Grant Thornton

FICCI

Indian transfer pricing safe harbours in the post COVID-19 era

A case for downward review

November 2021

Foreword

The cross-border trade accounted for about 17% of India's Gross Domestic Product (GDP) between April to June 2021 as per India Brand Equity Foundation (IBEF). A comparison indicates a 10% decline in this ratio from 2020 and about 14% decline from 2019. Emphatically, economic activity in India during August 2021, remained on its upward trajectory as per the Nomura India Business Resumption Index (NIBRI) which measures economic activity on a weekly basis with the pre-pandemic levels being the base.

One of the major drivers of the economic activity has been the cross-border trade facilitated by Multinational Enterprises (MNE). The Government of India has endeavoured to formulate policies aimed at creating an enabling environment for investment and employment. The transfer pricing Safe Harbour rules have the power to boost the MNE confidence on India as their preferred cross border trade partner. Having said that, the need of the hour is to soften the Safe Harbour provisions so as to mend the impact of the pandemic and restore India's growth vision.

The COVID-19 pandemic has had an unprecedented impact on the economic activities and human sentience across the globe. The projections given by the IMF/OECD about contraction in GDP ratio of advanced economies and emerging/developing countries (including India) beckon the protracted effect of the pandemic in what is now known as 'the post-COVID-19 era'.

Besides, directly having crippling effects on industries across the board such as aviation, tourism, hospitality, oil and gas, automotive, fashion and retail, COVID-19 pandemic also has had a cascading downbeat impact on sectors like finance, services, information technology, etc. The impact of the partial/ complete standstill of major economic activities / time consuming economic revival process also resulted in another upheaval of job losses and reduced job creation in various sectors having presence across countries.

The Government of India has taken several measures to support and refuel the economic growth of the country with a focus to boost employment. However, to relegate the deleterious impact of COVID-19 crisis, the MNCs are expecting a synergistic support from the Government of India, especially in the form of tax certainty related measures.

The Transfer Pricing (TP) Safe Harbour provisions being one of such measures is eagerly anticipated by the fraternity to be softened substantially especially to help cope with the post-COVID-19 business realities. The TP Safe Harbour provisions originally introduced in 2013 to reduce mounting TP litigation had found hardly any takers and it is only in 2017 after a significant softening of the provisions did the MNCs start accessing them in a big way.

Now in 2021, the Government of India through the Central Board of Direct Taxes (CBDT) has a further opportunity to incentivise the MNCs on the transfer pricing front as an acknowledgement of their bold decisions in holding employment of their people in India during the pandemic while many other domestic companies were forced to shut down gravely impacting the livelihoods of our people in India.

Recently, CBDT has released notification prescribing the same rates under Safe Harbour provisions for FY 2020-21 as were applicable for FY 2019-20. However, for the post-COVID-19 era the taxpayers would be expecting the authorities to align TP Safe Harbour provisions with the industry expectations to mitigate to the extent possible, the effects caused by the pandemic for at least the MNCs engaged in cross border trade with India especially the IT-ITeS sector which is a predominant benefactor. Expectations in the context of further relaxations to/softening of the parameters of Safe Harbour provisions, if acceded and implemented by the Government of India will further boost the investment sentiment of large MNCs and thereby propel the employment opportunities in India.

The report by Grant Thornton Bharat in collaboration with FICCI, Indian transfer pricing safe harbours in the post COVID-19 era, provides insights to various stakeholders on the impact of COVID-19 crisis on the emerging economies, developing countries and various sectors, which are directly/indirectly impacted by this pandemic situation. Further, it touches upon the genesis as well as the current structure of transfer pricing safe harbour regulations.

The report also explains in detail the expectations of various stakeholders from transfer pricing safe harbour rules for FY 2021-22 onwards, rationale for such expectations and recommendations to the Government of India.

This report details some of the important and requisite expectations from industry stakeholders such as rationalisation of safe harbour margins, widening the scope of safe harbour rules to bring additional international transactions within its ambit, upward revision in thresholds, regulate for any economic change such as LIBOR phase out, etc.

Implementing such measures may assist the Government of India's perception to rank up on parameters such as ease of doing business, attract foreign investment and as a result increase employment opportunity and augment tax collections for the country.

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Foreword FICCI

Streamlining the safe harbour regulations would indeed be the right step towards incentivising the industry to create more jobs, minimising transfer pricing disputes and improve the ease of doing business in India.

The Central Board of Direct Taxes (CBDT) formulated Transfer Pricing Safe Harbour Regulations (TP SH) in 2013. CBDT, vide a notification dated 20 May 2020, has clarified that the margins and conditions prescribed in TP SH 2017 for eligible international transactions will continue to apply under the safe harbour for the financial year 2019-20. Further, vide notification dated 24 September 2021, the rates applicable for FY 2019-20 have been prescribed for FY 2020-21.

It is important that safe harbour margins are aligned with the economic realities as all of us are aware of the impact of the COVID-19 on economic activities worldwide. Sectors, such as aviation, tourism, hospitality, oil and gas, automotive and retail, etc., have been directly impacted due to COVID-19. These sectors had a cascading impact on other sectors including finances, services, etc.

