



DIRECT TAX SPOTLIGHT

INTRODUCTION

This edition brings you a significant update on Direct Tax, designed to keep you informed and ahead in an evolving regulatory landscape.

We trust you will find the insights useful, relevant, and timely.

NITI AAYOG WORKING PAPER ON “ENHANCING CERTAINTY, TRANSPARENCY AND UNIFORMITY IN PERMANENT ESTABLISHMENT AND PROFIT ATTRIBUTION FOR FOREIGN INVESTORS IN INDIA”

A. Niti Aayog has come up with a working paper on taxation of Permanent Establishment (PE) in India. The paper recognizes the importance of foreign direct investment (FDI) and foreign portfolio investment (FPI) in India's Economic Growth. It further acknowledges the role of stable, predictable, and transparent tax regime in instilling confidence of such foreign investors in India. It highlights that an unexpected PE trigger could lead to substantial and unforeseen tax liabilities on income arising out of Indian operations, which deter investments in India. To tackle this issue of determination of PE and thereafter attribution of income to the same, the Niti Aayog has come up with suggestions in their working paper. The said suggestions are summarized below:

- 1) Legislative Clarity and Certainty:** The working paper recommends codification of clear principles to determine PE and the profit attribution thereto under the domestic law. This will promote predictable and stable tax environment in the country.
- 2) Enhanced Stakeholder Engagement:** The working paper recommends provision for formal and transparent mandatory public consultation with industry bodies, tax experts, and foreign

investors association for all proposed significant tax policy changes affecting international investors.

3) Robust Dispute Resolution Mechanisms: The working paper calls for significant investment to expand the capacity of Advance Pricing Agreement (APA) and Mutual Agreement Procedure (MAP) programs, with the aim of drastically reducing resolution timelines for managing both prospective disputes (APAs) and existing disputes (MAPs). Further, adopting standardized system such as the OECD's TRACE is recommended for streamlining withholding tax collection and treaty relief procedures for cross-border investments.

4) Capability Building and Consistency: The working paper highlights the need of training programs for the Assessing Officers to keep them up to date with international tax issues. It further recommends that India must continue to actively engage in the ongoing Pillar One and Pillar Two discussions to shape the global tax landscape. Further it recommends adapting India's domestic framework to ensure coherence with evolving international consensus.

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5) Introduction of Optional Presumptive Taxation Scheme: The working paper introduces an optional Presumptive Taxation Scheme for foreign companies, with industry-specific profit rates deemed as taxable. The salient features of the proposed schemes are as follows.

- **Industry Specific Presumptive Profit Rates –** Specific business models/ sectors have been assigned a deemed profit percentage on gross receipts earned in India.

S. No.	Industry/ Sector	Proposed Presumptive Profit Rate (on gross receipts)
1.	Infrastructure Construction/ EPC	10%
2.	Engineering Services/ Oilfield Services	10%
3.	Telecom/ Technology Equipment Supply with installation	5% (Supply portion), 20% (Services Portion)
4.	Digital/ E-commerce (Online platforms, streaming, etc.)	30 % of gross revenue from Indian users.
5.	General Services (Consultancy, Management, Software)	20% of gross fees.
6.	Marketing and Distribution support.	15 % of gross revenue from India.

- **Optional Regime (Rebuttable Presumption):** A foreign company can choose to opt in for a given financial year, declare income as per presumptive percentage, and pay tax. If it believes its actual profits attributable to India are lower than the presumptive figure, it can opt out and file a normal tax return with supporting audited Indian books. This opt-out mechanism ensures the scheme aligns with tax treaties and the principle of taxing only “actual” profits, ensuring fairness.
- **No Separate PE Determination Needed (Safe Harbour):** If a foreign company opts for the proposed scheme for presumptive taxation for a particular activity, the tax authorities would not separately litigate the existence of a PE for that activity.
- **Safe Harbour for PE Attribution:** It is recommended to explicitly notify that transfer pricing principles would be used for determining profits attributable to a PE. Existing safe harbour rules (Section 92CB) should be expanded to include transaction and remuneration approaches, along

with arm’s length rates for PE attribution, providing greater clarity and streamlining compliance.

- **Advanced Pricing Agreement (APA) for PE Attribution:** It is recommended that the CBDT should actively promote bilateral APA negotiations involving PE attribution, particularly in cases where foreign enterprises operate in India through branches or project offices. A formal framework outlining modalities for bilateral APA negotiations, including acceptable attribution methods, documentation standards, timelines, and coordination protocols with treaty partners, should be laid down. Clarity on access and procedure for multilateral MAP or APA in triangular structures, involving more than two jurisdictions, is also crucial to reduce double taxation and enhance certainty for multinational groups with integrated operations.
- **Coverage of Taxation Scope:** It is proposed that the presumptive provisions should clarify that when income is offered to tax under them, such income shall not be subject to any other provision of the Income Tax Act that could yield a higher tax.
- **Administrative Simplicity and Audit:** For those opting in, compliance should be straightforward, with exemption from maintaining detailed accounts in India for those activities. If opting out and claiming lower profits, maintaining and potentially auditing India related accounts would be required, acting as a deterrent against frivolous opting-out.
- **Treaty Eligibility for US LLCs:** Treaty eligibility under the India US DTAA should be explicitly extended to fiscally transparent US LLCs that meet Limitation of Benefits (LOB) criteria, facilitating dispute resolution access to APA and MAP mechanisms for such entities.
- **Scope of Activities and Nexus:** The rules should enumerate the types of Indian activities and income each presumptive rate applies to, aligning with common dispute scenarios such as construction/EPC projects, provision of services, royalty/technology-intensive sectors, and digital/e-commerce streams.



B. As a next step, it is recommended that Ministry of Finance consider these recommendations, possibly constituting a working group to draft the legal provisions, consulting with stakeholders (industry bodies, tax professionals, treaty partners), and include the final proposals in an upcoming Finance Bill.

Our Comments:

It is a trite to say that India's judicial system is bursting at seams and matters linger before Tribunals and courts for decades. Judicial delays in tax domains are more pernicious as these inject uncertainty in the entire taxation system. Advance Rulings is one way of by-passing a clogged judicial system, presumptive taxation is another. Therefore, the proposed scheme of presumptive taxation for foreign entities investing in India suggested by Niti Aayog is a welcome step, if designed and implemented carefully it can give reassurance of tax stability to foreign investors. An optional rebuttable system with safe harbours and APAs will be welcomed by MNEs.

The proposal expands the existing presumptive regimes of Section 44BB (10% for oil/ gas) and 44BBD (25% for electronics services) to certain other important sectors where foreign investment would be welcome.

Two problems arise in designing presumptive taxation schemes. One, defining classification criteria for eligible entities precisely. If classification criteria are not well-defined this itself becomes a source of fresh litigation. Two, optimizing profit attribution rates. If profit rates are not optimized, these may result either in erosion of revenues or in an uneven playing field. The key to Scheme's success will lie in determining and notifying optimum profit rates. Higher profit rates would defeat the very purpose of the scheme. Data-driven pilots in high-FDI sectors would be a good idea before notifying profit rates.

It will also be advisable to provide an upper limit of turnover for availing benefit of the scheme to limit revenue erosion.

