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Taxation of Corporate Guarantees in International Transactions

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Abstract

The use of intra-group corporate guarantees transfers actual economic activity across borders using zero monetary means; therefore, intra-group corporate guarantees represent a significant area of contention within transfer pricing. This research inquiry seeks to identify the criteria upon which a parent company's guarantee of a foreign affiliate's debt will be considered a chargeable transaction, as well as the methodologies for determining an arm's-length fee associated therewith, and whether or not there is evidence of convergence amongst national jurisdictions relative to these issues since the OECD finalized its guidelines regarding financial transactions in 2020. Doctrinal and comparative legal methodological techniques were employed by this research. Specifically, this research examined Chapter I, VII, and X of the OECD Transfer Pricing Guidelines together with applicable Indian legislative instruments (i.e., the Income Tax Act), Safe Harbour Rules, judicial decisions at the level of the Tribunals and the High Courts, and compared same with those used in the U.S., UK, Australia, China, Canada, and Singapore. Findings included that explicit financial guarantees are currently viewed as chargeable throughout most jurisdictions where such guarantees provide some type of benefit to the borrowing entity beyond mere participation in the borrowing entity's Group structure. However, measuring said benefit remains an open question due to ambiguity surrounding the baseline amount of implicit support afforded by a Group. Prior to 2018, Indian law did not view no-cost guarantees as being subject to India's transfer pricing regulations; however, the recent trend is toward viewing all intra-Group guarantees as international transactions. Further, tribunals in general have not accepted bank guarantee rates as benchmarks for measuring charges associated with guaranty arrangements. Characterization of withholding taxes related to such guarantees, and implementation of the Global Minimum Tax pursuant to Pillar II, create additional uncertainty. Finally, this research identifies documentation requirements for multinationals, treaty planning considerations for multinationals, and provides recommendations for policy makers.

Keywords: corporate guarantees; transfer pricing; arm's length principle; OECD Chapter X; implicit support; Indian tax law; withholding tax; Pillar Two

1. Introduction

Although Multinational Enterprises (MNEs) are viewed as separate companies with minimal links among them, MNEs operate through numerous interdependent obligations including financial, operational and reputational obligations. A parent company can provide support to their foreign-based subsidiary; however it does not have to be done so via money. The Parent Company can do this by lending its

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own creditworthiness. This is accomplished when the parent company, or an affiliate entity of the parent company, provides a corporate guarantee. In doing so the parent company guarantees to the third party lender/creditor that if the subsidiary fails to pay back the loan/debt, the guarantor will satisfy the obligation.

At the time that the guarantee is extended there is no exchange of funds and no invoices are generated from an ordinary commercial standpoint, and yet the agreement may reduce the interest rates applicable to the subsidiary's funding, create financing opportunities that did not previously exist, improve the subsidiary's standing in capital markets and move real economic benefits across international boundaries. The Guarantee is a key feature of transfer pricing due to the fact that while it provides a real economic benefit, there isn't a "real" transfer price involved in the contract. As such, it remains one of the most commonly disputed elements of tax in today’s environment. Since the OECD released their Base Erosion and Profit Shifting Project in 2013 (OECD, 2013), guarantee-based disputes have escalated. Prior to BEPS, guarantees had been subject to controversy; however, the projects emphasis on taxing income based upon “economic substance” and the subsequent guidance released in February 2020 regarding financial transaction finalization (now included as Chapter X of the Transfer Pricing Guidelines), provided Revenue Authorities with enhanced ability to dispute prior arrangements that would have otherwise gone unchallenged (OECD, 2020, 2022).

The article reviews the taxation of cross border corporate guarantees using several approaches. First, it examines exactly what the instrument is and why it doesn’t fit well into pre-existing categories of laws. Second, it evaluates the international consensus established by the OECD Transfer Pricing Guidelines including Chapter X. Third, it explores the unique and substantial amount of India-specific transfer pricing case law dealing specifically with guarantees. This includes decisions starting with Bharti Airtel and extending to the Safe Harbor Rules and recent High Court and Tribunal Practice. Fourth, it analyzes and compares how other countries (the United States, the United Kingdom, Australia, China, Canada, and Singapore) have addressed this same problem. Fifth, it examines withholding tax characterization and increasing convergence between Guarantee Taxation and the Global Minimum Tax under Pillar II. Sixth, it assesses how these developments will affect documentation and compliance within an MNE Group. Seventh, it considers the future trajectory of the law and implications for Groups that still view intragroup guarantees as merely an additional cost-effective component of treasury operations.

2. Literature Review

Guarantees are evaluated economically prior to their treatment in tax laws. Merton (1974) demonstrated through his structural model of corporate debt that firms' risky debts could be viewed as being comprised of two components; risk-free debt and a put option on the firm's assets. Therefore, when evaluating a guarantee that eliminates lenders' default risks, we can theoretically view this in terms of the cost of the put option. It is from this understanding that the option based and expected loss models were developed for use in transfer pricing.

The tax literature has followed the path taken by the OECD. Averyanova & Sampat (2015) analyzed the transfer pricing implications of intragroup financial guarantees in response to the OECD's BEPS Action Plan. Prior to settling upon its final position regarding Chapter X, attention turned to specific sections of Chapter X. Manivannan & Van Straten (2023), examined paragraph 10.161 of the Guidelines, which describes how borrowed funds over a company's ability to borrow at a reasonable interest rate will be viewed as loans to the guarantor followed by equity contributions into the guarantor, and suggested a method to test the borrower's debt capacity. Pletz (2019), discussed implicit support and noted that there is still significant debate surrounding the impact of implicit support on the pricing of guarantee fees, recommended selecting pricing methodologies and confirming those pricing methodologies using more than one methodology or model. Deshpande (2017) focused on performance guarantees since the OECD's guidance regarding financial guarantees did not include performance guarantees and explored the fee implications associated with these types of guarantees.