The adverse impact of the pandemic will continue to significantly impact the companies in these sectors. It is imperative to consider rationalisation of safe harbour margins to be announced for the block of years from financial 2021-22 onwards, widen the scope of the safe harbour for companies engaged in manufacturing and are covered under PLI scheme of the government and to transactions that are widely subject to transfer pricing litigation.

I am pleased to present to you the FICCI Grant Thornton report, Indian transfer pricing safe harbours in the post COVID-19 era: A case for downward review. The report elucidates in detail the journey of Indian transfer pricing safe harbour regulations and lists key issues and recommendations to make these regulations more effective. Streamlining the safe harbour regulations would indeed be the right step towards incentivising the industry to create more jobs, minimising transfer pricing disputes and improve the ease of doing business in India.

We will continue to work with the government and assist in the efforts to build an industry-friendly, flexible, liberalised, and transparent tax environment.

Dilip Chenoy
Secretary General
FICCI

Can the Indian transfer pricing safe harbours 'safely harbour' employment opportunities in the economy impacted by COVID-19?

Genesis of transfer pricing safe harbour and journey so far

Safe harbour regulations (TP SH) provide circumstances in which the income tax authorities shall accept the transfer price declared by the taxpayer, in respect of its eligible international transactions, without conducting an in-depth scrutiny of the declared transfer price. After almost a decade of transfer pricing disputes in India related to the export of information technology (IT) services, the TP SH were promulgated to provide alternative dispute resolution mechanism to taxpayers. These regulations cover taxpayers with international transactions pertaining to provision of software development services, IT enabled services (including knowledge process outsourcing services) and research and development services besides certain other transactions (advancing of intra group loans, provision of corporate guarantee, manufacture and export of core and non-core auto components, etc.). TP SH are aimed at helping taxpayers seek certainty and forestall unwarranted dispute that leads to protracted litigation in eligible international transactions.

The Central Board of Direct Taxes (CBDT) formulated TP SH in 2013 (by introducing rules 10TA to 10TG in the Income-tax Rules, 1962 [the Rules]. The TP SH received mild response from the taxpayer community, as the prescribed Safe Harbour margins for the eligible international transactions were perceived to be on a higher side and not aligned with the economic realities. This necessitated revision of TP SH in 2017 (hereinafter referred to as TP SH 2017). In TP SH 2017, the CBDT rationalised margins considering industry expectations, expanded the scope of eligible international transactions and covered the years from FY 2016-17 to FY 2018-19.

In a notification dated 20 May 2020, the CBDT clarified that the margins and conditions prescribed in TP SH 2017 for eligible international transactions will continue to apply under SH for FY 2019-20. It should be appreciated that with COVID-19 disruptions slowing the wheels of Indian economy from March 2020 onwards, and the COVID-19 impact assessment is still in process, CBDT would have considered it appropriate to maintain same margins under SH applicable for FY 2019-20, as were applicable under TP SH 2017. Further, the CBDT vide Notification No. 117/2021 dated 24.09.2021 has extended the validity of TP SH 2017 for FY 2020-21 as well with same rates as were applicable for FY 2019-20.

Nevertheless, the taxpayer community expects Government of India (GOI), through CBDT, to not only offer adequate tax relief in the SH, to be announced for the block of years from FY 2021-22 onwards (hereinafter referred to as TP SH 2022), but also use TP SH 2022 to incentivise taxpayers to sustain existing jobs/create more jobs in an attempt to bounce back from the disruptions caused by COVID-19 pandemic.

Impact of COVID-19 on Indian economy (particularly IT service sector)

The COVID-19 crisis has hit economic activities (barring few sectors) worldwide and it will take time for normalcy to resume. Economists, entrepreneurs, government spokespersons and stakeholders are busy gauging and quantifying the magnitude of the pandemic's impact on the global and Indian economy. Needless to mention that complete recommencement of economic activities will require a multi-pronged approach, involving contributions from both tax administrators and taxpayers.

Sectors, such as aviation, tourism, hospitality, oil and gas, automotive and fashion and retail (also referred to as impacted sectors) have been directly impacted due to COVID-19. These sectors have had a cascading impact on other sectors including finances, services, etc. Over the years, digitalisation made major inroads in the overall ecosystem of the impacted sectors, thereby increasing the dependence on IT for growth and better market penetration. However, the unrivalled impact of COVID-19 on these impacted sectors has started and would continue, to significantly impact the companies operating in the IT sector. Organisations in the impacted sectors are expected to reprioritise their overall spending on IT to cut costs.

Indian companies rendering IT-related services are major exporters of these services and eagerly awaiting relief interalia on the tax front. These companies are looking forward to TP SH 2022 hoping it will cater to their expectations, not just limited to obtaining certainty (on tax positions) but also towards tax reliefs and creation of an environment conducive to sustaining (during the COVID-19 pandemic period) and increasing jobs (for a reasonable period post COVID-19).

