# PRIMARY; CORRESPONDING; SECONDARY ADJUSTMENTS SAFE HARBOUR

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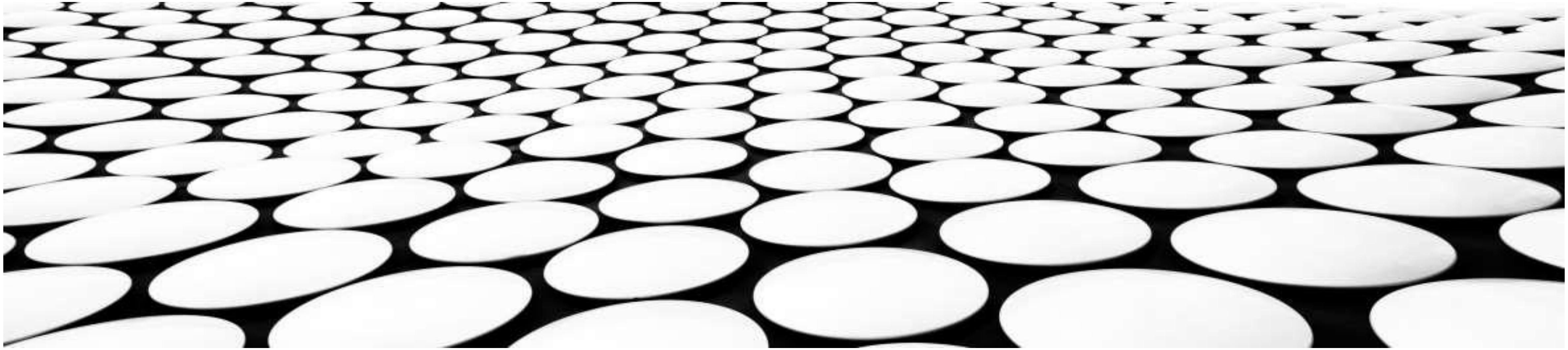


# CONTENTS

# PRIMARY ADJUSTMENT

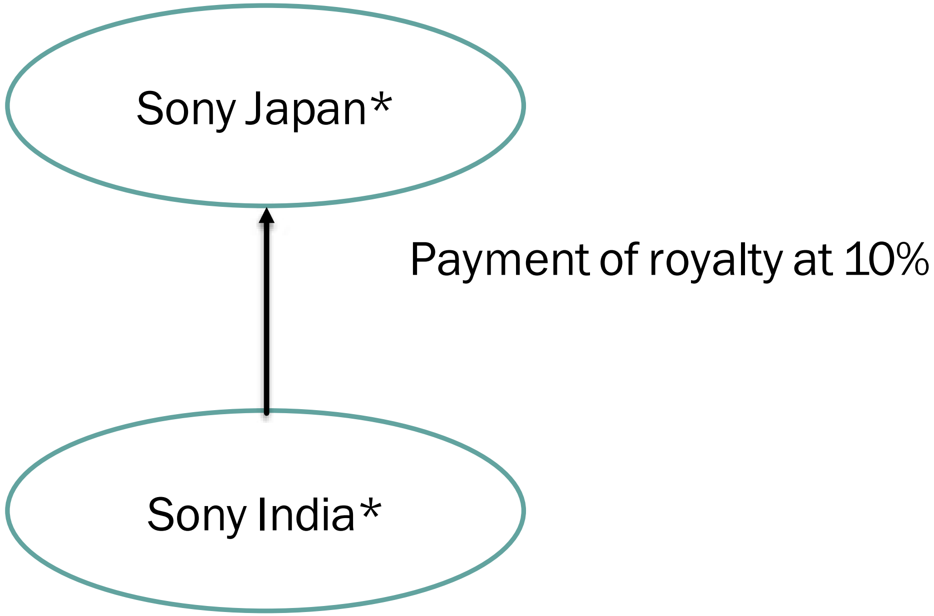
# DEFINITION

- **Section 92CE (3) (iv)- primary adjustment to a transfer price, means the determination of transfer price in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the assessee**

# MEANING

- Suo-moto adjustment by tax payer in return of income;
- Adjustment made by tax authorities during assessment and accepted by the taxpayer;
- Determination of arm's length price pursuant to:
  - Advance Pricing Agreement
  - Application of safe harbour rules
  - Mutual Agreement Procedure

# EXAMPLE OF PRIMARY ADJUSTMENT




- During assessment proceedings TPO makes an adjustment saying comparable royalty @ 6 %
- So this upward adjustment of 4% is primary adjustment

* Representational name used for example

# INDIAN TP DISPUTE RESOLUTION

PRIMARY SOURCE OF PRIMARY ADJUSTMENT

# DISPUTE RESOLUTION ROUTES

## Traditional vis-à-vis Modern mechanism

**Traditional Routes**

- Appeal to Commission of Income Tax (Appeals) / Application with Dispute Resolution Panel;
- Appeal to Income Tax Appellate Tribunal;
- Appeal to High Court*; and
- Appeal to Supreme Court*

**Modern Routes**

- Authority of Advance Rulings (‘AAR’);
- Mutual Agreement Procedure (‘MAP’); and
- Advance Pricing Agreement (‘APA’)