Domestic commentators have primarily relied upon India's case law. Agrawal (2016) reviewed the varying opinions expressed by India's various courts regarding corporate guarantees, provided context for guarantees within India's domestic transfer pricing regime, and foreign exchange and corporate regulations applicable to guarantees, and questioned if the Comparable

Uncontrolled Price Method can accurately determine an arm's length charge. Agrawal stated that while some ambiguity has been resolved through court decisions additional reform is required.

There exist two voids in the literature. Firstly, the majority of the literature focuses on either the OECD Standard or a single country's standards and only very few studies compare the lines of authority from multiple countries with respect to guarantees, including India's line of authority, which includes several High Court decisions subsequent to Agrawal's review. Secondly, limited research exists linking the transfer pricing determination to the withholding tax and Pillar II effects resulting from charging a fee. This paper will cover each gap.

3. Research Methodology

This study is based on a doctrinal/comparative methodology. The study is directed by four research questions: (1) When will an intra-group-guarantee represent a taxable transaction in accordance with Article 9(5) of the OECD Model Tax Convention (and/or local implementing legislation); (2) How should the arm’s-length-fee for a group-membership-guarantee be determined?; (3) What have the answers been under Indian law as compared to other leading jurisdictions?; and (4) How do the Withholding Taxes and the Pillar II structure impact a Group if a Fee is imposed?.

The primary source of this analysis are chapters I, V, VII and X from the OECD Transfer Pricing Guidelines (OECD, 2022), the OECD/UN Model Tax Conventions, and the BEPS Actions report and the GloBE Model Rules; for India, the Income-tax Act, 1961, the Income-tax Rules, 1962, the Safe Harbour notifications and reported decisions of the Income Tax Appellate Tribunal (ITAT), the High Courts and the Supreme Court; and for the comparator jurisdictions, the relevant statutes, regulations, administrative guidance and leading judgments. Secondary sources, mainly peer-reviewed articles in international tax journals, are used to test and interpret this material.

The comparator jurisdictions were chosen because each has either produced leading litigation on guarantee fees (the United States, Canada and Australia), issued specific administrative guidance or legislation (the United Kingdom and Singapore), or represents a large capital-importing economy with an active tax administration (China). The study does not use a statistical dataset; the ranges of fees reported for India are drawn from the decisions cited and should be read as indicative. Because the Income-tax Act, 2025 replaced the 1961 Act with effect from 1 April 2026, references to Indian provisions are to the 1961 Act under which the cited disputes arose. The law is stated as available to the author in October 2026.

4. Results and Discussion

4.1 What a Corporate Guarantee Actually Is, and Why It Resists Easy Categorisation

A corporate guarantee, at its most basic level, is a tri-party arrangement among the guarantor (often the parent company), the beneficiary lender (such as a bank or an investor in the capital markets) and the primary obligor (the subsidiary), whereby the guarantor undertakes to the lender to pay any of the obligations owed by the subsidiary should the subsidiary fail to do so. In this regard, the guarantee functions as a credit enhancement for the lender, since it adds a second obligor with better credit than the original obligor. Thus, from the standpoint of the lender, a corporate guarantee is similar to turning a loan made to a debtor with poor credit into a loan made to a debtor with good credit.

The OECD describes financial guarantees as lying on a spectrum, from a formal written guarantee that legally binds the guarantor at one end to implied support at the other (OECD, 2022, para. 10.155). Typically intra-group credit support is provided in one of three ways:

1. Guarantees (letter): A formally legally binding commitment by the Parent to a Bank or Bondholders that the Parent shall be liable for the debt obligations of its Subsidiary should that Subsidiary default. The legal impact is clear cut, however the financial implications can be difficult to measure.

2. Letters of Comfort: Soft, informal undertakings by the Parent that it is aware of and supportive of the Subsidiaries' borrowings, designed to provide assurance to Lenders but with no obligation to take action. As such they are difficult to assess from a Tax perspective as the Legal impact is unclear; a Letter of Comfort could affect a Lender's Credit Decision and hence create a Financial benefit for the Borrowing Subsidiary, without creating a Court-enforceable obligation upon the Parent.

3. Passive/Implicit Support: Not documented, there is nothing done by the Parent. There is simply an

assumed expectation due to the affiliation with the Group, that the Parent would prevent a Strategic Affiliate from failing. Such assumptions are routinely taken into consideration when assessing Credit Ratings for Affiliates of larger Groups.

Most of the tax controversy surrounds the first category. An explicit guarantee represents a discrete obligation and therefore constitutes a transaction between two legal persons, which can in theory be priced on an arm's length basis. Categories two and three raise the more fundamental question: is this merely an economic spill-over resulting from group membership, towards which tax law should remain neutral?

The importance of establishing whether a transaction exists is practical rather than purely theoretical. Transfer pricing adjustments are, in principle, two-sided: if a parent must recognise a guarantee fee as taxable income, then the subsidiary should be entitled to a corresponding deduction, subject to a working mutual agreement procedure under the applicable double taxation treaty. Where no treaty relief exists, or where the procedure fails, the same economic value may ultimately be taxed twice, once as taxable income of the parent and again as a non-deductible expense of the subsidiary. Unrelieved, that double taxation is a real drag on cross-border investment, and one that serves no obvious policy purpose.

4.2 The Core Tax Question: Is a Guarantee a Chargeable "Service"?

Assessing a guarantee fee to tax requires answering three questions in order. First, is the guarantee an "international transaction", or does it otherwise fall inside the transfer pricing or anti-avoidance rules of the relevant jurisdiction? Second, if it does, would an independent enterprise have paid for it; in other words, does the recipient obtain something real and measurable, and would an independent party in its position have been willing to pay for that benefit (OECD, 2022, paras. 7.6, 10.164)? Third, how should the fee be quantified, given that no observable open market exists for parent-subsidiary credit support in the way that markets exist for, say, comparable third-party loans or publicly traded corporate bonds?

