

May 28, 2025

Reproduced with permission from Tax Management International Journal, 5/28/2025. Copyright © 2025 by Bloomberg Industry Group, Inc. (800-372-1033) <http://www.bloombergindustry.com>

Indian Global Capability Centers—What Is the Cost of Delivery?

Rishi Harlalka, Priyam Singhania, Prachi Bhawrani, Jessie Coleman*

B B S R & Associates, BSR & Co, and KPMG US

Multinational companies with Global Capability Centers in India that use cost-based transfer pricing should adequately document their positions in inter-company agreements to explain their rationale as well as use APAs and MAPS to achieve certainty, say KPMG practitioners.

Multinational companies (“MNCs”) are continuing to establish Global Capability Centers (“GCCs”) in India that provide a range of services to their parent organizations. The selection of India as the location of the GCC not only reflects the traditional aspect of cost arbitrage, but also a convergence of various other factors such as a robust digital economy, a skilled talent pool, and a stable government.

For transfer pricing purposes, most GCCs adopt a “cost-plus” billing model (meaning the parent organization remunerates the GCC for its costs plus an arm’s length mark-up) which is consistent with the GCC’s economic characterization as a limited risk entity. Accordingly, the inter-company revenue of GCCs under the cost-plus model is a function of: a) costs of providing the services (usually referred to as an “operating expense cost base”); and b) the arm’s length mark-up to be applied on said cost base. MNCs with GCC’s in India are often subject to audits surrounding either—or both—components.

* [Rishi Harlalka](#) is a Partner in B B S R & Associates LLP, India. [Priyam Singhania](#) is a Director and [Prachi Bhawrani](#) is a Senior Manager in BSR & Co. LLP, India. [Jessie Coleman](#) is a principal in the Economic & Valuation Services group of KPMG LLP’s Washington National Tax practice.

The information in this article is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author(s) only, and does not necessarily represent the views or professional advice of KPMG LLP.

Historically, most transfer pricing disputes in India focused on the appropriate arm's length mark-up to be applied, which continues to involve a debate about the functional profile of the tested party and selection of appropriate comparable companies. From a practical perspective, due in large part to try to avoid tax disputes in India, many MNCs apply a much higher mark-up in India as compared to mark-ups in other countries for similar types of services. MNCs frequently seek to obtain certainty on the mark-up by pursuing bilateral / unilateral Advance Pricing Agreements ("APA").

In recent years however, the adequacy of the operating expense cost base has attracted increased scrutiny from the Indian tax authorities, thus expanding the scope of transfer pricing ("TP") audits. Recent examples show GCCs have faced significant TP adjustments on the cost base itself, despite the mark-ups not being challenged or being successfully defended in domestic litigation. Such instances can be found not only in domestic TP audits but also in APA proceedings.

Below is a brief overview of the trends and positions adopted by the Indian tax authorities on these topics (these are not comprehensive, but cover the common examples). While some of these examples may be contrary to general economic principles, it is important MNCs understand upfront the potential government positions:

- Free of cost asset / goods/ services—Where a GCC uses a multitude of assets and goods from its group entities for provision of services, but the associated costs are not charged back to the GCC, tax authorities consider these non-charged expenses as cost base erosion liable to be added back. For instance, if the US parent procures software licenses for the entire group but decides not to allocate the related costs to the GCC, the Indian tax authority will contend that these software license costs should have been charged to the GCC and then recharged back to the parent company with a mark-up. Other typical examples include providing training to employees of a GCC or offering shared services such as finance, human resources, supplying network servers/ communication equipment or use of platforms, or tools purchased by the group entity.
- Management fee—This is one of the most litigated areas of TP in India. Where a GCC receives a management fee charge from its group entity, the general expectation of tax authorities is to include such fee as part of operating expenses and include a mark-up on it. Further, even where such fee has been marked-up, there is an additional requirement for the GCC to demonstrate the benefits received through evidence, in absence of which, the tax authorities may disallow the fee although continue to include it for mark-up purposes, thus, creating a potential double taxation position. While some judicial decisions have not supported this approach, it remains essential for GCCs to maintain robust and demonstrable documentation to substantiate that a benefit was

provided in case of management fee cross charges. It may be helpful for this documentation to be gathered from both the GCC and the group entity.

