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Government of India
Ministry of Finance
Department of Revenue
Central Board of Direct Taxes
(Foreign Tax and Tax Research-I Division)

New Delhi, the 26th day of March, 2013

Circular No. 02 /2013

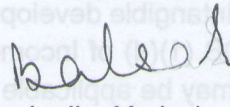
Sub: Circular on application of profit split method

It has been brought to the notice of CBDT that clarification is needed for selection of profit split method (PSM) as most appropriate method. The issue has been examined in CBDT. It is hereby clarified that while selecting PSM as the most appropriate method, the following points may be kept in mind:

1. Since there is no correlation between cost incurred on R&D activities and return on an intangible developed through R&D activities, the use of transfer pricing methods [like Transactional Net Margin Method] that seek to estimate the value of intangible based on cost of intangible development (R&D cost) plus a return, is generally discouraged.
2. Rule 10B (1)(d) of Income Tax Rules 1962 (the Rules) provides that profit split method (PSM) may be applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction. The PSM determines appropriate return on intangibles on the basis of relative contributions made by each associated enterprise.
3. Selection and application of PSM will depend upon following factors as prescribed under Rule 10C(2) of the Rules:
 - the nature and class of the international transaction;
 - the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprise;
 - the availability, coverage and reliability of data necessary for application of the method;
 - the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprise entering into such transactions;
 - the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprise entering into such transactions;
 - the nature, extent and reliability of assumptions required to be made in application of a method.

4. It is evident from the above that Rule 10C (2) of the Rules stipulates availability, coverage and reliability of data necessary for the application of the method as one of the several factors in selection of most appropriate method. Accordingly, in a case, where the Transfer Pricing Officer (TPO) is of view that PSM cannot be applied to determine the arm's length price of international transactions involving intangibles due to non-availability of information and reliable data required for application of the method, he must record reasons for non-applicability of PSM before considering TNMM or comparable uncontrolled price method (CUP) as most appropriate method depending upon facts and circumstances of the case.
5. Application of Profit Split Method requires information mainly about the taxpayer and associated enterprises. Section 92D of the Income-tax Act, 1961 provides for maintenance of relevant information and documents by the taxpayer as prescribed under Rule 10D of the Rules. Therefore, there should be good and sufficient reason for non-availability of such information with the taxpayer.
6. Depending upon facts and circumstances of the case, TPO may consider TNMM or CUP method as appropriate method by selecting comparables engaged in development of intangibles in same line of business and make upward adjustments taking into account transfer of intangibles without additional remuneration, location savings and location specific advantages.

The above may be brought to the notice of all concerned.


(Batsala Jha Yadav)
Director APA
Central Board of Direct Taxes

26/3/13

Copy to:

1. The Chairperson, Members and all other officers of the CBDT of the rank of Under Secretary and above.
2. All Chief Commissioners/Directors General of Income-tax.
3. The Director (PR, PP & OL), Mayur Bhawan, New Delhi for printing in the quarterly tax bulletin and for circulation as per usual mailing list (100 Copies).
4. The Comptroller and Auditor General of India (40 copies).
5. All Directors of Income-tax, New Delhi
6. The Director General of Income-tax, NADT, Nagpur
7. Guard File.
8. Joint Secretary and Legal Advisor, Ministry of Law and Justice, New Delhi
9. The Institute of Chartered Accountants of India, IP Estate, New Delhi

(Batsala Jha Yadav)
Director APA
Central Board of Direct Taxes