4.2.1 The "Shareholder Activity" Defence

Taxpayers have consistently argued that a parent's decision to guarantee a subsidiary's debt is not a service rendered to the subsidiary at all, but an act undertaken for the parent's own benefit as shareholder: to protect and enhance the value of its investment, to enable group-wide treasury efficiency, to maintain the group's overall credit standing with institutional lenders, or to meet covenants in the parent's own financing arrangements. Under the OECD's long-standing shareholder activity doctrine, activities undertaken by a group member solely because of its ownership interest in other group members are not chargeable to those members (OECD, 2022, para. 7.9). Relatedly, a group member does not receive a chargeable service merely because it enjoys incidental benefits, such as a better credit rating, that flow from its passive association with the group (OECD, 2022, para. 7.13).

The logic of this defence runs as follows. Suppose a parent wishes to protect the value of its equity stake in a subsidiary by ensuring that the subsidiary does not default on its debt and thereby suffer reputational damage in the credit markets that would impair the parent's investment. The parent issues a guarantee. On the taxpayer's account, it does this as an investor looking after its own position, not as a service provider. An independent guarantor, by contrast, would only take on someone else's debt if paid for the risk. Since the purpose of the parents' actions are fundamentally different from one another, taxpayers argue that there can't be an automatic equivalence made with the arm's-length guarantor-for-fee relationship that is used by transfer pricing law to compare.

Revenue authorities respond by arguing that when there is a tangible impact from the guarantee (usually as evidenced by an interest rate reduction based upon the specific terms of the guarantee as opposed to just being a member of the same corporate family; availability of funding that would not have existed without the guarantee; etc.) in favor of the subsidiary, then the parent did more for the subsidiary than simply hold shares in it. Therefore, since an independent third-party, acting in place of the subsidiary, could have paid for this benefit, it follows that the value was greater than zero and was transferred by the parent to the subsidiary (and therefore should be subject to tax) regardless of whether or not the amount paid for that benefit was equivalent to what they would have paid for a bank guaranteed loan.

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4.2.2 The OECD Position: Chapter X (2020)

The OECD's 2020 guidance on transfer pricing for financial transactions was included in Chapter Ten of the updated version of the Transfer Pricing Guidelines and represents the first international multi-lateral agreement ever issued on the subject (OECD, 2020; OECD, 2022) . Within section D of chapter ten (para. 10.154-191), the intra-group financial guarantee treatment within this document aims to provide a balance between the revenue authority view of what constitutes 'benefit' and the shareholder activity defense.

Several basic principles have been enunciated. Prior to determining a fee, the actual relationship and terms of the transaction must be correctly defined. First, a determination must be made as to whether the arrangement is an enforceable obligation, an informal undertaking lacking economic substance, or simply a benefit derived from group membership and therefore not a liability. When an express guarantee allows a borrower to borrow amounts greater than they could independently, then some portion of such amount can be defined as a loan to the guarantor, followed by a shareholding investment into the borrower (Sundar Manivannan & van Straten, 2023). The "benefit" must be real and above those benefits arising directly from being affiliated with the same group (OECD, 2022, paras. 10.164, 10.176).

Most importantly, however, the Guidance considers the fee charged to represent compensation to the guarantor for both the potential contingent risk associated with providing such a guarantee and for any benefit conferred upon the borrower (OECD, 2022, para. 10.173). Since the guarantor generally does not incur substantial costs in issuing a guarantee (only facing a potential loss), if fees were determined based upon actual costs incurred, such fees would undervalue the overall arrangement. Therefore, the Guidance develops an analytical approach examining each side: i.e., the maximum level at which a rational borrower will agree to compensate the guarantor for the savings achieved by obtaining lower interest rates on their loans, and ii.) the guarantor's minimum acceptable level of compensation to ensure that they do not expect to suffer losses and/or incur capital costs on account of extending credit through the issuance of such guarantees (OECD, 2022, paras. 10.177, 10.180). Each of these factors should be thoroughly evaluated and quantified in conjunction with all other elements relevant to such arrangements.

Finally, another important aspect of this new Chapter One is the development of an allocation of risk framework which was established in conjunction with the revisions to Chapter One after BEPS. For a party to be treated as bearing risk and entitled to a return for doing so, it must both (i) have the financial capacity to bear the risk and (ii) exercise control over it (OECD, 2022, paras. 1.56–1.106). A guarantee issued by a shell entity with no real assets, or by an entity that plays no substantive role in assessing or managing the credit risk of the guaranteed subsidiary, is unlikely to support a guarantee fee: the entity neither bears economic risk in any meaningful sense nor has the functional profile that would justify a return for risk-bearing.

4.2.3 Quantifying the Benefit: Methods Recognised Internationally

Once it is established that a chargeable benefit exists, the question becomes one of quantum. Chapter X identifies several approaches, each with significant practical limitations in the intra-group context, and declines to rank them (OECD, 2022, paras. 10.171–10.183):

1. The Comparable Uncontrolled Price (CUP) Method. Where publicly available data on guarantees between independent parties exist, they can in principle be used directly, and internal comparables (for example, guarantees the group has obtained from banks) may also be relevant. In practice, independent guarantees of the kind given within groups are uncommon, so reliable comparables are scarce (OECD, 2022, para. 10.172).

2. The Yield Approach (Interest Saved). This method compares two rates: what the subsidiary would pay on its own credit standing (taking account of implicit support) without the guarantee, and what it actually pays with the guarantee in place. The gap between them, in basis points, is the economic value created (OECD, 2022, paras. 10.174–10.176). The full spread sets only the maximum fee, since an independent borrower would gain nothing by paying away the entire saving (OECD, 2022, para. 10.177). The Guidance does not prescribe how the saving should be shared; the split in a given case turns on the parties' bargaining positions and the realistic alternatives available to each.

3. The Cost Approach and the Valuation of Expected Loss. These view a guarantee as similar in structure to

an insurance contract; and they price it based on what the insurer expects to lose in terms of the likelihood that the subsidiary will fail to meet its obligations (the "probability of default") times the amount lost when this happens ("loss given default"), adjusted for the recovery rate and term of the obligation, plus an additional amount for the capital required to absorb potential losses associated with the contingent obligation (OECD, 2022, para. 10.179-10.180). Because expected loss can be calibrated against default statistics published by rating agencies, these approaches produce a fee that is less sensitive to prevailing interest-rate conditions and more sensitive to credit-risk modelling assumptions. The result marks the minimum fee a guarantor would accept (OECD, 2022, para. 10.180).