- *Pass-through costs*—The Indian tax authority generally questions why companies do not apply a mark-up to “pass-through” expenses. By way of example, a third party provides \$100 of services to multiple group entities (\$60 to the Indian GCC and \$40 to a US affiliate). For administrative convenience, the Indian GCC pays the entire \$100 to the third party. The taxing authority often claims this type of pass-through cost (the \$40) paid by the Indian GCC (on behalf of the US affiliate) should also incur a mark-up. The position is contrary to Indian judicial rulings that generally suggest when a service provider does not bear any risk or undertake any function / responsibility towards a cost, the expense can be considered as pass-through and thus can be excluded from the mark-up.
- *Sub-contracting costs*—GCCs often outsource projects to third-party contractors and incur the related costs. While most MNCs classify sub-contracting costs as “pass-through” and charge those costs to its affiliates without applying any additional mark-up, the Indian tax authorities have consistently maintained that these costs should be subject to a mark-up as the GCC retains and controls the risks and responsibilities associated with such services.
- *Costs relating to share-based compensation (“SBC”)*—In many instances, the SBC costs associated with the options / Restricted Stock Units (“RSUs”) granted to employees of the Indian GCC are recorded in the GCC’s financial statements due to accounting requirements, but are viewed as purely notional in nature and, thus, not included in the “operating expense” cost base for mark-up purposes, nor claimed as a tax deductible expense. The Indian tax authorities have challenged such exclusions from the cost base, viewing them as “cost base erosion” despite the higher taxes paid by the GCC due to the non-deduction of these costs in their tax return and in spite of having a handful of taxpayer favorable court rulings. In other instances, tax authorities have insisted for only the mark-up related to the SBC costs be recognized, *de hors* the exclusion of the underlying cost itself.
- *Foreign exchange losses*—The inclusion / exclusion of foreign exchange loss / gain from / to the cost base has been a subject matter of differing judicial opinions and GCCs take different approaches. Additionally, it is not uncommon for GCCs to agree in APAs to exclude such losses from the cost base to mitigate the impact of foreign exchange on the arm’s length determination. It is crucial that the treatment is aligned with the inter-company agreement and the GCC risk profile.
- *Indian Accounting Standards (“IndAs”) adjustments*—The IndAs accounting framework in India is similar to and largely aligned with the International Financial Reporting Standards (“IFRS”) and may differ significantly from the existing Indian Generally Accepted Accounting Principles (“IGAAP”) in recording, accounting, and characterization of costs /income in the financial

statements. Additionally, it may require fair valuation / recognition of notional items of income and expenses. Thus, applying this framework could result in differences between the items of costs and income as recorded in the financial statements and that which should be used for mark-up purposes. Examples of such IndAs adjustments impacting the cost base could include “Impairment of Rights-of-use assets” or “Other Comprehensive income/expenses” as adjusted from employee benefit expenses, etc. Since the Indian tax authorities have not released any position paper on such adjustments, nor has there been significant judicial debate on this matter, so far, the GCCs are usually required to take specific tax positions on such IndAs adjustments in determination of the cost base, thus creating uncertainty and a resultant TP risk.

Conclusion

There are several important considerations for MNCs with GCCs that use cost-based transfer pricing when defining the cost base. The issue around cost base is compounded by the fact that, in most cases, very limited data is available on the composition of the cost base of comparable companies. Moreover, during the bilateral negotiations (APAs and MAPs), the ultimate agreement often does not adequately cover the issue of the cost base components. The issue of cost base is usually left to the Indian Competent Authorities, as they are viewed as local tax matters and are largely unaffected by the functional profile and benchmarking analysis used in these negotiations. Given the various complexities, taxpayers must use their judgement about how best to define the cost base, include such definitions in their legal agreements and have supporting documentation to explain their rationale. Including such clarity in the inter-company agreement is also particularly relevant considering that various judicial rulings have given significant weight to the contractual terms. It is also critical that the TP documentation maintained by the GCC should be consistent with the positions ultimately adopted.

It is also important to note that free of cost items may also have implications under the domestic Corporate Tax and Indirect Tax (Goods & Service Tax) regimes and therefore, it is crucial that taxpayers consider wider tax implications whilst defining the appropriate cost base.

MNCs should also consider practical approaches like APAs and MAPs to achieve certainty on these matters. Additionally, in their APA agreements, MNCs should include specific language regarding the cost base and outline how they can efficiently meet annual compliance obligations to support the cost base.

This article does not necessarily reflect the opinion of Bloomberg Industry Group, Inc., the publisher of Bloomberg Law and Bloomberg Tax, or its owners.

