

## Full Range versus Inter-quartile Range - A Comparative View

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On the Transfer Pricing front, the budget has given more than one reason for the industry to cheer. While on one hand rollback of APA provisions has been permitted, the newly elected Government has also proposed (or at least so it appears from the budget speech) two major amendments which industry and experts had for long been pressing. The importance of proposed amendments (on range and data years) can be gauged from the fact that they found specific mention in FM's speech when normally such aspects of nuanced operation could equally have been side-lined to details of fine print.

In the budget speech, the Honourable Finance Minister announced that range concept shall be introduced. However, as of now there is no clarity on whether it would be 'full range' (as advocated by OECD) or just the inter-quartile range. This article examines the OECD view and country practices in this regard as well as the case for adoption of 'full range'.

### Review of Country Practices

#### USA

Through various examples, US Treasury Regulations discuss the determination of an arm's length.<sup>[1]</sup> In line with OECD Guidelines, Treasury Regulations recognize that the results arrived at in a comparability analysis may not be equally reliable but require further analysis. Thus, based on comparability principles the results may require a further pruning to arrive at the arm's length range. However, where data available on potential comparables is not sufficient, US regulations suggest the use of an inter-quartile range to arrive at the arm's length range.

#### Canada

Canadian Revenue Agency refers to the full range of results as against the inter-quartile range.<sup>[2]</sup> Where results for the tested party fall outside the full range, the CRA usually makes an adjustment to the median of the set.

#### United Kingdom

UK Transfer Pricing legislation relies upon the OECD guidelines and follows the full range concept. In HMRC's view, there is no logical reason to suppose that the middle two quartiles are any more comparable to the tested transaction compared to the top and bottom quartiles.<sup>[3]</sup> Nevertheless, inter-quartile range is still commonly used in most analyses, and where results of the tested transaction fall in the top or bottom quartile, one can expect a detailed scrutiny on whether the data in the relevant quartile is really comparable to the tested transaction.

#### Australia

In Australia, the use of inter-quartile range is not mandated.<sup>[4]</sup> However, in practice, the inter-quartile range is often used. The final outcome as to the part of range that must be relied upon depends on the functional analysis and characterisation of the tested party.

### OECD View

OECD Guidelines state that there would seldom be situations when comparability analysis provides a single result to be used as the arm's length price. Instead, the more common situation is that a number of figures would result giving rise to a "range of figures all of which are **relatively equally reliable**"

Before proceeding further, it needs to be clarified that OECD Guidelines discuss (in paras 3.55 to 3.62 of the 2010 Guidelines) two concepts – ‘range’ in the sense of the full range and the arm’s length range which is a subset of the full range. This distinction comes out clearly in paragraph 3.59 of the OECD Guidelines and extracted below.

*“Where the application of one or more methods produces a **range of figures**, a substantial deviation among points in that range may indicate that the data used in establishing some of the points may not be as reliable as the data used to establish the other points in the range or that the deviation may result from features of the comparable data that require adjustments. In such cases, further analysis of those points may be necessary to evaluate their suitability for inclusion in any **arm’s length range**.”*

Hence, in OECD’s view, the broader set of comparables arrived at through economic analysis requires further filtering to derive the arm’s length range. OECD does not recommend any specific statistical measure for step two derivation of the arm’s length range but stresses on application of comparability principles for further refinement of derived results.

### India

India’s current position on arm’s length price is amongst the queerest and shared in approach by few other countries (for instance Brazil). Indian Transfer Pricing regulations determine the ‘Arm’s Length Price’ as the arithmetic mean of comparable prices [to allow some flexibility a narrow (+/-) 3 percent band around the Transfer Price is allowed]. It is an accepted fact that the measure is heavily influenced by extreme values leading to skewed results. Moreover, like the median, the mean is but one point in the full range of comparable values.

### **Conclusion**

The following points emerge from the above discussion:

- Many country legislations do not mandatorily require the use of a statistical proxy but accept the full range provided comparability of the range points can be demonstrated satisfactorily through reliable data;
- More often than not use of a statistical measure is a compromise between the application of full range and limited availability of data for closely evaluating points in the full range;
- Given data availability full range is better than inter-quartile range which is merely one of the ways to address data unavailability issue.

Review of country practices and OECD view indicates that ‘full range’ is also an option that can be considered. It is but natural that all comparables in the full range should be given due recognition unless there are reasons for exclusion based on comparability principles or data insufficiency. In circumstances wherein statistical proxies are used as a matter of rule, a glaring contradiction emerges – a comparable is accepted based on comparability analysis but yet discarded implicitly through the application of statistical proxy claimed to reflect the arm’s length result. In brief, comparables should only be accepted or rejected based on functional comparability and not by the mechanical application of statistical measures. Having said that, even if the Government introduces inter-quartile range for determination of arm’s length results, the amendment shall go a long way in reducing Transfer Pricing disputes.

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[1] Refer US Treasury Regulation 1.482-1(e) under section 482 of the US Tax Code

[2] IC87-2R, paragraph 34.

[3] Refer HMRC Guidance - INTM467150

[4] Refer ATO TR 97/20