4. The Capital Support Method. Where the difference between the borrower's and the guarantor's credit standing reflects a difference in their capitalisation, this method estimates the additional capital the borrower would need to reach the guarantor's credit rating in the absence of the guarantee, and prices the guarantee by reference to the return on that notional capital (OECD, 2022, paras. 10.182–10.183).

Within the cost and expected-loss approaches, the Guidance recognises that the expected loss and capital requirement can be estimated with different models, including credit default swap pricing and option pricing (OECD, 2022, para. 10.179). Both are widely used:

(a) Credit default swap (CDS) models. These attempt to derive a market-based price by reference to the cost of purchasing credit protection on the borrower's debt in the CDS market. A CDS is, in economic terms, very similar to a guarantee: the protection seller promises to compensate the protection buyer for losses resulting from the reference entity's default. The main technical constraints to employing these methods relate to the limited number of active CDS contracts referencing the debt obligations of non-listed affiliates of multinational enterprises (MNEs), especially those located in emerging or developing economies. This means there will be significant comparability adjustments required when implementing this method, and therefore a considerable amount of uncertainty.

(b) Models of option pricing. Based upon the structural credit model of Merton (1974) and subsequent researchers' work, this alternative views the guarantee as being analogous to a call option granted by the guarantor to the lending subsidiary. In this scenario, the guarantor's potential exposure will mirror that of an entity that writes a call option with a strike price equal to the amount of the lending subsidiary's outstanding liabilities. Therefore, if the value of the lending subsidiary's assets fall below its liability obligations (i.e. the lending subsidiary defaults), the call option will be exercised and the guarantor will bear the resulting losses. Financial economists have developed mathematical formulas for calculating this contingent claim using information regarding the value of the subsidiary's assets, the volatility of such assets, the total amount borrowed by the subsidiary and the term of the loan. While this theoretical framework is attractive due to its strong roots in financial theory and because it is built upon widely accepted concepts of finance, it requires a considerable amount of data. Additionally, since many private companies do not provide public information regarding their asset volatility, it may also require some speculative estimates.

There is no single analytical technique that all users agree is superior. Accordingly, the OECD Guidelines decline to endorse any one particular methodology and rather suggest that users identify the best available method according to how accurately they define each element of the transaction; how accurately they can describe the roles performed by each party involved in the transaction; and how much reliable data exists with regard to the relevant elements of the transactions. Such standards demand case-by-case analysis, are always subject to varying interpretations and thus lend themselves to disputes.

4.3 The Baseline Question: Implicit Support

A conceptually prior and practically consequential issue is the baseline against which the benefit of an explicit guarantee should be measured. Should the analysis compare the guaranteed rate with the rate the subsidiary would obtain in the complete absence of any group connection (a purely hypothetical stand-alone entity with the subsidiary's assets and operations but no parental backing whatsoever), or with the rate it would obtain as a member of the group but without the specific explicit guarantee? Chapter X adopts the second baseline: the effect of group membership on the borrower's credit standing is taken into account first, and only the benefit of the explicit guarantee beyond that is considered (OECD, 2022, paras. 10.76–10.80, 10.164, 10.176).

The distinction carries significant financial consequences. Rating agencies have used group rating approaches for decades. Under them, a subsidiary of a strong group, especially a strategically significant or wholly owned one, may receive a higher credit rating than its stand-alone financial performance would warrant, on the presumption that the parent would provide extraordinary support in a time of stress rather than allow the subsidiary to fail. The impact on the subsidiary's rating from an explicit guarantee may therefore be much smaller than assumed by tax authorities if the implied support already included in the baseline assessment of the subsidiary has already taken account of the benefits of being part of the same group: tens of basis points rather than the hundreds of basis points that some tax authorities assume for their calculations when they ignore entirely both the existence and extent of implicit support.

A very narrow interpretation exists whereby a taxpayer's reliance on a deliberate interpretation that ignores the existence of implicit support is treated as part of the baseline for evaluating whether a particular passive affiliation will create a taxable "chargeable transaction." In this view, transfer pricing evaluates economic status based upon agreements, undertakings or services agreed to by parties, rather than based upon their economic status. A corporation's status as a member of a larger group is merely a factual statement regarding the corporate structure of such corporation (OECD, 2022, paragraphs 7.13 & 10.78).

However, given the nature of determining the subsidiary's implied baseline rating which includes all of the benefits from being part of a group but does not include any benefits from having an explicit guarantee, there exists considerable subjectivity involved in making the required judgments to accomplish such determination. The judgmental process used to determine the amount of group support uplift applied by rating agencies is not done with sufficient specificity to allow precise translation to an appropriate number of basis points required in a typical transfer pricing analysis. Thus, the degree of uncertainty created by such determinations leads to disputes between taxpayers and taxing authorities well prior to any debate over how to allocate fees among members of a consolidated group (Pletz, 2019)

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4.4 The Indian Position: A Markedly More Contested Landscape

India has generated one of the largest volumes of transfer pricing litigation on guarantees of any country, reflecting both the global reach of Indian multinational groups and the historically aggressive stance of the Indian tax administration on transfer pricing adjustments. The case law has developed considerably: from an early line holding that no-cost guarantees fell outside the definition of "international transaction", exemplified by *Bharti Airtel*, to a more fact-specific body of later decisions treating guarantees as chargeable, with the Safe Harbour Rules offering a fixed rate for taxpayers who opt in. The Supreme Court has not yet delivered a reasoned ruling on the merits, although it has declined to interfere with a High Court decision on guarantee rates (*Glenmark Pharmaceuticals*, 2018).

