

AN ALERT FROM THE BDO TRANSFER PRICING PRACTICE

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TRANSFER PRICING



SUBJECT

INDIA TRANSFER PRICING UPDATE INTRODUCTION OF RANGE CONCEPT AND USE OF MULTI-YEAR DATA

SUMMARY

On October 19, 2015, the Indian Central Board of Direct Taxes (CBDT) issued notification S.O. 2860 (E), to amend the Income Tax Rules, 1962 thereby introducing the “range” concept and allowing use of multi-year data.

DATE/TIMING

The new rules will determine the arm’s-length price (ALP) for transactions under certain situations and apply to transactions entered on or after April 1, 2014.

BACKGROUND AND DETAILS

Prior to the amendment, Indian Transfer Pricing Regulations (Regulations) required the ALP to be calculated as the arithmetic mean of comparable prices determined most appropriate under the specified methods. The Regulations allowed a tolerance band of plus or minus three percent of the taxpayer’s intercompany transaction price (one percent in the case of wholesale traders) in comparing against the ALP. One drawback of this approach was that it assigned equal weight to comparable companies with excessive profitability (or outliers). Further, the Regulations required taxpayers to rely only on the current year (CY) data of comparable companies, where CY is defined as the year in which the intercompany transaction took place. If CY data for a comparable company was unavailable, then the company was excluded from the set of comparable companies.

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Multi-Year Data

The amended rules allow the use of prior year data (i.e., the year immediately preceding the CY) if CY data is unavailable at the time of filing the tax return. However, if CY data is subsequently available during the course of a tax audit, then CY data shall be used irrespective of its unavailability at the time of tax return filing.

The table below shows the data construction for comparable companies in application of the Resale Price Method, Cost Plus Method, or Transactional Net Margin Method:

Year of Data Used	Additional Years to be Considered*	Price to be Included in Dataset
Current Year	Preceding two fiscal years: [CY-1] and [CY-2]	Weighted average of prices of CY, [CY-1], and [CY-2]
Immediately preceding CY [CY-1]	[CY-2]	Weighted average of prices of [CY-1] and [CY-2].

*with exceptions

Range Concept

Under the amended rules, the ALP range extends from the 35th percentile to the 65th percentile, if the set of comparables consists of six or more companies. If the taxpayer's transaction price falls within this range, then that price is considered arm's-length. However, if the transaction price falls outside this range, then the ALP will be the median (50th percentile). The new rules also allow the application of the range concept to the dataset when the Comparable Uncontrolled Price (CUP) method is selected as the most appropriate method.

If the number of comparable companies is less than six, the use of arithmetic mean to determine the ALP will continue to apply.

BDO INSIGHTS

With the introduction of the amended rules, it is evident that the Indian Government is steadily taking steps towards aligning the Indian Transfer Pricing Regulations with accepted international practices, including the United States Regulations. It is important to note that the Indian ALP range (between 35th and 65th percentiles) is narrower than the United States interquartile range (between 25th and 75th percentiles). Another noteworthy point about the amended rules is that CY data of comparable companies, if subsequently available, will be taken into account at the time of audit. As a result, benchmarking results may change at the time of audit.

Taxpayers with intercompany transactions in India should carefully review their Indian financials and benchmarking results for fiscal years April 1, 2014 - March 31, 2015, and onward to assess how the amended rules may affect their transfer pricing positions.

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