ITR WORLD TAX

India's TP Reforms in the Technology sector: Global ripple effects of Safe Harbour and APA changes

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Introduction

The Indian Budget 2026 has introduced significant reforms to India's Safe harbour ('SH') provisions under transfer pricing, particularly for the category of Information Technology ('IT') services. Being a hub for GCCs, these revisions directed towards IT companies are expected to create a more conducive environment for GCCs in India. IT services are one of the most frequently litigated categories of transactions where Indian GCCs have faced persistent tax disputes despite maintaining markups in the range of 15–16% on cost. Tax authorities have consistently compared limited risk service providers to entrepreneurs, disregarding their functional profile and proposing adjustments based on markups as high as 25-30%. These are usually rationalised only at higher appellate levels after protracted litigation with arguments covering even granular details of comparable companies. This involves significant time, efforts and resources from both taxpayers and tax authorities.

The recent changes in SH regulations are aimed at simplifying compliance, streamlining procedures and providing certainty to a wider range of taxpayers. Moreover, these changes are likely to ease pressure on the litigation system, as well as on the existing APA programme.

While these are domestic amendments, their implications extend well beyond India, affecting MNE groups and the intercompany arrangements of overseas counterparties. This article discusses recent developments in the Indian SH regime, the broader impact on MNE groups and preparedness required on their part.

What's changed in the IT Services SH Rules?

Considering the low turnover threshold for eligibility and relatively higher markups for covered services, SH was not a popular route for MNEs in the past. Currently, the SH option for IT services has been made more attractive by an increased revenue threshold for eligibility, a uniform and reduced markup and an automated approval process. The threshold has been significantly increased and in addition, the SH rate has been reduced for the first time in several years, enhancing the overall appeal of the scheme and materially changing the practical relevance of SH for MNEs.

A comparison of the old and new provisions has been summarised below:

Particulars	Earlier rules	New rules
SH category	4 Different buckets for Software development services, IT enabled services, Knowledge Process Outsourcing services and Contract R&D Services relating to software development	As these services are interconnected, they have been clubbed under a singl category - IT services
SH Mark-ups	Ranging from 17-24%	Reduced to a common rate of 15.50% This would also be far more acceptable from a global TP perspective, considering the counterparty's jurisdiction
Revenue threshold	Upto INR 3 billion (300 Crores)	Upto INR 20 billion (2000 crores). This means that large global IT companies can now opt for the scheme, ensuring tax certainty and lowering audit costs
Period	To be opted every year	Once applied and approved, the same SH will be valid for a 5-year period (equivalent to the term of an APA in India). This transforms the SH regime to a long -term strategic commitment rather than a short-term process
Approval of application	Verification of application by tax authorities to confirm whether valid on an annual basis	Approved by an automated rule-driver process without any need for tax officers to physically examine and accept the application

The revised markup is more closely aligned with outcomes at the higher appellate levels, where courts have held that low-risk service providers should earn limited returns commensurate with their functional profile. Further, SH margins in India were earlier often considered excessive at the counterparty's jurisdiction, increasing the risk of adjustments abroad. The revised markup will substantially reduce this exposure.

Inside the new SH framework

The new SH structure has streamlined compliance by carving out a dedicated procedure specifically for IT services, since such transactions account for a

significant portion of SH applications. Key procedural aspects have been highlighted here.

1) The aggregate revenue threshold of INR 20 billion will be tested only in the first year of the five-year block. Hence once a taxpayer qualifies in Year 1, the SH option remains valid for the entire 5-year block, even if the threshold is exceeded in any of the subsequent four years. This provides certainty for taxpayers by fixing the eligibility test at the outset, rather than requiring repeated annual threshold and gives MNEs greater predictability in transfer pricing planning.

2) The SH application should be filed by the due date of filing corporate tax return for the first year, providing ample time for making a strategic decision

3) If a taxpayer withdraws their option (by furnishing a declaration), they cannot re-exercise the option until the original 5-year period expires. Further, withdrawal is only permitted upto a short period from the end of the first tax year.

4) Introduction of an automated verification and approval process whereby the system verifies if the taxpayer and transactions are 'eligible' and if the option exercised is valid. Automating the approval of SH applications will eliminate the risk of bias during tax authority examinations

5) Status of the application will be communicated within two months from the end of the filing month, thereby expediting the approval process.

Emphasis on Functional profile

For a taxpayer to qualify as 'eligible' to opt for IT services SH, five conditions must be assessed by the authorities to ensure that the taxpayer assumes only insignificant risks and the foreign principal performs the economically significant functions in the value chain.

(a) The foreign principal undertakes most economically significant functions—such as conceptualization, product design, and strategic direction—through itself or associated enterprises, while the eligible taxpayer performs assigned tasks.

(b) The foreign principal or its associated enterprises provide capital, funds, and key assets (including intangibles), and the eligible taxpayer is remunerated only for the work performed.

(c) The eligible assessee operates under direct supervision of the foreign principal or its associated enterprises, which not only has the capability to control or supervise but also actually controls or supervises research, product development, or related activities.

