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News Flash

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CBDT releases Draft Safe Harbour Rules

With a view to reduce the number of transfer pricing audits and prolonged disputes in matters relating to comparability analysis under transfer pricing, the Finance (No.2) Act, 2009 inserted a section 92CB of the Income-tax Act, 1961 (the Act) for notifying Safe Harbour rules. Since then, taxpayers have been anxiously waiting for these rules and finally, the CBDT has released the Safe Harbour rules in a draft form. Such efforts are in line with those of the OECD in attempting to introduce bilateral Safe Harbour provisions between sovereign countries.

The "Safe Harbour" rates are not arm's length prices, but are in the nature of presumptive taxation, which generally enthuse taxpayers to opt for the same, as a compromise in return for avoiding protracted litigation. The draft Safe Harbour rules prescribe, amongst other things, the eligible taxpayer, international transaction covered sector-wise, the target operating profit margin/ Safe Harbour rates, the procedure for filing, the timeline for audit and also a new Form 3CEG (Application to Opt for Safe Harbour).

The below table provides a snapshot of the draft Safe Harbour rules:

S.No	Eligible International Transaction	Proposed Safe Harbour
1.	Software Development services*	Operating Profit (OP) / Operating Expenses (OE) is 20% or more
2.	Information Technology enabled services*	
3.	Knowledge Process Outsourcing (KPO) Services*	OP/OE is 30% or more
4.	Advancing of intra-group loans by Indian companies to their wholly owned subsidiaries	The interest rate is equal to or greater than the base rate of State Bank of India as on 30th June of the relevant previous year plus • 150 basis points (Loan does not exceed INR 500 million) • 300 basis points (Loan exceeds INR 500 million)
5.	Provision of corporate guarantees by Indian companies to their wholly owned	The commission or fee is 2% or more per annum on the amount guaranteed (maximum threshold INR 1 billion)

	subsidiaries	
6.	Contract research and development (R&D) services with insignificant risks	Software Development - OP/OE is 30% or more Generic Pharmaceutical drugs - OP/OE is 29% or more
7.	Manufacture and export of auto components	Core auto-components - OP/OE is 12% or more Non-core auto-components - OP/OE is 8.5% or more

** With insignificant risks and total annual value of such international transactions not exceeding INR 1 billion*

Some key points of the proposed Safe Harbour rules worth highlighting are:

- Applicable for Financial Years 2012-13 and 2013-14
- The Safe Harbour rules are voluntary; in case the same are not opted for, routine compliance and assessment procedures would apply, and the determination of arm's length price shall be made without having regard to the Safe Harbour rules.
- These rules do not cover Specified Domestic Transactions (i.e. Domestic Transfer Pricing).
- Documentation as per Section 92D of the Act and Accountant's Report in Form 3CEB as per Section 92E of the Act to continue, despite adoption of Safe Harbour rules.
- No comparability adjustments are permitted, and the benefit of tolerance band (+/- 3 % or 1%) is not made available.
- A taxpayer opting for Safe Harbour rules would not be entitled to invoke Mutual Agreement Procedure.
- The nature of services under each of the eligible international transactions is definitive and not inclusive.
- The description of an eligible taxpayer with insignificant risk is in line with criteria prescribed in Circular No. 6/2013 dated 29 June, 2013.
- Definitions of operating income and expenses are provided along with certain exceptions. However, there is some inconsistency in treatment of certain items as operating/ non-operating.
- Form 3CEG has to be filed with the Assessing Officer before the due date for filing of return.
- Assessing Officer (AO) would verify the eligibility of the taxpayer/ international transaction and acceptability of transfer price as per Safe Harbour Rules and pass the order.
- AO may refer such verification to Transfer Pricing Officer (TPO). TPO is required to pass the order within 6 months, if satisfied.
- In case the AO/TPO is not satisfied, routine assessment procedures apply and the determination of arm's length price shall be without having regard to the Safe Harbour Rules.
- These rules specifically exclude international transactions with no tax or low-tax jurisdictions (countries with maximum marginal tax rate less than 15%) and notified areas as provided under section 94A of the Act.

Safe harbours typically include a premium payable by taxpayers for avoiding disputes and protracted litigation. Hence, it is common to see a bit of conservatism from the Government, as one would observe in similar rules issued by other countries around the world. However, given the rates proposed, one would envisage that very few multinational companies with operations around the world would opt for these rules, which could disturb their global arrangements.

While the draft Safe Harbour rules are optional, it could influence the conduct and decision-making of tax authorities during audits and appeals, even in cases where taxpayers do not opt for these rules.

It would be interesting to see the approach of the Advance Pricing Arrangement (APA) Authorities,

both bilateral and unilateral, while framing APAs for taxpayers whose functions would otherwise fall within the ambit of Safe Harbour rules. This is so because taxpayers, particularly captive KPO, contract R&D, IT and ITeS service providers having sufficiently large cost bases would seriously consider obtaining certainty through APAs in the backdrop of the high mark-ups proposed under the Safe Harbour rules.

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