

CBDT notified Safe Harbour Rules for AY 2020-21



**VISHNU DAYA & CO LLP
CHARTERED ACCOUNTANTS**

FOREWORD:

The Central Board of Direct Taxes (CBDT) has notified Safe Harbour Rules as Rule 10TD, which shall apply for Assessment Year 2020-21. The Rule came into existence through the Income-tax (9th Amendment) Rules, 2020. The Board empowered under Section 295 read with Section 92CB (2) of the Income-tax Act, 1961, amended the Income-tax Rules, 1962 and the amendment came to be known as the Income-tax (9th Amendment) Rules, 2020.

In this note, we have summarised the safe harbour rules applicable for AY 2020-21.

Regards,

Vishnu Daya & Co LLP

Chartered Accountants

GF No. 7 & III Floor,

Karuna Complex, No. 337,

Sampige Road, Malleshwaram,

Bangalore – 560 003

SAFE HARBOUR RULES

Transfer pricing implies the prices at which various overseas divisions of a company transact with each other. Generally, safe harbour is defined as circumstances in which the tax authority shall accept the transfer price declared by the taxpayer to be at arm's length. Safe harbour provisions prescribe the minimum return/price for a specified list of intra-group transactions with respect to Transfer Pricing.

Following the best practices of international tax jurisdiction, the Indian government introduced the concept of Safe Harbour Rules (SHR) in Finance Act 2009. Post that, the first round of SHR provisions were introduced in August 2013 for a period of three years, followed by revision in 2017 in the SHR which was applicable till financial year 2019-20. Different rates were prescribed for different category of international transactions. Of these, the category of software development, ITeS and KPO were popularly opted for. Tax experts said in the past, these were applicable for more than one year but this time the government decided to announce only for one year considering fiscal 2020-21 would be impacted by COVID-19 disruptions.

SHR Applicable for AY 2020-21

Rule 10TD and 10TE of the Income Tax Rules, 1962 relate to Safe Harbour Rules and its procedure. CBDT notifies changes to these rules and states that rates applicable from AY 2017-18 to 2019-20 will continue to apply for AY 2020-21.

As per Rule 10TD(1), where an eligible assessee has entered into an eligible international transaction and the option exercised by the said assessee is not held to be invalid under rule 10TE, the transfer price declared by the assessee in respect of such transaction shall be accepted by the income-tax authorities, if it is in accordance with the circumstances as specified in sub-rule (2) or (2A) as the case may be. However, only Rule 2A was applicable for AY 2017-18 to 2019-20 and in the recent notification this has been extended to AY 2020-21 as well.

The Safe Harbour Rules applicable to AY 2020-21 are as below:

Sl. No.	Eligible International Transaction	Circumstances
1.	Provision of software development services referred to in item (i) of rule 10TC.	<p>The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is -</p> <p>(i) not less than 17 per cent, where the value of international transaction does not exceed a sum of one hundred crore rupees; or</p> <p>(ii) not less than 18 per cent, where the value of international transaction exceeds a sum of one hundred crore rupees but does not exceed a sum of two hundred crore rupees.</p>
2.	Provision of information technology enabled services referred to in item (ii) of rule 10TC.	<p>The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is -</p> <p>(i) not less than 17 per cent, where the value of international transaction does not exceed a sum of one hundred crore rupees; or</p> <p>(ii) not less than 18 per cent, where the value of international transaction exceeds a sum of one hundred crore rupees but does not exceed a sum of two hundred crore rupees.</p>
3.	Provision of knowledge process outsourcing services referred to in item (iii) of rule 10TC.	<p>The value of international transaction does not exceed a sum of two hundred crore rupees and the operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is -</p> <p>(i) not less than 24 per cent. and the Employee Cost in relation to the Operating Expense is at least sixty per cent.</p> <p>(ii) not less than 21 per cent. and the Employee Cost in relation to the Operating Expense is forty per cent. or more but less than sixty per cent. or</p> <p>(iii) not less than 18 per cent and the Employee Cost in relation to the Operating Expense does not exceed 40%.</p>

