



CBDT notifies the revised safe harbour rules

Introduction

For the first time after enactment of Transfer pricing (“TP”) Rules in 2001, the Government of India, in Finance Act 2009, introduced the “Safe Harbour Rules” for not only to reduce the TP disputes in relation to routine international transactions but also to provide compliance relief administrative simplicity and certainty to the taxpayers and tax administration. In continuation of the same, the Central Board of Direct Taxes (“CBDT”) introduced the final safe harbour rules in September 2013.

Till date the Indian safe harbour rules have evoked a tepid response from the taxpayers due to high margins running up to 30%. Accordingly, in order to align with the margins decided by Tribunal and in Advance Pricing Agreements (“APA”) and to turn the safe harbour as a popular dispute resolution mechanism, CBDT vide its Notification dated June 7, 2017, has revised the Indian safe harbour rules.

Key Amendments

CBDT (in its Notification No. 46/2017/F. no. 370142/6/2017-tpl, dated June 7, 2017), has revised the Indian safe harbour rules. The key amendments in the safe harbour rules have been discussed as under:

- ❖ A revised set of eligible transactions (comprising of the revised safe harbour rates) have been introduced by way of newly inserted sub-rule 2A of Rule 10TD of Income Tax Rules, 1962 (“the Rules”). A comparative analysis of the eligible transactions along with applicable safe harbour rates provided in sub-rule 2 of Rule 10TD of the Rules with newly inserted sub-rule 2A of Rule 10TD of the Rules of the Rules is tabulated below:

S. No.	Eligible Transactions	Existing Rates in sub-rule 2	New Rates introduced in sub-rule 2A	Remarks
1	For Provision of Software development Services	20%-22%	17%-18%	<ul style="list-style-type: none"> New safe harbour rates not applicable when value of international transactions exceeds INR 200 Crores
2	For Provision of IT-enables Services (BPO)	20%-22%	17%-18%	<ul style="list-style-type: none"> New safe harbour rates not applicable when value of international transactions exceeds INR 200 Crores
3	For Provision of Knowledge Process Outsourcing Services	25%	18%-24%	<ul style="list-style-type: none"> New safe harbour rates will vary based on the proportion of employee cost to total operating cost. Further, the New safe harbour rates not applicable when value of international transactions exceeds INR 200 Crores
4	Advancing of intra-group loans where the amount of loan is denominated in Indian Rupees (INR).	SBI Base Rate + 150 to 300 basis points	SBI's Fund Lending Rates as on April 1 of the relevant year + 175 to 625 basis points (depending upon the credit rating of the Associated Enterprise)	<ul style="list-style-type: none"> The new safe harbour rates will not be applicable when the amount of loan exceeds INR 100 Crores
5	Advancing of intra-group loans where the amount of loan is denominated in foreign currency.	NA	SIX MONTH LIBOR RATE + 150 to 600 basis points based on the (depending upon the credit rating of the Associated Enterprise)	<p><u>Newly Inserted</u></p> <ul style="list-style-type: none"> The new safe harbour rates will not be applicable when the amount of loan exceeds INR 100 Crores
6	For corporate guarantee	1.75% - 2%	1%	<ul style="list-style-type: none"> NA
7	For provision of contract research and development services wholly or partly relating to software development	30%	24%	<ul style="list-style-type: none"> The new safe harbour rates not applicable when value of international transactions exceeds INR 200 Crores
8	For contract research and development services wholly or partly relating to generic pharmaceutical drugs	29%	24%	<ul style="list-style-type: none"> The new safe harbour rates not applicable when value of international transactions exceeds INR 200 Crores
9	Manufacture and export of core auto components	12%	12%	<ul style="list-style-type: none"> No change
10	Manufacture and export of non-core auto components	8.50%	8.50%	<ul style="list-style-type: none"> No change
11	Procurement of "Low Value Added Services"	NA	The entire value of the international transaction, including a mark-up not exceeding 5 percent, does not exceed a sum of ten crore rupees	<p><u>Newly Inserted</u></p> <ul style="list-style-type: none"> The exclusion of "shareholder costs" and "duplicate costs" from the cost pool and the "reasonableness of the allocation keys used for allocation of costs" to the taxpayer by the associated enterprise are certified by an "accountant"

- ❖ The maximum coverage of Safe Harbour Rules have now been *reduced to three years* from five years in case if the taxpayer opt to exercise the amended safe harbour rates as provided in sub-rule 2A of Rule 10TD of the Rules;
- ❖ An inclusive definition of *employee cost* in relation to the transaction pertaining to provision of KPO services have also been inserted;
- ❖ An elaborated definition of *low value added services* has also been brought in within the amended Safe Harbour Rules. This definition also provides the list of certain services which shall not be considered as low value added services;
- ❖ Following items have been added to broaden the scope of *operating expenses*:
 - *Cost to cost reimbursement of expenses paid to/ recovered from the associated enterprises; and*
 - *Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the taxpayer to the employees of the taxpayer*

In case of low value added services, where the exclusion of shareholder costs and duplicate costs from the cost pool and the reasonableness of the allocation keys used for allocation of costs to the taxpayer by the associated enterprise is to be certified by an accountant, an inclusive definition of the term *accountant* with reference to Section 288 of the Income-tax Act, 1961 has been introduced in the amended Safe Harbour Rules.

NANGIA'S TAKE

Following are the key takeaways in relation to revised Safe Harbour Rules:

- ❖ *Reduction in corporate guarantee rate will surely help the taxpayers to avoid unwanted litigation and may encourage to exercise the Safe Harbour option;*
- ❖ *The slash in safe harbour rates in case of provision of Software Development, BPO, KPO services will surely encourage the taxpayers to opt the Safe Harbour regime. However, the benefit of the reduced rates shall not be applicable to the taxpayers wherein the value of their aforesaid international transactions exceeds INR 200 crores. To that extent, this will definitely discourage the large taxpayers to exercise the Safe Harbour option.*
- ❖ *Having said that, the APA route will remain open for such taxpayers, which advocates the lower margins (broadly within the range of 15% - 18%) in case of aforesaid transactions;*
- ❖ *Inserting the transaction pertaining to procurement of "low value added services", the CBDT has taken a step forward to align the Indian transfer pricing regulations with the OECD TP Guidelines (Revision in Chapter 7 - In FY 2016). However, the threshold (of INR 10 crore) for such services (including mark-up of 5%) is considered to be very less; and*
- ❖ *The introduction of safe harbour in relation to "Advancing of intra-group loans where the amount of loan is denominated in foreign currency", wherein the interest rates are based in LIBOR based rates, is a welcome step. The tax authorities may take a cue therefrom and may proceed to levy interest on the taxpayer's AEs' outstanding balances using the LIBOR based rates instead of local prevailing rates.*





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