

Any Legroom to Make Safe Harbour Rules More Lucrative?

Jan 27, 2023



Lalit Attal

Partner at BDO India

The Safe Harbour Rules ('SHR'), supposed to be harbour and provide certainty from assessment, reduce compliance, and ensure administrative convenience providing room to channelise resources in other business area for the taxpayers. For Tax Authorities, SHR ensures reduced time for assessment and litigation. With the intended objective, SHR benefitting eligible assessee for eligible transactions was introduced just a year after Advance Pricing Agreement ('APA'). However, at present APA is seen as a preferred option due to higher chances of achieving a well-negotiated price proximate to arm's length price, although it has lost its charm in recent years among the taxpayers. With assessment year 2022-23 being the last year of applicability, SHR may be extended and some modifications to the rules will be a welcome development toward making Safe Harbour a euphoric success.

In the current economic situation, to provide certainty and ease of doing business, the following measures is expected to make Safe Harbour more attractive for the taxpayers:

Compliance Relief: The issue of reduced documentation requirement for the taxpayers opting for safe harbour is expected. The Rangachary committee set up to examine and suggest rules for safe harbour in 2012 had recommended that documentation burden for taxpayers opting for the safe harbour route should be less stringent than other taxpayers not following this option. No relaxation in documentation presents a major disadvantage for taxpayers who may be willing to pay a premium for availing the benefit of the safe harbour in exchange for the twin benefits of certainty on transfer prices and relief from compliance burden.

Scope expansion and rates rationalisation: Expansion in the scope and rationalizing the rates will aid in realizing SHR's true potential. With the radical changes in the economy and ever evolving intra group transactions, the following changes will be welcomed:

Eligible Transactions	Challenges and Resolutions
Software development services ('IT') and Information technology enabled services ('ITeS')	<ul style="list-style-type: none"> • Differential rates for IT and ITeS transaction can be considered, given that mark-up percentage vary between these two services during APA/ assessment proceedings. It is recommended to consider 16% mark-up for ITeS sector. • It is recommended to revise the turnover slab - a. less than INR 200 Cr; and b. more than INR 200 Cr. and less than INR 500 Cr. • New Category: Expand the scope of eligible transactions to cover engineering design services with a mark-up of 17% and 18% for respective turnover slabs.
Knowledge process outsourcing	<ul style="list-style-type: none"> • The rates generally decided in APA is substantially lower when compared with SHR rates and therefore the existing SHR with

three layers of rate complicate this and makes it unattractive. A single mark-up which is closer to the mark-up agreed in APA and MAP framework may be considered.

Intra-group loan

- With cessation of LIBOR, alternate reference rate like Secured Overnight Financing Rate ('SOFR'), Sterling Exchange Rate ('SONIA'), Euro Short-term rate ('Ester') etc. can be considered for arriving at the safe harbour rates.
- The scope can be extended to receipt of intra-group loan in SHR similar to advancing of intra-group loan.

Corporate Guarantee

- The Appellate authorities generally order corporate guarantee fees to be 0.5%. Rates in SHR can be capped at 0.75% of the loan utilized amount and not guaranteed.

Research and development

- The current rates prescribed in SHR are unattractive for taxpayers. It is recommended to either eliminate this category from SHR or be aligned with industry practice. This is because the mark-up agreed in APA and MAP for R&D services are much lower than the SH rates.

Manufacture and export of core-auto components at 12%

- Given the industry is experiencing a turmoil due to macro-economic factors and low profitability, a reduction in the safe harbour margins will be hailed as a positive step for the market players.
- **New Category:** A number of manufacturers and distributors face TP litigation around royalty payment and intra-group services (management charges). Royalty payments (based on category) may be introduced under SHR with an allowable percentage on revenue subject to earning a minimum profit on net level (expressed in percentage). This can be divided further at Industry level and nature of royalty pay-out. Benefit and receipt test may also be introduced to prevent abuse of the provisions.

Receipt of low- value added intra-group services

- It is recommended to simplify the definition of (LVA-IGS) and expand the scope beyond INR 10 Cr limit. Similar to royalty payments, these payments may also be allowed with an allowable percentage on revenue subject to earning a minimum profit on net level (expressed in percentage). Benefit and receipt test may also be introduced to prevent abuse of the provisions.

Undoubtedly, SHR is a step towards ease of doing business in the India TP environment where the litigation looms larger than the international transactions taking place between the AEs of the MNE group. However, broad basing the eligible transactions list and having lower margins will make it more attractive to opt for and reduce the time spent by TPOs during TP audits.

* Views expressed are personal and may not reflect that of the organization.