NITI Aayog

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Enhancing Certainty, Transparency and Uniformity in

PERMANENT ESTABLISHMENT

and Profit Attribution for Foreign Investors in India

CONSULTATIVE GROUP ON TAX POLICY

Enhancing Certainty, Transparency, and Uniformity in Permanent Establishment and Profit Attribution for Foreign Investors in India

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Foreword

The roadmap for transforming India into 'Viksit Bharat' by 2047 underscores a critical necessity: India's tax policy and processes must not just keep pace with, but actively promote rapid growth and development. Given this ambitious target and India's dynamic economic landscape, it is imperative that our current taxation policy and structure are continually and carefully analyzed to ensure they are fit for purpose.

In a competitive, globalized world, tax schemes are also essential distinguishing criteria that can induce Foreign Direct Investment (FDI) by significantly contributing to the Ease of Doing Business. The government has therefore encouraged the tax administration to foster a fair and friendly reputation among taxpayers, with a focus on simplification of rules and procedures at the same time to be responsive to stakeholder demands, which requires a process of continual consultation. The focus must be on both immediate responses to emerging challenges and deliberate, long-term structural reforms to serve the goal of Viksit Bharat@2047.

As India advances towards its 2047 vision, creating a transparent, predictable, and efficient regulatory and tax architecture is a critical pillar for sustaining long-term economic growth. To this end, NITI Aayog established a **'Consultative Group on Tax Policy'** (CGTP) with a strong emphasis on collaborative governance. Through this consultative approach, various themes have been identified to facilitate the Ease of Doing Business, promote FDI, simplify tax laws and processes, and make the system future-ready.

This document, ***'Enhancing Certainty, Transparency, and Uniformity in Permanent Establishment and Profit Attribution for Foreign Investors in India',*** is the first working paper being released under these themes. The regime governing Permanent Establishments (PE) occupies a central role, as it delineates the taxable nexus for foreign enterprises and shapes cross-border investment flows.

The paper presents a compelling picture of the opportunities available in refining our approach to Permanent Establishments. By providing greater clarity and predictability in our tax regulations, India is poised to attract substantial new foreign investment and encourage existing multinational corporations to expand. The findings of this paper emphasize the importance of clear, consistent, and internationally aligned PE regulations.

While government initiatives to streamline processes are crucial in making India an attractive investment destination, this paper also serves as a critical assessment. While India has demonstrated encouraging growth in attracting foreign capital, structural impediments such as ambiguous PE regulations can continue to hold us back.

I congratulate Dr. P.S.Puniha and members of the Consultative Group on Tax Policy (CGTP) and all other contributors for their meticulous efforts in preparing this report. I hope it serves as a valuable resource for policymakers, industry stakeholders, and researchers alike. We encourage its careful consideration and the proactive implementation of its recommendations to further solidify India's position as a premier global investment hub.

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Executive Summary

Foreign direct investment (FDI) and foreign portfolio investment (FPI) are recognized as vital catalysts for India's economic growth. A stable tax regime is crucial for instilling confidence in foreign investors. However, foreign investors frequently encounter significant tax uncertainty and compliance burdens, particularly stemming from issues related to Permanent Establishment (PE) and the attribution of profits. The complexities and ambiguities surrounding Permanent Establishment (PE) rules and profit attribution methodologies in India have a tangible impact on the inflow of Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). Foreign investors consistently prioritize tax certainty and predictability, as ambiguity introduces a significant risk premium that can either deter investment altogether or push investors towards complex, often indirect, structures designed for tax arbitrage. An unexpected PE trigger could lead to substantial and unforeseen tax liabilities on Indian income, thereby deterring investment. Similarly, unpredictable changes in tax rules or protracted disputes can make India a less attractive destination for capital.

The evolving legal interpretations of PE, notably recent Supreme Court rulings such as the ***Formula One World Championship Ltd. v. CIT*** and ***Hyatt International (Southwest Asia) Ltd. vs. ACIT*** cases, coupled with the complexities of profit attribution and the lingering effects of past retrospective taxation, collectively create an environment that can deter investment.

