



Corporate Guarantee: Computation of Guarantee Fees at Arm's Length Price

Vinti Agrawal*

Abstract

The most recent controversy surrounding Indian tax courts, pertains to the issue of international transactions with respect to intra-group financing. It includes short as well as long term borrowing and lending, guarantees etc. The debate centres around transfer pricing (herein after referred to 'TP') provisions and how the computation of arm's length price is to be done. The article has focussed on one aspect of intra group financing, that is, the provision of corporate guarantee. The paper first describes the meaning of guarantee and then highlights various provisions relating to corporate guarantee, under the Companies Act, 2013 and the Foreign Exchange Management Act, 1999. The article then describes various legislative provisions relating to the transfer pricing issue and how guarantees fit into such provisions. It is ambiguous, as courts have not provided for a settled principle, in this regard. The author, thus, highlights various approaches the Indian tax courts have adopted when the issue of corporate guarantee came before them. The paper provides an answer to the issue of whether the guarantee fee can be computed at arm's length price, using compared uncontrolled price as the method for computation. The author concludes by stating that while

* Third Year, BA LLB (Hons), National Law University, Odisha; vinti.aggar@gmail.com.

the courts have attempted to resolve these ambiguities, there is still scope for further reform.

Keywords: Corporate guarantee, Comparable Uncontrolled Price, International transaction, Intra-group financing, Transfer pricing.

I. Introduction

The recent trend in the corporate world is that associate companies (or associates) of multi-national enterprises (herein after referred to as 'MNE's') are focussing on working and functioning independently from their holding companies. The freedom provided by the holding companies in managing their own undertakings in developing economies like India, has aided the associate companies in growing faster, in the domestic market. However, barriers exist with respect to matters related to finance. The problem arises when the associate companies are forced to rely on their parent companies for a guarantee when they require capital to run their business or gain goodwill of the customers.

Indian banks require a guarantee from the holding or parent company whenever they lend to Indian associates of the MNE. Moreover, the guarantee has a positive effect on the lending rate. In the same way, when the awarders, especially Government bodies and other Public Sector Undertakings award turnkey contracts or when they enter into concession agreements, they always require a performance guarantee that has to be executed by the holding company of the MNE associate.

Indian Multinational Companies (herein after referred to as 'MNC's') that are operating outside the territorial jurisdiction of India seek to benefit from the lesser cost of borrowing from their domestic jurisdiction, instead of borrowing from the holding company at almost twice the domestic market rates. However even such borrowing is required to be guaranteed by their parent company.

There is a huge debate in India regarding the issue of whether certain transactions that are related to intra group financing result in an 'international transaction', falling under the ambit of the transfer pricing provision. If such transactions fall under the

purview of transfer pricing provisions, then another issue arises regarding computation of arm's length price.

The main aim of this research paper is to critically analyse the issue regarding corporate guarantee in India from the perspective of whether it falls under the ambit of transfer pricing provisions incorporated under the Income Tax Act, 1961. Part I of the paper deals with basic concepts relating to corporate guarantee under the Foreign Exchange Management Act, 1999 (hereinafter referred to as 'FEMA') and Companies Act, 2013. Part II deals with provisions relating to transfer pricing under Income Tax Act, 1961. Part III deals with the judicial approach taken by Indian tax courts in dealing with the above issue. Finally, Part IV deals with the computation of arm's length price in relation to corporate guarantees by using the comparable uncontrollable price method.

II. The Concept of Corporate Guarantee

The term "contract of guarantee" has been defined in Indian Contract Act, as a contract to perform the promise, or discharge the liability, of a third person in case of his default.¹ The person who provides the guarantee is termed as the "surety" and the person, for whose default the guarantee is provided, is termed as the "principal debtor". Furthermore, the creditor is the person to whom the guarantee is provided. In Halsbury's Laws of England,² it has been stated that 'A guarantee is an accessory contract whereby the promisor undertakes to be answerable to the promise for the debt, default or miscarriage of another person, whose primary liability to the promise, must exist or be contemplated.'³ Liability accrues on the surety only if the principal debtor fails to repay.

