Tax Flash News

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Draft Income-tax Rules, 2026: Significant reforms in Safe Harbour Rules

Executive summary

The Central Board of Direct Taxes ('CBDT') has released the draft Income-tax Rules, 2026 ('the draft rules') along with the proposed Forms, in relation to the Income-tax Act, 2025 ('the Act'), which is scheduled to come into force from 1 April 2026. Prior to the formal notification, the draft Rules and Forms have been placed in public domain for stakeholder consultation.[1]

In line with the changes proposed by the Union Budget 2026-27, the draft rules introduce significant amendments to the safe harbour regime, including:

- Consolidation of multiple service categories (IT, ITeS, KPO and Software R&D) defined in the current safe harbour rules under a single category of Information Technology ('IT') services;
- Revised profit margin of 15.5 per cent (in relation to operating expenses incurred) for the consolidated IT services category, which is significantly lower than the prescribed range of profit margins of 17 per cent to 24 per cent across various services categories in the current safe harbour rules;

[1] The consultation window is open till 22 February 2026

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- Enhanced applicable transaction value threshold from existing level of INR 300 crores (approx. USD 33 million) to INR 2,000 crores (approx. USD 220 million);
- Extension of safe harbour validity period for a period of five years; and
- New safe harbour for data centre services.

The compliance procedures and documentation requirements have also been prescribed.[2]

Key changes

New safe harbour rules for IT Services

1) Eligibility criteria

The draft rules propose to consolidate multiple service categories, namely software development services, information technology enabled services, knowledge process outsourcing services, contract research and development services wholly or partly related to software development into a single category of IT Services with insignificant risk.

The draft rules outline the following factors to be considered for identifying eligible taxpayers, with insignificant risk:

- The foreign principal performs most of the economically significant functions such as conceptualisation, product design, and strategic direction and framework, while the taxpayer only executes the work assigned to it.
- The foreign principal or its associates provide all capital, assets, and intangibles, and the taxpayer is simply remunerated for its services.
- The foreign principal has the capability to exercise, and actually exercises, control and supervision over core functions through strategic decisions.
- The taxpayer does not assume significant risks; actual conduct to take precedence over contractual terms.
- The taxpayer holds no legal or economic ownership rights over any intangibles or their outcomes, arising during the provision of services; ownership vests with the foreign principal, as per contract and conduct of the parties.

2) Application and verification procedure

- The draft rules prescribe that a one-time application is required to avail safe harbour benefits for a block period of five years.
- Eligible taxpayer is required to submit Form no. 49 with the Director General of Income-tax (Systems) ('DGIT (Systems)'), any time on or before 30 June of the second year of the five-year block period (i.e. the 30 June immediately following the first tax year).

[2] This Flash News summarises the draft safe harbour rules. The draft rules related to other transfer pricing provisions are being summarised in a separate Flash News.

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- The electronic verification process will assess taxpayer and transaction eligibility, as well as the validity of the option exercised, and the same must be completed within two months from the end of the month in which Form no. 49 is filed.
- Taxpayers will have an opportunity to remove any defects before rejection, if any and reasons in case of rejection will be communicated. No remedial action has been prescribed in the draft rules if the safe harbour application is rejected.

The DGIT (Systems) shall, with the approval of the CBDT, lay down the data structure, standards, format and procedure of furnishing and verification of such statements, order, declaration, including any modification, if required.

3) Compliance requirements

The taxpayer in respect of each of the four consecutive tax years following the first tax year, furnish a statement before furnishing return of income of that tax year, providing details of eligible transactions, their quantum and profit margins. The annual filing format for subsequent-year statements has not yet been prescribed in the draft rules.

Additionally, taxpayers are required to continue filing Form no. 48 and maintain transfer pricing documentation.

4) Withdrawal of safe harbour option

Taxpayers may withdraw from the safe harbour option by filing a declaration. However, the taxpayer will not be able to exercise safe harbour option again for the original five-year term. The format/ procedure for withdrawal from safe harbour has not yet been prescribed in the draft rules.

It remains unclear whether a withdrawal would result in the termination of the safe harbour option for the entire five-year block period or only on a prospective basis for the remaining years.

New safe harbour rules for Data Centre Services

The draft rules have expanded the scope of eligible transactions to include provision of data centre services, with a safe harbour margin of 15 per cent.

Data centre services are defined in the draft rules as services provided by a data centre through the use of physical infrastructure, including land, buildings, leaseholds, power, servers, computers, networking and other equipment, cable landing stations, cables, connectivity, security, human resource and other resources in India and shall not include ‘data hosting services.

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Other important aspects

- **Safe harbour for transactions other than IT services** - Under the draft rules, there are no changes proposed to safe harbour for other eligible transactions (intra group loans, provision of corporate guarantee, contract R&D relating to pharmaceutical drugs, manufacture and export of auto components and receipt of low-value adding intragroup services).