India's PE jurisprudence has steadily broadened, moving beyond traditional physical presence to encompass "virtual" or service presence. This evolution emphasizes "substance over form" and economic nexus, often leading to frequent assertions of PE by tax officers across various industries. Concurrently, profit attribution has historically been inconsistent, oscillating between aggressive initial assessments, global profit ratio methods, and the "separate enterprise" fiction, with mixed application of the Arm's Length Principle (ALP). This lack of clear, objective standards has resulted in protracted litigation, with major PE disputes often taking anywhere from 6 to 12+ years to reach finality, tying up resources and increasing compliance costs and interest liabilities for foreign firms. India's proactive engagement with global tax reforms, including the Base Erosion and Profit Shifting (BEPS) project (specifically Action 7, Pillar One, and Pillar Two), while aimed at curbing tax avoidance, also introduces new challenges and necessitates strategic adaptation for foreign entities navigating the Indian tax landscape.[1]

[1] BEPS Action 7: Prevention of Artificial Avoidance of Permanent Establishment (PE) Status This action targets schemes used by MNEs to avoid having a taxable presence, or Permanent Establishment (PE), in India. Previously, foreign companies could use agents or warehouses without being considered a PE, thereby avoiding corporate tax. The new rules broaden the definition of a PE, particularly for commissionaire arrangements and other similar structures. This means more foreign companies will likely be deemed to have a PE in India, making them subject to Indian corporate income tax on profits attributable to their Indian operations.

Pillar One: New Nexus and Profit Allocation Rules: Pillar One aims to reallocate a portion of MNEs' profits from their home countries to market jurisdictions where they have sales but lack a physical presence. The core idea is that a company's profit should be taxed where it generates revenue, not just where it has a physical office. This will primarily affect large, highly profitable MNEs, especially in the digital and consumer-facing sectors. Foreign entities will need to reassess their global profit allocation and tax liabilities, potentially leading to a higher tax burden in India if they meet the revenue and profitability thresholds.

Pillar Two: Global Minimum Tax : Pillar Two, also known as the Global Anti-Base Erosion (GloBE) rules, establishes a 15% global minimum effective tax rate for large MNEs. If a foreign entity's effective tax rate in India (or any other country) falls below this minimum, its home country can levy a "top-up tax" to bring the total rate up to 15%. This reform ensures that MNEs can't completely avoid tax by shifting profits to low-tax jurisdictions. For foreign companies in India, this means that even if they benefit from Indian tax incentives or lower statutory rates, they may still face a higher overall tax bill due to the top-up tax provisions.

Despite these tax irritants, India has witnessed a remarkable increase in FDI inflows over the last two decades, demonstrating its inherent attractiveness as an investment destination. This growth indicates that India's fundamental economic strengths, such as its large market, demographic dividend, and ongoing economic reforms, are powerful drivers of investment. However, the persistent tax uncertainty acts as a drag on the full potential of FDI. By addressing these tax issues, India can not only sustain its positive FDI growth trajectory but significantly enhance it, attracting higher quality and more sustainable FDI rooted in genuine economic activity rather than tax arbitrage. This would ultimately secure and potentially expand India's tax base in the long term, fostering mutual benefit for both the nation and its foreign investors.

This report proposes a comprehensive framework designed to enhance tax certainty and predictability for foreign investors. The recommendations include the introduction of an optional, industry-specific Presumptive Taxation Scheme for foreign companies, coupled with broader legislative clarity, administrative efficiency, robust dispute resolution mechanisms, and strategic alignment with international best practices. This multi-pronged approach is anticipated to dramatically reduce litigation, boost investor confidence, improve administrative efficiency, and secure India's tax base by attracting higher quality, sustainable FDI.

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I. Introduction: The Critical Nexus of Permanent Establishment, Profit Attribution, and India's Investment Climate

Foreign direct investment (FDI) and foreign portfolio investment (FPI) are widely recognized as vital catalysts for India's economic growth. A stable, predictable, and transparent tax regime is fundamental to instilling confidence in foreign investors, enabling them to accurately assess risks and returns. India's economic potential has indeed attracted substantial foreign capital, with FDI Equity Inflows showing remarkable growth over the past two decades. For instance, FDI Equity Inflows increased from USD 5,856 million in 2005-06 to a provisional USD 50,018 million in 2024-25. This consistent growth trajectory highlights India's inherent appeal, driven by its large market, demographic dividend, and economic reforms. However, the fluctuations observed in these inflows and the desire for even greater capital infusion underscore the critical need to address underlying tax challenges that could otherwise impede India's full potential as a global investment hub.