¹Indian Contract Act, 1872, §126.

²LORD HAILSHAM, HALSBURY'S LAWS OF ENGLAND, 49 (LexisNexis, 4thed. 2003).

³*Id.*

Corporate Guarantee Under Companies Act, 2013 and Foreign Exchange Management (Guarantees) Regulations, 2000

Section 185 prohibits any company from giving loans, guarantees and securities in favour of its directors or to any other person in whom the director is interested in.⁴ The explanation of 'to whom director is interested in' is given as⁵:

- a) any director of the lending company, or of a company which is its holding company or any partner or relative of any such director;
- b) any firm in which any such director or relative is a partner;
- c) any private company of which any such director is a director or member;
- d) body corporate at a general meeting of which not less than twenty five per cent of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together, or
- e) body corporate, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.

In 2014, the Ministry of Corporate Affairs has clarified the applicability of Section 185 of the Companies Act, 2013 vis-à-vis Section 372A of the Companies Act, 1956: that any guarantee given by a holding company, in respect of loans provided by a bank or financial institution to its subsidiary company, exemption as provided in clause (d) of subsection (8) of section 372A of the Companies Act, 1956 shall be applicable till section 186 of the Companies Act, 2013 is notified.⁶

⁴Sagar Gupta, *Section 185 of Companies Act, 2013 - Loan to Directors*, Taxguru (July 3, 2014), available at <http://taxguru.in/company-law/section-185-companies-act-2013-loan-directors.html>.

⁵*Id.*

⁶Ministry Of Corporate Affairs, General Circular No 03/2014, Dated: 14/2/2014, Clarification With Regard To Section 185 And 186 Of The Companies Act, 2013 – Loans And Advances To Employees - Reg.,

Foreign Exchange Management (Guarantees) Regulations, 2000

The fundamental principle essential for covering transactions under FEMA is that it permits all current account transactions except those prohibited by law itself and it prohibits all capital account transactions except those expressly provided by law. Capital account transaction means a transaction which alters the assets or liabilities, including contingent liabilities outside India, of persons residing in India, or assets or liabilities in India of persons residing outside India. Therefore, transactions by an Indian resident or even a non-resident that decreases or increases its assets or liabilities, falls under the ambit of this section.

In exercise of the powers conferred upon the Reserve Bank of India (hereinafter referred to as 'RBI') under Section 6 (3)(j)(i) read with Section 472 of the FEMA, the RBI has issued Foreign Exchange Management (Guarantees) Regulations, 2000 to regulate the issuing of guarantees.

There is a restriction placed on the giving of a guarantee. No person resident in India shall give a guarantee or surety in respect of, or undertake a transaction, by whatever name called, which has the effect of guaranteeing a debt, obligation or any other liability owed by a person resident in India to, or incurred by, a person resident outside India. This rule thus provides that guarantees can be given by a resident in favour of non-resident only if special permission has been granted by the RBI or it is expressly legitimatised by way of future notification.

Indian Transfer Pricing Regulations

Chapter X of the Income Tax Act, 1961 lays down the provisions governing transfer pricing in India. Section 92 of the this Act provides that, if any income arises from any international transaction that is entered by the taxpayer with its associated enterprise, then such income has to be computed taking into regard arm's length price.

