

27 May 2020

Global Tax Alert

News from Transfer Pricing

India Tax Administration extends applicability of transfer pricing safe harbor rules to financial year 2019-20

EY Tax News Update: Global Edition

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Executive summary

India's Central Board of Direct Taxes (CBDT), the apex Indian tax administration body, first issued transfer pricing (TP) safe harbor rules (SHR) in 2013. The SHR listed specific transactions that were covered, provided procedures for adopting safe harbors, the transfer prices to be adopted, the compliance procedures upon adoption of a safe harbor and circumstances in which a safe harbor adopted may be held to be invalid. Those rules were applicable for five years and ended with financial year (FY) 2016-17. The CBDT extended and modified the SHR for three additional FYs ending FY 2018-19.¹

On 20 May 2020, the CBDT amended the SHR to extend the applicability to FY 2019-20, without any further modifications. Taxpayers opting for the SHR for FY 2019-20 need to file the return of income for the year on or before the date of furnishing the prescribed Form 3CEFA for opting for the SHR, the due date for this election is 30 November 2020.

Further, the *Finance Act, 2020* amended the ITL to enable the CBDT to prescribe SHR for the attribution of profits to a business connection or permanent establishment (PE) of a nonresident. However, those SHR have not been issued to date.

Detailed discussion

International transactions and applicable safe harbor transfer price

A summary of the safe harbor transfer price declared by an eligible taxpayer that shall be accepted by the tax authorities for FY 2019-20 is as follows:

Eligible international transaction	Threshold limit value	Safe harbor margin											
Provision of software development services other than contract research and development (R&D) services, with insignificant risks	Up to INR1 billion	17% or more on total operating costs											
	Above INR1 billion up to INR2 billion	18% or more on total operating costs											
Provision of information technology enabled services, with insignificant risks	Up to INR1 billion	17% or more on total operating costs											
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Provision of Knowledge Process Outsourcing services, with insignificant risks	Up to INR2 billion	<table border="1"> <thead> <tr> <th>Margin on total operating costs</th> <th>Employee cost to operating costs</th> </tr> </thead> <tbody> <tr> <td>24% or more</td> <td>60% or more</td> </tr> <tr> <td>21% or more</td> <td>40% or more but less than 60%</td> </tr> <tr> <td>18% or more</td> <td>40% or less</td> </tr> </tbody> </table>		Margin on total operating costs	Employee cost to operating costs	24% or more	60% or more	21% or more	40% or more but less than 60%	18% or more	40% or less		
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<p>The Interest rate declared in relation to the international transaction is not less than the one-year marginal cost of funds lending rate of SBI as on 1 April of the relevant previous year plus,</p> <table border="1"> <thead> <tr> <th>Basis points</th> <th>CRISIL² credit rating of associated enterprise (AE)</th> </tr> </thead> <tbody> <tr> <td>175</td> <td>between AAA to A or its equivalent</td> </tr> <tr> <td>325</td> <td>BBB-, BBB or BBB+ or its equivalent</td> </tr> <tr> <td>475</td> <td>between BB to B or its equivalent</td> </tr> <tr> <td>625</td> <td>between C to D or its equivalent</td> </tr> <tr> <td>425</td> <td>credit rating of AE is not available, and the amount of loan advanced to the AE including loans to all AEs in INR does not exceed INR 1billion in aggregate as on 31 March of relevant previous year</td> </tr> </tbody> </table>		Basis points	CRISIL ² credit rating of associated enterprise (AE)	175	between AAA to A or its equivalent	325	BBB-, BBB or BBB+ or its equivalent	475	between BB to B or its equivalent	625	between C to D or its equivalent	425	credit rating of AE is not available, and the amount of loan advanced to the AE including loans to all AEs in INR does not exceed INR 1billion in aggregate as on 31 March of relevant previous year
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Eligible international transaction	Threshold limit value	Safe harbor margin												
Advancing of intra-group loan to a nonresident WOS where the amount of loan is denominated in foreign currency	<p>The interest rate declared in relation to the eligible international transaction is not less than the six-month London Inter-Bank Offer Rate (LIBOR) of the relevant foreign currency as on 30 September of the relevant previous year plus,</p> <table border="1" data-bbox="555 651 1492 1137"> <thead> <tr> <th data-bbox="563 663 738 719">Basis points</th> <th data-bbox="746 663 1484 719">CRISIL credit rating of AE</th> </tr> </thead> <tbody> <tr> <td data-bbox="563 730 738 786">150</td> <td data-bbox="746 730 1484 786">between AAA to A or its equivalent</td> </tr> <tr> <td data-bbox="563 797 738 853">300</td> <td data-bbox="746 797 1484 853">BBB-, BBB or BBB+ or its equivalent</td> </tr> <tr> <td data-bbox="563 864 738 920">450</td> <td data-bbox="746 864 1484 920">between BB to B or its equivalent</td> </tr> <tr> <td data-bbox="563 931 738 987">600</td> <td data-bbox="746 931 1484 987">between C to D or its equivalent</td> </tr> <tr> <td data-bbox="563 999 738 1126">400</td> <td data-bbox="746 999 1484 1126">credit rating of AE is not available, and the amount of loan advanced to the AE including loans to all AEs does not exceed INR 1billion in aggregate as on 31 March of relevant previous year</td> </tr> </tbody> </table>	Basis points	CRISIL credit rating of AE	150	between AAA to A or its equivalent	300	BBB-, BBB or BBB+ or its equivalent	450	between BB to B or its equivalent	600	between C to D or its equivalent	400	credit rating of AE is not available, and the amount of loan advanced to the AE including loans to all AEs does not exceed INR 1billion in aggregate as on 31 March of relevant previous year	
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Providing corporate guarantee to WOS	No threshold	The commission or fee declared in relation to the international transaction is at the rate of 1% or more per annum on the amount guaranteed												
Provision of contract R&D services wholly or partly relating to software development, with insignificant risks	Up to INR2 billion	24% or more on total operating costs												
Provision of contract R&D services wholly or partly relating to generic pharmaceutical drugs, with insignificant risks	Up to INR2 billion	24% or more on total operating costs												
Manufacture and export of core auto components	No threshold	12% or more on total operating costs												
Manufacture and export of non-core auto components where 90% or more of total turnover during the relevant previous year is in the nature of original equipment manufacturer (OEM) sales	No threshold	8.5 % or more on total operating costs												
Receipt of low value-adding intra-group services	Up to INR100 million	Mark-up on costs not exceeding 5%. The cost allocation methodology should be certified by an accountant												