Global economic impact of COVID-19

The COVID-19 pandemic has had a severe economic impact and statistics reveal that this will continue for an unforeseeable future. These statistics throw light on the increasing pressure on pricing of IT related services and the threat to existing jobs in the economy.

1 The International Monetary Fund (IMF), in its G-20 surveillance note (COVID-19 – Impact and policy considerations), has given projections of the GDP growth rates of advanced, emerging and developing economies, along with the GDP growth rate of the world, for 2020 and 2021. The severity of the pandemic's impact on the global economy is evident from the negative GDP growth rates projected for 2020.

Real GDP Growth (percent change)

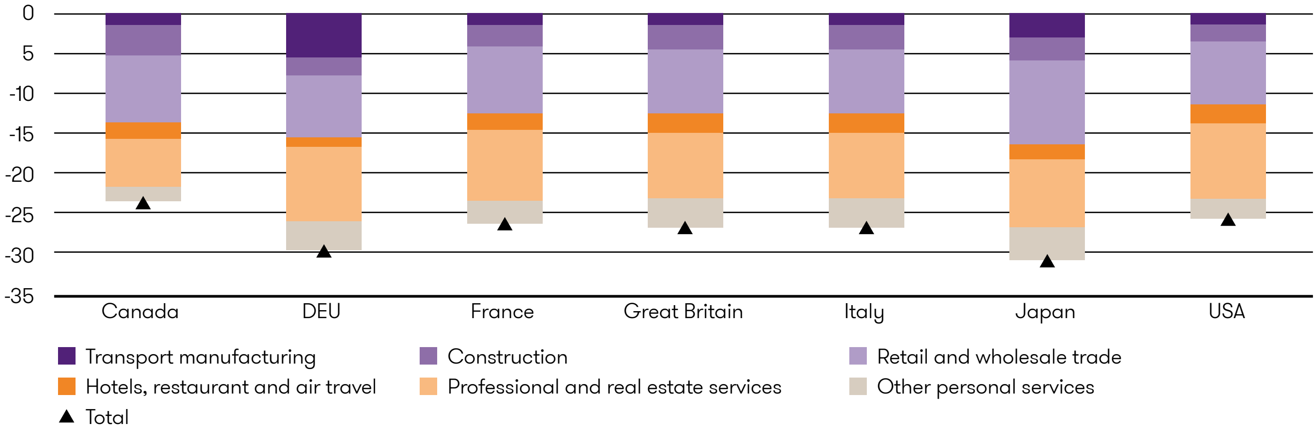
	Year over year					
	Estimates January 2021		Projections January 2021		Deviations from October 2020	
	2019	2020	2021	2022	2021	2022
World	2.8	-3.5	5.5	4.2	0.3	0.0
Advanced Economies	1.6	-4.9	4.3	3.1	0.4	0.2
Euro Area	1.3	-7.2	4.2	3.6	-1.0	0.5
Emerging Market and Developing Economies	3.6	-2.4	6.3	5.0	0.3	-0.12

Source: IMF

2 The Organisation for Economic and Co-operation Development (OECD) in its report, Evaluating the Initial Impact of COVID-19 Containment Measures on Economic Activity, has emphasised that allowing only partial shutdowns in certain sectors will have an overall direct initial hit of 25-30% on the GDP in many of the advanced economies (i.e. G7 countries).

The potential initial impact of partial or complete shutdown on activity in the G7 economies

Percent of GDP at constant prices



*Source: Evaluating the initial impact of COVID-19 containment measures on economic activity by OECD

3 In its report, the OECD has also estimated the initial impact of partial/complete shutdowns on activity as percentage to GDP in selected advanced and emerging market economies (including India).

The potential initial impact of partial or complete shutdowns on activity in selected advanced and emerging market economies

*Source: Evaluating the initial impact of Covid 19 containment measures on economic activity by OECD

4 The economic crisis caused by COVID-19 has had a devastating impact on the job market. COVID-19 has led to moderate-to-drastic reduction in the existing pool of the jobs in the market and is likely to affect creation of new employment opportunities, particularly in the severely impacted sectors.

The distressing impact of COVID-19 on unemployment arena has been already highlighted and deliberated upon at length by various economic panels, agencies, economists, labour welfare associations etc. over various platforms. Further, experts also believe that while such impact on existing job opportunities might converse over medium term, creation of new job opportunities impacted by COVID-19 would definitely require direct intervention and proactive measures by government.

Such uncertain economic conditions are bound to create unprecedented challenges for business community in the form of supply chain disruptions, inability to meet financial obligations, liquidity crunch. The uncertainties will also create tremendous pressure on the bottom line of commercial organisations and force businesses to resort to various cost reduction measures.

Other key global trends that may be considered while announcing TP SH 2022

In addition to COVID-19, it is also extremely important that GOI takes into consideration the following key global trends while issuing TP SH 2022.

Cost arbitrage enjoyed by India (being the low cost country) has gradually reduced over a period of time with increase in the overall cost of operations, thereby compelling Multinational Corporations (MNCs) to explore and develop alternative jurisdictions for setting-up global service delivery centres.