* *Only if substantial question of law*

# TP Assessment Procedure

1. U/s 92CA the AO may refer determination of ALP to the TPO, with prior approval of Commissioner

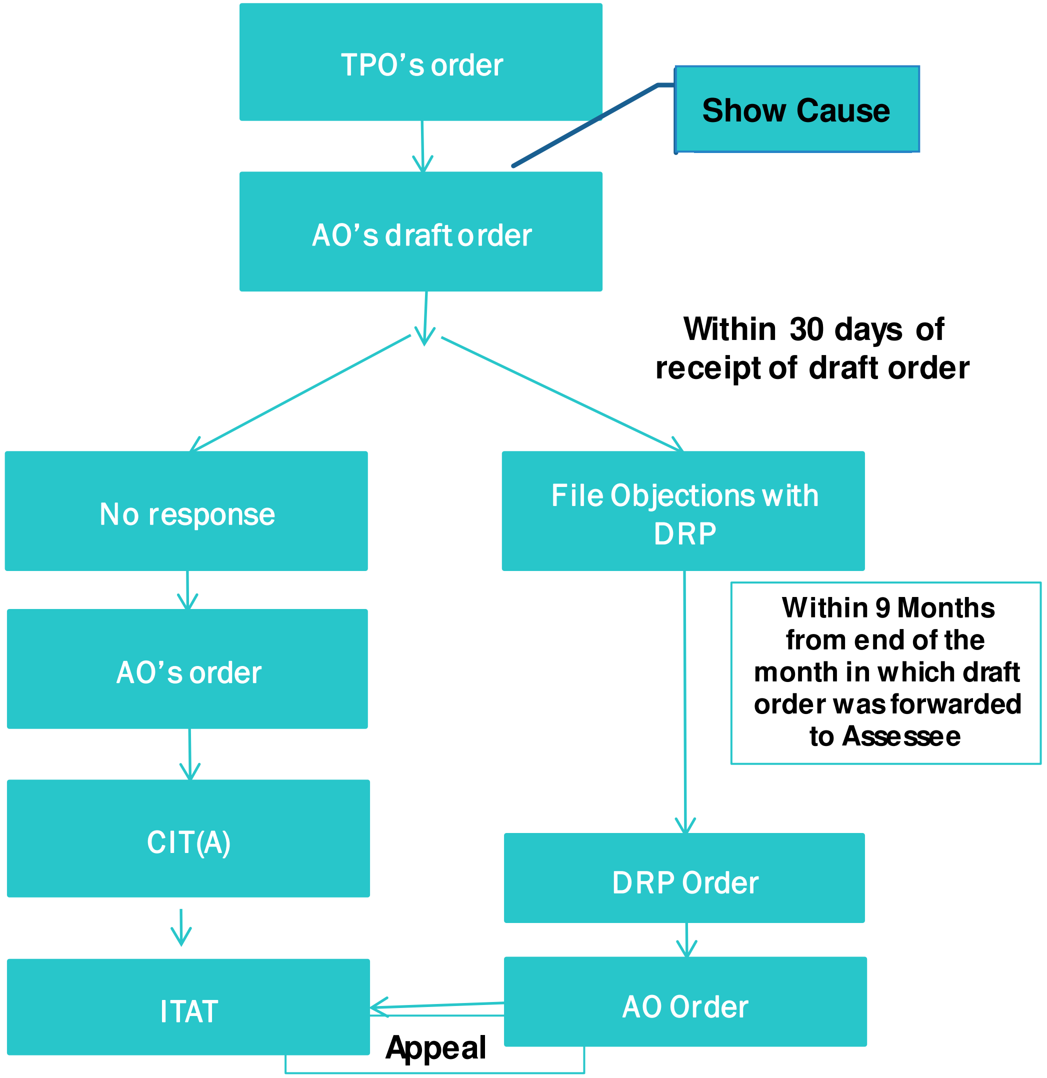
2. TPO would then notify the taxpayer to produce evidence supporting transfer price as arm's length

3. TPO would determine ALP based on information gathered from the assessee/ other sources and intimate the AO & taxpayer

4. AO would compute income of the taxpayer in conformity with ALP determined by the TPO and pass a draft order

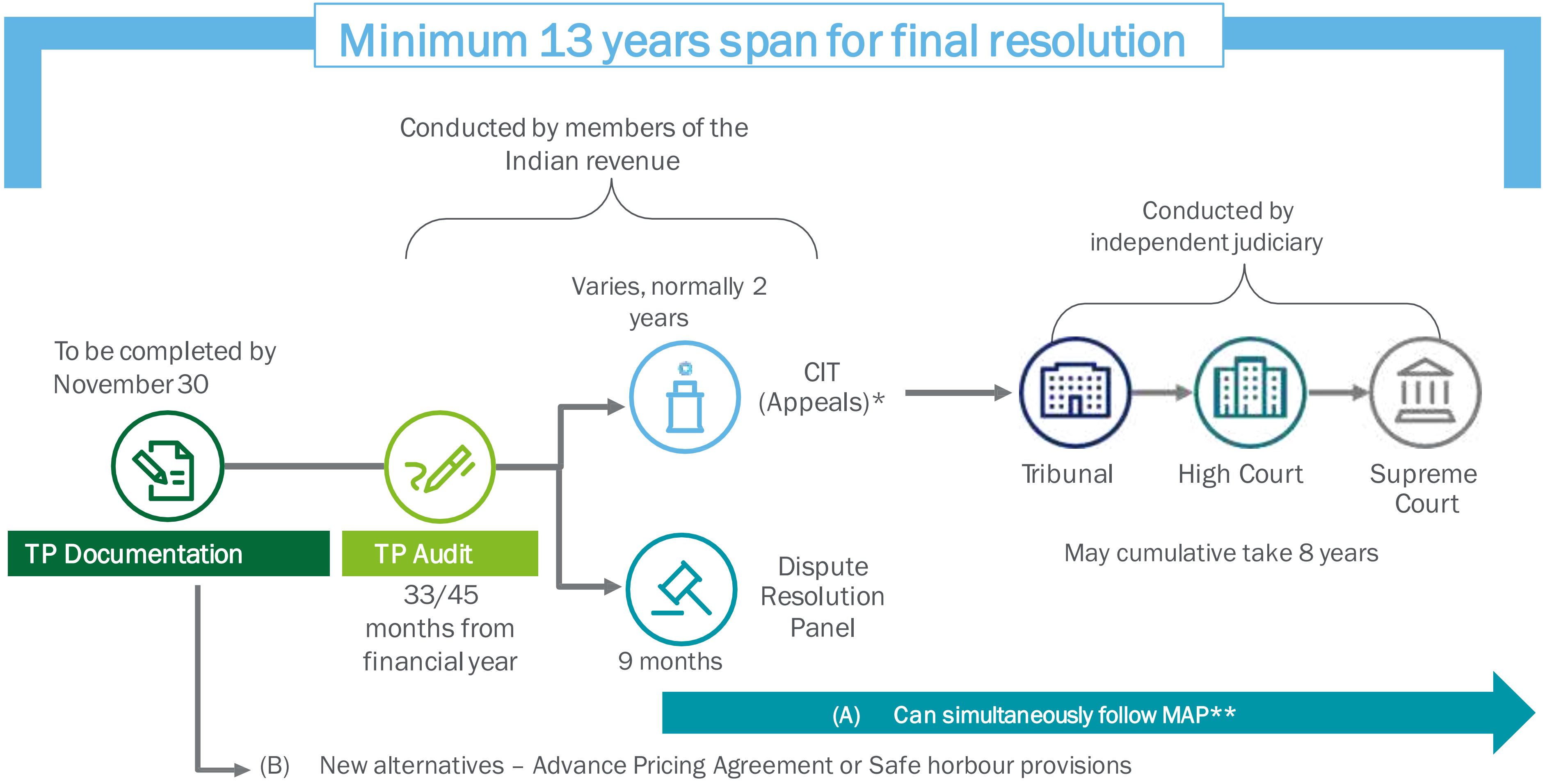
# DISPUTE RESOLUTION PANEL

- The AO to provide "draft" order to assessee, in case any adjustment is proposed.
- The assessee has to file the objections within 30 days of receipt of the draft order;
- Directions of the DRP to be issued within 9 months of the end of month draft order forwarded to Assessee;
- The directions issued by the DRP Panel are appealable in the ITAT by the Assessee.



# DISPUTE RESOLUTION ROUTES

Time frame and new alternatives




** CIT(Appeals) – Commission of Income-tax (Appeals)*

*** MAP – Mutual Agreement Procedure*

# QUIZ

- What are the different primary adjustment scenarios?

