

Transfer Pricing tolerance range for arm's length price determination for AY 2021-22 notified at 3% of transaction price (1% for wholesale trading)

Summary

Vide notification no. 124/202, dated 29 October 2021, the Ministry of Finance has notified the tolerance range of 3% (1% for wholesale trading) for determining the arm's length price under transfer pricing regulations for AY 2021-22. It is important to note that such tolerance range remains unchanged since AY 2013-14.

Applicability

Under the Transfer Pricing Regulations under Section 92C of the Income-tax Act 1961, read with Rule 10CA of the Income-tax Rules 1962, the 35th to 65th percentile of the dataset is construed as the arm's length range for cases where there are six or more comparable uncontrolled entries to the dataset where the comparable uncontrolled price method, resale price method, cost plus method or transactional net margin method is selected as the most appropriate method.

However, in other cases, i.e., where there are less than six data points or where the method selected is other method or the profit split method, instead of the 35th to 65th percentile range, the arithmetic mean of the dataset is used. In such cases, a tolerance range of 3% (1% for wholesale trading) is permitted. If the arm's length price (determined based on the arithmetic mean of the dataset) is within the tolerance range of +/-3% (1% for wholesale trading) of the transaction price, the transaction price is accepted to be at arm's length.

The definition of wholesale trading remains unchanged, which is defined as trading in goods where (i) the purchase cost of finished goods is 80% or more of the total cost and (ii) average monthly closing inventory of such goods is 10% or less of sales.

Our comments

Considering the unprecedented impact caused by the COVID-19 pandemic in FY 2020-21, the industry was expecting widening of the tolerance range for AY 2021-22 to accommodate situations causing an adverse deviation in transaction prices from the arm's length price. However, such an expectation has not been addressed by the Central Board of Direct Taxes, as it has merely extended the applicability of the tolerance range for AY 2020-21 to AY 2021-22, as well.