Over the last decade, many jurisdictions (primarily developing countries in Europe and Asia) nurtured and developed available skill set in a structured manner to offer alternative service delivery pockets to MNCs.

Tax administrations worldwide would be under a significant pressure to enhance the tax revenue collection for their governments that could result into an in-depth review and scrutiny of related party transactions. Any position under TP SH 2022, which increases the possibility of such in-depth scrutiny for the foreign associate enterprise in its tax jurisdiction, will act as an impediment for the taxpayer in India to opt for the SH.

MNCs could cut down their investments on research and development projects to reduce/control costs. MNCs may also explore reduction in costs by laying off employees, in case of lack of short term visibility on utilisation. By making TP SH 2022 an attractive option, GOI should make all possible attempts to positively influence MNCs' decision to maintain their back-office operations in India.

Persistent efforts by OECD, through its Base Erosion and Profit Shifting (BEPS) project, has led to a new and powerful global platform for both taxpayers and tax administrations to realign transfer pricing with economic value creation. The BEPS project has also led to formulation and implementation of information exchange arrangements (between tax jurisdictions globally), empowering tax administrators worldwide to conduct focused transfer pricing audits. This has resulted in tax administrations moving in a direction that protects and enhances its tax base. Therefore, any TP SH announced by tax administrators with one-sided view of enhancing its tax base may not be welcomed by taxpayers.

The OECD has also, in its recently released document, Tax Administration Responses to COVID-19: Measures Taken to Support Taxpayers, emphasised that consideration be given by tax administrations to various measures which may give early certainty to taxpayers about their tax liabilities and this may unlock cash flow or release resources.

Further, considering the deleterious impact of COVID-19 on the job market, GOI should consider TP SH 2022 as a tool to spur job growth and not just as dispute resolution mechanism.

Moreover, unlike the historical approach of notifying TP SH after the end of the relevant financial year, the CBDT may take this opportunity and consider notifying TP SH very soon for the block of years from FY 2021-22 onwards. Such a proactive measure, based on fair and objective assessment of the adverse impact of COVID-19, will provide visibility and viable framework for obtaining certainty on tax front to the MNCs who are considering to enter and/or expand their operation base in India.

Expectations from TP SH 2022

This section briefly describes the relevant aspects of TP SH 2017 (including its applicability for FY 2019-20 and FY 2020-21) and possible expectations of taxpayer community (impacted by COVID-19 pandemic) from the TP SH 2022. For the purpose of better presentation (in this article), the eligible international transactions have been grouped under two broad buckets: transactions pertaining to provision of services and transactions other than provision of services.

Transactions pertaining to provision of services

In the era of technology, businesses across sectors are dependent on IT services. A predominant section of global service delivery centres in India caters to such requirements of their parent/group companies based in the Americas and Europe. Global service delivery centres and other captive service centre(s), especially those catering to sectors severely impacted by COVID-19, would expect the government to take appropriate measures to support them.

One such measure is appropriate consideration of expectations from TP SH 2022. Expectations such as rationalisation of safe harbour margins, widening the scope of safe harbour rules by bringing additional international transactions within its ambit and by upward revision in thresholds, have been briefly described in the table.

Eligible international transaction, existing threshold, and safe harbour rates as per TP SH 2017

Provision of software development services at safe harbour rates being not less than 17-18% on operating cost with threshold value of ≤ INR 100 crore and > INR 100 crore but ≤ INR 200 crore

Provision of IT-enabled services at safe harbour rates being not less than 17-18% on operating cost with threshold value of ≤ INR 100 crore and > INR 100 crore but ≤ INR 200 crore

Provision of knowledge process outsourcing services, at safe harbour rates as tabulated below on operating cost with threshold value of ≤ 200 crore

Employee cost (EC) is at least 60% of operating cost (OC)	**24%**
EC is at least 40% but less than 60%	**21%**
EC is less than 40%	**18%**

Provision of contract research and development services wholly or partly relating to software development, at safe harbour rate being not less than 24% on operating cost with threshold value of ≤ INR 200 crore

Our outlook and recommendations

a) Rationalisation of operating margins in light of COVID-19 impact

Taxpayers' expectation on margin rationalisation is driven by the current economic realities, especially where service recipients belong to the industries/sectors severely hit by the COVID-19 pandemic. Hence, taxpayers would expect that the CBDT considers the services rendered by captive service centres in India to its group companies operating in sectors, such as aviation, tourism, hospitality, oil and gas and automotive.

The impact of COVID-19 will continue to prevail. Therefore, the CBDT, while formulating relief measures (through TP SH 2022), may consider an approach of enforcing prescribed margins under TP SH for a block of years, unlike the option provided to the taxpayer to apply for safe harbour for a standalone financial year under the existing TP SH 2017 (including its applicability for FY 2019-20 and FY 2020-21).

