

## **Safe harbour rules aren't quite working, APAs are**

The good news is that, after 2-3 years of tax disputes piling up with no resolution as the US side simply refused to negotiate with the Indian taxman, a fair amount of progress has been made. As reported by this newspaper today, around 70% of the US companies who have been asked to adjust their incomes upwards significantly for tax purposes—based on the assessments made in the last couple of years, transfer pricing adjustments have risen from R45,385 crore in FY12 to R70,016 crore in FY13—have entered into Advance Pricing Agreements (APAs) with the taxman. The APA, in a very broad sense, lays down rules for calculating arms-length-pricing and, therefore, provides the assessee firm tax stability for the length of the APA which is normally 5 years. Since such APAs with the taxman of one country (unilateral APAs) don't necessarily have to be recognised by the taxman of the other country, the idea is to make them 'bilateral' as early as possible—that means, any tax deduction by the taxman in one country will be accepted in the other. Given there were more than 100 cases of tax dispute that had piled up between India and the US under the mutual agreement procedure (MAP), and around 70 firms have already applied for APAs with the Indian taxman, this represents a significant step forward—the next step, and Indian tax officials are hopeful of success, is for the US taxman to accept these and convert them into bilateral APAs. Were that to happen, a large part of the stuck Indo-US tax thicket will be that much closer to resolution.

What is unfortunate, however, is the lukewarm response to the other tax resolution mechanism on offer, the Safe Harbour Rules (SHR). SHR, in a sense, are even better than APAs since, once a certain minimum profit margin is declared as acceptable to the taxman—say, a profit of 15%—the tax authorities commit to not doing a detailed audit of companies, making it ideal for contract R&D or IT work offshored to India. Apart from the inordinate length of time it took to notify the SHR based on the Rangachary panel's recommendations, the norms themselves were too high. So, while the Rangachary panel found IT companies were quoting profit margins of 15%, the taxman thought they should be as high as 24%. While the panel finally plumped for a 20% SHR, this was obviously too high for firms. Similarly, in the ITeS space, while companies with a turnover of under R500 crore were quoting margins of 15%, the taxman wanted 26% and the panel finally recommended 20%. Since there is the additional problem that there is no guarantee the US taxman, for instance, will give a US MNC a set off for a 20% tax paid on its Indian operations, SHR has naturally failed to deliver. Since APAs take a long time—about 6-12 months for unilateral ones and 2 years for bilateral ones—the tax authorities have to make SHR more attractive as they offer an easier solution.