KPMG

# TAX FLASH NEWS

20 June 2017

# CBDT notifies rules for the computation mechanism of interest income pursuant to secondary adjustments

## Background

The Finance Act, 2017 had introduced provisions of secondary adjustment in the Indian Income-tax Act, 1961 (the Act) under Section 92CE. 'Secondary adjustment' has been explained as an adjustment in the books of accounts of the taxpayer and its associated enterprise (AE) to reflect that the actual allocation of profits between the taxpayer and its AE are consistent with the transfer price determined as a result of primary adjustment (i.e. based on the arm's length price as may be determined) thereby removing the imbalance between the cash account and actual profit of the taxpayer.

The term 'primary adjustment' refers to an adjustment to the transfer price made:

- Suo moto by the taxpayer in the return of income
- By the Assessing Officer (AO) during assessment proceedings and accepted by the taxpayer;
- By an adjustment determined by an Advance Pricing Agreement (APA) entered into by the taxpayer;
- By an adjustment made as per the Safe Harbour Rules (SHRs); or
- By an adjustment arising as a result of resolution of an assessment by way of the mutual agreement procedure (MAP) under an agreement entered into for avoidance of double taxation.

For more details on secondary adjustments, please see our earlier Flash News on Budget provisions[1].

[1] KPMG Flash news dated 3 February 2017 - Budget 2017: Transfer Pricing proposals

The provisions further explain that when there is enhancement of taxable profits or reduction in losses due to adjustment to transfer prices charged to AE, the additional amount receivable from the AE should be repatriated by the taxpayer and offered for tax in the country of the taxpayer (in this case India). If the same is not received by the taxpayer, then a notional interest on the outstanding amount receivable from the AE (deemed as an advance) should also be offered to tax as an income of the taxpayer.

The manner of computation of the notional interest as explained above on the amount deemed as advance made by the taxpayer to the AE was to be prescribed by the Central Board of Direct Taxes (CBDT). CBDT has now, vide a notification[2] dated 15 June 2017, inserted rule 10CB in the Income-tax Rules, 1962 (Rules) to provide for computation mechanism of notional interest income pursuant to these secondary adjustments.

### Key aspects regarding the computation of interest income pursuant to secondary adjustments

- **Time limit for the repatriation of excess money -** Sub-rule (1) of new rule 10CB of the Rules

| Situations where the primary adjustment has been made | Time limit for repatriation pursuant to secondary adjustment is set at 90 days: |
|---|---|
| Suo-moto adjustment to transfer price made by the taxpayer in the return of income | from the due date of filing return of income under section 139(1) of the Act |

[2] CBDT Notification No. 52/2017, F.No.370142/12/2017 -TPL

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| Situations where the primary adjustment has been made | Time limit for repatriation pursuant to secondary adjustment is set at 90 days: |
|---|---|
| Adjustment made by the AO and accepted by the taxpayer | from the date of the order of AO or the appellate authority, as the case may be |
| Adjustment due to APA entered into by the taxpayer | from the due date of filing return of income under section 139(1) of the Act |
| Adjustment made as per SHRs | from the due date of filing return of income under section 139(1) of the Act |
| Adjustment due to resolution of an assessment by way MAP under an agreement entered into for avoidance of double taxation. | from the due date of filing return of income under section 139(1) of the Act |

- **Rate of interest -** Sub-rule (2) of new rule 10CB of the Rules

  The rate of interest to be charged on the excess money which is not repatriated into India within the prescribed time limit of 90 days as explained above shall be computed as under:

  - **International transaction in INR** - at the one year marginal cost of funds lending rate (MCLR) of State Bank of India as on 1 April of the relevant previous year plus **325 basis points**.
  - **International transaction in foreign currency** - at six-month London Inter-Bank Offer Rate (LIBOR) as on 30 September of the relevant previous year in the relevant foreign currency plus **300 basis points**.

## Our comments

As the provisions for secondary adjustments will be applicable from FY 2016-17 onwards, the notification is being issued well in advance i.e. before the due date of filing of return. It is a timely action on part of the CBDT, as it provides clarity to all the taxpayers who would be covered under the above provisions.

The prescribed notional interest mechanism is in line with the recent revised ratios for outbound loans under the Safe Harbour Rules. The need to add-on 325 to 300 basis points on the basic MCLR *(which was 9.2 and 8 percent as on 1 April 2016 and 1 April 2017 respectively)* or LIBOR *(which was 1.24 percent as on 30 September 2016)* seems to be high, given the fact that it is notional interest rate on secondary adjustment. For example, if a taxpayer faces an adjustment on interest receivable on an outbound loan (primary adjustment) where certain interest has already been charged, then this charge of notional interest would be on the adjusted amount of interest receivable if not repatriated (secondary adjustment) into India. Levying notional interest on secondary adjustments (deemed advance, as explained above) at par with Safe Harbour rates, which are premium rates offered to taxpayers to enable them to dispense with the transfer pricing litigation process, seems unfair.

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