III. Concept of Associated Enterprise

Section 92A of the Income Tax Act, 1961 defines 'associated enterprise.' According to this section, it is an enterprise of one or more persons who participate either directly or indirectly, or with

available at http://www.mca.gov.in/Ministry/pdf/Circular_04_10032015.pdf.

the help of intermediaries in the management or the control, or the capital of the enterprise.⁷

Section 92A (2) of the Income Tax Act, 1961 provides for thirteen conditions wherein two enterprise can be considered to be associated enterprises. Amongst these thirteen conditions, the fourth condition deals with guarantees. It states that, if one enterprise guarantees not less than 10% of the total borrowings of the other enterprise, then it is deemed to be an associated enterprise.⁸ A German court has held that a business relationship is a basic requirement for the inference of associated enterprise, though a loan may justify an inference of associated enterprise, mere investment without business relationship was not found acceptable for such inference.⁹

IV. Scope and Ambit of International Transactions

Section 92B of the Income Tax Act, 1961 defines 'international transaction' while Section 92F (v) defines the term 'transaction'. It provides that a transaction entered into by an enterprise with a person other than an associated enterprise shall be deemed to be a transaction with an associated enterprise, if the following conditions are satisfied¹⁰:

1. There exists a prior agreement in relation to the relevant transactions between such other person and the associated enterprise; or
2. The terms of the relevant transaction are determined in substance between such other person and the associated enterprise.

According to Section 92B, lending or borrowing falls under the ambit of 'international transaction'. The term 'borrowings' has been

⁷Income Tax Act, 1961, § 92A.

⁸Income Tax Act, 1961, § 92A (d).

⁹Case No. IR 97/88, dated 30th May 1990.

¹⁰Prem Sikka & Hugh Willott, *The Dark Side Of Transfer Pricing: Its Role In Tax Avoidance And Wealth Retentiveness*, 21 JOURNAL OF CRITICAL PERSPECTIVES ON ACCOUNTING, 345 (2010).

provided rather than 'loans,' which incorporates liabilities like deposits, advances from customers, amounts due to suppliers etc.¹¹ Since the term guarantee has been used in connection with the term 'borrowings', it is reasonable to argue that the definition of the term guarantee has to be in pursuance of a borrowing, and cannot be interpreted as a guarantee from an associated enterprise.¹²

V. The Safe Harbour Provision

Section 92CB of the Income Tax Act, 1961 defines the term 'safe harbour' as 'circumstances under which the income-tax authorities shall accept the transfer pricing declared by the assessee.'¹³ It is that provision of a statute that postulates that certain conduct of the associated enterprise will be deemed not to violate transfer pricing rules and accept it as declared by the taxpayer.

An eligible assessee is one who provides the corporate guarantee and applies for safe harbour rules under the prescribed format.¹⁴ The class of transactions which can be considered as eligible transactions, are those whose amount guaranteed does not exceed one hundred crore rupees or those that exceed one hundred crore rupees and the credit rating of the associated enterprises, done by an agency registered under the SEBI is of adequacy to highest safety, is an eligible transaction.¹⁵ The safe harbour margin for guaranteeing one hundred crore rupees is at the rate of 2% or more per annum on the amount guaranteed and for the guarantee

¹¹MUKESH BUTANI, *TRANSFER PRICING: AN INDIAN PERSPECTIVE* 60 (LexisNexis Butterworths, 2nd ed. 2007).

¹² SAMPATHIYENGAR, *LAW OF INCOME TAX*, 8069 (Bharat Law Publications, 11th ed. 1941).

¹³Income Tax Act, 1961, §92CB.

¹⁴ Income Tax Rules, 1962, Rule 10TB(3).

¹⁵Income Tax Rules, 1962, Rule 10TC.

provided above one hundred crore rupees, the rate is 1.75% or more per annum on the amount guaranteed.¹⁶

VI. Judicial Approach

There is an ambiguous situation in India regarding whether corporate guarantees fall under the ambit of 'international transaction', as courts could not provide for a settled principle regarding this. The courts have decided that if the guarantee fee is charged, then it definitely falls under the ambit of 'international transaction', as it has a bearing on profit, income, losses or assets of the business. However, if fee is not charged, then taking into consideration the purpose for which it is given, the courts will decide on a case to case basis, as to whether it falls under the ambit of international transaction or not.

