

### New rules notified for Safe Harbour Rules

To reduce the number of transfer pricing audits and prolonged disputes, section 92CB of The Income Tax Act, 1961 (the Act) was introduced with effect from 1<sup>st</sup> October 2009 (i.e. applicable for AY 2010-11 and onwards) to provide that the determination of arm's length price under section 92C of the Act and section 92CA of the Act shall be subject to safe harbour rules.

Safe Harbour Rules provide a blanket exception from the application of transfer pricing rules for certain classes of international transactions. If an assessee has exercised the option of Safe Harbour Rules, then the transfer price declared by the assessee in respect of such transactions shall be accepted by the income-tax authorities. The CBDT vide Notification No. 46/2017 dated 7<sup>th</sup> June 2017 has notified amended safe harbour rules which shall come into effect from April 1, 2017 and shall continue to remain in force from AY 2017-18 to AY 2019-20. The assessees eligible under the present safe harbour regime for AY 2017-18 shall also have the right to choose the safe harbour option most beneficial to them.

A comparison of the amended safe harbour rules vis-à-vis the rules which existed upto AY 2017-18 are tabulated as under:

S. No.	Eligible International Transaction	Existing (upto AY 2017-18)		Amended (AY 2017-18 to AY 2019-20)	
		Operating Profit Margin	Aggregate Value of transactions entered during the previous year	Operating Profit margin	Value of transactions
1	Provision of software development services and provision of information technology services	20% or more	Less than equal to Rs. 500 Crores	17% or more	Less than equal to Rs. 100 Crores
		22% or more	More than Rs. 500 Crores	18% or more	More than Rs. 100 Crores but Less than equal to Rs. 200 Crores
		Operating profit margin <b>25% or more.</b>		The value of international transaction <b>does not exceed Rs. 200 crores and:</b>	
2	Provision of knowledge process outsourcing services			Operating Profit Margin	Employee Cost in relation to operating expense

			18% or more	Less than or equal to 40%		
			21% or more	More than 40% but less than 60%		
			24% or more	60% or more		
4	Advancing of intra-group loans where the amount of loan is denominated in Indian Rupees (INR).	The interest rate shall not be less than the base rate of State Bank of India as on valuation date i.e., 30 <sup>th</sup> June of the relevant previous year <b>plus</b> the basis point as mentioned below:	The interest rate declared is not less than the 1 year marginal cost of funds lending rate of State Bank of India <b>as on 1st April</b> of the relevant previous year <b>plus</b> -			
			<b>Value of Transaction</b>	<b>Basis Point</b>	<b>Basis Points</b>	<b>CRISIL Credit rate of the foreign associated enterprise</b>
			Less than or equal to Rs. 50 crores	150	175	Between AAA to A or its equivalent
			More than Rs. 50 Crores	300	325	BBB-, BBB or BBB+ or its equivalent
					475	Between BB to B or its equivalent
625	Between C to D or its equivalent					
425	<ul style="list-style-type: none"> <li>• Credit rating of the associated enterprise is not available <b>and</b></li> <li>• Aggregate amount of loan to all associated enterprises in INR is less than or equal to Rs. 100 Crores as on 31<sup>st</sup> March of relevant previous year.</li> </ul>					
5	Advancing of intra-group loans where the amount of loan is denominated in foreign currency	<i>Same as above</i>	The interest rate declared is not less than the 6 months London Inter-Bank Offer Rate (LIBOR) of the relevant foreign currency as on <b>30th September</b> of the relevant previous year <b>plus</b> :			
			<b>Basis Points</b>	<b>CRISIL Credit rate of the foreign associated enterprise</b>		
			150	Between AAA to A or its equivalent		
			300	BBB-, BBB or BBB+ or its equivalent		
			450	Between BB to B or its equivalent		

				600	between C to D or its equivalent
				400	<ul style="list-style-type: none"> <li>• Credit rating of the associated enterprise is not available <b>and</b></li> <li>• Aggregate amount of loan to all associated enterprises in INR is less than or equal to Rs. 100 Crores as on 31<sup>st</sup> March of relevant previous year.</li> </ul>
6	Providing corporate guarantee	<b>Value of Transaction</b>	<b>Nature of service</b>	<b>Rate p.a. of the amount guaranteed</b>	<p>A uniform commission rate of <b>1% or more</b> has now been offered for all the outbound corporate guarantees irrespective of the value of transaction.</p> <p>However, if the corporate guarantees exceeded Rs. 100 Crore, the credit rating of the overseas beneficiary needs to be done by an agency registered with SEBI and such credit rating has to be adequate to highest safety standards.</p>
		Less than or equal to Rs. 100 Crores	Commission or fees	2% or more	
		More than Rs. 100 Crores	Commission or fees	1.75% or more	
8	Provision of contract research and development services wholly or partly relating to software development	<p>The Operating Profit Margin declared by the assessee shall <b>30% or more</b>.</p> <p><i>(The existing definition of Contract R&amp;D includes upgradation of existing products where source code has been made available by the principal)</i></p>			<p>The Operating Profit Margin declared by the assessee shall be <b>24% or more</b> where the value of the international transaction does not exceed a sum of <b>Rs. 200 Crore</b>.</p> <p><i>(An exception has been carved out whereby the source code if made available by the principal to carry out routine functions like debugging of the software, then it shall not be included in the definition of contract R&amp;D services and accordingly safe harbour rules shall not apply to such transaction)</i></p>
9	Provision of contract research and development services wholly or partly relating to generic pharmaceutical drugs	<p>The Operating Profit Margin declared by the assessee shall <b>29% or more</b></p>			<p>The Operating Profit Margin declared by the assessee shall be <b>24% or more</b> where the value of the international transaction does not exceed a sum of <b>Rs. 200 Crore</b>.</p>

10	Manufacture and export of core auto components	The Operating Profit Margin declared by the assessee shall <b>be 12% or more</b>	<i>No change</i>
11	Manufacture and export of non-core auto components	The Operating Profit Margin declared by the assessee shall <b>be 8.5% or more</b>	<i>No change</i>
12	Receipt of low value-adding intra-group services	-	<p><b><i>This is a newly inserted eligible international transaction.</i></b></p> <p>The entire value of the international transaction <b>shall not exceed a sum of Rs. 10 Crores</b>. The said amount is <b>including a mark-up not exceeding 5%</b>.</p>

### **The Key**

*The CBDT has notified a new safe harbour regime. The new rules comes into effect from April 1, 2017 and shall continue to remain in force for two succeeding years, upto AY 2019-20. The objective behind the revision of existing safe harbour rules is to reduce transfer pricing disputes, to provide certainty to taxpayers, to align safe harbour margins with the industry standards and to enlarge the scope of safe harbour transactions. By Capping the threshold limit to Rs. 200 Crores for all contract service providers in IT, ITES, KPO, and R&D for IT and generic pharmaceutical drugs, the CBDT has restricted the scope of applicability of safe harbour rules to relatively smaller entities. It has now been made mandatory under the new safe harbour regime for an overseas borrower to have credit rating approved by CRISIL or other rating agency. However, getting credit rating done would put an additional burden on the taxpayer to opt for safe harbour rules. Further, in line with the OECD and UN TP Manual, the CBDT has extended safe harbour rules to low value adding intra-group services, keeping the threshold at Rs. 10 crores.*