  For such other transactions a separate procedure has been proposed for exercising the safe harbour option. This process involves a review of the validity of the option by the Assessing Officer ('AO'). To exercise the safe harbour option for other transactions, the taxpayer must submit Form no. 49 to the AO by the due date for filing the income tax return.

- **No exemption from transfer pricing compliances** – The draft rules specify that taxpayers must continue to file Form no. 48 (equivalent to Form no. 3CEB in the current rules[3]) and maintain Transfer Pricing documentation even if they chose to apply for safe harbour.

- **Mutual Agreement Procedure not to apply where safe harbour for international transactions is accepted** - The draft rules restrict taxpayer to invoke mutual agreement procedure (under an agreement for avoidance of double taxation entered into with a country or specified territory outside India), in relation to an eligible international transaction declared by an eligible taxpayer under the draft rules and is accepted by the income-tax authorities.

[3] Rule 10E of the Income-tax Rules,1962

Our comments

By consolidating taxpayer categories and rationalising cost-plus margins, the draft rules are expected to provide greater clarity and predictability in transfer pricing matters for IT services companies. As the new framework is rolled out, it will be important for stakeholders to stay engaged and closely monitor developments to ensure a smooth transition and optimal utilisation of the revised provisions. Certain issues for further consideration are:

- The draft rules have been issued under the new legislative framework becoming effective from 1 April 2026. Accordingly, it appears that the proposed safe harbour margin of 15.5 per cent for IT services would be applicable for tax year 2026–27 onwards.

- Under the draft rules, the safe harbour election for IT services transactions currently appears to apply mandatorily to the entire five-year block period. It remains to be seen whether the final rules will allow taxpayers the flexibility to opt-in for specific years rather than the full five-year block period.

- Under the draft rules, the Form no. 49 has been prescribed as a common application form for safe harbour for both IT services transactions and for other

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eligible transactions. However, the procedure and the timeline for applying for the safe harbour for the two categories are different. Further clarity and alignment on procedural aspects such as - whether a taxpayer eligible under both categories would be required to file two separate forms, whether the verification procedures would be common or separate, would be expected in the final rules.

- As the DGIT (Systems) will lay down the procedural and verification-related details, it needs to be seen how DGIT (Systems) will verify the factors prescribed for establishing that the taxpayer bears insignificant risk.

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KPMG in India addresses:

Ahmedabad
Commerce House V, 9th Floor, 902, Near Vodafone House, Corporate Road, Prahlad Nagar, Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Hyderabad
Salarpuria Knowledge City, Orwell 6th Floor, Unit-3, Survey No 83/1, Plot No 2, Raidurg, Hyderabad – 500 081.
Tel: +91 40 6111 6000

Noida
Unit No. 501, 5th Floor, Advant Navis Business Park, Tower-A, Plot# 7, Sector 142, Expressway Noida, Gautam Budh Nagar, Noida – 201 305.
Tel: +91 0120 386 8000

Bengaluru
Embassy Golf Links Business Park, Pebble Beach, 13/02, 'B' Block, 1st & 2nd Floor, Off Intermediate Ring Road, Bengaluru – 560 071
Tel: +91 80 6833 5000

Jaipur
Signature Towers, Office No. 402, Fourth Floor, S Plot No. DC-II, Lal Kothi District Shopping Center, Tonk Road, Jaipur – 302 001
Tel: +91 141 – 672 1000

Pune
9th floor, Business Plaza, Westin Hotel Campus, 36/3-B, Koregaon Park Annex, Mundhwa Road, Ghorpadi, Pune – 411 001.
Tel: +91 20 6747 7000

Chandigarh
Elante Offices, Unit No. A505, 5th Floor, Plot No.178-178A, Industrial Area Phase-1, Chandigarh – 160 002.
Tel: +91 172 664 4000

Kochi
Syama Business Centre, 49/179, 3rd Floor, NH 47, Bypass Road, Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Chennai
KRM Towers, Ground, 1st, 2nd, & 3rd Floor, No. 1, Harrington Road, Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Kolkata
Unit No. 604, 6th Floor, Tower – 1, Godrej Waterside, Sector – V, Salt Lake, Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai
Lodha Excellus, Apollo Mills Compound, 2nd Floor, N M Joshi Marg, Lower Parel, Mumbai- 400 011.
Tel: +91 22 3989 6000

Vadodara
Ocean Building, 303, 3rd Floor, Beside Center Square Mall, Opp. Vadodara Central Mall, Dr. Vikram Sarabhai Marg, Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada
PR heights, 4th Floor, NH 16 Service Rd, opp. Manipal Hospital Road, Tadepalle, Andhra Pradesh – 522 501.
Tel: +91 0864 536 2000

Gurugram
Building No.10, 8th Floor, DLF Cyber City, Phase II, Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

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KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Lower Parel, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000

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