# CORRESPONDING ADJUSTMENT

# Corresponding Adjustments



have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2. Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.

## ARTICLE 10

## DIVIDENDS

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, dividends paid by a company which is a resident of a Contracting State

# CORRESPONDING ADJUSTMENTS

- OECD Model DTC Article 9(2)) – An Adjustment made by the second territory, where transfer pricing adjustment has been made in another territory to mitigate double taxation
- It is an adjustment subject to the agreement by the second tax authority and generally requested under Mutual agreement procedure.

# CORRESPONDING ADJUSTMENTS

- A in country A Sells Goods to B in country B. Profits are as below:

| | Before TP Adjustment | After TP Adjustment |
|---|---|---|
| Profit of A | 20 Mill | |
| Profit of B | 35 Mill | |
| Total Taxable profit | 55 Mill | |

# CORRESPONDING ADJUSTMENTS

- TP adjustment of 2 Mill in A’s Profit.

| | Before TP Adjustment | After TP Adjustment |
|---|---|---|
| Profit of A | 20 Mill | 22 Mill |
| Profit of B | 35 Mill | 35 mill |
| Total Taxable profit | 55 Mill | 57 mill |

**Double taxation of 2 million in both profit of A as well as B

# SCENARIOS

There could be 3 possible scenarios:

1. State B may fully agree with the primary adjustment of 2 million made in the case of A in State A.
2. State B may disagree over the primary adjustment, in principle.
3. State B may disagree only on the quantum of the primary adjustment, and compute the allowable corresponding adjustment *suo-moto*.

# MUTUAL AGREEMENT PROCEDURE

- The practical application of corresponding adjustment is not provided in the OECD TPG.
- MAP- OECD TPG-“*A means through which tax administrations consult to resolve disputes regarding the application of double tax conventions. This procedure, described and authorised by Article 25 of the OECD Model Tax Convention, can be used to eliminate double taxation that could arise from a transfer pricing adjustment.*”

- What happens if treaty does not have article 9(2) equivalent?

Press-Release-Clarification-India-position-acceptance-MAP-bil... 1 / 1 123%

New Delhi, 27th November, 2017.

PRESS RELEASE

**Clarification of India's position on the acceptance of MAP and bilateral APA in cases of countries where Article 9(2) of OECD Model Tax Commentary is absent**

A number of references have been received from time to time regarding the acceptance of applications pertaining to Transfer Pricing MAP cases and bilateral Advance Pricing Agreements (APAs) where the Associated Enterprise (AE) of the Indian entity is resident of a country with which India has entered into a Double Taxation Avoidance Agreement (DTAA) but the Agreement does not contain Paragraph 2 of Article 9 (or its relevant equivalent Article) relating to 'Corresponding Adjustment'.

The matter has been examined by the Central Board of Direct Taxes (CBDT) and it has been decided to accept Transfer Pricing MAP and bilateral APA applications regardless of the presence or otherwise of Paragraph 2 of Article 9 (or its relevant equivalent Article) in the DTAAs.

# CORRESPONDING ADJUSTMENTS

application of the national law of some countries may result in adjustments to profits at variance with the principles of the Article. Contracting States are enabled by the Article to deal with such situations by means of corresponding adjustments (see below) and under mutual agreement procedures.

***Paragraph 2***

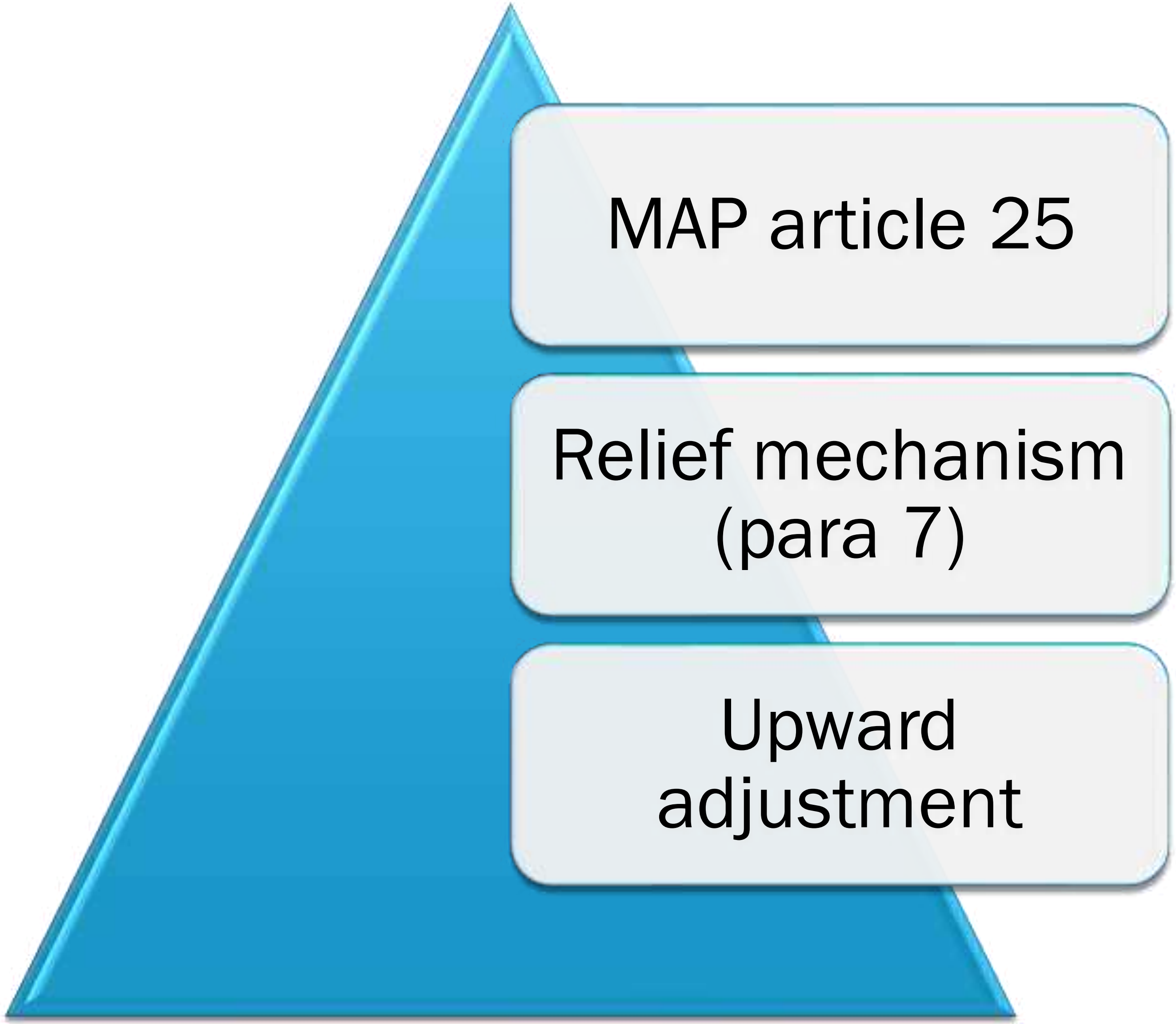
5. The re-writing of transactions between associated enterprises in the situation envisaged in paragraph 1 may give rise to economic double taxation (taxation of the same income in the hands of different persons), insofar as an enterprise of State A whose profits are revised upwards will be liable to tax on an amount of profit which has already been taxed in the hands of its associated enterprise in State B. Paragraph 2 provides that in these circumstances, State B shall make an appropriate adjustment so as to relieve the double taxation.

