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OECD releases Discussion Draft on Safe Harbours

Safe harbour concept and background

A safe harbour in a transfer pricing regime is a provision that applies to a defined category of taxpayers or transactions and that relieves eligible taxpayers from certain obligations otherwise imposed by a country's general transfer pricing rules. Prices established under a safe harbour would be automatically accepted by the tax administrations that have expressly adopted safe harbour rules.

Vide Finance Act, 2009, the Indian government introduced safe harbours in the Indian transfer pricing regulations. However, since then no safe harbour rules have been prescribed, without which the enactment, quite evidently, remains ineffective.

The Organisation for Economic Co-operation and Development's (OECD) existing transfer pricing guidelines[1] provide guidance on safe harbours[2], which is now proposed to be revised. In this regard, the OECD Committee on Fiscal Affairs (the Committee) has released a discussion draft on safe harbours (the discussion draft), which comprises the proposed revisions.

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[1] OECD transfer pricing guidelines for Multinational Enterprises and Tax Administrations adopted in 1995.
[2] In chapter IV of the OECD transfer pricing guidelines for Multinational Enterprises and Tax Administrations adopted in 1995.

Key aspects of the discussion draft

At the outset, the discussion draft acknowledges that an increased number of countries have evaluated that the benefits of safe harbours outweigh the related concerns provided the rules are carefully targeted and prescribed. The OECD also observes that the utility of safe harbours are most apparent when they are directed at taxpayers or transactions involving low transfer pricing risks.

The **benefits** of safe harbours as put forth in the discussion draft are that of simplifying/reducing compliance, providing certainty to taxpayers, and facilitating redirection of tax administrative resources to complex/high risk transactions/taxpayers.

The discussion draft has also identified several **concerns** surrounding implementation of safe harbours. These may be in the form of possible contravention of arm's length principle, risk of double taxation and double non-taxation, inappropriate tax planning and inequitable treatment of taxpayers.

The discussion draft **recommends** that the risks of double taxation and double non-taxation and inappropriate tax planning may be largely eliminated by adopting safe harbours on a bilateral or multilateral basis, by means of competent authority agreements between countries. The agreements could define a category of taxpayers and/or transactions to which a safe harbour provision would apply, and pricing parameters that would be accepted by the contracting countries.

Where safe harbours are adopted unilaterally, the country adopting the safe harbour should be prepared to consider modification of the safe-harbour outcome under mutual agreement procedures to mitigate the risk of double taxation.

PwC comments

Given that transfer pricing has become one of the most controversial tax issues in India, with a constantly growing number and diversified nature of disputes, introduction of safe harbour rules would at least alleviate smaller taxpayers or less complex transactions from the rigours of transfer pricing compliance and consequential disputes. It would simultaneously enable tax authorities to redirect their scrutiny efforts and resources to more complex and risky cases.

Further, with the very recent introduction of advance pricing arrangements (APAs) in India, it is also an opportune time for a concurrent prescription of safe harbours rules, as that would go a long way in eliminating low value and/ or less complex, i.e., less risky transactions, from permeating the APA domain, as taxpayers who are eligible for safe harbours would then not resort to APAs. This would lead to only high value and/or more complex, i.e. high risk transactions being taken to APAs, and quite rightly so.

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