Interpretation of the Definition of International Transaction Given Under Section 92B

The explanation¹⁷ of Clause (c) of Section 92B of the Income Tax Act, 1961, specifies 'capital financing' as a part of international transaction which includes any type of long-term or short-term borrowing, lending or guarantee etc. It gives substantial clarity to the statute that corporate guarantee is included under the ambit of 'international transaction' under Section 92B as the word 'guarantee' is used under explanation of clause (c) of Section 92B.¹⁸

However, the term 'international transaction' under Section 92B has a condition precedent i.e. 'a bearing on the income, profits, losses or assets of the business'.¹⁹ If the parent company extends its assistance to its associated enterprise for which no fee is charged,²⁰ then there is no bearing on profits, incomes, losses or assets of the

¹⁶Sandeep Sharma, *Safe Harbour Rules – Transfer Pricing*, Taxguru (Jan 11, 2014), available at http://tax_guru.in/income-tax/safe-harbour-rules-transfer-pricing.html.

¹⁷Finance Act, 2012 (23 of 2012) (w.e.f. 1.04.2012).

¹⁸Four Soft Pvt. Ltd. v. D.C.I.T., (2014) 164 TTJ 561.

¹⁹Income Tax Act, 1861, §92B.

²⁰ Bharti Airtel Ltd. v. Addl. C.I.T., ITA no. 5816/Del/2012.

business.²¹ Further, the explanation under Section 92B does not change the basic nature of the definition of 'international transaction' and it has to be read in collaboration with the main provisions, harmonizing it with the scheme of the provision, provided under Section 92B.²²

Moreover, even if it is assumed that there was a bearing on profits, income, losses or assets of the business, then there must also be some material on record to indicate that an intra-associate enterprise international transaction having the said impact was on a real basis, and not on a contingent or hypothetical basis.²³ The bearing on the profits, income, assets or losses must be immediate or in the future,²⁴ containing an element of certainty about the happening of the event. An impact that is 'contingent' will not be considered as an 'international transaction' under the transfer pricing provisions of Indian law. In the case of a guarantee, liability will arise only in case of default by the debtor and hence, calls for a hypothetical situation.

Corporate Guarantee is Considered to be a Commercially Expedient Transaction

Commercial expediency includes any such expenditure which a prudent businessman incurs for the purpose of his business,²⁵ and thus indicates the intention of the parties.²⁶ A guarantee given in the pursuance of the business interest of the associate enterprise, without the charging of guarantee fees, is considered to be a commercially expedient transaction and thus attracts no arm's

²¹Redington (India) Ltd. v. J.C.I.T., ITA no. 513/Mds/2014.

²²Income Tax Act, 1861, §92B.

²³Everest Kanto Cylinder Ltd. v. A.C.I.T. (L.T.U.), (2015) 167 TTJ 204.

²⁴ *Id.*

²⁵S.A Builders Ltd. v. C.I.T., (2007) 288 ITR 1 (SC).

²⁶ C.I.T., Punjab, Haryana, J. & K., H.P. & Union Territory of Chandigarh v. Panipat Woollen & General Mills Co. Ltd., (1976) 103 ITR 66 (SC).

length adjustment.²⁷ Further, a transaction must be commercially expedient from the businessman's perspective and not from that of the tax authorities²⁸ and hence must not be questioned by the transfer pricing officer.²⁹

Thus, if the assessee claims that it provided guarantee to its associated enterprise without charging guarantee fees solely for the purpose of its business then the transfer pricing officer can question the commercial expediency of the transaction. Moreover, such commercially expedient transactions do not fall under the ambit of international transaction and hence no arm's length price can be computed in that regard.

Corporate Guarantee Given by Parent Company is Considered to be Quasi-Equity in Nature

The corporate guarantee provided by the parent company to support the continuous flow of cash,³⁰ without charging any benefit³¹ is a shareholder activity and cannot be brought under the TP provisions.³² When the parent company controls the capital structure of the subsidiary company, then any action taken by the assessee will strengthen the creditworthiness of the associate enterprise, as it forms an integral part of the equity support.³³ The OECD Guidelines, 1995³⁴ states that an activity performed by a group member solely for its ownership interests in one or more

²⁷A.C.I.T. v. Nimbus Communication Ltd., (2014) 30 ITR 349; A.C.I.T. v. W. S. Industries (India) Ltd., (2011) 9 ITR 596.