4.4.1 The Statutory Backdrop

Section 92B(1) of the Income-tax Act, 1961 defines "international transaction" as a transaction between associated enterprises involving, among other things, the provision of services, lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises. The Finance Act, 2012, was amended with retroactive application from April 1st 2002. The amendments defined capital finance as including any form of short- or long-term financing through loaning or guarantying. The changes were an immediate result of legislative action taken in reaction to taxpayer arguments presented during early assessments that guarantees were outside of the definition of “International Transaction” since they did not include a payment of money or a transfer of assets between the two parties. However, the retroactive nature of these amendments have also been challenged. In addition to the challenge of its applicability prior to the enactment of the amendment, some courts have refused to apply it retrospectively. For example, in Siro Clinpharm (2016).

Beginning on April 1st 2026, the Income Tax Act, 2025 will replace the Income Tax Act, 1961. Since the substantive provisions relating to transfer pricing are similar under both Acts, the issues related to transfer pricing should be applicable under the new act as well.

4.4.2 Bharti Airtel and the "No Bearing on Profits" Line

In Bharti Airtel Ltd. v. ACIT (2014), the Delhi Bench of the Income Tax Appellate Tribunal ruled that a Corporate Guarantee given by an Indian company to a Bank for the benefit of its Foreign Subsidiary, where no Guarantee Commission was paid, was not an International Transaction subject to Transfer Pricing Adjustment under Section 92A. The Tribunal based their decision upon the fact that a transaction can be considered as per Section 92B(1) only when the transaction has an influence over the profits/income/ losses/assets of the Enterprise. The Tribunal stated that the burden rested with the Revenue to demonstrate that the effect is a real, either past or future, effect and not merely a hypothetical or speculative effect. Any assistance provided by the assessee at no cost and that would not normally be available to it from other parties were deemed to lack such an influence.

Therefore, the Tribunal declined to accept what may be referred to as a "Benefit Theory" of adjustments put forth by the Revenue, i.e., any economic benefit accruing to the Subsidiary without more provides sufficient justification for an adjustment. This rationale of the Bharti Airtel case has been upheld in subsequent cases, e.g., Videocon Industries Ltd. v. ACIT (2015).

Furthermore, in Micro Ink Ltd. v. ACIT (2015), the Ahmedabad bench took the position that issuance of a corporate guarantee constitutes a Shareholder Activity or Quasi-Capital (i.e., an entrepreneurial action taken to protect the Parent Company's investment) as opposed to provision of services for consideration. Additionally, the Micro Ink case makes a clear distinction between corporate guarantees and bank guarantees. When banks issue guarantees, they are providing a service related to their primary business of credit intermediation and receive payment for premiums based on risk, regulatory capital requirements, and operational expense. On the other hand, a parent issuing a guarantee for its subsidiaries' obligations does so in order to act as an equity holder protecting its interest; the parent is not engaged in commercial lending activities. Therefore, treating these types of transactions similarly is viewed as inappropriate because one type of transaction is fundamentally different from the other. The Bombay High Court endorsed the same distinction in *CIT v. Everest Kanto Cylinders Ltd.* (2015), holding that the commission charged by commercial banks could not be used to benchmark a corporate guarantee.

4.4.3 The Subsequent Shift: Guarantees as International Transactions

The *Bharti Airtel* approach did not go unchallenged for long. Other tribunal benches, including the Mumbai bench in *Everest Kanto Cylinders*, treated corporate guarantees as international transactions, and the dispute in that case moved to the appropriate rate, where the tribunal's figure of 0.5% was upheld by the Bombay High Court (*CIT v. Everest Kanto Cylinders Ltd.*, 2015). In *PCIT v. Redington (India) Ltd.* (2020), the Madras High Court treated guarantees given by the taxpayer to its subsidiaries as financial services for which remuneration was required, and later tribunal decisions have relied on it to reject the shareholder activity argument. The dividing line that emerges is between a guarantee that is demonstrably value-neutral, for instance where the subsidiary's own credit standing was already sufficient to obtain the same financing on comparable terms, and one that materially improves the subsidiary's borrowing position in a way that an independent party would have priced.

Performance guarantees, which secure the performance of a contract with a third party rather than the repayment of a financial debt, raise distinct questions. They are not financing transactions in the ordinary sense, and their pricing cannot simply borrow the methods developed for financial guarantees (Deshpande, 2017). Indian practice on this category is less settled than on financial guarantees.

What develops from these determinations is a layered, fact-based structure. Most explicit financial commitments to reduce loan cost are considered chargeable international transactions; however, performance guarantees without a financing component do not fit as well in this framework. Letters of comfort with no legally-binding obligations create ambiguity for treatment based upon the terms of the documents and the degree of reliance demonstrated by lenders.

4.4.4 The Safe Harbour Rules

The Central Board of Direct Taxes has tried to reduce this uncertainty through the Safe Harbour Rules in Rule 10TD of the Income-tax Rules, 1962, which cover corporate guarantees specifically. When first notified in 2013, the rules required a commission of at least 2% per annum on guarantees to a wholly owned subsidiary of up to ₹100 crore, and 1.75% on larger guarantees

where the subsidiary had an adequate credit rating (Notification No. 73/2013). The rules were revised in 2017 (Notification No. 46/2017) so that an Indian entity charging at least 1% per annum on the amount of a corporate guarantee provided to its wholly owned subsidiary is accepted as having priced it at arm's length, without a monetary threshold. They have since been extended by successive notifications, most recently to financial years 2024-25 and 2025-26 (Notification No. 21/2025).

Reception to the 1% rate has varied. For taxpayers, it provides a degree of certainty that allows compliance to be managed around a known number, eliminating much of the uncertainty of open-ended disputes. For the tax administration, it reduces opportunities for structuring guarantees at no cost. However, when it comes to administering the policy, the 1% rate is not a very flexible policy choice. It does not take into consideration either the creditworthiness of a subsidiary. It does not distinguish between a very creditworthy subsidiary, which may actually have an arm's length fee lower than 1% and one having financial problems, for which the arm's length fee could exceed the 1% mark by a large margin. The downside of simple administration of the tax policy lies in lack of accuracy in pricing, which explains the reason why many taxpayers opted for litigation rather than compliance with the tax obligation.