6. It should be noted, however, that an adjustment is not automatically to be made in State B simply because the profits in State A have been increased; the adjustment is due only if State B considers that the figure of adjusted profits correctly reflects what the profits would have been if the transactions had been at arm's length. In other words, the paragraph may not be invoked and should not be applied where the profits of one associated enterprise are increased to a level which exceeds what they would have been if they had been correctly computed on an arm's length basis. State B is therefore committed to make an adjustment of the profits of the affiliated company only if it considers that the adjustment made in State A is justified both in principle and as regards the amount.



Primary adjustment is **JUSTIFIED**

# GLOBAL SCENARIO



# RELIEF MECHANISM

- What are the two ways relief can be given by a corresponding adjustment?

Recalculating profits of second jurisdiction

Granting tax relief to second jurisdiction

NOT AN AUTOMATIC PROCESS-SUBJECT TO THE MUTUAL AGREEMENT BETWEEN THE COUNTRIES

# INDIAN TREATIES

70 treaties have Article9(2)/equivalent

Press release dt 27/11/2017

# RAPID FIRE QUIZ

- Is corresponding adjustment automatic?

# SAFE HARBOUR

# SAFE HARBOUR RULES

**OECD Transfer Pricing Guidelines, 2017**

4.102 A safe harbour in a transfer pricing regime is a provision that applies to a defined category of taxpayers or transactions and that relieves eligible taxpayers from certain obligations otherwise imposed by a country's general transfer pricing rules. A safe harbour substitutes simpler obligations for those under the general transfer pricing regime.

**Section 92CB OF Income Tax Act, 1961**

- "circumstances in which the tax authority shall accept the transfer price declared by the eligible taxpayer"

# SAFE HARBOUR RULES-INDIA

| Particulars | Remarks |
|---|---|
| Introduction | 13 September 2013 |
| Validity | First time:<br>5 years AY 2013-14 to AY 2017-18<br>Revision:<br>3 years AY 2017-18 to AY 2019-20 |
| Objective | Avoidance of litigation |
| Safe Harbour Rules has over riding effect on Section 92C and 92CA of the Act | |
| Safe Harbour Application (Form 3CEFA) can be made by an Eligible Assessee for an Eligible international transaction as defined under Rule 10TB and Rule 10TC of the Rules | |

# SAFE HARBOUR RULES – RULES 10TA TO 10TG

| | |
|---|---|
| **Meaning** | • Safe Harbour Rules refers to determination of price margin which are acceptable to tax authorities to provide protection to taxpayers from TP scrutiny proceedings<br>• Prices established under such rules would be automatically accepted by the tax administrations that have expressly adopted such rules |
| **Applicability** | • Rules to be applicable for a maximum period of 5 years beginning AY 2013-14 or the period opted by the Assessee<br>• Does not apply where the AE is located in any country or territory notified under section 94A or in a no tax or low tax country or territory |
| **Compliance** | • The Assessee shall furnish a Form 3CEFA on or before 30 November of the first assessment year of the covered period for which it is seeking protection |
| **Arbitration** | • Objection to Commissioner within 15 days of receipt of TPO order<br>• Commissioner shall pass its order within 2 months from the end of the month in which the objection is received by him |

# DEFINITIONS UNDER SHR

10TB. (1) Subject to the provisions of sub-rules (2) and (3), the **<u>'eligible assessee</u>'** means a person who has exercised a valid option for application of safe harbour rules in accordance with rule 10TE, and— (i) is engaged in providing software development services or information technology enabled services or knowledge process outsourcing services, with insignificant risk, to a non-resident associated enterprise (hereinafter referred as foreign principal); (ii) has made any intra-group loan; (iii) has provided a corporate guarantee; (iv) is engaged in providing contract research and development services wholly or partly relating to software development, with insignificant risk, to a foreign principal; (v) is engaged in providing contract research and development services wholly or partly relating to generic pharmaceutical drugs, with insignificant risk, to a foreign principal; 1[***] (vi) is engaged in the manufacture and export of core or non-core auto components and where ninety per cent or more of total turnover during the relevant previous year is in the nature of original equipment manufacturer sales 2[; or] 3[(vii) is in receipt of low value-adding intra-group services from one or more members of its group.]

# VARIOUS DEFINITIONS UNDER SHR …

## IT services

i. Business application software and information system development using known methods and existing software tools;
ii. support for existing systems;
iii. converting or translating computer languages;
iv. adding user functionality to application programmes;
v. debugging of systems;
vi. adaptation of existing software; or
vii. preparation of user documentation,

## ITeS

i. back office operations;
ii. call centres or contact centre services;
iii. data processing and data mining;
iv. insurance claim processing;
v. legal databases;
vi. creation and maintenance of medical transcription excluding medical advice;
vii. translation services;
**viii. payroll;**
ix. remote maintenance;
x. revenue accounting;
xi. support centres;
xii. website services;
xiii. data search integration and analysis;
xiv. remote education excluding education content development; or
xv. clinical database management services excluding clinical trials,

## KPO

i. geographic information system;
**ii. human resources services;**
iii. engineering and design services;
iv. animation or content development and management;
v. business analytics;
vi. financial analytics; or
vii. market research,

## Contract R&D

i. research and development producing new theorems and algorithms in the field of theoretical computer science;
ii. development of information technology at the level of operating systems, programming languages, data management, communications software and software development tools;
iii. development of Internet technology;
iv. research into methods of designing, developing, deploying or maintaining software;
v. software development that produces advances in generic approaches for capturing, transmitting, storing, retrieving, manipulating or displaying information;
vi. experimental development aimed at filling technology knowledge gaps as necessary to develop a software programme or system;
vii. research and development on software tools or technologies in specialized areas of computing (image processing, geographic data presentation, character recognition, artificial intelligence and such other areas);or
viii. upgradation of existing products where source code has been made available by the principal, except for routine functions like debugging of software

*Note - The definition of contract R&D services relating to software development has been amended to exclude services which involve making available source code to carry out routine functions like debugging of software