The taxation of foreign enterprises operating within a jurisdiction is fundamentally governed by the concepts of Permanent Establishment (PE) and the attribution of profits thereto. These principles determine a country's right to tax the business income of non-resident entities, thereby profoundly influencing the investment climate and the flow of capital. In India, while the Income Tax Act, 1961, employs the term "business connection" (Section 9) for a similar purpose, the more detailed and specific definitions of PE are primarily found in Double Taxation Avoidance Agreements (DTAAs). These bilateral treaties, often modelled on the UN Model Convention, typically define PE under Article 5 and include common types such as Fixed Place PE, Construction PE, Service PE, and Agency PE. India's general preference for the UN Model, which typically grants broader taxing rights to source countries, has influenced its approach to PE definitions and enforcement.

Furthermore, India has proactively expanded the concept of "business connection" through Significant Economic Presence (SEP), introduced in the Income Tax Act (Section 9(1)(i), Explanation 2A) with effect from April 1, 2021. This provision specifically targets digital businesses, constituting a SEP if transactions or user thresholds are exceeded, irrespective of physical presence. A critical implication of PE determination is that if a foreign enterprise is deemed to have a PE in India, only the portion of its business income that is "attributable" to that PE is taxable in India, typically governed by Article 7 of DTAAs and principles of transfer pricing.

For foreign investors, the imperative for tax certainty and predictability cannot be overstated. Ambiguity surrounding what constitutes a PE, particularly with evolving business models like the digital economy, creates significant tax risk. An unexpected PE trigger could lead to substantial and unforeseen tax liabilities on Indian income, thereby deterring investment. Similarly, establishing a PE or being subject to India's tax jurisdiction due to SEP significantly increases the compliance burden and costs for foreign entities, including obligations to file tax returns, maintain books of accounts, undergo audits, and adhere to complex transfer pricing regulations. Once a PE is established, the complex task of attributing profits to it arises, leading to differing views between tax authorities and companies and potential for higher tax demands.

The Indian tax landscape is shaped by a complex interplay of domestic law, bilateral treaty law, and evolving global tax reforms. Domestic laws, such as the "business connection" clause and the Significant Economic Presence (SEP) provisions, provide the foundational taxing rights. Bilateral treaties (DTAAs), often influenced by the UN Model which grants broader source taxing rights, frequently override domestic law for non-residents, providing specific PE definitions and attribution rules. Simultaneously, multilateral instruments and global reforms, such as the BEPS project (including

Action 7, Pillar One, and Pillar Two) and the Multilateral Instrument (MLI), influence both domestic law and treaty interpretations, pushing for substance-based taxation and reallocation of taxing rights.[2] This multi-layered system inherently contributes to uncertainty, as changes or interpretations in any one layer can have ripple effects across the entire framework. For foreign investors, navigating this intricate environment requires a nuanced understanding of these interconnected legal and policy dimensions. Past instances of retrospective taxation, such as the Vodafone case, or aggressive interpretations of tax laws have also created a lingering perception of an unpredictable and challenging tax environment, making foreign investors hesitant, even if such issues are subsequently addressed. In essence, a transparent, stable, and reasonable tax regime concerning PE and profit appropriation is fundamental to attracting and retaining FDI, allowing foreign investors to accurately assess risks and returns and fostering confidence.

II. Evolution of Permanent Establishment (PE) Law in India: A Jurisprudential Review

India's approach to Permanent Establishments has undergone a significant evolution, reflecting its status as a capital-importing country keen on source-based taxation. This journey from the broad concept of "business connection" to more nuanced modern PE interpretations has been shaped by a series of landmark court decisions.

In the early years, prior to the late 1990s, India's jurisprudence on PEs was limited. The Income Tax Act's "business connection" clause (Section 9) served as the primary basis for taxing foreign companies, as seen in older cases like ***CIT v. R.D. Aggarwal*** (1965). However, as India entered into more tax treaties, the treaty definition of PE became increasingly important, laying the groundwork for future interpretations.