(d) The eligible assessee does not assume significant realized risks; where contractual terms assign risk control to the foreign principal but actual conduct differs, conduct prevails over contract.

(e) The eligible assessee holds no legal or economic ownership of any intangibles or outcomes generated during service delivery or research; such ownership vests with the foreign principal as supported by contract and conduct.

In summary, for an IT service company to be regarded as bearing insignificant risk for SH purposes, the key responsibilities must rest with the foreign principal. In practice, MNEs must ensure that the foreign principal undertakes strategic decision making and assumes major risks, while the Indian service provider executes its role without bearing any key risks.

While the above conditions exist, considering the examination process has become automated now, it remains to be seen how this will be verified in practice.

As per the new Income Tax Rules, 2026, effective in India from 1 April 2026, the SH application (in Form No. 49) must now be certified by the CEO or the Chairman and Managing Director of the taxpayer, in addition to existing verification by the person authorized to sign the corporate tax return. This increases the responsibility of top management to ensure that the taxpayer qualifies as an eligible assessee for SH by meeting the conditions relating to the foreign principal's performance of economically significant functions and its supervision of the taxpayer. Considering an additional certification is now required on these factors, the onus has greatly shifted to the taxpayer to ensure that it satisfies the relevant conditions.

Notably, in this context, the actual conduct of the parties takes precedence over contractual arrangements. This is aligned with OECD principles which emphasize that if the conduct contradicts the contract, the actual conduct will prevail in accurately delineating the transaction. Hence, evaluating and documenting the functional profile of the taxpayer in line with the actual conduct of the parties becomes critical. Robust and well-substantiated documentation will play a key role in supporting this analysis.

The evolving APA landscape

In addition to the revisions to the SH regime, the Union Budget has also introduced important enhancements to the APA regime. Specifically, for companies engaged in IT services, a fast-track Unilateral APA process has been introduced with the objective of concluding such APAs within two years, extendable by six months on the taxpayer's request. This two-year timeline resonates with the median time period of APA conclusions as observed in OECD peer review, indicating that the Indian APA program is progressing towards aligning with global best practices, starting with the IT sector.

Despite being a successful programme for achieving tax certainty, significant delays in concluding APA cases in the past posed major challenges to the taxpayer in the form of facing continued TP adjustments till conclusion, managing litigation concurrently during the APA tenure, etc. The average conclusion time for a unilateral APA is around 3-4 years. The accelerated timelines for APA ensure a reduction in period of uncertainty around transfer pricing outcomes and is a welcome move towards prevention of probable backlogs of APA cases.

However, considering the faster pace of conclusion, MNEs and taxpayers will need to ensure timely availability of relevant data, prompt responses to information requests, and readiness for site visits. At the same time, APA authorities will need to have adequate resources and bandwidth to effectively manage the compressed timelines.

Safe Harbour or APA: Making the right choice

With the increase in the SH threshold, many MNEs that were previously ineligible can now adopt a stable pricing approach for a significant portion of their India operations, provided they meet the prescribed characterization criteria. However, it is important to note that SH offers only unilateral protection in India, and the corresponding counterparty does not receive similar protection in its jurisdiction. Further SH is also not an option where eligible transactions are with a counterparty in a no-tax / low-tax country (tax rate lower than 15%).

In contrast, while APAs provide greater certainty, they are more time-consuming. They also involve an application fee, and do not guarantee a successful agreement. Having said that, taxpayers with more complex transactions, those that fall outside the SH functional profile or exceed the applicable threshold should evaluate a unilateral APA as a viable alternative, particularly considering the availability of the fast-track process.

For MNEs seeking relief from double taxation, bilateral or multilateral APAs would be a more suitable option, as they provide coordinated tax certainty across jurisdictions.

The Road ahead for MNEs

The revised framework places greater responsibility on multinational groups to align their pricing, documentation, and governance structures at a global level. MNEs must therefore take appropriate care to

1) **Assess eligibility and practical feasibility for SH**, with particular focus on the entity's functional profile and the ability to sustain the prescribed markup of 15.50% over the entire five-year period. This evaluation should also take into account the prevailing political uncertainties and the current and projected financial performance of the Group.

2) **Recognize that withdrawal from the SH regime is not straightforward**. Considering the limited window for withdrawal, any decision to opt in must be supported by proactive planning and close coordination at the Group level to ensure alignment across the board.

3) **Determine the most appropriate five-year period for opting into the regime**, ensuring that the chosen timeframe aligns with business projections and anticipated operational stability.

4) **Review and align all existing intercompany agreements** to ensure consistency with the SH rules. Alternatively, if at a Group level, the counterparty is not in consensus to change the pricing policy, the Indian taxpayer can still opt for SH by offering additional income to achieve a 15.50% mark-up in its corporate tax return, along with a secondary adjustment by paying additional tax on the excess income.

5) **Update and maintain transfer pricing documentation** accordingly, as opting for SH does not eliminate the obligation to prepare and retain adequate transfer pricing documentation.

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