²⁸C.I.T. v. Walchand & Co. (Pvt.) Ltd., (1967) 65 ITR 381 (SC); *see also* C.I.T. v. Sales Magnesite (Pvt.) Ltd., (1995) 214 ITR 1.

²⁹Kirby Building Systems India Ltd. v. A.C.I.T., (2014) 166 TTJ 294.

³⁰A. MICHAEL HEIMERT & MICHELLE JOHNSON, GUIDE TO INTERNATIONAL TRANSFER PRICING: LAW, TAX PLANNING AND COMPLIANCE STRATEGIES 18 (2010).

³¹D.C.I.T. v. M/s Lear Automotive India Pvt. Ltd., (2014) 148 ITD 575.

³²Kohinoor Food Ltd. v. A.C.I.T., ITA no. 3669/Del/2012.

³³*Id.*

³⁴OECD TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATION (1995) ¶7.9.

group members, that is, in its capacity as a shareholder, would be referred to as 'shareholder activity'³⁵ and no payment may be claimed if the subject is a shareholder activity.³⁶

Thus if the corporate guarantee is provided without charging any guarantee fees, solely for the purpose of enhancing its own business by providing support to the associated enterprise i.e. to have a continuous flow of cash through the loan taken, then it is considered to be a shareholder activity. Such activities are not considered to be international transactions and hence do not fall under the purview of transfer pricing provisions.

Corporate Guarantee as an Intra-Group Transaction

When the high credit rating of the associate enterprise is due to the guarantee provided by another group member, or it derives benefit from the other group's reputation, then intra group services usually exist.³⁷ The 'implicit support' provided by the parent company to its subsidiary company does not protect one from avoiding guarantee fees in toto, as it enhances the creditworthiness of the borrower and hence fees must be charged.³⁸ The creditworthiness of the associate enterprise is increased for obtaining a loan from the market or through any other financial institution, which is a service provided by the parent company.³⁹ The associate enterprise is benefitted from the guarantee, as it can borrow the loan at a lower

³⁵ Rahul K Mitra, *Intra-Group Services And Shareholder Activities, Transfer Pricing*, 15 INTL. JOURNAL BLOOMBERG BNA 3 (2014).

³⁶ Jakob Bundgaard, *Tax Law On Intra-Group And Shareholder Security From A Transfer Pricing Perspective*, INTL. TRANSFER PRICING JOURNAL 81 (2006).

³⁷ OECD TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATION (1995), ¶7.13.

³⁸ *General Electric Canada Inc. v. The Queen*, (2009) TCC 563.

³⁹ *Prolifics Corporation Ltd. v. D.C.I.T.*, ITA no. 237/Hyd/2014.

interest rate as compared to the rate on a stand-alone basis without a guarantee.⁴⁰

The parent company agrees to take the risk on behalf of its associate enterprise, which would not have been undertaken in case of a third party without charging a consideration for it, because there is always an element of benefit or cost by way of the risk undertaken.⁴¹ Guaranteed loans primarily shift the risk from the lender to the guarantor.⁴² A parent company takes the risk because of its position as a guarantor for which it needs to be compensated through a guarantee fee.⁴³

Thus, the courts have also interpreted that since parent companies, while providing guarantees, incur risks, they need to be compensated by way of guarantee fees. Moreover, it is an intra-group transaction wherein creditworthiness of the associate enterprise is enhanced when it gets a guarantee from its parent company, thus fees must be charged. Therefore, a corporate guarantee falls under the ambit of 'international transaction'.