The modern PE interpretation began to take shape around 1999 with cases involving foreign telecom firms such as ***Motorola Inc.***, ***Ericsson Radio Systems***, and ***Nokia***. These companies supplied network equipment to Indian telecom operators via Indian subsidiaries that provided marketing and some support. The tax department alleged that the subsidiaries constituted Dependent Agent PEs (DAPE) of the foreign parents, asserting that a portion of the equipment sales profits were taxable in India. In a landmark 2005 Special Bench ruling by the Delhi ITAT covering these cases, the tribunal indeed found that a PE existed, largely because employees of the foreign company were seen working in India through the subsidiary and facilitating sales. In the ***Motorola*** case, despite the Indian PE's own accounts showing losses, the Tribunal upheld using the parent's global profit margin applied to Indian sales to attribute profits. This decision signalled a more aggressive posture, indicating that an affiliate in India significantly aiding business could trigger a PE, even if formal contracts were executed abroad.

The early 2000s saw the PE concept expanding to new business models. In 2008, cases like ***Amadeus*** and ***Galileo*** (ITAT Delhi) dealt with foreign Global Distribution System providers. Here, the foreign company had no fixed office but had installed computer terminals/software at travel agents in India through its subsidiary. The tribunal held that this setup created a fixed place PE (the computers at agents' premises under the foreign company's control) and also a dependent agent PE via the subsidiary. This was a significant evolution, asserting PEs in the digital and services context, even without a traditional office or employees in India, emphasizing that "physical presence" could mean

[2] Multilateral Instrument (MLI): A tool designed to implement the BEPS-related treaty changes quickly and efficiently. Instead of requiring countries to renegotiate thousands of individual bilateral tax treaties, the MLI allows countries to simultaneously modify their existing treaties by signing and ratifying the instrument. It includes provisions for preventing treaty abuse, modifying PE rules, and improving dispute resolution.

having business apparatus or personnel in India on one's behalf. The Delhi High Court later upheld taxation of such digital presence, foreshadowing today's "digital PE" concept. Around the same time, foreign defense contractors faced PE allegations, notably

Rolls Royce Plc. (UK). In a 2007 ruling, the ITAT found multiple forms of PE (fixed place, solicitation, and dependent agent PE) because the Indian subsidiary (RRIL) was "almost a sales office" for Rolls, doing core marketing and client liaison. This broadened the PE concept to any scenario where an Indian presence was integral to revenue generation, even if sales contracts were executed abroad. For construction projects, foreign EPC companies were routinely scrutinized for "site PEs" if a project site existed beyond a certain duration. While Indian tax authorities took a broad view, the Supreme Court's judgment in ***Ishikawajima-Harima*** (2007) ruled in favour of the taxpayer, holding that mere offshore supply in a turnkey project, unaccompanied by onshore presence, did not create a PE nor taxable business income in India, providing temporary relief to offshore suppliers.

A turning point arrived in the mid-to-late 2000s with apex court guidance. The Supreme Court's judgment in ***DIT v. Morgan Stanley & Co.*** (2007) was significant. Morgan Stanley, a US company, had set up a back-office support subsidiary (captive BPO) in India. The Supreme Court made two important rulings: first, merely having a subsidiary's office is not a PE of the parent if the subsidiary is carrying on its own business, emphasizing respect for separate legal entities. Second, and crucially for attribution, even if a PE is deemed (say, through a Service PE due to seconded staff), if the Indian entity's transactions with the foreign enterprise are at arm's length (ALP), then no further profit can be attributed to the PE. This was a taxpayer-friendly precedent, introducing a measure of certainty that foreign companies could structure Indian operations such that their Indian affiliate earns an arm's length markup, potentially satisfying Indian taxation with that payment alone. The ***Morgan Stanley*** principle was later reinforced in cases like ***Honda SIEL*** (SC 2010). However, subsequent lower court rulings did not uniformly apply this principle, especially in cases where the Indian presence was for marketing or sales, unlike Morgan Stanley's support function. For example, the ***Rolls Royce*** ITAT (2007) explicitly rejected the plea that since RRIL was remunerated at arm's length, no further profits could be attributed, citing that the UK-India treaty allowed taxing not just direct profits but also "indirect" profits attributable to PE. This direct contrast between ***Morgan Stanley*** and ***Rolls Royce*** revealed a significant judicial divergence, meaning foreign investors could not rely on a consistent application of the ALP, leading to unpredictable outcomes and prolonged litigation. Another instructive case was ***SET Satellite (Singapore) Ltd.*** (Bombay High Court, 2008), where a dependent agent PE was found for advertising revenues, but the Court accepted a relatively low profit attribution (about 10-15% of advertising revenues), reaffirming that courts sought reasonableness in attribution.