Key considerations

- ▶ The procedural aspects relating to compliance formalities for opting for the safe harbor, eligible taxpayers, verification by the tax officer, assessment procedure and implications where conditions are not met, remain same as before.
- ▶ Taxpayers who have entered into an eligible international transaction and wish to opt for SHR for FY 2019-20 or extend applicability of a prior SHR election, are required to file a return of income on or before furnishing of Form 3CEFA to the Assessing Officer, by the due date of 30 November 2020.
- ▶ Taxpayers opting for safe harbor for FY 2019-20 are required to maintain prescribed TP documentation and file the Accountant's report in Form 3CEB by the due date of 31 October 2020.
- ▶ Where the transfer price declared by the eligible taxpayer is accepted by the tax authorities, the taxpayer shall not be eligible to invoke the Mutual Agreement Procedure under the relevant tax treaty. Further, taxpayers electing the safe harbor will not be able to claim any further adjustment to the price, either on account of comparability differences or the benefit of the range as prescribed under the ITL.

Implications

Complying with the arm's length principle can be burdensome. Even good faith efforts to comply result in uncertainty because tax authorities may analyze the transaction in a different way. The modifications made to the SHR in 2017 were intended to make the use of SHRs more attractive for taxpayers. The extension of the SHR for the FY 2019-20 is a welcome move by the CBDT. Taxpayers should evaluate the feasibility of opting for the SHR for FY 2019-20, as an option for managing potential TP controversy.

Endnotes

1. For FY 2016-17, as the amended rules overlapped with the prior rules, taxpayers had the option to opt for the rule which was more beneficial.
2. CRISIL (formerly Credit Rating Information Services of India Limited) is a global analytical company providing ratings, research, and risk and policy advisory services.

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