# … VARIOUS DEFINITIONS UNDER SHR …

| Terminology | Definition as per Rule 10TA and Rule 10TB |
|---|---|
| **Operating expense** | “Operating expense" means the costs incurred in the previous year by the assessee in relation to the international transaction during the course of its normal operations including *costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the assessee to the employees of the assessee, reimbursement to associated enterprises of expenses incurred by the associated enterprises on behalf of the assessee, amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of those associated enterprises and which relate to normal operations of the assessee and*, depreciation and amortisation expenses relating to the assets used by the assessee, but not including the following, namely:—<br>**(i) interest expense**;<br>(ii) provision for unascertained liabilities;<br>(iii) pre-operating expenses;<br>**(iv) loss arising on account of foreign currency fluctuations**;<br>(v) extraordinary expenses;<br>(vi) loss on transfer of assets or investments;<br>(vii) expense on account of income-tax; and<br>**(viii) other expenses not relating to normal operations of the assessee**<br>“Provided that reimbursement to associated enterprises of expenses incurred by the associated enterprises on behalf of the assessee shall be at cost:”<br>Provided further that amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of the associated enterprises and which relate to normal operations of the assessee shall be at cost;” |

# … VARIOUS DEFINITIONS UNDER SHR …

| Terminology | Definition as per Rule 10TA and Rule 10TB |
|---|---|
| **Operating revenue** | "Operating revenue" means the revenue earned by the assessee in the previous year in relation to the international transaction during the course of its normal operations *including costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the assessee to the employees of the assessee* but not including the following, namely:—<br><br>i. interest income;<br>ii. income arising on account of foreign currency fluctuations;<br>iii. income on transfer of assets or investments;<br>iv. refunds relating to income-tax;<br>v. provisions written back;<br>vi. extraordinary incomes; and<br>vii. other incomes not relating to normal operations of the assessee |
| **Operating profit margin** | Operating profit margin in relation to operating expense means the ratio of operating profit, being the operating revenue in excess of operating expense, to the operating expense expressed in terms of percentage. |

# … VARIOUS DEFINITIONS UNDER SHR …

| Low value adding intra-group services: support services by the AEs | |
|---|---|
| Exclusions parameters | Excluded services |
| • Constituting the profit-earning activities<br>• Contributing to the economically significant activities of the Group<br>• shareholder services or duplicate services<br>• Requiring use of unique and valuable intangibles<br>• Leading to creation of unique and valuable intangibles<br>• Involving assumption or control of significant risk by the service provider<br>• Giving rise to creation of significant risk for the service provider<br>• Where reliable external comparable services exist for benchmarking | • R&D services;<br>• manufacturing and production services;<br>• IT services;<br>• KPO services;<br>• BPO services;<br>• Purchasing activities of raw materials or other materials that are used in the manufacturing or production process;<br>• Sales, marketing and distribution activities;<br>• Financial transactions;<br>• Extraction, exploration, or processing of natural resources; and<br>• Insurance and reinsurance |

# SAFE HARBOUR RULES

| Transaction | SHR | |
|---|---|---|
| | Monetary threshold[1] | Prescribed minimum mark-up[2] / rate |
| Software development and ITeS | <= Rs. 1 Billion | 17% |
| | Rs. 1 Billion to Rs. 2 Billion | 18% |
| KPO | Does not exceed Rs. 200 Crores and ratio of employee costs to total costs is >= 60% | 24% |
| | 40 - 60% | 21% |
| | < 40% | 18% |
| Contract R&D: Software development | Does not exceed Rs. 2 Billion | 24% |
| Contract R&D: Generic pharmaceutical drugs | | |
| Provision of Corporate Guarantees | No threshold | 1% |
| Manufacture and export of core auto components | No threshold | 12% |
| Manufacture and export of noncore auto components | No threshold | 8.5% |

1. Monetary threshold is applicable for each category of the eligible transaction and not the entity level turnover
2. Prescribed mark-up is at a minimum level to be made by the eligible assessee.

# … SAFE HARBOUR RULES

| New SHR for Loans advanced to AE | | |
|---|---|---|
| Credit Rating of AE | For loans denominated in Indian Currency: Interest Rate = Base Rate[5] + | For loans denominated in foreign Currency: Interest Rate = Base Rate[6] + |
| AAA to A | 175 bps | 150 bps |
| BBB-, BBB, BBB+ | 325 bps | 300 bps |
| BB to B | 475 bps | 450 bps |
| C to D | 625 bps | 600 bps |
| Not available subject to threshold[7] | 425 bps | 400 bps |

5. One year marginal cost of funds lending rate of the State Bank of India as on 1st April of the relevant previous year
6. Six month London Inter-Bank Offer Rate of the relevant foreign currency as on 30th September of the relevant previous year
7. Aggregate loan to all AEs does not exceed Rs. 100 Crores as on 31st March of the relevant previous year

## Receipt of Low Value Adding Intra-Group Services (LVA-IGS):

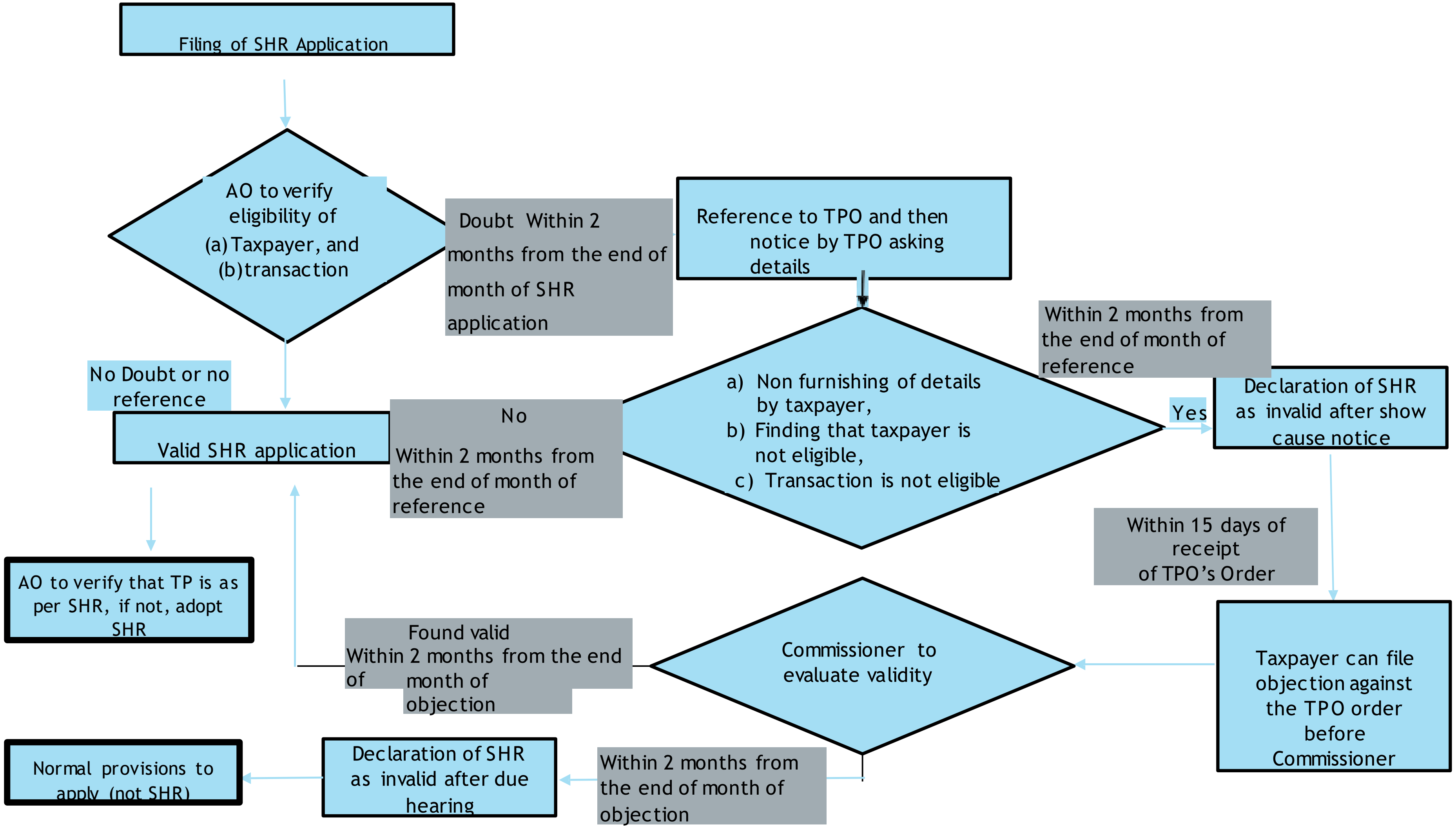
**Conditions to be fulfilled [Monetary Threshold: Up to Rs. 10 crore, Mark-up: Not to exceed 5%]**

