



Safe harbour commitment to GCCs

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Introduction

India is home to over 1,580 multinational companies with Global Capability Centres (GCCs) across various verticals specialising in IT, business process management, engineering and Research & Development (R&D) services. They collectively contribute to a substantial US\$46 billion in revenues and directly employ more than 1.66 million people. GCCs account for 24 percent of export revenues. The GCC market is expected to hit US\$60 billion by 2025, with the expectation that over 1,900 GCCs will have their footprint in India by 2025.¹

The Indian government has legislated dispute prevention and resolution mechanisms periodically to promote

ease of doing business and provide a stable fiscal environment. To this end, Safe Harbour Rules (SHRs) provide for circumstances in which income tax authorities would accept the transfer price declared by the taxpayer at prescribed rates for a specific nature of transactions, subject to specified thresholds.

During its introduction in 2012, SHRs were regarded as a panacea for Transfer Pricing (TP) audits and litigation in India, especially for captive service providers, including GCCs. SHRs appeared to be easier to comply with due to simplified procedures and by providing greater certainty within a reasonable time frame. SHRs have

received a lukewarm response from the taxpayers due to the low thresholds that do not meet the requirements of large enterprises and the ambiguities and restrictions that come into play while adopting the SHRs for small and medium-sized enterprises.

In the recently announced Union Budget 2024, the Finance Minister proposed expanding and making more attractive coverage under the SHR laws in the Indian Income Tax Act, 1961. While detailed rules are to be announced, given this backdrop, the announcement is welcome and could become a harbinger for MNE groups setting up and expanding GCCs in India.

¹ <https://indbiz.gov.in/india-to-have-over-1900-gccs-by-2025-report/>

With this background, this policy presents the desired measures for GCCs that could be addressed as part of the SHRs:



Scope of SHRs by covering additional international transactions within its ambit

When the SHRs were introduced in 2012, the GCCs provided various services that predominantly fell into the IT and Information Technology Enabled Services (ITES) categories. The scope of services and capabilities that GCCs provide is evolving and on the rise. These include digital, cloud engineering and marketing communication support services. The MNC stakeholders operating in India expect to widen the scope of SHRs for TP, covering these additional and growing transaction categories. These transaction categories are subject to substantive litigation year on year, towards determining Arm's Length Price (ALP) and where the issue is mainly about the difference in comparable companies selected and/or filters adopted while undertaking the search on third-party Indian databases.

Considering the evolving business ways, the government must introduce such integrated services under the SHRs and provide a separate cost-plus margin percentage.



Merging specific categories of services

To make the Indian SHRs more attractive, they should be streamlined and simplified for adoption. Merging specific categories of services under a single grouping could be useful, considering the constantly evolving landscape for GCC integrated service offerings. Certain services fall within the scope of software development that calls for a markup of between 17 and 18 percent, and others that constitute contract R&D relating to software development are pegged at a markup of 24 percent. As part of the revamped SHRs, the government may consider combining elements of software development and contract R&D relating to software development into a single category and propose a single markup. The same holds for ITeS and KPO services under SHRs, which currently warrant a range of markups. At an industry benchmark level, comparable companies have also moved up the spectrum, and the restricted classifications have consequently outlived their utility.





Rationalisation of safe harbour net cost-plus margins

The operating cost-plus margins currently prescribed in the Indian SHRs range from 17 to 24 percent, depending on the nature and category of international transactions. These markup percentages have been in effect since FY2017. Safe Harbour margins are perceived to be higher than the arm's length range, leading to fewer taxpayers opting for the same. Safe Harbours constitute unilateral measures, and a higher markup runs the exposure that a deduction may not be allowed in the counterparty jurisdiction. Therefore, the markups under SHR must be rationalised to make them globally competitive (where rates between 5 and 10 percent are prevalent) and acceptable for the overseas group entities while considering economic conditions. To this end, margins concluded in APA/MAP and at the higher appellate forums in domestic litigation can serve as helpful reference points.



Relooking the turnover threshold in SHRs

The present low turnover limits of INR 100 crore/INR 200 crore have made it unviable for many GCCs to avail of the Safe Harbour option. Considering the critical mass of size and scale achieved by many GCCs, the government could increase the turnover threshold by ten times, from INR 200 crore to INR 2000 crore, prompting more GCCs to opt for the SHRs scheme.



Clarity on the treatment of various items of cost and revenue while calculating Profit Level Indicators (PLIs)

Treatment of specific cost and revenue items, such as free-of-cost software, services, severance pay, pass-through costs, adjustments on account of IND AS, creates ambiguity and causes hesitation in opting for SHR. Guidance on the operating cost and operating revenue should be usefully clarified in the SHR.



Contributors

Manisha Gupta

Tax GCC Leader
Deloitte India

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Suchint Majmudar

Devesh Doshi

Deloitte.

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