4.	Advancing of intra-group loans referred to in item (iv) of rule 10TC where the amount of loan is denominated in Indian Rupees (INR).	<p>The interest rate declared in relation to the eligible international transaction is not less than the one-year marginal cost of funds lending rate of State Bank of India as on 1st April of the relevant previous year plus,-</p> <ul style="list-style-type: none"> (i) 175 basis points, where the associated enterprise has CRISIL credit rating between AAA to A or its equivalent; (ii) 325 basis points, where the associated enterprise has CRISIL credit rating of BBB-, BBB or BBB+ or its equivalent; (iii) 475 basis points, where the associated enterprise has CRISIL credit rating between BB to B or its equivalent; (iv) 625 basis points, where the associated enterprise has CRISIL credit rating between C to D or its equivalent; or (v) 425 basis points, where credit rating of the associated enterprise is not available and the amount of loan advanced to the associated enterprise including loans to all associated enterprises in Indian Rupees does not exceed a sum of one hundred crore rupees in the aggregate as on 31st March of the relevant previous year.
5.	Advancing of intra-group loans referred to in item (iv) of rule 10TC where the amount of loan is denominated in foreign currency.	<p>The interest rate declared in relation to the eligible international transaction is not less than the six-month London Inter-Bank Offer Rate of the relevant foreign currency as on 30th September of the relevant previous year plus, -</p> <ul style="list-style-type: none"> (i) 150 basis points, where the associated enterprise has CRISIL credit rating between AAA to A or its equivalent; (ii) 300 basis points, where the associated enterprise has CRISIL credit rating of BBB-, BBB or BBB+ or its equivalent; (iii) 450 basis points, where the associated enterprise has CRISIL credit rating between BB to B or its equivalent;

		<p>(iv) 600 basis points, where the associated enterprise has CRISIL credit rating between C to D or its equivalent; or</p> <p>(v) 400 basis points, where credit rating of the associated enterprise is not available and the amount of loan advanced to the associated enterprise including loans to all associated enterprises does not exceed a sum equivalent to one hundred crore Indian rupees in the aggregate as on 31st March of the relevant previous year.</p>
6.	Providing corporate guarantee referred to in sub-item (a) or sub-item (b) of item (v) of rule 10TC.	The commission or fee declared in relation to the eligible international transaction is at the rate not less than one per cent per annum on the amount guaranteed.
7.	Provision of contract research and development services wholly or partly relating to software development referred to in item (vi) of rule 10TC.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 24 per cent, where the value of the international transaction does not exceed a sum of two hundred crore rupees.
8.	Provision of contract research and development services wholly or partly relating to generic pharmaceutical drugs referred to in item (vii) of rule 10TC.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 24 per cent, where the value of the international transaction does not exceed a sum of two hundred crore rupees.
9.	Manufacture and export of core auto components referred to in item (viii) of rule 10TC.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 12 per cent.

10.	Manufacture and export of non-core auto components referred to in item (ix) of rule 10TC.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 8.5 per cent.
11.	Receipt of low value-adding intra-group services in item (x) of rule 10TC.	The entire value of the international transaction, including a mark-up not exceeding 5 per cent., does not exceed a sum of ten crore rupees: Provided that the method of cost pooling, the exclusion of shareholder costs and duplicate costs from the cost pool and the reasonableness of the allocation keys used for allocation of costs to the assessee by the overseas associated enterprise, is certified by an accountant.]

Conclusion

The Safe Harbour Rules were awaited for a long time and are used by many taxpayers as a dispute resolution mechanism for transfer pricing issues. The Rules for AY 2020-21 are announced now with retrospective effect. The taxpayers intending to opt for SHR may apply before the statutory due date for undertaking TP compliance for AY 2020-21 on or by October 31, 2020. The government has wisely announced the rate for only one year and it seems reduced rates would be announced for future years to match the sentiments of the industry.

Our Offices:

Bangalore	Chennai
GF No. 7 & 3rd Floor, Karuna Complex, No. 337 Sampige Road, Malleshwaram Bangalore – 560 003 Tel +91 80 2331 2779 Fax +91 80 2331 3725	No. 3A, 3rd Floor Amber Crest Apartment (Next to Egmore Ashoka Hotel) Pantheon Road, Egmore Chennai – 600 008 Tel +91 44 2855 4447 Fax +91 44 2855 3521

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In case of any clarification please reach us:

Particulars	Name	Mail ID	Mobile Number
Indirect Taxes	Dayananda K	daya@vishnudaya.com	+91 9845 025 682
Indirect Taxes	Vinayak Hegde	vinayaka@vishnudaya.com	+91 9902 586 492
Direct Taxes	Shankar D	shankar@vishnudaya.com	+91 9880 715 963

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