- Should not be part of core business (not profit earning activities nor contributing economically significant activities),
- Should not be shareholder/duplicative activities,
- Shouldn't use intangibles/nor should result in creation of intangibles,
- Shouldn't have reliable external comparables for determining arm's length,
- Shouldn't be R&D activities, manufacturing and production services, IT (software development) services, KPO services, BPO services, purchasing activities, sales/marketing/distribution activities, financial transactions, insurance/re-insurance,
- Computation of management service fee transaction to be certified by an accountant.

# PROCEDURE FOR OPTING FOR SHR

| Point | Particulars |
|---|---|
| Application for SHR | In the prescribed Form 3CEFA on or before the due date for filing the return of income before the Assessing Officer (AO) |
| Timing of application | • only the Assessment Year (AY) for which SHR is to be applied, or<br>• first of the AY in case the option is to be exercised for more than one AY |
| Condition | • Return of income for AY of exercise of SHR or first year of AYs for SHR to be filed in time |
| Procedure for subsequent years (if more than one AY is opted for) | Taxpayer to file statement before furnishing the return of income with details such as:<br>• Eligible Transactions<br>• Quantum<br>• Profit margins / rates |
| Validity of SHR | For years applied for, however, not in following cases:<br>• Where the exercise is held to be invalid by the Transfer Pricing Officer (TPO) or commissioner (in case of objection against the TPOs order)<br>• Taxpayer opts out from SHR for the relevant AY by furnishing declaration |
| SHR Assessment for first year | • Please refer next slide |
| SHR Assessment for subsequent year | • No SHR Audit unless the AO doubts the eligibility of taxpayer / international transaction or finds that the facts and circumstances have changed in subsequent years, such as change in the FAR profile of the taxpayer, or substantive contractual conditions governing the role of the taxpayer, or the conduct of the taxpayer or substantive nature of the transaction. |

# PROCEDURE FOR SHR AUDITS



# TRENDS

- Guarantee commission rate reduced to 1% flat
- IT/ITES segment has been brought down to 17%-18%
- KPO to 18%/21%/24%
- R&D Service provider to 24%.

# BENEFITS OF SAFE HARBOUR

Simplification of compliance and reduction of compliance cost

Provision of certainty

Freeing Tax administration resources towards high risk cases

# DISADVANTAGES OF SAFE HARBOUR

- May not adhere to arm's length
- Unilateral may lead to double taxation
- Inappropriate tax planning
- Maybe issue of uniformity and equity

# INDIAN JURIDICAL PRECEDENTS

- The High Court has in the following judgments rejected the reliance on safe harbor rules by holding that safe harbor rules are prospective in nature and were not effective for the year under consideration:

  - Fiserv India Pvt Ltd (TS-437-HC-2016(Del)-TP);
  - Agilis Information Technologies International Pvt Ltd (TS-536-HC-2016(Del)-TP);
  - Cash Edge India Pvt Ltd (TS-262-HC-2016(Del)-TP)

- The Ahmedabad ITAT in the case of SNL Financial (India) Pvt Ltd (TS-320-ITAT-2016(Ahd)-TP) held that reliance on safe harbor application filed by the taxpayer for subsequent year should be taken into consideration for determining the characterization of the taxpayer for the year under consideration

# SH – GLOBAL SCENARIO

| Sr. No. | Name of the Country | SH Rules |
|---|---|---|
| 1 | Singapore | 1. The IRAS has provided SH for intercompany loan transactions:<br>(a) SH interest margin to be applied for cross-border intercompany loans provided by the Singapore taxpayer;<br>(b) The said practice is with effect from 1 January, 2017;<br>(c) SH provision may not apply to any loans provided or received in prior years;<br>(d) The interest margin, which will be published on an annual basis, can be applied on all new loans, which are below the S$15 million threshold, provided or received by Singapore taxpayers; and<br>(e) Interest rate margin needs to be applied on the selected interbank rate (i.e., LIBOR/SIBOR) in the case of floating interest rate arrangements or the swap rate in the case of fixed interest rate arrangements. |
| 2 | Australia | 1. The Australian Taxation Office ("ATO") on 22 February 2017, has released the Practical Compliance Guideline ("PCG"), outlining simplified transfer pricing record keeping options and to minimize the cost of compliance and compliance burden for eligible taxpayers, offering an administrative SH to allow taxpayers to better manage risks associated with international related party dealings; |
| | | 2. The SH would apply on low value intra-group services and loan; |
| | | 3. SH which allow for a 7.5% mark-up on 'non-core' services provided or received where service revenue/ expenses are not more than 15% of the Australian group's total revenue/expenses. A mark-up of between 5% and 10% may be permitted if the services are provided to, or received from, another country that requires a different mark-up; |
| | | 4. Taxpayers relying on the administrative concession must apply a consistent mark-up for the relevant services globally. |
| | | 5. The ruling also allows for smaller companies that receive or provide services worth not more than AUD 500,000 per annum, to apply the administrative practices to all services (i.e. core and non-core). |
| 3 | New Zealand | The provision of a SH mark-up on cost of 7.5% in applying the Cost Plus method for non-core activity services and for services under the specified de minims threshold of NZD 1,000,000. |

