Arm's-length Range, Multiple year Data
(Analysis of Recent TP amendments)

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Applying the new Range Concept – Part 1

- CBDT Notification No 83/2015 dated 19th October 2015
- Amended rules allow for use of a “range concept” for determination of ALP and “use of multiple year” data for undertaking TP comparability analysis
- Applicable for international txns & SDT undertaken w.e.f 1 April 2014
- Minimum of 6 comparable entities are required to be selected
- 3-year data of comparable entities considered in constructing the data set and the weighted average of data of each company will be used
- **Data points lying within 35-65th percentile of data set series would constitute the “range”**
- If number of comparables less than 6, then arithmetic mean of PLIs shall be used as ALP
- **Income Tax Rules - Rule 10CA(4) to (8) define range concept in detail**

Applying the new Range Concept – Part 2

- Step 1: Arrange margins/prices data in ascending order
- Step 2: Compute
  - A = .35 * number of data points
  - B = .65 * number of data points
- Step 3: If A & B are whole numbers:
  - Lower = Average of data point at A and (A+1)st position
  - Upper = Average of data point at B and (B+1)st position
- Step 4: If A& B are not whole numbers:
  - Lower = Round up A and use data point at such position
  - Upper = Round up B and use data point at such position

Math refresher!

- **Percentile**
  - Indicates the value below which a given % of observations in a group of observations fall
  - In simpler words: “A percentile is a number where a certain percentage of scores fall below that percentile”
  - In even simpler words: Say, if you scored 67 out of 90 it has no meaning unless you know your score is in the 90^{th} percentile which means you scored better than 90% of the people who took the test!
- **Arithmetic Mean** is average of the dataset
- **Median** is the middle value of the organized dataset
- Most statisticians will tell you that: “”Averages can be misleading! Try a percentile” – Why?
  - Outliers will affect the mean a lot; not percentile. Remember Bodhtree Consulting?!
- **<u>Quiz question: What percentile is the Median?</u>**

Applying Range Concept - Illustrations

Percentile	Formula	Result	Value to be Selected
35th	Total no of data points * 35% [**7** * 35%]	2.45	3rd Value
65th	Total no of data points * 65% [**7** * 65%]	4.55	5th Value
Median	Total no of data points * __% [**7** * ___]	____	___ Value

Percentile	Formula	Result	Value to be Selected
35th	Total no of data points * 35% [**20** * 35%]	7.00	Mean of 7th & 8th Value
65th	Total no of data points * 65% [**20** * 65%]	13.00	Mean of 13th & 14th Value
Median	Total no of data points * __% [**20** * 0.5]	____	Mean of ___ & ___ Value

RANGE- AN ILLUSTRATION

Scenario 1 – Benchmarking sale of goods

Three-year old weighted average margin of comparable companies	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**
	10	15	16	-4	5	25	30	6	30
Ascending order	-4	5	6	10	13	15	16	25	30
Arithmetic mean	12.89%								
Range 35th to 65th percentile	10% to 15% (calculated)								

Scenario 2 – Benchmarking sale of goods

Three-year old weighted average margin of comparable companies	1	2	3	4	5	6	7	8	9
	10	15	16	-4	5	40	30	6	13
Ascending order	-4	5	6	10	13	15	16	30	40
Arithmetic Mean	14.56%								
Range 35^{th} to 65^{th} Percentile	10 to 15% Calculated								

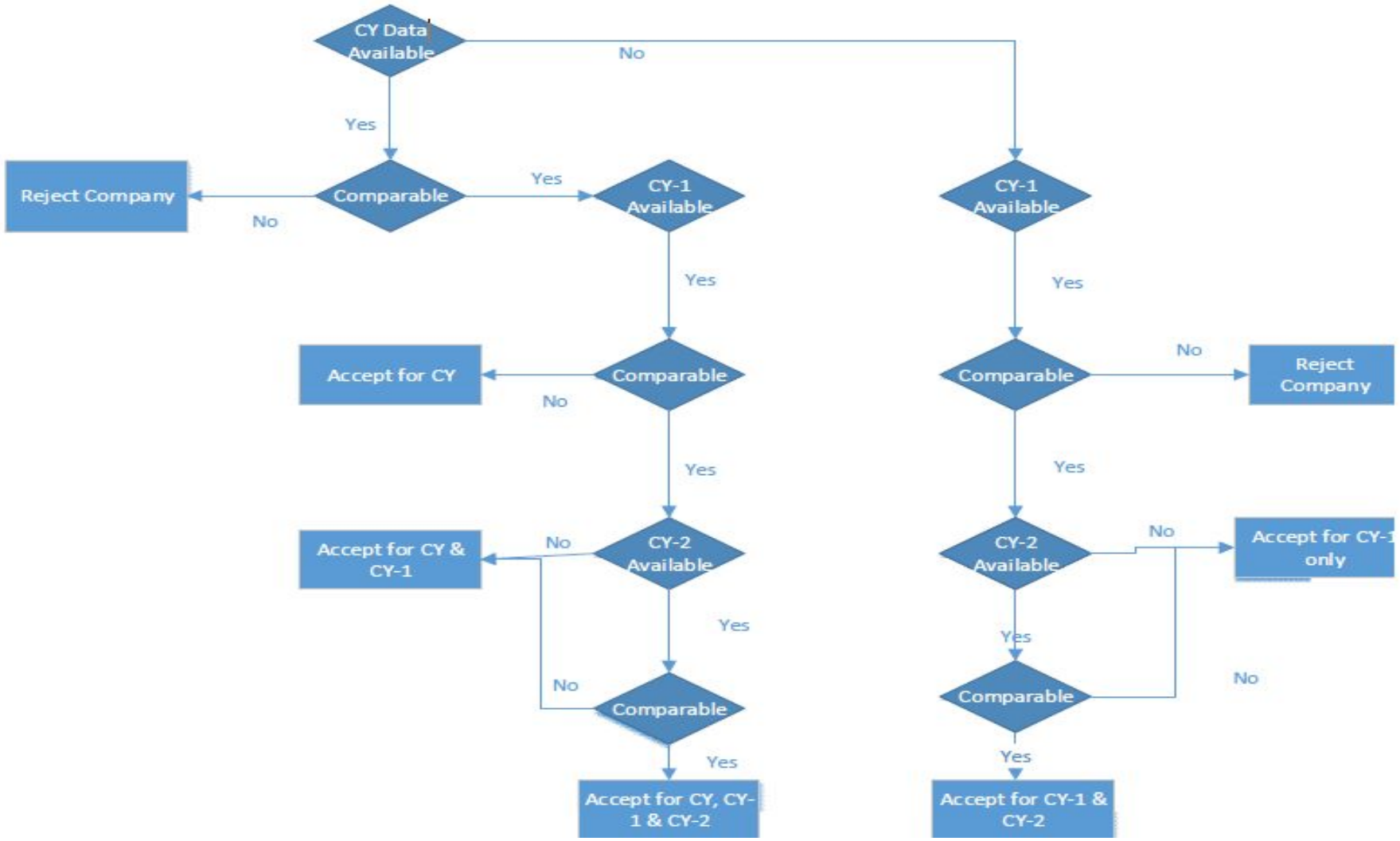
What do other countries follow?