4.4.5 The Going Rate: Indian Benchmarking Practice

When an intra-company guarantee is found by tax authorities or tribunals to be subject to fees and the Safe Harbour rule does not apply, then usually it is necessary to determine how much of a fee should be charged. Transfer pricing officers will frequently use bank guarantee rates to compare against which they then argue for around 3 % per annum. Tax payer's have typically argued that because a corporate guarantee given from parent to subsidiary carries a lot less risk than that of third party guarantees, therefore bank rates are inappropriate. In addition, tax payers have also argued that bank charges include costs associated with regulatory capital that do not exist in an intra-group transaction. Tribunals have typically agreed with this position and thus have rejected the use of bank rates as a comparison for determining the appropriate rate of fees for such arrangements. (Thomas Cook (india) ltd. V. ACIT, 2016; cit v. Everest kanto cylinders ltd., 2015). The rates of fees determined for these types of transactions has been typically in the range of 0.2 % per annum up to 1.5 % per annum. However, based upon all available information 0.5 % per annum is the rate that has been applied most consistently. For example, in Glenmark Pharmaceuticals (2018), the rates of 0.53 % per annum and 1.47 % per annum were approved and left unchanged.

4.5 Comparative Jurisdictional Approaches

This situation is representative of a large number of countries around the world. Each country addresses similar issues differently as far as legislation and administration are concerned:

• United States. Section 482 of the Internal Revenue Code applies the arm’s-length standard to all controlled transactions. The Treasury Department finalized the Services Regulations in 2009, providing that a group member will not obtain a chargeable benefit solely because of its passive association within the group (Treas. Reg. § 1.482-9(l)(3)(v)). There have been court cases regarding whether guarantee fees represent a “source of income.” In Container Corp. v. Commissioner (2010), the Tax Court ruled that the fees paid by a U.S. Subsidiary to its Mexican Parent for guaranteeing its notes were akin to receiving payment for performing services in Mexico; accordingly, they represented foreign-source income, not subject to withholding in the U.S.; the Fifth Circuit supported this ruling in 2011. The Congress then enacted Section 861(a)(9) into law via the Small Business Jobs Act of 2010, stating that all future guarantee fees collected by U.S. persons for issuing guarantees after 27 Sep 2010 shall constitute U.S. Source Income.

• United Kingdom. As mentioned earlier, there is a transfer pricing law in place in the United Kingdom; however, unlike most other countries, it is part of regular tax laws, rather than separate legislation. Part IV of TIOPA 2010 is intended to mirror the OECD Transfer Pricing Guidelines. Specific guidelines for guarantees and implicit support can be found in HMRC’s International Manual (HMRC, n.d.-a, n.d.-b). With regard to borrowing after January 1, 2026, new provisions, including a new provision in Section 153A, intend to make the U.K.’s rules consistent with Chapter X – when a guarantee allows a borrower to borrow additional funds beyond what independent lenders would lend to them, the amount above that is considered non-arm’s length; thus, any guarantee fee deductions related to that

excess cannot be taken (HMRC, n.d.-a).

• Australia. The Australian Taxation Office (ATO) published its opinions on cross border guarantees in a 2008 Discussion Paper titled Cross-Border Intra-Group Finance Guarantees & Loans (ATO, 2008). While this case does not address guarantees directly, it is perhaps one of the leading authorities on the issue of cross-border borrowing and guarantees at present. Chevron Australia Holdings Pty Ltd v Commissioner of Taxation (2017) was decided by the Full Federal Court. It states that if an unrelated party had obtained a related-party loan (independent lender), it would include obtaining a guarantee from its parent company as well; consequently, parental support may enter into the cost of intra-group debt regardless of whether an explicit guarantee exists.

• China. Article 41 of the Enterprise Income Tax Law (2007) requires related-party transaction prices to be determined using the arm’s length principle. Special tax audits and assessments are governed by Public Notice #6 issued by the State Administration of Taxation [2017]. Because published guidance specifically addressing intra-group guarantee fees is limited, whether a deduction can be taken for a fee paid by a Chinese subsidiary to an off-shore guarantor and/or whether the fee is required to be withheld will depend upon applicable general laws and administrative practices.

• Canada. Section 247 of the Income Tax Act contains Canada's transfer pricing rules. The leading case worldwide on guarantee fees is Canadian: in *General Electric Capital Canada Inc. v. The Queen* (2009), the Tax Court of Canada considered guarantee fees of 1% per annum paid by the Canadian subsidiary to its U.S. parent for its 1996–2000 taxation years. The Court held that implicit support from the parent had to be taken into account in determining the arm's length price, and that the fees paid did not exceed an arm's length amount. The Federal Court of Appeal dismissed the Crown's appeal, confirming that "the existence of the implicit guarantee is relevant to the inquiry" (*The Queen v. General Electric Capital Canada Inc.*, 2010).

• Singapore. Since the sixth edition of its Transfer Pricing Guidelines (2021), the Inland Revenue Authority of Singapore (IRAS) has expected taxpayers to follow the OECD guidance on financial transactions, including financial guarantees, and recognises that implicit support may be relevant in assessing a borrower's creditworthiness (IRAS, 2021). This approach is consistent with Singapore's role as a regional holding company and treasury centre, where guarantee arrangements are common.

4.6 Withholding Tax and Characterisation Issues

Once a guarantee fee has been identified as liable to tax, the question of how the host country's source characterises that fee for purposes of withholding tax arises, as does the question of how the relevant double tax treaty divides taxing rights over that fee. Under the OECD Model Convention, the term "interest" is defined as income from the receipt of debt claims of any nature (OECD, 2017, art. 11(3)), but a guarantor does not hold a debt claim against the borrower, thus creating a misfit. The United States has dealt with the source issue through legislation; however, the majority of other countries have not done so.

Countries have classified guarantee commissions in different ways, either as fees for technical services, as interest, or as business profits, leading to vastly different withholding rates depending on the classification of the income under most bilateral treaties.

