

What's New

News Flash



September 2013

Changes made in the Final Safe Harbour Rules

The CBDT has revised the Draft Safe Harbour (SH) Rules issued on August 14, 2013 after considering comments received from various stakeholders. While the final SH Rules are yet to be notified, based on the press release issued by the Ministry of Finance on September 18, 2013, the final SH Rules would incorporate the following changes:

Changes made in the Final SH Rules	Corresponding Draft SH Rules as had been notified earlier
Applicability	
<ul style="list-style-type: none">SH Rules shall be applicable for a period of five fiscal years (FY) beginning from FY 2012-13 (i.e., tax assessment year 2013-14 onwards)	<ul style="list-style-type: none">Applicable for FYs 2012-13 and 2013-14 only

<ul style="list-style-type: none"> • Taxpayer can opt for a period not exceeding five years by filing the relevant form with the Assessing Officer (AO) and submitting a statement regarding the quantum of international transaction, nature of services and the SH Rate for the relevant FYs. The option can be held as invalid only if there is a change in facts and after giving opportunity to the taxpayer • Taxpayer can opt out of the SH for any of the subsequent years falling within the period of five years, by furnishing a statement to this effect to the AO 	<ul style="list-style-type: none"> • Taxpayer could exercise the option for a year. Provision to opt for SH for future FYs was not prescribed. • Not applicable, as the taxpayer did not have the option to opt in for five years
<p>SH for software development services, Information Technology Enabled Services (ITES) and Knowledge Process Outsourcing (KPO) services</p>	
<ul style="list-style-type: none"> • For software development services and ITES: <ul style="list-style-type: none"> (a) Threshold for annual transaction value has been removed (b) If annual transaction value exceeds INR 5 billion (approx USD 80 million), then the SH rate* is 22% (c) If annual transaction value is up to INR 5 billion (approx USD 80 million), then the SH rate* is 20% • KPO services: <ul style="list-style-type: none"> (a) Threshold for annual transaction value has been removed (b) SH rate* has been revised to 25% (c) Nature of services included under KPO has been rationalized to provide a distinction from routine Business Process Outsourcing services 	<ul style="list-style-type: none"> • For software development services and ITES: <ul style="list-style-type: none"> (a) Maximum threshold for annual transaction value was INR 1 billion (approx USD 16 million) for which the SH rate* was 20% (b) No SH was available for annual transaction value exceeding INR 1 billion (approx USD 16 million) • KPO services: <ul style="list-style-type: none"> (a) Maximum threshold for annual transaction value was INR 1 billion (approx USD 16 million) for which the SH rate* was 30% (b) No SH was available for annual transaction value exceeding INR 1 billion (approx USD 16 million)
<p>SH for contract R&D services – No change</p> <ul style="list-style-type: none"> • Software Development – SH rate* is 30% 	

<ul style="list-style-type: none"> • Generic Pharmaceutical drugs – SH rate* is 29% 	
SH for financial transactions (outbound guarantees)	
<ul style="list-style-type: none"> • Threshold for providing corporate guarantees by Indian companies to their wholly owned subsidiaries has been removed • In case the amount guaranteed is up to INR 1 billion, the SH rate of commission is 2% p.a. of the guaranteed amount • In case the amount guaranteed exceeds INR 1 billion (approx USD 16 million), the SH rate of commission is 1.75% p.a. of the guaranteed amount, subject to the wholly owned subsidiary being rated to be of adequate to highest safety by an agency registered with SEBI 	<ul style="list-style-type: none"> • The maximum threshold for the amount guaranteed was INR 1 billion (approx USD 16 million) for which guarantee commission or fee was 2% p.a. • No SH was available for amount guaranteed in excess of INR 1 billion (approx USD 16 million)
SH for financial transactions (outbound intra-group loans) – No change	
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, <i>plus</i> : <ul style="list-style-type: none"> • 150 basis points (loan does not exceed INR 500 million or approx USD 8 million) • 300 basis points (loan exceeds INR 500 million or approx USD 8 million) 	
SH for manufacture and export of auto components – No change	
<ul style="list-style-type: none"> • Core auto-components – SH rate* is 12% • Non-core auto-components – SH rate* is 8.5% 	
Procedural aspects	
<ul style="list-style-type: none"> • SH Rules provide for a time bound procedure for 	<ul style="list-style-type: none"> • Procedure was time bound only in a limited way

<p>determination of the eligibility of the taxpayer and the international transactions</p> <ul style="list-style-type: none"> ● Any rejection of the option exercised by the taxpayer shall be by way of a reasoned order and the taxpayer shall have a right to file an objection with the Commissioner against adverse finding regarding the eligibility. ● Time limits of two months from end of the month in which the application/ reference/ objection, has been received, is prescribed: <ul style="list-style-type: none"> (a) for the AO to refer the case to the Transfer Pricing Officer (TPO); (b) for the TPO to pass an order determining the validity of the option exercised by the taxpayer; and (c) for the Commissioner to pass an order on the objection received from the taxpayer ● It is further provided that if any of the authorities fail to adhere to the prescribed time limit, option exercised by the taxpayer shall be considered valid 	<ul style="list-style-type: none"> ● No redressal forum was provided earlier ● No time limit for AO to refer to TPO was prescribed ● TPO was provided six months time limit only in case the TPO was satisfied with the taxpayer's application (as per CBDT's press release on Draft SH Rules) ● No such provision was prescribed earlier
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* *Operating Profit / Operating Expenses*

All the above changes introduced in the Final SH Rules undoubtedly evidence the Indian Government's intention to benefit as many taxpayers as possible and reduce litigation. It is also encouraging to see that the CBDT has favourably considered some of the representations made by various stakeholders.

However, having said that, the final SH rates are still not attractive enough for large captive service providers. This is because they would face economic double taxation, as Revenue authorities of the headquarter countries are unlikely to accept the high mark-ups under the unilateral SH rules of India. In fact, one would have hoped that in current times, given the weakening Rupee, the Indian Government could have provided lower SH rates for garnering more foreign exchange for the country, by boosting exports at minimal compliance cost for taxpayers.

The large captive players in the fields of IT, ITES, KPO, contract R&D, etc, may now seriously consider the option of APAs, particularly bilateral APAs, for better and optimal up-front resolution of transfer pricing issues in India.

While taxpayers might opt for either unilateral or bilateral APAs for proper resolution of their TP models, a bilateral APA would be preferable, since the bilateral APA team would operate under lesser fetters as compared to the unilateral APA team, since they would be involved in bilateral negotiations with other sovereign countries; and taxpayers would have the opportunity to plead resolution for mark-ups at convenient convergence points of inter-quartile ranges (as per practice followed by other countries) and arithmetic mean (as per provisions enshrined in the Indian TP regulations), as opposed to the restricted usage of the arithmetic mean in a unilateral APA.

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