The 2010s brought further refinement and new challenges, particularly from the digital economy. The Delhi High Court in ***e-Funds Corp. v. DIT*** (2017) held that a subsidiary's premises are not automatically the foreign company's PE unless the foreign company has the right to use that space for its own business and exercises control, refining the "place of business" test. The Supreme Court's ***Formula One*** verdict (2017) was another high-profile case, holding that a leased race circuit constituted a fixed place PE for the foreign company, emphasizing that control and conducting business there, rather than the duration of access, are key. Meanwhile, India amended domestic law to address the digital economy by introducing the concept of Significant Economic Presence (SEP) in the Finance Act 2018, aiming to deem a "virtual" PE for foreign digital companies exceeding certain user or revenue thresholds, even without physical presence. This reflected India's proactive stance to ensure that digital multinationals contributing economic value in India pay taxes here, though SEP's implementation remains inchoate for attribution.

The 2020s culminated in the landmark ***Hyatt International*** case. ***Hyatt (UAE)*** provided strategic

and management services to hotels in India. The Delhi High Court (2021), upheld by the Supreme Court in 2025, ruled in favour of the tax department, finding a PE even without a formal office, due to substantial business operations and continuous, meaningful presence of Hyatt's personnel in the Indian hotels. Crucially, the ***Hyatt*** ruling emphasized the "separate enterprise" fiction for attribution, holding that an Indian PE must be viewed on its own, and profits can be attributed to it even if the overall enterprise had global losses. This directly countered the argument used in the earlier ***Nokia*** case that global loss equals zero Indian profit. The Supreme Court's upholding of ***Hyatt*** solidifies the trend of Indian courts prioritizing economic reality: if significant value-creating functions happen in India, India can establish taxing rights.

This evolution illustrates a maturation of Indian PE jurisprudence towards economic substance. Initially, the system relied on broad "business connection" or aggressive interpretations of Dependent Agent PEs and fixed places. The Supreme Court's intervention with ***Morgan Stanley*** introduced the Arm's Length Principle as a potential safe harbour, somewhat reining in overzealous assertions. Subsequent refinements in cases like ***e-Funds*** (emphasizing "disposal over the place of business") and ***Formula One*** (solidifying "substance over form" for even temporary presences) further clarified the tests for PE existence. The introduction of SEP explicitly addressed the digital economy. The ***Hyatt*** ruling represents a significant culmination, reaffirming "substance over form" and the economic reality of value creation in India, even without a traditional office. More importantly, it decisively shifts the attribution principle towards the "separate enterprise" fiction, allowing for profit attribution even if the global entity is in loss. This trajectory shows India's tax system becoming more sophisticated and aligned with the economic realities of modern global business, moving beyond mere physical footprints to taxing economic value created within its borders. While this provides clearer tests for ***what constitutes a PE***, it simultaneously puts more pressure on ***profit attribution***, as the "separate enterprise" fiction demands a robust method to determine hypothetical arm's length profits for the Indian PE, independent of global results. This makes the need for clear attribution rules even more urgent.

The following table summarizes key Indian PE rulings and their impact:

S. No.	Case (Year of final judgment)	Industry	Core PE Issue	Outcome of Case	Final Authority	Approx. Time to Resolve
1.	***Motorola Inc. & Others*** (ITAT 2005)	Telecom equipment	Foreign vendor selling via India subsidiary – Dependent Agent?	PE held (DAPE). Used global profit % on Indian sales for attribution.	ITAT (Delhi, Special Bench)	~6–7 years (late 1990s to 2005)
2.	***Morgan Stanley*** (SC 2007)	Financial services (BPO)	Back-office subsidiary – Service PE through seconded staff?	No additional PE profit; subsidiary at ALP, so foreign co not taxed further. Clarified ALP principle.	Supreme Court	~4 years (fast-tracked via AAR)
3.	***Rolls Royce Plc.*** (ITAT 2007)	Aerospace/ Defense	Marketing subsidiary – multiple PE allegations (fixed place, agency)	PE held. AO's 75% profit attribution cut to 35% of global profits on Indian sales due to functions abroad.	ITAT (Delhi)	~8–9 years (assessment ~1998, ITAT 2007) [1]