From the above approach of the judiciary, it can be seen that whether a corporate guarantee is classified as an international transaction or not depends upon the purpose for which it is given, as also the benefits the associate enterprise derives from it and whether it has any bearing on the profit, income, losses or assets of the business.

VII. Computation of Guarantee Fees at Arm's Length Price by using CUP Method

Section 92C of the Income Tax Act, 1961 provides for the provision of computation of international transaction at arm's length price.

⁴⁰ Hales S.J., *Determining Arm's-Length Guarantee Fees*, 39TM INTERNATIONAL JOURNAL 156 (2010).

⁴¹ Everest Kanto Cylinder Ltd. v. A.C.I.T. (L.T.U.), (2015) 167 TTJ 204.

⁴² Raymer Mcquiston, *Drafting An Enforceable Guaranty In An International Financing Transaction: A Lender's Perspective*, 10 BERKELEY JOURNAL OF INTL. LAW 4 (1993).

⁴³ Everest Kanto Cylinder Ltd. v. A.C.I.T. (L.T.U.), (2015) 167 TTJ 204.

The Finance Minister, during his budget speech has announced that the 'range concept' (i.e. transactional net margin method, resale price method and cost plus method) has been introduced in India but arithmetic mean concept will still be a method to be applied where the comparables are inadequate. Though selection of method is determined on a case to case basis, still there are two methods that can be used for comparing guarantee fees: CUP method and transactional net margin method.

CUP Method

The comparable uncontrolled price (hereinafter referred to as 'CUP') method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstance.⁴⁴ The CUP method is the most preferable method for the computation of the arms length price, in the absence of any other method that is proven to be more reliable.⁴⁵

In situations where it is possible to find a comparable uncontrolled transaction, CUP can be considered to be one of the methods to determine the relations between the associated prices at arm's length. The CUP method is applied in the controlled transactions of the property and services. FAR (Functions performed, assets used and risks assumed) analysis test should be undertaken for the computation of CUP as it has a direct effect on the pricing of product/services.⁴⁶ The method of CUP can be computed in two ways: internal CUP method and external CUP method.

⁴⁴Working Draft On Transfer Pricing Methods, available at http://www.un.org/esa/ffd/tax/2011_TP/TP_Chapter5_Methods.pdf. (last visited Sept. 15, 2015).

⁴⁵Serdia Pharmaceuticals (India) Pvt. Ltd. v. A.C.I.T., (2011) 136 TTJ 129.

⁴⁶Aztec Software and Technology Services Ltd. v. A.C.I.T., (2007) 109 TTJ 892.

External CUP Method

An external CUP is the method of computation of price applicable when the transaction is between two independent enterprises which involve comparable goods or services under comparable circumstances.⁴⁷ In most cases, when there is computation of corporate guarantee fees, tax authorities compare it with a bank guarantee by taking naked bank quotes as an uncontrolled transaction. However, naked bank quotes given by the bank cannot constitute a CUP as it is a quotation and is always subject to negotiations between the bank and its customers⁴⁸ wherein they may not charge any commission⁴⁹ and hence it cannot be considered as an actual uncontrolled transaction.⁵⁰

The commercial considerations are paramount for fixing charges in bank guarantees.⁵¹ The corporate guarantee issued by the parent company to its associate enterprise is incidental to its business and has been issued to provide financial help to its associate.⁵² Hence, corporate guarantees cannot be compared with bank guarantees due to the difference in the functions they serve. However, according to Regulation § 1.482-3(1)(5), Internal Revenue Service, Treasury, in the United States of America, public data maintained in the regular business affairs, which are negotiable must be relied on in setting prices in controlled transactions.⁵³ The above principle is of universal application and there is no justification regarding its non-applicability in the Indian transfer pricing administration.⁵⁴

⁴⁷D.C.I.T. v. C.M.A. C.O.M. Global India (Pvt.) Ltd., (2013) 151 TTJ 18.

⁴⁸ *Id.*

⁴⁹Reliance Industries Ltd. v. A.C.I.T., ITA no. 4537/Mum/2007.