• Fees for technical or other services. In many countries, developing countries impose an income tax on fees for technical or other services charged to a non-resident person at source. One such example is India, where the withholding tax on the fee is set at 20% under in accordance with section 115(A) of the Income Tax Act 1961. In other cases, depending on the double tax treaties (DTTs) that India has signed with other countries, the rate of withholding tax may be reduced to either 10% or 15%. However, regardless of whether the fee is classified as one for technical services, there may be arguments that the classification will not hold any merit since the guarantee is a contractual obligation but does not involve any technical knowledge or expertise.

• Interest. In some countries, guarantee fees have been characterised as interest on the ground that such fees effectively represent a cost of borrowing and therefore should be treated in the same manner as the underlying interest-bearing debt. The withholding tax on interest, as defined under bilateral treaties, typically ranges from 10% to 15%, which may differ from the rate applicable to service fees in some treaties. This classification of guarantee fees as interest may result in significant planning implications.

• Business profits or other income. Under the business profits article of OECD-model treaties, the fee is only taxed in the country of residence of the guarantor unless the guarantor is engaged in business activities in the source jurisdiction. In this regard, the OECD Model's other income article also determines other income to be taxed in the country of residence. On the other hand, the UN Model allows the taxing of other income in the source jurisdiction (United Nations, 2021, art. 21(3)). Although taxing business profits in the residence jurisdiction is the most favourable outcome for the recipient, it is very difficult to prove given the fact that the guarantee has formed part of a broader financial services relationship.

Whether a guarantee fee will be subject to withholding tax remains unsettled from an international perspective and different treaty networks will handle structurally identical transactions differently. Groups that have not explicitly dealt with this issue in their guarantee agreements and internal documentation may be exposed to unexpected withholding tax as a result of their classification of the fee as routine treasury receipts in their own ledgers.

4.7 BEPS, Pillar Two and the Evolving International Framework

Given the dynamic nature of the international framework, it is worth considering how the global minimum tax (Pillar Two) fits within the larger BEPS reform agenda. The BEPS principles of substance, transparency and linking profit to actual economic performance are also changing the way transfer pricing authorities examine guarantee arrangements that may previously have been below their radar.

BEPS Action 4 addressed the deduction of interest and economically equivalent payments, recommending a fixed-ratio rule that caps net interest deductions at between 10% and 30% of EBITDA. The report expressly lists guarantee fees with respect to financing arrangements among the payments economically equivalent to interest (OECD, 2015). India's version of the rule, section 94B of the Income-tax Act, 1961, introduced by the Finance Act, 2017, limits deductions for interest paid on debt from non-resident associated enterprises to 30% of EBITDA. Importantly for present purposes, it deems debt issued by an unrelated lender to have been issued by an associated enterprise where an associated enterprise provides an implicit or explicit guarantee to that lender. A guarantee can therefore have two separate tax consequences: a fee that must be charged at arm's length under transfer pricing rules, and a cap on the deductibility of interest on the guaranteed debt under the interest limitation rules. This new combination could result in a negative event for which no single set of rules had been created.

Pillar two brings another level of complexity into play with a global minimum tax of fifteen percent (15%) on the profits of all multinational enterprise (MNE) Groups operating in each jurisdiction. The effective tax rate (ETR), as defined within the GloBE Rules, will be determined by combining the GloBE income and covered taxes from each entity within the jurisdictions (OECD, 2021, Article 5). Fees recognized as income by a guarantor in a low-tax jurisdiction can reduce the jurisdictional ETR below fifteen percent (15%), thereby triggering a supplemental tax collected via the Qualified Domestic Minimum Top-Up Tax (QDMTT) in that same jurisdiction or, if QDMTT cannot be implemented, under the Income Inclusion Rule or the Undertaxed Profits Rule. In the paying subsidiary's jurisdiction, a deductible guarantee fee reduces GloBE income; because it usually also reduces covered taxes, its effect on that jurisdiction's ETR depends on the local tax rate and other adjustments.

The net effect of Pillar Two on guarantee fee planning is that the traditional strategy of locating the guarantor in a low-tax jurisdiction to shelter fee income may yield little benefit for in-scope groups, since the shortfall would be collected through a QDMTT in the guarantor's jurisdiction, by the parent jurisdiction under the IIR or by other jurisdictions applying the UTPR. At the same time, the substance-based income exclusion, which shelters a return on the payroll and tangible assets of an entity from top-up tax (OECD, 2021, art. 5.3), offers little protection to shell or holding company guarantors that have no real operational substance where they are established. The combined effect of transfer pricing rules and Pillar Two may, over time, substantially erode the tax planning utility of guarantee fee arrangements involving low-substance guarantors in preferential tax regimes.

5. Implications

5.1 Implications for MNE Groups

As a result of the significant uncertainties involved in determining the level of "chargeability" and also the amount of "guarantee fees", in addition to the increasing complexity of tax authority audit practices

in relation to these issues, prudent multinational enterprise (MNE) groups will need to develop common, minimum standards for managing "transfer pricing risk" related to guarantees:

1. Contemporaneous Benefit Analysis. Document the standalone credit rating of the subsidiary (with consideration of the impact of any implied support but without reference to the guarantee) prior to issuing a guarantee; record the rating or the lending terms achieved with the guarantee; and document the resultant interest rate reduction or improved access to finance benefit. This contemporaneous documentation will become critical evidence in resolving disputes that may arise regarding whether there is a chargeable benefit. It is recommended that the credit rating process follow a recognized methodology, for instance the published corporate rating methodologies of the major rating agencies. Additionally, a qualified credit analyst should perform or verify the credit rating analysis versus relying solely on an estimate from the group's treasury department.

2. Common Group-Wide Policy. There is no doubt that tax authorities take note of situations where an MNE charges guarantee fees in certain jurisdictions but does not do so in other jurisdictions for similar arrangements. For example, in TVS Supply Chain Solutions Ltd. v. DCIT (2026), the taxpayer relied upon the 1% fee it charged to some foreign subsidiaries as an internal comparable for a zero-cost guarantee provided to another affiliate. These inconsistencies undermine the "shareholder activity defense" wherever it is advanced. The first step toward establishing a credible position is to establish a uniform groupwide policy for charging guarantee fees, which can be incorporated into an intercompany agreement framework, and be consistently applied and periodically reviewed.

