Transfer Pricing: India extends Safe Harbour Rules to cover FY20

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Summary

The Indian Safe Harbour rules are an optional dispute avoidance mechanism that prescribe the minimum cost plus mark-up/transfer price that an eligible tax payer has to maintain in relation to eligible categories of international transactions for a specified block of financial years (FYs).

The previous block of covered years was FY 2016-17 (FY17), FY18 and FY19. The Central Board of Direct Taxation (CBDT)[1] has extended the applicability of the rules to FY20, without any change in the safe harbour thresholds.

Introduction

- Under the Safe Harbour (SH) Rules[2], a taxpayer can opt for the prescribed minimum cost plus mark-up/transfer price for the covered block of FYs in order to insulate himself/herself from transfer pricing litigation for eligible international transactions, covering sectors such as information technology (IT), information technology enabled services (ITeS), knowledge process outsourcing (KPO) research and development (R&D), automotive, pharmaceutical, financial instruments, and intra-group services.
- The rules, which were introduced in 2013 as a dispute avoidance mechanism to address mounting transfer pricing litigation and were amended in 2017 and the covered period of FYs was notified as FY17, FY18 and FY19. While the original safe harbours had a few takers, the amended threshold largely found favour amongst the taxpayers.
- The CBDT has now extended the applicability of these rules to FY20 as well, without any modifications.
- All other provisions, including the definitions of eligible assessee, eligible international transactions, operating costs, etc., remain unchanged.

Safe Harbour mark-ups for FY20

1. For information technology sector

[1] vide notification dated 20 May 2020
[2] Rule 10TA to 10TG of Income-tax Rules, 1962 ("the Rules")

Sl no.	Eligible international transactions	Transaction limits in INR crores	Mark-up over operating costs
1	Provision of software development and information technology enabled services	Upto 100	17%
		Above 100, upto 200	18%
2	Provision of knowledge process outsourcing (KPO) service	Upto 200	18% to 24%[3]
3	Provision of contract R&D services in relation to software development	Upto 200	24%

2. For pharmaceutical sector

Sl no.	Eligible international transaction	Transaction limits in INR crores	Mark-up over operating costs
1	Provision of contract R&D services relating to generic pharma drugs	Upto 200	24%

3. For automobile sector

Sl no.	Eligible international transaction	Mark-up over operating costs
1	Manufacture and export of core auto components	12%
2	Manufacture and export of non-core auto components	8.5%

4. For financial transactions

Sl no.	Eligible international transaction	Interest rate and guarantee fee
1	Providing intra-group loan in INR to wholly-owned subsidiary	One-year MCLR of SBI, as on 1 April, of the relevant previous year plus 175 to 625 basis points depending on the credit rating of the associated entity (borrower)
2	Providing intra-group loan in foreign currency to wholly owned subsidiary	Six-month LIBOR rate, as on 30 September, of the relevant previous year plus 150 to 600 basis points depending on the credit rating of the associated entity (borrower)
3	Providing corporate guarantee to wholly-owned subsidiary	1% per annum of the amount of corporate guarantee is the minimum fee/commission

[3] based on employee cost/total cost %

5. For low value adding intra-group services

Sl no.	Eligible international transaction	Interest rate and guarantee fee
1	Receipt of low value-adding intra-group services	5% mark-up on total cost of providing low value-adding intra-group service, provided the value of international transaction including a mark-up of 5% does not exceed INR 10 crores.

Our comments

Unlike in 2017, when SH coverage was given for three FYs up to FY19, this time, the coverage has been extended only for one year (FY20). This may be due to the widespread economic uncertainty caused by the COVID-19 pandemic. The CBDT may use this mechanism for FY21 as well to further assuage concerns of the multi-national companies that are struggling to keep their operations up and running amidst widespread disruption of their global supply chains.

The CBDT may further consider reduction of safe harbour thresholds in line with the forecasted global and Indian GDP growth decline, to support captives and encourage job retention while attracting more investments. The taxpayers should conduct a cost-benefit analysis and decide on adoption of SH option for FY20.

Contact us

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NEW DELHI National Office Outer Circle L 41 Connaught Circus, New Delhi 110 001 T +91 11 4278 7070	**NEW DELHI** 6th floor, Worldmark 2, Aerocity, New Delhi – 110 037 T +91 11 4952 7400	**AHMEDABAD** 7th Floor, Heritage Chambers, Nr. Azad Society, Nehru Nagar, Ahmedabad – 380 015	**BENGALURU** 5th Floor, 65/2, Block A, Bagmane Tridib, Bagmane Tech Park, C V Raman Nagar, Bengaluru – 560 093 T+91 80 4243 0700	**CHANDIGARH** B-406A, 4th Floor, L&T Elante office Building Industrial area, Phase-I, Chandigarh 160 002 T +91 172 4338 000
CHENNAI 7th Floor, Prestige Polygon 471, Anna Salai, Teynampet Chennai - 600 018 T +91 44 4294 0000	**DEHRADUN** Suite No 2211, 2nd Floor Building 2000 Michigan Avenue, Doon Express Business Park, Subhash Nagar, Dehradun 248 002 T +91 135 264 6500	**GURGAON** 21st Floor DLF Square Jacaranda Marg, DLF Phase II, Gurgaon 122 002 T +91 124 462 8000	**HYDERABAD** 7th Floor, Block III White House Kundan Bagh, Begumpet Hyderabad 500 016 T +91 40 6630 8200	**KOCHI** 7th Floor, Modayil Centre Point, Warriam Road Junction, MG Road, Kochi 682 016 T +91 484 406 4541
KOLKATA 10C Hungerford Street 5th Floor, Kolkata 700 017 T +91 33 4050 8000	**MUMBAI** 16th Floor, Tower II Indiabulls Finance Centre SB Marg, Prabhadevi (W) Mumbai 400 013 T +91 22 6626 2600	**MUMBAI** Kaledonia, 1st Floor, C Wing (Opposite J&J office) Sahar Road, Andheri East, Mumbai - 400 069 T +91 22 6176 7800	**NOIDA** Plot No. 19A, 7th Floor Sector – 16A, Noida 201 301 T +91 120 4855 900	**PUNE** 3rd Floor, Unit No 309 to 312, West Wing, Nyati Unitree Nagar Road, Yerwada Pune- 411 006 T +91 20 6744 8800

For more information or for any queries, write to us at **contact@in.gt.com**

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