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News

**India****India Safe Harbor Rule Changes May Cut Transfer Pricing Lawsuits**

By Siri Bulusu

The Indian government revised its safe harbor rules for transfer pricing transactions by expanding the types of transactions eligible and reducing the profit margins for previously eligible transactions—a move practitioners said should reduce transfer pricing litigation.

Safe harbor rules generally allow companies to avoid a tax adjustment when transactions meet specified profit margins or other criteria. Under the new rules, effective from April 1 until assessment year 2019, receipt of low-value-adding intra-group services is now an eligible transaction. Lower margins also were introduced for previously eligible transactions, including:

- software development, where the margins were lowered from 20 percent or 22 percent, depending on the value of the transaction, to 17 percent or 18 percent; and
- contract research and development services related to generic pharmaceutical drugs, where the margin was lowered from 29 percent to 24 percent but a limit of 2 billion rupees (\$31 million) was placed on the transaction amount.

“The new safe harbor rules are meant for small taxpayers and will provide them with more certainty and predictability in India,” Sanjay Kumar, senior director of tax at Deloitte India, told Bloomberg BNA June 13. “This will encourage investment into the country.”

**Earlier Regime**

India's safe harbor rules were introduced in 2013, but few companies were eligible or opted to use the rules in the time since, Kumar said.

Karishma R. Phatarphekar, transfer pricing leader at BMR & Associates LLP, said tax authorities made transfer pricing adjustments with markups of between 20 percent and 25 percent under the earlier rules. Those cases resulted in “litigation where companies would have to defend their 15 or 17 percent arm's-length markup,” he told Bloomberg BNA June 13.

Kumar said the earlier regime “had very few takers and the government realized that and brought down the margins, which shows the government is responsive to the transfer pricing issues.”

Practitioners said the changes to the safe harbor rules are significant enough to potentially reduce the number of companies that opt for advance pricing agreements, as it would be more time-consuming and costly to obtain an APA than it would be to use the revised rules.

**Rule Changes**

The new rules list includes the following changes, according to a BMR & Associates LLP report:

(1) Software development services and information technology enabled services:

- For international transactions of up to 1 billion rupees, the operation profit margin has been set at 17 percent.
- For international transactions from 1 billion to 2 billion rupees, the operating margin is set at 18 percent.

**Snapshot**

- Safe harbor rules revised to reduce profit margin, expand eligible transactions
- Practitioners say new rules, which apply from April 1, 2017, through assessment year 2019, could reduce burden on India's advance pricing agreement program

(2) Knowledge process outsourcing services where the value of the international transaction is less than 2 billion rupees and the employee cost to operating expense ratio is:

- 60 percent or more, the operating profit margin is set at 24 percent;
- between 40 percent and 60 percent, the operating profit margin is set at 21 percent; and
- less than 40 percent, the operating profit margin is set at 18 percent.

(3) Advancing of intra-group loans where the amount of the loan is denominated in Indian rupees and foreign currency:

- The interest rate for loans denominated in Indian rupees shouldn't be less than the one-year marginal cost of funds lending rate of the State Bank of India plus spread.
- The interest rate for loans denominated in foreign currency shouldn't be less than the six-month London Interbank Offered Rate plus spread.
- The spread should be based on the CRISIL credit rating of the associated enterprise.

(4) When providing a corporate guarantee, the fee declared on the eligible international transaction must be at a rate no less than 1 percent per annum of the amount guaranteed, and must be no less than 2 percent for some transactions.

(5) When providing contract R&D services for information technology or generic pharmaceuticals, the operating margin is set at 24 percent for international transactions less than 2 billion rupees.

(6) For manufacturing and export of auto components, the operating margin on the eligible transaction declared by the taxpayer can't be less than 12 percent for core auto components and can't be less than 8.5 percent for non-core auto components.

(7) For the receipt of low-value-adding intra-group services, the entire value of the international transaction, including a markup not exceeding 5 percent, must be 100 million rupees or less.

### **Advance Pricing Agreement Program**

In 2012, the Indian government introduced an advance pricing agreement program to reduce transfer pricing litigation, a program that has been deemed successful except for how long it takes for applications to be filed and accepted.

"Half of the APA applications would be for smaller companies that would now be eligible for the safe harbor rules so the advantages are that it will take pressure from the APA program, provide certainty to foreign investors into India, and reduce current litigation because the government is saying a 17 percent mark-up is fine," Phatarphekar said.

While practitioners agree the new rules are welcome, they say the key will be how it's implemented by the tax authorities. With global pressure to reduce outsourcing, the new rules are aimed at inviting businesses to continue to work with associated enterprises in India.

"Industries are facing pressure when creating value from the low-cost, highly educated workforce of India, so the new rules are precipitated by India wanting to cut litigation and show foreign companies that they are welcome to do business here," Vispi T. Patel, head of Mumbai-based chartered accounting firm Vispi T. Patel & Associates, told Bloomberg BNA June 12.

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### **For More Information**

The revised safe harbor rules are at <http://src.bna.com/pR2>.

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