While doing so, the CBDT may consider adopting appropriate multipliers, which are aligned with the impact and recovery curve of the economy/concerned sectors. Such multipliers can then be applied to the prescribed margins under TP SH 2022 to arrive at an effective safe harbour rate applicable for the respective years in the block. This will enable taxpayer to avail of the much-needed relief in the form of lower safe harbour margins in the initial years, which are adversely impacted by COVID-19, of the block (to be covered under the TP SH 2022) and at the same time, obtain a commitment from taxpayers to accept a relatively higher margin for the subsequent years of the block bearing the fruits of recovery.

Adopting different multipliers for different industries may also be explored. Such multipliers could be based on the economic impact assessed by globally acclaimed research organisations or trade institutions or any other global organisation focusing on formulation of tax policies.

Moreover, taxpayers who do not wish to avail of the benefits attached to the block, may be given an option to exercise safe harbour only for a particular financial year.

Additionally, the CBDT may consider imposing certain additional conditions to be adhered to by the eligible taxpayer who wish to avail of benefits under the TP SH 2022. Such conditions should primarily target to ensure that there is no major job loss/salary reduction situation on account of the COVID-19 impact. To encourage taxpayers to retain jobs and avoid short-term reduction in workforce, it is important to rationalise margins under TP SH. Such a pragmatic approach by the CBDT would help the affected businesses in their cost reduction exercise and will also discourage them to implement harsh measures in the form of layoffs.

Illustration: Consider block of four years (say from FY 2021-22 to FY 2024-25)

Year in the block	Margin* %	Remarks/Suggestions
Year 1	0.85×	Suggestion on conditions to be followed by taxpayer availing of the relief under TP SH 2022: • No employee layoffs, beyond certain threshold (to be prescribed under TP SH 2022) • No salary cost reduction beyond a prescribed percentage of the annual CTC of the employees • All costs incurred during the mandatory lockdown period should be billed and collected (with application of operating margins to be prescribed under TP SH 2022)
Year 2	0.95×	
Year 3	1.00×	Taxpayers, who have opted for SH and availed of benefits for a part of the block (i.e. FY 2021-22 and FY 2022-23), are not able to continue to be covered under SH (for balance period of the block) for any reason, then these taxpayers would be either required to file modified income tax return for all the earlier years (for which safe harbour was opted) and would be open for tax scrutiny in the normal course without any immunity (which is otherwise available through SH) or proceed under SH without availing of any benefits. For all time-bound tasks with respect to commencement of any assessment proceedings, the date of filing such modified income tax return should be considered as the date of filing the original return.
Year 4	1.05×	

* The multipliers given in this column are only for the purpose of illustration and should not be construed as a recommendation.

Eligible international transaction, existing threshold, and safe harbour rates as per TP SH 2017	Our outlook and recommendations
	Note: Taxpayers not wishing to commit the entire block to TP SH, should be having an option to apply for a safe harbour for each of the years on standalone basis at 'x' percentage prescribed in the safe habour. **b) Rationalisation of thresholds based on transaction values** The current rules restrict the availability of safe harbour option to assessees with eligible software development, ITeS, KPO and contract R&D services transactions of up to INR 200 crore. This has resulted in a large number of assessees with a transaction value of higher than the threshold, not being able to opt for the safe harbour option. The CBDT may consider removing the current thresholds as they conflict with the objective of reducing disputes and providing certainty to the taxpayers. Further, a uniform margin may be prescribed irrespective of value of transactions, as against the existing rules that prescribe a higher margin for the higher value of transactions. In the service industry where majority costs are variable in nature, higher value of service transactions does not necessarily result in higher margins. Doing away with the threshold and prescribing a uniform margin will ensure that the safe harbour rules do not discourage the taxpayers from expanding operations in India and thereby help fuel economic growth.
	c) Exclusion of costs relating to abnormal drop in productivity The cost relating to abnormal drop in productivity during COVID-19 effected period to be excluded from cost base for charging mark-up. In order to demonstrate eligibility to claim this exclusion from cost base, the company should maintain a documentation to show the drop in productivity and link it to COVID period. The IT/ITES services providers involved in providing onsite services (say employees deputed to overseas projects in USA, Canada, etc., could not return to India due to travel restrictions and hence, such employees were paid salaries, allowances, accommodation, etc., though no work was performed) may be allowed a relief in the form of exclusion of abnormal bench costs (abnormal bench costs due to COVID-19 vis-a-vis normal bench costs in normal circumstances) from the costs base for markup purpose. The company in such case should maintain a documentation to show the abnormal bench cost and related reasons.