4.	***SET Satellite (Singapore)*** (Bombay HC 2008)	Media/ Broadcasting	Advertising revenue via Indian agent – Dependent Agent PE?	PE held. Profit attribution limited to 10%–15% of Indian ad revenues (substantial reduction, recognizing most content costs abroad).	High Court (Bombay)	~7–8 years
5.	***Amadeus & Galileo*** (ITAT 2008)	Online services (CRS)	Computer systems and local subsidiary distributing service – PE via digital presence?	PE held (fixed place via computer network). Initially 15% of India revenue as profit, but since local agent at ALP, effectively no further tax applied.	ITAT (Delhi)	~8 years
6.	***E-Funds Corp.*** (SC 2017)	IT/BPO Services	Indian subsidiary providing support – can parent be said to have PE at subsidiary's premises?	No PE. SC held subsidiary's premises not at disposal of parent; and routine outsourcing doesn't create PE. Refined "place of business" test.	Supreme Court	~10+ years (assessment 2004, SC 2017)
7.	***Formula One*** (SC 2017)	Sporting event	Short-term event (3 days) at a leased circuit – fixed place PE?	PE held. Despite event duration, control over circuit and recurring nature (annual race) made it a fixed place PE. Affirmed substance-over-form (control matters more than time).	Supreme Court	~5 years (quick, given high stakes)
8.	***Hyatt International*** (SC 2025)	Hospitality Services	Foreign company providing mgmt./ services to Indian hotels – no physical office, but ongoing functions – Service PE?	PE held. SC affirmed strategic/ management services created meaningful presence. Emphasized a PE can exist without own office if business is conducted in India. Case confirmed separate-entity approach for attribution (liable even if global loss).	Supreme Court	~12+ years (assessment ~2010, SC 2025)

Notes: The above timeline is illustrative, not exhaustive. It shows that most major PE disputes took anywhere from 6 to 12+ years to reach finality, underlining the protracted nature of litigation in this domain. It also reflects shifts in jurisprudence: early aggressive attributions (Motorola, Rolls) gave way to more nuanced views (Morgan Stanley, e-Funds), and recent judgments (Hyatt) further clarify the principles but in doing so overturn some earlier taxpayer-favourable positions (like Nokia's global loss argument).

III. Evolution of Profit Attribution Law in India: Addressing Historical Inconsistencies

Once a Permanent Establishment is established, Article 7 of tax treaties (and corresponding domestic rules) governs how to calculate the profits attributable to that PE and thereby taxable in India. This area has proven to be highly litigious and inconsistent over time, largely due to the absence of specific rules in Indian law, which often led tax officers to resort to rough estimates under Rule 10 of the Income-tax Rules, 1962.

In the late 1990s and early 2000s, assessing officers tended to use simplistic formulas, often greatly overstating Indian profits. In some cases, they arbitrarily assigned a very high percentage (50%–80%) of the global profits from India-related sales to the Indian PE, arguing that without the Indian operations the sales would not occur. For example, initial assessments in the ***Motorola/Ericsson*** saga reportedly sought to attribute as much as 75%–80% of the revenue to India, essentially treating the Indian market as the chief value driver. However, such positions rarely withstood appeal scrutiny.

Tribunals and courts began to introduce corrections, leading to the emergence of the global profit ratio method. The ***Motorola*** Special Bench (2005) set a pattern by using the global net profit margin of the multinational and applying it to Indian turnover, particularly when local accounts were deemed unreliable. This method, sometimes referred to as "apportionment based on global accounts," provided a veneer of objectivity by tying the attributed profit to the actual profitability of the enterprise. The ***Nokia*** case (ITAT 2014) followed this method, applying Nokia's global profit percentage to its Indian sales to compute PE profits. However, since Nokia happened to have a global loss that year, the result was zero profit in India, which the tribunal and later the Delhi High Court accepted. This demonstrated that using a global ratio could cut both ways, preventing the taxation of phantom profits if the overall business was in loss.

