by ensuring that the use of multiple year data is made non-mandatory while at the same time providing an appropriate clarification to the same effect so as to avoid the ongoing disputes which have arisen from a literal interpretation of the legislation.

We sincerely hope that the above comments may be useful to the CBDT.

Yours sincerely,

Pankaj Bhuta [B.Com (Hons.), F.C.A.]

Harshal Bhuta [M.Com., F.C.A., A.D.I.T., LL.M. Candidate 2014-15 for the International Tax Law Program at WU (Vienna)]

Tanvi Vora [M.Com, A.C.A.]



P. R. BHUTA & CO. Chartered Accountants

Address : 2-I, Jeevan Sahakar, 2nd Floor,
Sir P. M. Road, Fort,
Mumbai – 400001, India.

Telephone : +91 22 22660010/3427 ; 66333699

Fax : +91 22 22662793

E-mail : info@bhutaco.com

Website : www.bhutaco.com

⁵ OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, para. 3.77, para. 3.78.