Eligible international transaction, existing threshold, and safe harbour rates as per TP SH 2017	Our outlook and recommendations
	d) Revision in slabs of employee cost ratios (with respect to KPO services) Under the TP SH 2017 applicable until FY 2020-21, the operating margins to be declared in context of the KPO services are directly linked to the quantum of employee costs (as a percentage of total cost). Such approach would have been formulated on the presumption that higher the quantum of employee cost (as a percentage of total costs) higher is the value addition by the Indian service provider and therefore higher should be the operating margin to be declared in the TP SH. Taxpayers at large would not only expect (under TP SH 2022) rationalisation of operating margins to be declared (at different levels of employee cost as a percentage of total costs) on account of the COVID-19 impact, but would also expect rationalisation of thresholds pertaining to the employee cost as a percentage of total costs. In this context, it would be in the interest of the taxpayer community if CBDT takes cognisance of the following points: • MNCs would focus on fulfilling its bare minimum business requirements during the COVID-19 impact period. In such situation, higher service costs (for KPO services sourced from India) could act as a major deterrent for MNCs to maintain/expand their service delivery capabilities in India. Thus, rationalisation of margins is essential. • With Tier II cities in India emerging as preferred location for service centres, these centres would most probably have relatively lower cost structure compared with corresponding cost structures in Tier 1 locations. Nonetheless, employee cost could still be the highest component of such structures as other cost elements in Tier II locations could be on lower side. In such a scenario, the employee costs as a percentage of total cost may be more than 60% of the total costs and attract 24% as operating margin as per TP SH 2017. However, this does not necessarily mean that services rendered by such service centres are functionally high value KPO services warranting for high operating margins. Such distortion could be at least diluted to a great extent by increasing the employee cost thresholds of less than 40% between 40% and 60% and more than 60% to less than 60%, between 60% and 75% and more than 75% respectively. • Due to the ongoing crisis, the industry at large is compelled to adopt work from home. However, it is also possible that industry at large (specifically IT and ITeS sector) may want to make work from home culture 'the new normal' even post COVID-19. In such a situation, the employee costs as a percentage of total costs could be on a higher side, even for a medium-to-relatively-low value added KPO service.
	e) Clarity on definition of covered service transactions Existing overlaps in the definitions of routine 'software development services' and high-end 'contract R&D services' makes taxpayers apprehensive from opting for coverage under the rules. For example, update of existing products where source code is provided to the taxpayer is classified as contract R&D services. However, access to source code of the software applications is a pre-requisite for most routine software development/ enhancement/maintenance projects as well. Such overlaps may be rectified/clarified by the CBDT so as to provide taxpayers with the requisite certainty to come forward and opt for these rules.

Transactions other than provision of services

Eligible international transaction, existing threshold, and safe harbour rates as per TP SH 2017

Advancing of intra-group loans denominated in INR

With CRISIL or equivalent credit rating of AE	One-year marginal cost of funds lending rate of State Bank of India as on April q of the relevant previous year plus
Between AAA to A or its equivalent	175 basis points
BBB-, BBB or BBB+ or its equivalent	325 basis points
between BB to B or its equivalent	475 basis points
between C to D or its equivalent	625 basis points
not available and loan amount ≤ 100 crores as on 31st March	425 basis points

Advancing of intra-group loans denominated in foreign currency

With CRISIL or equivalent credit rating of AE:	Not less than the six-month London Inter-Bank Offer Rate (LIBOR) of the relevant foreign currency as on 30 September of the relevant previous year plus
Between AAA to A or its equivalent	150 basis points
BBB-, BBB or BBB+ or its equivalent	300 basis points
between BB to B or its equivalent	450 basis points
between C to D or its equivalent	600 basis points
not available and amount of loan does not exceed 100 crores as on 31 March	400 basis points

Our outlook and recommendations

a) Relaxation from mandatory credit rating requirements

Commercial organisations would focus on cost reduction measures due the impact of COVID-19 on their businesses. Obtaining credit rating for intra group loan transactions, specifically due to requirement of safe harbour rules results into incurrence of avoidable cost for the MNCs. Hence, it is expected that the CBDT consider relaxation for requirement of obtaining credit rating to support the businesses in their cost reduction exercise. The CBDT may amend and prescribe the rules in a manner that gives enough weightage to certain other factors (i.e. collateral security, guarantee and tenure) for such loan transactions, once requirement of obtaining credit rating is done away with.

Alternatively, the CBDT can prescribe more cost efficient approach i.e. use of internationally accepted synthetic credit rating tools (such as Moody's RiskCalc, etc.).

b) Widening the scope of eligible international transaction

The Indian government and the RBI, as a step towards combating the adverse impact of COVID-19 on economy, have taken various measures to allow seamless access of funds to the commercial organisations in the current scenario of financial uncertainty and instability. However, there seems to be reluctance on the part of the lending banks and financial institutions to display the required confidence on the borrowers to release additional funds. This may compel MNCs to explore alternative route to access funds i.e. by taking loans from group companies located in another tax jurisdiction to fund their working capital requirements, need of funds to meet the fixed financial obligations and liquidity requirements, which are aggravated by the COVID-19 pandemic. Hence, MNCs would expect that scope of the TP SH be expanded to cover even international transactions pertaining to availing of loans from group companies.

Similarly, eligible international transaction of advancing of loan currently covers loan advanced to wholly owned subsidiaries only. It is also expected that the scope of such loan transaction is expanded to cover international transactions of advancing of loan to other associated enterprises who may not be wholly owned subsidiary.