⁵⁰ Asian Paints Ltd. v. A.C.I.T. (L.T.U.), ITA no. 1686/Mum/2010.

⁵¹Glenmark Pharmaceuticals Ltd. v. A.C.I.T., ITA no. 5031/Mum/2012.

⁵²Four Soft Pvt. Ltd. v. D.C.I.T., (2014) 164 TTJ 561.

⁵³Aztec Software and Technology Services Ltd. v. A.C.I.T., (2007) 109 TTJ 892.

⁵⁴ *Id.*

So the external CUP can be applied taking LIBOR as a rate for comparable uncontrolled transaction,⁵⁵ but taking naked bank quotes is not a correct way of computing guarantee fees at arm's length price.

Internal CUP Method

Under the internal CUP method, the assessee has entered into the same transaction with related as well as unrelated parties and the price imposed on the unrelated party is taken as the comparable standard for the price to be imposed on related parties. For computation of internal CUP method, one should first locate all possible internal as well as external comparables. During the analysis, the first question to be answered is whether either of the associated enterprises is involved in the transaction with any other independent enterprise. The results derived from applying the CUP method will generally satisfy the best method rule if the uncontrolled transaction has no difference with the controlled transaction that would affect the price, or if there are only minor differences that have a definite and reasonably ascertainable effect on price and for which appropriate adjustments are made.⁵⁶

However, if CUP method is not satisfied or cannot be applied then transactional net margin method can be applied.⁵⁷ This method tests the net profit margin earned in a controlled transaction with the net profit margin earned by the related party on the same transaction with a third party or the net margin earned by a third party on a comparable transaction with another third party.⁵⁸

⁵⁵ A.C.I.T.Vapi Circle, Vapi v. Micro Inks Ltd., ITA no. 1442/Ahd/2006.

⁵⁶ Reg. § 1.482-3(b)(2)(ii)(A).

⁵⁷ R.B.S. Equities (India) Ltd. v. Additional Assistant Commissioner of Income-tax, IT Appeal No. 3077 (Mum) of 2009.

⁵⁸ ROBERT FEINSCHREIBER, TRANSFER PRICING METHODS: AN APPLICATION GUIDE 234 (2004).

VIII. Conclusion

The controversy regarding the recognition of guarantee as an international transaction is varied. There have been different approaches by different courts - some treating it as a service, while others as a shareholder activity or a commercially expedient transaction. However, the enforcement of TP laws has been gradually improving, particularly after the Advance Pricing Agreement Programme was introduced in 2012.

The definition of 'international transaction', provided under Section 92B of the Income Tax Act, 1961, has a prerequisite that the transaction must have an impact on income, profit, losses or asset of any of the enterprise. This means that it can also have an impact on the beneficiary instead of the guarantor. So, the decision in the Bharti Airtel case was erroneous as it stated that the guarantee provided by the parent company to its subsidiary company is not an international transaction, because no cost has been incurred by the guarantor. In the case of *Vodafone India Services Pvt. Ltd.*,⁵⁹ the Bombay High Court held that for the transfer pricing provisions to apply, the income must be affected or it must potentially be affected. So, if there is a possibility that the income could potentially increase then TP provisions must be applied.

With regard to implicit support provided by the parent company to its subsidiary company, Indian companies do not provide for any guidelines and hence international best practices have to be taken into consideration. However, it is not possible to provide for a straightjacket formula, as there are various perspectives involved in scrutinizing whether the implicit support provided by the parent company constitutes a service or not. Therefore, recognising guarantees as a service is a debatable issue and is still ambiguous.

Though transfer pricing issues in India are highly debatable and ambiguous, the pace at which the courts are disposing off the issue indicates that the judiciary has viewed transfer pricing matters with utmost concern with an intention to promote inbound and outbound investments.

⁵⁹ *Vodafone India Services Pvt. Ltd v. Union of India*. IT No. 7514/Mum/2013.