The crux of attribution debates became whether the PE should be viewed as a hypothetically independent entity (which might have made profit even if the overall company did not), or whether one should never attribute more profit to a part than the whole enterprise has. The ***Nokia*** view favoured the latter, asserting no profit if there was a global loss. However, this approach faced criticism for potentially outsourcing Indian taxation to global performance and ignoring the treaty mandate that a PE is an "independent entity". This conflict came to a head in ***Hyatt***. The Delhi High Court's larger bench in ***Hyatt International*** (2021), upheld by the Supreme Court in 2025, emphatically sided with the "separate enterprise" view. It held that Article 7 of the treaty requires treating the PE as if it is independent, and not tethering it to global results. The Court declared that profits can be attributed to an Indian PE even if the global enterprise never made profits, marking a pivotal evolution in law by explicitly rejecting the idea that global losses shield local operations from tax. This means that going forward, the focus will be on Indian segment profitability, using the separate entity fiction, rather than a mechanistic global ratio.

Throughout these cases, a parallel discussion revolved around the role of the Arm's Length Principle (ALP), typically used for inter-company pricing, in resolving profit attribution. The argument was that if the Indian subsidiary or PE is compensated on an arm's length basis for all its functions, then, per OECD guidance, no additional profit should attach to the PE. The Supreme Court in ***Morgan Stanley*** (2007) supported this view for that specific case. However, Indian tax authorities were wary, fearing it could allow companies to avoid tax by artificially allocating minimal profit to India via inter-company arrangements. Indian courts showed mixed responses: in ***Rolls Royce*** (ITAT 2007), the tribunal explicitly did not accept ALP as a safe harbour, reasoning that the UK-India treaty's Article

7(3) contemplated taxing indirect profits from PE's sales activity regardless of the commission RRIL received. Conversely, in the ***Galileo/Amadeus*** ITAT ruling (2008), the tribunal concluded no further profits needed attribution once the subsidiary was adequately remunerated at ALP. The draft CBDT Committee report of 2019 further highlighted this divergence, disagreeing with fully relying on OECD's ALP approach for attribution, arguing that it "focuses only on supply side and ignores demand (market) factors," which is not ideal for India. This indicates a policy preference in India to ensure some profit is taxed where sales and market exist, even if transfer pricing might suggest the local entity already received its due.

Recognizing the confusion of case-by-case outcomes, **the CBDT Committee in 2019**[3] proposed amending Rule 10 to include a semi-formulaic approach. Key elements of their draft included a

a. **Three Factor Apportionment,** where profits would be attributed based on sales, employees, and assets, equally weighted, ensuring sales (market) received a fixed 1/3rd weight. For highly digital or user-driven models, a

b. **User-based Factor for Digital** would be added, with 10% or 20% weight for "users" in India, acknowledging value created by user participation. The proposal also included a

c. **Minimum Profit Threshold**, where the formula would be applied on "profits derived from India" defined as at least 2% of Indian revenue, providing a floor to prevent companies from claiming no profit in India by pointing to thin global margins. Finally,

d. **Compensation for Existing TP Adjustments** was proposed, crediting profits already taxed via transfer pricing to avoid double taxation.

This draft report represented a significant attempt to codify profit attribution, bringing clarity, objectivity, and predictability by blending formulary apportionment with the arm's length concept.

In recent years, profit attribution percentages in disputes have clustered in a more moderate range, often 10%–25% of relevant revenues, a decline from the extremes of earlier years. For instance, the ***Honda Cars*** case (Delhi HC 2017) attributed about 20% of the project fee to Indian PE, and the ***MasterCard*** ruling (AAR 2018) attributed roughly 15% of Indian transaction revenue. Tax tribunals, when forced to pick numbers, often reference past precedents, such as 10-15% of ad revenues in media sector cases (following ***SET Satellite***) or 15-20% for distribution/support services. The overall trend has been a decline in the proportion of profits attributed over the decades: from assessing officers pushing 50%+ in the late 1990s, tribunals cutting down to 30-35% (e.g., ***Rolls Royce***), to courts preferring the 10-20% range or even 0% if ALP was proven (***Morgan***, ***e-Funds***). With the draft rules as guidance and increased awareness, attributions are anticipated to standardize, perhaps around the 15-25% effective range for typical cases. However, uncertainty persists because each case's facts differ, and without a binding rule, both taxpayers and tax officers have had leeway to argue their side.

[3] In 2019, the Central Board of Direct Taxes (CBDT) in India formed a committee to address issues related to the attribution of profits to a Permanent Establishment (PE). The committee's main objective was to bring greater clarity, objectivity, and predictability to the rules for profit attribution, which had been a subject of extensive litigation. This draft Report was placed in the public domain on 18 April, 2019 https://www.pib.gov.in/PressReleasePage.aspx?PRID=1570902#:~:text=Central%20Board%20of%20Direct%20Taxes,the%20website%20of%20the%20Department.