# SH – GLOBAL SCENARIO (CONTD.)

| Sr. No. | Name of the Country | SH Rules |
|---|---|---|
| 4 | France | 1. The French Tax Code ("FTC") has introduced SH under "General interest deduction limitation rule"; |
| | | 2. Interest deduction for companies subject to corporate income tax in France, 25% of net financial expenses of a company are no longer deductible |
| | | 3. SH has been introduced to prevent the application of this limitation when the total amount of net financial expenses of a company does not exceed EUR 3 million. The calculation of this threshold excludes the interests that are not deductible according to sections 209 and 212 of the FTC; |
| | | 4. The limitation applies as from the first euro of net financial expenses exceeding EUR 3 million and the tax is paid on the entire amount (i.e. not limited to the amount exceeding the threshold). This is a permanent disallowance as there would be no carry-forward mechanism for the disallowed interest. |
| 5 | Brazil | 1. The Brazilian Tax Authorities (“BTA”) have formulated SH in the case of export sales, the regulations provide a SH whereby a taxpayer will be deemed to have an appropriate TP with respect to export sales when the average export sales price is at least 90% of the average domestic sales price of the same property, services, or intangible rights in the Brazilian market during the same period under similar payment terms; |
| 6 | Russia | 1. The article 269 of the Russian Tax Code ("RTC") provides the concept of SH; |
| | | 2. As per 2015 provisions laid down by RTC states that SH would not only apply only to debt obligations where one party is a bank, will also apply to all debt obligations arising out of controlled transactions, while the boundaries of the SH will expand; and |
| | | 3. Simply, in controlled transactions, taxpayers may check whether the interest rate lies within the set SH and only then, if the interest rate is higher (for expenses) or lower (for income), should apply TP rules in order to substantiate its level. If the interest rate complies with the SH, there is no need to confirm the arm's length nature of the applied interest rate. |
| | | 4. The SH rates determined based on interbank lending rates ( such as LIBOR – USD, LIBOR - GBP, EURIBOR, SHIBOR) plus spread ranging from 4% to 7% |

# SH – GLOBAL SCENARIO (CONTD.)

| Sr. No. | Name of the Country | SH Rules |
|---|---|---|
| 7 | United States | US TP regulation consist of service cost method ("SCM") which is elective in nature for valuing notified service payments by US tax payer. If US tax payer elects SCM for underlined transactions, his conduct is governed by mark-ups prescribed by IRS in its list of services. |
| | | The list consist of 2 categories (A) 101 types of services which are suppose to be paid at cost to cost basis (B) low margin covered services. Former is termed as White list and few examples of same are as under: |
| | | **A** - White List Services - |
| | | (a) Payroll |
| | | (b) Accounts Payable; |
| | | (c) Corporate & Public Relations; |
| | | (d) Accounting & Auditing; |
| | | (e) Health, Safety, Environment & Regulatory Affairs; |
| | | (d) Treasury Activities; |
| | | (e) Staffing & Recruiting; |
| | | (f) Benefits; |
| | | (g) Legal Services; etc. |
| | | **B** - Low margin covered services are controlled services transactions for which the median comparable mark up on total services costs is less than or equal to 7% |
| | | Benefit test need to be kept in mind while applying SCM |

# SH – GLOBAL SCENARIO (CONTD.)

| Sr. No. | Name of the Country | SH Rules |
|---|---|---|
| 8 | Mexico | The Mexican SH is targeted towards the maquiladoras, i.e. companies engaged in toll manufacturing for foreign companies, operating in Mexico. Under the regime, maquiladoras are deemed to comply with the TP regulations; and not constitute permanent establishments, if they report profits of :<br>• 6.9% of operating assets; or<br>• 6.5% of operating costs; whichever are higher. |
| 9 | Romania | Interest expenses on these inter-company loans are deductible within the following limits: |
| | | • In the case of loans denominated in hard currency (any other currency than the local currency), a ceiling established annually through government decision (i.e. 6%). |
| | | • In case of loans denominated in local currency, the reference interest rate of the National Bank of Romania. |

# QUIZ

Q. What are the advantages of Safe harbour?

Q. What are the disadvantages of Safe harbour?

# SECONDARY ADJUSTMENT

# DEFINITION

- Section 92CE (3) (v)- "secondary adjustment" means an adjustment in the books of account of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.

- The OECD Guidelines define the term secondary adjustments as “an adjustment that arises from imposing tax on a secondary transaction”. A secondary transaction is further defined as “a constructive transaction that some countries will assert under their domestic legislation after having proposed a primary adjustment in order to make the actual allocation of profits consistent with the primary adjustment.”

# SECONDARY TP ADJUSTMENT

Provisions of Secondary Adjustment (SA) introduced by Finance Act 2017, to align Indian TP regulations with OECD TP Guidelines and international best tax practices

►TP adjustment referred to as Primary Adjustment (PA) [Section 92CE (iv)]

►Difference between ALP and transaction value referred to as excess money [Section 92CE (iii)]

►Secondary adjustment is basically invoicing and recovery of the primary adjustment, which is **adjustment in the books of account of the assessee and AE** to reflect that the actual allocation of profits between the parties are aligned to the ALP determined, thereby removing imbalance between cash account and actual profit of the assessee [Section 92CE (v)]

►Secondary adjustment prevalent in overseas jurisdictions as well.

►Some countries treat this as a deemed dividend

►Some countries treat this as a deemed loan

➔India has now offered both the options as a choice for the taxpayer

►Law is:

►Invoice and recover the TP adjustment within prescribed time limit, else

►Treat the TP adjustment (**the excess money which is available with the AE)** as deemed loan and compute interest to be offered to income at prescribed rates OR

►At the option of assessee pay additional tax @ 18% plus surcharge and cess on excess money (TP adjustment)

# APPLICABILITY

The Primary adjustment (PA) should be on account of

- Suo-moto adjustment by tax payer in return of income;
- Adjustment made by tax authorities during assessment and accepted by the taxpayer;
- Determination of arm's length price pursuant to:
  - APA
  - MAP
  - Application of safe harbour rules
- Secondary adjustment would not apply if:
  - Primary adjustment is <=INR 1 crore; and
  - Primary adjustment is for AY 2016-17 and earlier years (i.e. 31 March 2016 and earlier years)
- Taxpayer can collect the excess money from any of its non-resident AEs
  - irrespective of whether such AE is a party to the transaction resulting in primary adjustment (retrospective amendment from AY 2018-19 onwards)
- Additional tax, if opted by the assessee, shall be treated as **final payment of tax** in respect of the excess money and
  - **no further credit** shall be claimed by the assessee in respect of tax so paid [Section 92CE (2B)] ➔if paid, no need for secondary adjustment (invoicing and recovery) and no need to compute interest under Sec. 92CE (2) **from the date of payment of such tax**

