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Income Tax Act – Safe Harbour Rules

Rules 86 to 91 — Detailed Elaboration — Effective Tax Year 2026-27

What is Safe Harbour?



Definition: Safe Harbour refers to conditions where the income-tax department accepts the transfer price reported by a taxpayer without detailed scrutiny. If the taxpayer follows the prescribed profit margins or rates under Rule 89, they can avoid extensive transfer pricing examinations and disputes.

Statutory Protection

Transfer price declared by the assessee is accepted by tax authorities without scrutiny - No TP adjustment made.

Threshold-Based

Protection applies only if declared price meets prescribed operating profit margins or interest rate benchmarks (Rule 89).

Opt-In Regime

Not mandatory. Assessee voluntarily exercises the option by filing Form No. 49 for eligible international transactions.

Block Period

Margin thresholds apply for 3-year block from TY 2026-27. IT services safe harbour valid for 5 consecutive years once exercised.

Legal Basis: Rules 86-91, Income Tax Act 2025 | Effective from Tax Year 2026-27 |

Eligible International Transaction Categories

- (1) IT Services: Software Dev / ITeS / KPO / Contract R&D-Software
- (2) Intra-Group Loans to non-resident AE
- (3) Corporate Guarantees to wholly-owned non-resident subsidiary
- (4) Pharma Contract R&D (Generic Drugs)
- (5) Auto Components: Core & Non-Core OEM exports
- (6) Low Value-Adding Intra-Group Services
- (7) Data Centre Services to foreign company

Key Principle: Safe Harbour only protects the transfer price. Sections 171 & 172 documentation and audit report obligations continue to apply in full irrespective of the election.

Rule 87 – Who Is an Eligible Assessee?



An eligible assessee is one who has exercised a valid option under Rule 90 AND falls into one of these 7 categories:

1 - IT Services

Software dev, ITeS, KPO, Contract R&D (software)

Providing any of these services to a foreign principal — but only with insignificant risk.

2 - Intra-Group Loan

Has made any intra-group loan to a non-resident AE.

3 - Corporate Guarantee

Guarantee provided to a foreign associated enterprise

4 - Pharma R&D

Provides contract R&D for generic pharmaceutical drugs with insignificant risk to a foreign principal.

5 - Auto Components

Manufactures & exports core/non-core auto components with 90%+ turnover as OEM sales.

6 - Low Value Services

Is in receipt of low value-adding intra-group services from one or more group members.

7 - Data Centre Services

Has provided data centre services to a foreign company.

'Insignificant Risk' – 5 Factors [Sub-rules (2) & (3)]

✓ (a) Functions: Foreign principal performs core functions; assessee executes assigned work.

✓ (d) Risk: Assessee bears NO significant realised risk; actual conduct prevails over contracts.

✓ (b) Assets: Foreign principal provides all funds, capital & intangibles; assessee only receives remuneration.

✓ (e) IP: Assessee has NO legal/economic ownership over intangibles; all IP vests with foreign principal.

✓ (c) Supervision: Assessee works under direct supervision; foreign principal actively controls & monitors.

Advantages of Safe Harbour (Part 1 of 2)



"The provisions of sections 171 and 172 in respect of an international transaction shall apply irrespective of the fact that the assessee exercises his option for safe harbour in respect of such transaction."

What Safe Harbour GIVES YOU

- ✓ Declared transfer price accepted without scrutiny if margin meets threshold.
- ✓ No comparability adjustment under Section 165(3)(a)(ii).
- ✓ No further questions on the transfer price for that eligible transaction.

What Safe Harbour Does NOT Give You

- ✗ Immunity from Section 171 documentation obligations.
- ✗ Immunity from Section 172 audit report obligations.
- ✗ Shield against any compliance obligations outside transfer price determination.

Section 171 – Maintenance and furnishing of transfer pricing documents

Assessee involved in related-party international or domestic transactions must maintain proper transfer pricing records.

Section 172 – Audit Report Obligations

Every person who has entered into an international transaction or specified domestic transaction during a tax year shall obtain a report from an accountant.

Only Transfer Price is Protected

Safe harbour acceptance covers only one thing - the declared transfer price will not be questioned.