Having an alternative mechanism in place of these financing arrangements in the form of safe harbour rates, in addition to APA route, would judiciously address MNCs' ongoing concerns related to protracted litigations

c) Appropriate consideration to phasing out of LIBOR

Existing safe harbour rates for loans denominated in foreign currency, as described in adjacent column, are based on the LIBOR as a reference rate. The Intercontinental Exchange (ICE), which administers and publishes LIBOR, has acknowledged that LIBOR may phase out by the end of 2021. It is widely believed that Sterling Overnight Index Average Rate (SONIA) may be considered as next best alternative to the LIBOR. However, certain countries are inclined towards adopting their respective alternative reference rates (ARR). On account of such contingency about the LIBOR as a reference rate, it is expected that the CBDT consider the transition of LIBOR appropriately while prescribing the revised safe harbour rates for loan transactions.

d) Interest moratorium where Associated Entity is incurring losses due to COVID-19 pandemic

CBDT may consider allowing moratorium from charging of interest on the loans for Financial Year (FY) 2021-22 where the Indian company is opting for safe harbour for a block of four years starting from FY 2021-22 and if the overseas AE has incurred losses due to COVID-19.

Eligible international transaction, existing threshold, and safe harbour rates as per TP SH 2017	Our outlook and recommendations
Providing corporate guarantee – with safe harbour rate being not less than 1% per annum on the amount guaranteed	**a) Rationalisation of safe harbour rate of guarantee commission** It would not be irrational to imagine that the banks and financial institutions may sturdily insist on explicit guarantee, in view of COVID-19 driven financial turmoil, while entering into new financing arrangements/renewing the existing financing arrangements. Hence, a sudden rise in such explicit guarantee transactions between group companies of MNCs may be witnessed. This would also give rise to expectations of various stakeholders that existing safe harbour rate of guarantee commission be rationalised by aligning it with the new economic realities shaped by the COVID-19 pandemic. The quantum of guarantee commission/fee should not outweigh the benefit conferred by the guarantee in the form of reduced interest cost. In current prevailing economic circumstances, existing safe harbour guarantee commission rate of minimum 1% may not justify the benefit in the form of interest differential. Moreover, tax judicial authorities in India have also, in many cases, held guaranteed commission of 0.5% to be at arm's length. Hence, it is highly recommended that the CBDT may consider lowering the minimum guarantee commission rate appropriately by giving due weight to the current economic scenario. **b) Widening the scope of eligible international transaction** As discussed earlier about the indispensable need to bring transactions of availing of loan within the purview of safe harbour rules on account of prevailing economic conditions, it is highly recommended that international transactions of receipt of corporate guarantee are also considered by the CBDT as eligible international transaction. This is also a need of the hour as there would be resurgence of loan and guarantee arrangements between group companies due to the impact of COVID-19 on the financial stability and liquidity in the global markets. Further, it is also recommended that the scope of existing eligible international transaction providing of corporate guarantee is expanded to cover such international transactions with other associated enterprises who may not be wholly owned subsidiary. **c) Guarantee commission** Moratorium where Associated Entity is incurring losses due to COVID-19 pandemic CBDT should consider allowing moratorium from charging of guarantee fee on the amounts guaranteed for Financial Year (FY) 2021-22 where the Indian company is opting for safe harbour for a block of four years starting from FY 2021-22 and if the overseas AE has incurred losses due to COVID-19.
Manufacture and export of core auto components – with safe harbour rate being not less than 12% on operating cost Manufacture and export of non-core auto components – with safe harbour rate being not less than 8.5% on operating cost	**a) Rationalisation of safe harbour margins** Automotive industry is experiencing hardest hit due to unending the COVID-19 pandemic. Adverse impact on the Indian auto components industry, of global slowdown in automotive industry and regulatory measures in the form of shift from BS IV to BS VI standard, has been further fuelled by COVID-19 situation. Hence, the industry has fairly high expectations that the CBDT streamline the safe harbour margins, which reasonably reflect the current economic and industry realities in this challenging time. The CBDT may consider applying the similar approach as discussed for the provision of service transaction earlier wherein the benefits in terms of margin reduction is provided in the initial years of the block. Moreover, the CBDT may also consider stimulating auto components industry players, which caters to electric vehicles (EV) by proposing lower safe harbour rates. Such move by the CBDT will also be in line with the Indian government's policy of promoting EV vertical in the country and it would also contribute to the creation of employment opportunities in India. **b) Widening the scope of SH coverage** In order to promote the domestic manufacturing, the GOI has introduced Production Linked Incentive (PLI) scheme for 10 key sectors i.e., electronics and technology, pharmaceutical, telecom and networking equipments, textile products, food products, steel products, advance chemistry cell battery, automobile and auto components, etc. Therefore, CBDT should consider extending the SH rates for companies engaged in manufacturing and covered under PLI scheme of GOI and propose the SH margin of 10% on Operating cost in year one and two and further lower it for subsequent years when the turnover of the Indian company increases. The turnover threshold for this benefit could be the revised MSME threshold.