# RULE 10CB

| Type of primary adjustment | Time limit for repatriation: 90 days from | Applicable interest rate for delayed receipts | |
|---|---|---|---|
| | | Indian Rupee transaction | Foreign currency transaction |
| Suo-moto adjustment by the taxpayer in ROI | from the due date of filing return of income | 1-Year Marginal Cost of fund Lending Rate (MCLR) of SBI as on 1st April of relevant Previous Year (FY) (+) 325 basis points | 6-Month London Interbank Offered Rate (LIBOR) as on 30th September of relevant FY (+) 300 basis points<br><br>*(*Rate of exchange for calculation of value in INR = TTBR of such currency on the last day of previous year in which such international transaction was undertaken)* |
| Adjustment made pursuant to APA and APA entered into on or before due of ROI | | | |
| Adjustment pursuant to Safe Harbour | | | |
| Adjustment made by Indian Tax Authority and accepted by the taxpayer | from the date of relevant order | | |
| Adjustment made pursuant to APA and APA entered into after the due date of ROI | from the end of the month in which APA entered into | | |
| Adjustment made pursuant to MAP | from the date of giving effect by AO to MAP | | |

# SECONDARY TP ADJUSTMENT
## SCENARIOS

| Sr No | Particulars | Option 1: Bringing excess money within 90 days | Option 2: Deemed Advance | Option 3: Payment of 'one-time tax' |
|---|---|---|---|---|
| 1 | Primary adjustment (say voluntary for FY 2019-20) | 100 | 100 | 100 |
| 2 | Tax on primary adjustment say @25.17% | 25.17 | 25.17 | 25.17 |
| 3 | Secondary Adjustment (Interest on Primary Adjustment from due date, say 15 February 2021 to 31 March 2021 @ say 8% ☐ For FY 2020-21) | NA | 1 | NA |
| 4 | Tax on Secondary Adjustment | NA | 0.25 for FY 2020-21<br>2.01 (25.17% on 8) for FY 2021-22 onwards perpetual | 20.97<br>(18% tax + SC/Cess)<br>[One time] |
| 5 | Total tax | NA | Ongoing | 46.14 |

# PRACTICAL CHALLENGES

- **Transactions with multiple AEs which are combined for TNMM analysis**
- Where Indian Co has entered into variety of transactions with multiple AEs and some of these international transactions have taken place in INR while the others are in foreign currency, in case the funds are not received within prescribed time limit of 90 days, computation of interest might be complex exercise since interest rate prescribed for transactions in INR and foreign currency are different
- **Double taxation**
- Overseas tax jurisdictions may not agree with such additional expenditure as tax treaty are silent on extending “corresponding adjustment” to secondary adjustment
- **Non acceptance of PA by AEs**
- AEs may not accept the claim of ‘primary adjustment’ for various reasons
- **Where Foreign Company ceases to be AE at a later stage while being AE on the date of transaction ➔how can the secondary adjustment be effected?**

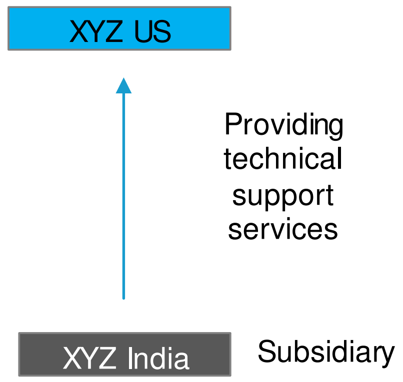
# SECONDARY TP ADJUSTMENT

## Case Study

**Case 1 - Facts:**

- XYZ India, is engaged in provision of technical support services to its AE in US (XYZ US)
- Financial information for XYZ India(Taxpayer) for FY 2019-20 are as follows:

| **Particulars** | ***INR crores*** |
|---|---|
| Provision of technical support services by XYZ India | 100 |
| **Net Profit (5%)** | **5** |
| TPO determined ALP net profit at 10% | 10 |
| **Net Primary Adjustment** | 5 |




- Taxpayer accepted the TP adjustment made by AO/TPO

**Key Questions**

1. Whether secondary adjustment TP provision are applicable in this case?
2. How money repatriation provision will work in the case?

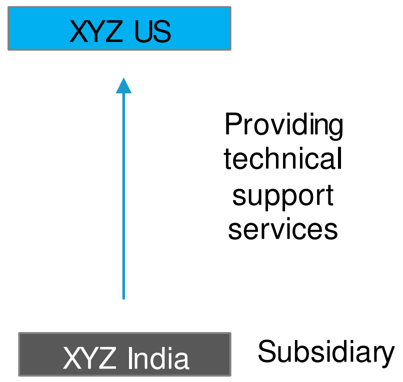
# SECONDARY TP ADJUSTMENT

## Case Study

**Case 2 - Facts:**

- XYZ India, is engaged in provision of technical support services to its AE in US (XYZ US)
- Financial information for XYZ India(Taxpayer) for FY 2014-15 are as follows:

| **Particulars** | ***INR crores*** |
|---|---|
| Provision of technical support services by XYZ India | 100 |
| **Net Profit (8%)** | 8 |
| TPO determined ALP net profit at 8.5% | 8.5 |
| **Net Primary Adjustment** | 50 lakh |




- Taxpayer accepted the TP adjustment made by AO/TPO

**Key Questions**

1. Whether secondary adjustment TP provision are applicable in this case?
2. How money repatriation provision will work in the case?

# QUIZ

- Under what circumstances can secondary adjustment be made?

# QUERIES

YOUR

QUESTIONS

PLEASE !!!

# THANK YOU!

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# PRACTICAL CHALLENGES

- **Certain issues arising due to requirement of adjustment in books of accounts**
- •PA to a transfer price will be made in the hands of the taxpayer only if it has impact of increasing his income or reducing his losses. This will generally mean that either the export or receipt are to be increased or expense or import price to be reduced.
- •Having regard to the definition of SA, sales/ revenue may need to be supplemented or the import/expenses may need to be reduced by passing either the entry of receivable to sale/revenue or by passing the entry of creditors to purchase or expenses.
- •PA in the five specified scenarios in section 92CE(1) may take place in a year different from the year to which the transaction pertains to.
- •The requirement u/s 92CE(3) is that the book adjustments will need to be made in the books of the taxpayer and its AE. The AE may not be bound by the domestic laws of India and may in fact even be from a jurisdiction where there may not be a mandate to maintain books of accounts including under ITA.
- •Section 92CE(3) may not be able to enforce this requirement on the foreign AE, except where the foreign AE is otherwise required to maintain books of accounts in India. The absence of book entry may not impact the consequences of imputation of interest on excess money deemed as advance.
- •Implication of SA from indirect tax perspective such as excise, custom, service tax, GST etc.
- •Framework for accounting treatment of SA in books from I-GAAP/ Ind-AS perspective
- •FEMA implications due cash repatriation