- OECD advocates the usage of Inte-Quartile Range (IQR)
  - This is the range from the 25^{th} to the 75^{th} percentile of results derived from the uncontrolled comparables
- TP Adjustments usually done to the Median
- Concept of IQR has been adopted by majority of the countries in their TP regulations
  - UK, USA, Austria, Australia, France, Singapore, South Afric, Mexico, Indonesia, Denmark, China etc.

Multiple year data – Dataset construction

- **STEP 1**: In case current year ('CY') data is available, assess comparability for CY.
    - If found not comparable for CY, comparable is rejected.
    - If comparable for CY, use available data for CY.
        - Proceed to check comparability for CY-1.
        - ➢ If CY-1 data is available and comparable, then accept for CY-1.
        - ➢ If CY-1 is comparable, proceed to check comparability for CY-2 and accept if comparable for CY-2.
            - **Step 2:** If data for CY not available, check for CY-1 data.
        - If CY-1 data not available/not comparable, reject company.
        - If CY-1 data available and comparable, check for comparability for CY-2. Accept CY-2 data if

Multiple year Data Flowchart



Operating margins – Multiple year Data Rule 10CA (2) and (3)

Comparable	Availability of Data		
	2015	2014	2013
A Ltd	Available and Comparable	Available and Comparable	Available and Comparable
B Ltd	Not Available	Available and Comparable	Available and Comparable
C Ltd	Not Available	Not available	Available and Comparable
D Ltd	Available but not Comparable	Available and comparable	Available and Comparable
E Ltd	Available and Comparable	Available but not Comparable	Available and Comparable

Applicability of Range & Multiple year data

Methods	Multiple year Data	Range Concept
CUP	No	Yes
Cost-Plus	Yes	Yes
RPM	Yes	Yes
TNMM	Yes	Yes
PSM	No	No
Other Method	No	No

Issues with Range Concept & Multiple year Data

- Interesting pick of 35-65th percentile – not a quartile range?
- What about the arm's length price for concluded and filed APA's based on arithmetic mean

Evolution of TP over the past few years

- TP assessment procedure – reference to TPO has been overhauled
- Removal of SDT for tax neutral related party transactions (S.40A(2))
- Secondary adjustments introduced
- Thin capitalization Rule
- Time limit for completion of assessment tweaked
- OECD BEPS introduced
  - CbCR, Master File, Local File
  - Equalization Levy

Current TP litigation

- Comparability analysis
  - Functional comparability, application of filters, different financial year ending
- Adjustments
  - Customs adjustment, Working capital, Risk adjustment, Idle capacity, Depreciation
- Management charges
- Local savings
- Share valuation
- Deemed international transaction
- Start-up losses, extraordinary expenditure
- Royalty payments
- Cost sharing
- AMP expenses/Intangible valuation
- Application of Sixth Method

Points to ponder in TP

Q1) **Does the arm's-length range and multi-year data solve underlying problem?**

- NO! Comparability analysis is still very subjective
- Comparing "Apples" and "Oranges" but both are considered comparable under TNMM as a fruit….
- Endless litigation loop of comparability analysis….1000's of differing judgments!

Q2) **Should there be a prescribed set of filters and adjustments?**

- Suitable "adjustments" – turnover and other filters constantly litigated

Q3) **Is ALP a gold standard; should we consider Global Formulary Apportionment?**

- PSM and CbCR are a step in this direction

Q4) **APA's, Safe Harbours and Risk-based TP assessments are a positive step but more fundamental qn is whether economic analysis can be enshrined in law?**

- Economic expert panel to analyse transactions?

<u>Bottomline: TP is not art, science – its magic?!</u>

Thanks!

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