Stakeholders are expecting that the scope of TP SH to be also expanded to cover limited risk distributor entities and/ or marketing and sales support entities of MNCs operating in India. Further, scope of the rules should be widened to cover transactions in the nature of business support services, investment advisory services, etc which are some of the key areas of TP litigation. This measure may also act as a pull factor for the MNCs, which are contemplating shifting of market focus to India from other geographies, especially in view of the COVID-19 pandemic.

Further, the CBDT may consider expanding scope of the rules for specified domestic transactions to cover all the service transactions which are covered in case of international transactions. Moreover, it is also expectation of various stakeholders that rules should also apply to deemed international transactions.

Opting for a safe harbour route should be coupled with significant reduction in the time, effort and cost of compliance requirements. However, the existing TP SH do not provide relief on this aspect as there are still certain documentations and certification requirements, which can be further relaxed to some extent. The CBDT may consider for providing exemption from the requirement to maintain detailed TP documentation for the taxpayers who opt for coverage under the safe harbour rules, especially for subsequent years in cases where the application is filed for more than one year in order to make the safe harbour provisions more attractive.

Conclusion

The CBDT has welcomed recommendations from various stakeholders and factored appropriately, to the extent feasible, while prescribing TP SH. Such cohesive approach of the CBDT has also enabled it in revamping the initial perception about TP SH and projecting it as viable option to attract the interest of MNCs.

Certain germane statistics from the Economic Survey of India 2019-20 highlight the need of various tax simplification measures. As per chapter 6 (Targeting ease of doing business in India) of the Economic Survey of India 2019-20, India has made significant progress in the overall rank on the parameter of ease of doing business in India (from 133rd rank in 2009 to 63rd rank in 2019) over the decade. Having said that, India is still lagging behind on the parameter of paying taxes (115th position in 2019 vis-à-vis 169th position in 2009). Attracting more taxpayers to SH by streamlining the TP SH, in line with the industry expectations and unprecedented economic realities triggered by the COVID-19 pandemic, would indeed support in preventing disputes and thereby improving the country's ranking on ease of doing business in India. Besides, certainty on taxation matters is one of key factors for foreign investors while making their decisions about entering into new markets and/or expanding their existing operations in any new tax jurisdictions. Hence, investor friendly and progressive tax measures in the form of the TP SH could certainly contribute to GOI's efforts of attracting foreign investment, which invariably leads to creation of job opportunities.

Downward review of the TP SH for the post-COVID-19 era is certainly the need of the hour for not just diverting the taxpayers and tax authorities time away from avoidable and expensive transfer pricing audits towards employment generation and protection but also for augmenting tax collections.

Ease of doing business in India

Overall rank improved to

63 in 2019 from 133 in 2009

Paying taxes

Overall rank improved to

115 in 2019 from 169 in 2009

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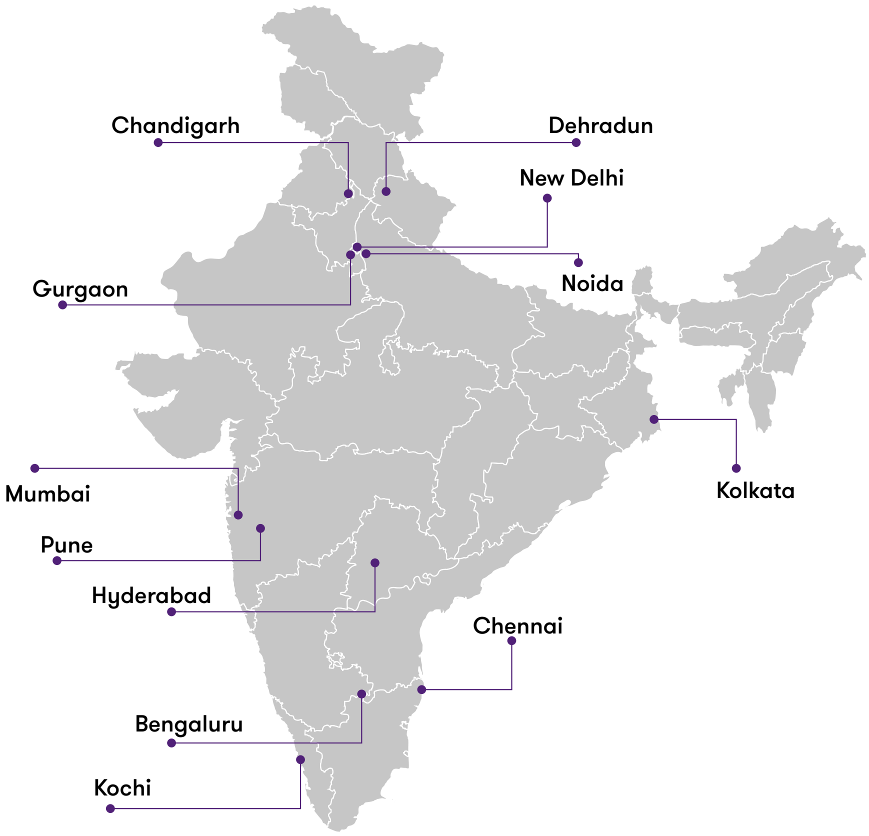

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