Documentation Must Be Maintained

The assessee must continue to maintain all documentation as required under Sections 171 and 172. These are audit report and documentation obligations that survive the safe harbour election entirely.

Compliance Framework Intact

Safe harbour does not create a compliance holiday. All other provisions of the transfer pricing framework, including Sections 171 and 172, remain fully operative for every international transaction.

Advantages of Safe Harbour (Part 2 of 2)



Why opt for Safe Harbour? Key benefits for eligible assesseees under Rules 86-91, Income Tax Act 2025

Certainty on Transfer Price

If declared TP meets the prescribed threshold, the AO accepts it as the arm's length price. No further questioning or TP adjustment on that transaction.

Reduced Litigation Risk

Eliminates TP disputes, appeals, and associated costs on eligible transactions. Reduces exposure to penalties for under-reporting.

No Comparability Adjustment

No comparability adjustment permitted under Section 165(3)(a)(ii) for safe harbour transactions. Declared margin stands as-is.

Multi-Year Stability (IT)

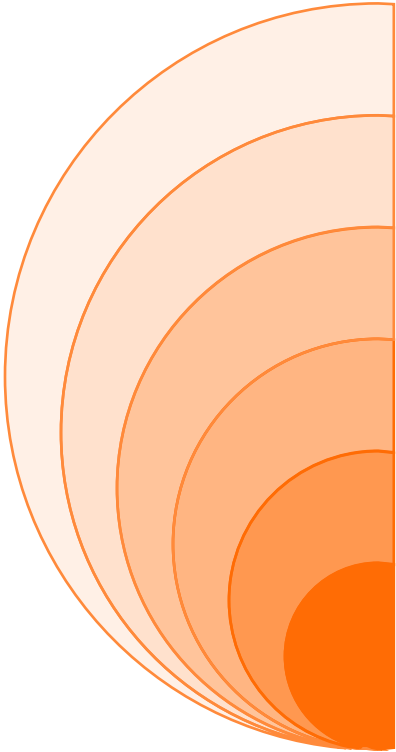
IT services safe harbour remains in force for 5 consecutive years. Only annual statement required for years 2-5 — no fresh application.

Reduced Compliance Burden

No need to conduct extensive benchmarking studies or maintain comparables for the eligible transaction. Simple Form 49 filing suffices.

Deemed Valid Provision

If AO/TPO fails to act within time limits, the safe harbour option is automatically treated as valid. Built-in taxpayer protection.



Rule 89 – Safe Harbour Thresholds



≥ 15.5%

IT Services

OP Margin on OE

≥ 24%

Pharma R&D

OP Margin on OE

≥ 15%

Data Centre

OP Margin on OE

≥ 12%

Core Auto
Components

≥ 8.5%

Non-Core Auto
Components

≥ 1%/yr

Providing corporate
guarantee

≤ 5% & ≤ 10Cr

Receipt of low value
adding intragroup
services

Intra-Group Loans – Interest Rate Spreads (over MCLR/Reference Rate)

INR Loans (over 1-yr SBI MCLR as at 1st April)	
AAA to A	+175 bps
BBB-/BBB/BBB+	+325 bps
BB to B	+475 bps
C to D	+625 bps
Unrated (≤Rs.100Cr)	+425 bps

Foreign Currency Loans (over Reference Rate as at 30th Sept)	
≤Rs.250Cr – AAA to A-	+150 bps
≤Rs.250Cr – BBB+/BBB/BBB-	+300 bps
≤Rs.250Cr – Below BBB- / Unrated	+400 bps
>Rs.250Cr – AAA to A-	+150 bps
>Rs.250Cr – BBB+/BBB/BBB-	+300 bps

Reference Rates for FCY Loans

USD: SOFR+45bps | EUR: EURIBOR | GBP: SONIA+30bps | JPY: TORF+10bps | AUD: BBSW | SGD: SORA+45bps

Block Period: Margin thresholds apply for a block of 3 tax years commencing from TY 2026-27 and continue for subsequent block periods unless modified. **No comparability adjustment under Sec 165(3)(a)(ii).**

Rule 90 – Procedure for Transactions Other Than IT Services



Applies to: Intra-group loans, Corporate guarantees, Pharma R&D, Auto components, Low value-adding services, Data centre services

STEP 1 : WHAT ASSESSEE MUST DO?