3. Selecting and Defending a Pricing Methodology. MNEs should choose a pricing methodology and utilize it consistently across intragroup guarantees. While the yield method has been found to be relatively simple and based on observable interest rates compared to other methods, most commonly utilized in these types of analyses, utilizing two methods when possible (e.g., Pletz, 2019), i.e., one method being more conservative than the other, would provide corroboration for the selected methodology. Documentation for the selection of comparables, any necessary adjustments to account for differences between controlled and uncontrolled transactions, and any resultant arm's-length price ranges should also be documented.

4. Identifying Types of Guarantees. Taxation and transfer pricing treatment vary substantially depending on type (performance guarantee vs. financial guarantee); therefore, each type should be analyzed and documented individually. In both the legal documentation and transfer pricing analyses, performance guarantees typically relate to operational risks associated with a contractual commitment whereas financial guarantees relate to credit risk associated with a debt obligation.

5. Treaty Characterization Review. If an MNE charges a fee for providing a guarantee, it is important to identify its characterization as either taxable or exempt from withholding taxes under the applicable double taxation treaty before filing returns and reports and applying it consistently throughout the MNE's tax filings and financial reporting. If an MNE has genuine doubts about treaty characterization, they may wish to consider whether an Advance Pricing Agreement ("APA") or Advance Ruling ("AR") is available in their relevant taxing jurisdiction.

6. Master File and Country-by-Country Reporting. Pursuant to the BEPS Action 13 Standard, the Master File should contain information describing how the MNE is financed, including its intercompany financing activities (OECD, 2022, Chapter V, Annex I). Additionally, Country-by-Country Reporting ("CbCR") applies to MNEs with total consolidated group revenue exceeding EUR 750 Million. India implemented this framework pursuant to Section 286 of the Income-tax Act 1961, using separate thresholds for the Master File, specifically outlined in Rule 10DA of the Income-tax Rules, 1962. An MNE's failure to disclose guarantee arrangements within their Master File and/or Local File and/or Country-by-Country Report and/or inconsistent disclosure thereof across the foregoing documents provides clear audit risks.

5.2 Implications for Tax Administrations and Policymakers

The analysis for tax administrations indicates it is very likely that any appeals will be successful if benchmarking the level of guarantee (guarantee) against bank guarantee levels, or ignoring potential implicit government support are utilized. Tax authorities should therefore concentrate their audit

efforts on assessing the baseline creditworthiness and ability of the guarantor to assume the financial burden associated with providing such a guarantee. Policymakers in India may wish to consider establishing a single "safe harbor" rate (i.e., 1%) as an alternative to potentially lengthy litigation, although this approach provides little accuracy. An additional alternative could include developing a few different "bands" for rates based on the credit worthiness of the guaranteed entity. Such an alternative would provide some benefit from maintaining simplicity, while possibly reducing litigation incentives. Additionally, clarification regarding performance guarantees and letters of comfort by statute or through administration would help minimize dispute.

6. Conclusion

Transfer Pricing Law, Corporate Finance Theory & Credit-Risk Economics meet at a difficult point. A guarantee does not involve a transfer of assets nor typically a cash outlay; however, a Guarantee can have a significant impact upon the recipient's economic position. As tax administrations strive to create a tax base where all value received (across national borders) results in a recognized taxable event, they have been pushing to treat explicit Financial Guarantees as Chargeable Transactions requiring Arm's Length Compensation. Conversely, taxpayers have resisted the complete loss of the Shareholder Activity Doctrine as it has historically limited the ability of Transfer Pricing Law to recognize/charge for the normal risks of share ownership.

The OECDs 2020 Chapter X Guidance attempts to strike a middle ground. While maintaining the Shareholder Activity and Passive Association Carve-Outs in Principle, the OECD insists that these doctrines should be carefully defined and supported by Facts-Specific Evidence prior to their invocation. Further, the OECD provides a Structured Framework (although disputed), for determining charges for Guarantees when they are deemed Chargeable. This Guidance creates a common language for both taxpayers and Revenue Authorities who were previously unable to speak about this topic. The influence of this guidance can be seen throughout the countries studied herein including the U.K.'s forthcoming 2026 Legislation, Singapore's Guidelines, and the reasoning of Tribunals in India. However, as noted above, the level of compliance among the countries studied varies significantly.

India's experience illustrates how difficult it can be, even within a single jurisdiction with an established Appellate System, to determine whether there are stable Answers to Doctrinal/Empirical Questions. The Doctrinal Side (i.e., What constitutes a Transaction? What constitutes Shareholder Activity? What constitutes an Arm's Length Price?) can be reasonably clearly articulated. Conversely, the Empirical Side (i.e., What Specific Guarantee was actually Worth in a Specific Market at a Specific Time) cannot be easily resolved.

Further, the addition of Pillar Two introduces additional complexity into an already complex picture. Although the interaction between Transfer Pricing Laws and the GloBE Rules has not yet been fully developed, it is expected that the application of these laws will reveal how they affect existing Guarantee Arrangements - especially those utilizing Low-Substance Guarantors in Preferential Jurisdictions. Therefore, future Research could Test the Findings of this Study using Empirical Methods (e.g., compiling a Dataset of Tribunal Outcomes and Comparing Awarded Fees with Credit Spreads).

It appears that the Assumption that Intercompany Guarantees are Free Administrative Conveniences that go Unnoticed may be coming to an End. Organizations that continue to enter into large guarantees without a concurrent Benefit Analysis; a Group-Wide Pricing Policy; a Defensible Quantification Method; or a Considered Treaty Characterization will assume greater Risk under the Laws of India and the United States - as well as any other Country that utilizes the OECD Chapter X Framework. Compliant Infrastructure must evolve at the same rate as the Arm's Length Principle evolves toward the Guarantee Desk.

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