➤ File your income tax return first

The return must be filed *before or on the same date* as Form 49.

➤ File Form 49 with the Assessing Officer (AO)

Must be filed on or before the return due date. Must be filed electronically and signed by the authorized person.

STEP 2 : WHAT AO DOES?

AO checks two things

- (a) Are you an eligible assessee? (b) Is the transaction an eligible international transaction? If satisfied — your option is valid.
- If AO has doubts — refers to TPO **within 2 months**

STEP 3 : TRANSFER PRICING OFFICER (TPO) REVIEW

➤ TPO can ask for documents

TPO may seek documents from assessee by notice **within 2 months** from month of receipt.

- TPO declares option INVALID (with hearing) if: assessee not eligible; transaction not eligible; documents not furnished. **Within 2 months** from AO reference.

STEP 4 : IF ASSESSEE DISAGREE WITH TPO

- Object to the Commissioner
File your objection with the Commissioner of Income Tax (CIT) **within 15 days** of receiving TPO's order.
- CIT decides **within 2 months**
CIT hears you and passes a final order on validity.

STEP 5 : ONCE VALID: AO CHECKS YOUR PRICE

- Does your declared price match safe harbour margins?

AO compares your transfer price against the prescribed margins/rates in Rule 89(2)

- Matches - safe harbour accepted - No transfer pricing adjustment made.
- Doesn't match - AO substitutes - AO adopts the prescribed margin or interest rate instead.

GOLDEN RULE — DEEMED VALIDITY

If any authority misses their deadline — your option is automatically treated as valid.

AO
2 months to refer to TPO
Assessee
15 days to object to CIT

TPO
2 months to pass invalidity order
Commissioner
2 months to pass order

THE WHOLE PROCESS IN ONE LINE: FILE RETURN → FILE FORM 49 → AO CHECKS → TPO IF DOUBTED → CIT IF OBJECTED → PRICE CHECK IF VALID.

Rule 91 – Procedure for IT Services Transactions



Applies specifically to: IT services (software development, ITeS, KPO, Contract R&D for software) — 5-Year Block

5 Years

Safe harbour remains in force once validly exercised

1st Year

Rs.2,000Cr revenue threshold tested only in first year

2 Months

Acceptance/rejection intimation after option exercised

6 Months

Last date to withdraw from end of first tax year

Filing

Form No. 49 filed with DG Income-tax (Systems) on/before due date u/s 263(1)(c) for FIRST of the 5 years. NOT with AO (unlike Rule 90).

Verification

Electronic verification of: (a) assessee eligibility; (b) transaction eligibility; (c) valid exercise of option.

Acceptance

Intimation within 2 months. Option cannot be rejected without opportunity to remove defects. Reasons given if rejected. If accepted, file ITR for all 5 years per safe harbour provisions.

Withdrawal

Option ceases if withdrawal declaration filed. Cannot withdraw after 6 months from end of first year. Withdrawal applies from that year onwards — NOT retroactive. Cannot re-exercise till 5-year period expires.

Annual Filing

For each of 4 subsequent years, file statement by return due date providing: details of eligible transactions; their quantum; and profit margins.

Form 49 Certification

Filed electronically (DSC/EVC). Certified by CEO or CMD. Verified by person authorised u/s 265. DG (Systems) specifies format/procedure with Board approval.

AO may make a transfer pricing reference u/s 166 for international transactions other than eligible international transactions — safe harbour does NOT shield unrelated transactions.

Rule 86 – Key Definitions (Part 1 of 3)



A) Accountant

Individual with 10+ yrs experience & receipts >Rs.50L; OR firm member where firm receipts >Rs.3Cr. Foreign accountants also qualify if firm has presence in 2+ countries.

B) Contract R&D – Software

Covers: new theorems/algorithms; OS/programming language dev; internet technology; software design research; generic approaches for data processing; experimental dev to fill knowledge gaps; R&D in image processing/AI; source code upgrades (excluding routine debugging).

C) Core Auto Components

Engine parts (pistons, valves, cooling); Transmission/steering (gears, axles, clutches); Suspension/braking (brakes, shock absorbers, leaf springs); Lithium-ion batteries for electric/hybrid vehicles.

D) Corporate Guarantee

Explicit guarantee by a company to its wholly owned non-resident subsidiary for short/long-term borrowing. Excludes letters of comfort, implicit guarantees, performance guarantees.

E) Data Centre

Dedicated secure space where computing/networking equipment is concentrated for collecting, storing, processing, distributing or providing access to large amounts of data.

F) Data Centre Services

Services using full physical + IT infrastructure: land, buildings, power equipment, cooling, servers, storage, OS, network software, and human resources in India

Rule 86 – Key Definitions (Part 2 of 3)



G) Generic Pharmaceutical Drug

A drug comparable to an already-approved drug in dosage form, strength, route of administration, quality, performance characteristics, and intended use.

H) ITeS – 15 Services

Back-office ops; Call centres; Data processing/mining; Insurance claims; Legal databases; Medical transcription (excl. advice); Translation; Payroll; Remote maintenance; Revenue accounting; Support centres; Website services; Data search & analysis; Remote education (excl. content dev); Clinical DB management (excl. clinical trials). R&D excluded.

I) Intra-Group Loan

Loan to non-resident AE — NOT from a bank/financial institution/normal lending enterprise. Excludes credit lines and facilities with no fixed repayment term.

J) KPO Services – 7 Categories

Geographic information systems; Human resources services; Engineering & design; Animation/content development; Business analytics; Financial analytics; Market research. R&D explicitly excluded.

K) Low Value-Adding Intra-Group Services

Support services that are: not core business; not shareholder/duplicate services; don't use/create unique intangibles; don't involve significant risk; no reliable external comparables. Excludes R&D, manufacturing, IT/software, KPO, BPO, raw material purchasing, sales/marketing, financial transactions, natural resources, insurance.

L-M) Non-Core Auto / Low-Tax Territory

(l) Non-core auto: all auto components other than core auto components.

(m) No/low-tax territory: country where maximum income-tax rate is less than 15%.

Rule 86 – Key Definitions (Part 3 of 3)

N) Operating Expense

INCLUDES

- Costs in normal operations (incl. ESOP costs borne by AEs for assessee employees)
- Reimbursements to/from AEs at cost
- Depreciation and amortization on assets used

EXCLUDES

- Interest expense
- Pre-operating expenses
- Foreign currency fluctuation losses
- Extraordinary expenses
- Provisions for unascertained liabilities
- Income-tax expense
- Losses on asset/investment transfers (not in op. expense)
- Any other expenses unrelated to normal operations

O) Operating Revenue

INCLUDES

- Revenue earned in the tax year from the international transaction during normal operations
- ESOP/stock-based compensation costs provided by the associated enterprise to the assessee's employees

EXCLUDES

- Interest income
- Foreign currency fluctuation gains
- Income from asset/investment transfers
- Income-tax refunds
- Provisions written back
- Extraordinary income
- Other non-normal income

P) Operating Profit Margin

Ratio of operating profit (Operating Revenue minus Operating Expense) to Operating Expense, expressed as a percentage.

Q) Relevant Tax Year

The tax year for which the safe harbour option is validly exercised

R) Development Services

Business app/info system dev; ancillary support; language conversion; adding user functionality; debugging; adaptation; user documentation. R&D excluded.

Safe Harbour Rules – At a Glance



Applicable Rules	Rules 86–91, Income Tax Act 2025
Eligible Transactions	IT Services, Intra-group loans, Corporate Guarantee, Pharma R&D, Auto Components, Low Value Intra-group Services, Data Centre Services
IT Services Margin	≥ 15.5% Operating Profit on Operating Expense
Revenue Cap (IT)	≤ Rs. 2,000 crore (consolidated: Software + ITeS + KPO + Contract R&D)
Block Period (Thresholds)	3 tax years commencing TY 2026-27, continues unless modified
IT Safe Harbour Duration	5 consecutive tax years once validly exercised
Form	Form No. 49 (DSC/EVC); certified by CEO/CMD
Sections 171 & 172	Continue to apply irrespective of safe harbour election
Withdrawal Window	Within 6 months from end of first tax year only
Re-exercise after withdrawal	Not permitted until original 5-year block expires



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THANK YOU

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