The trajectory of profit attribution in India indicates a shifting philosophy: from arbitrary and aggressive demands to a more nuanced, yet firm, assertion of source-based taxation, particularly emphasizing market contribution. The initial phase saw tax officers making high, arbitrary attributions, reflecting a strong source-country bias but lacking objective basis. This was followed by a first judicial correction that introduced the global profit margin, bringing some objectivity but potentially problematic for India's revenue if global losses occurred. The ***Hyatt*** ruling marks a critical pivot, by emphasizing the "separate enterprise" fiction, it disconnects Indian PE profitability from global results, asserting India's right to tax value created locally, even if the multinational as a whole is unprofitable. This aligns with the principle that a PE should be treated as if it were an independent entity. The CBDT 2019 draft, with its 3-factor formula including a 1/3rd weight for sales/market and a user-based factor for digital, explicitly acknowledges and seeks to quantify the value derived from India's market. This is a clear policy signal that India intends to capture profits linked to its demand side, moving beyond a pure supply-side (functional) analysis often associated with strict ALP. The challenge remains to bridge the gap between the "separate enterprise" fiction (which often points to ALP) and India's policy preference for market-based profit allocation, without creating new ambiguities or conflicts with treaties that rely on ALP.

Profit attribution outcomes of different Industries

The following table summarizes typical profit attribution outcomes (as upheld by courts or law) in different industries, illustrating the variation and reasoning:

Industry / Sector	Example Case or Provision	Tax Officer's initial stance	Final Attributed Profit (Court/Law)	Reasoning / Remarks
Telecom Equipment	***Motorola, Ericsson*** (ITAT 2005)	Used global profit margin (approx 20%+) on Indian sales (books showed loss).	Allowed: Global margin applied, but if global loss then nil.	Tribunal accepted using global accounts to determine profit. Set precedent that PE profit can mirror overall profitability.
Oil & Gas Services	Section 44BB, IT Act (statutory presumptive)	(AO not needed – statute fixes profit)	10% of gross revenues deemed profit (taxed at ~40% →4% of revenue).	Long-standing presumptive rule to simplify taxation for non-resident oilfield service providers. Considered reasonable industry margin.
Shipping & Airlines	Sections 44B (shipping) & 44BBA (airlines)	(Statutory presumptive rates)	Shipping: 7.5% of freight; Airlines: 5% of fares deemed profit.	Special regimes recognizing typical low margins in these industries, avoiding complex accounting apportionment.
Media – Advertising	***SET Satellite*** (Bom HC 2008)	AO often attributed ~20-30% of ad revenues.	Court upheld 10-15% of ad revenues as attributable profits.	Most revenue paid back for content rights; Indian function (ad sales) merits only limited profit. Accepted industry norm.
Financial Services/ BPO	***Morgan Stanley*** (SC 2007); ***E-Funds*** (SC 2017)	AO in some cases alleged 15-20% of costs as profit.	SC held 0% additional if arm's length paid (i.e., foreign company's PE profit covered by what Indian affiliate already earned).	Arm's Length Principle: If Indian entity is fully rewarded for its functions, no residual profit for foreign enterprise's PE.

Technology Services	***Galileo/Amadeus*** (ITAT 2008)	AO attributed 15% of gross booking fees as profit.	ITAT initially 15% of revenue, but then 0% extra since subsidiary's ALP remuneration sufficed.	Recognized significant functions (software, network) done abroad; after ALP payment to local agent, taxing more would double-count.
Aerospace/Defence Sales	***Rolls Royce*** (ITAT 2007, Delhi HC 2011)	AO attributed 75% of global profit on India sales.	Final 35% of global profits on Indian sales.	Reduced on finding manufacturing & R&D happened abroad; 35% corresponded to marketing role of Indian PE. Still relatively high due to critical role of Indian operations.
E-commerce/ Digital	Current Law: Equalisation Levy (EL) 2020	(Not PE per se; 2% on gross revenue as proxy)	2% of gross online sales (direct levy on revenue, in lieu of income tax).	Interim measure for digital economy. Roughly equates to taxing a presumed profit (e.g. 20% profit margin taxed at 10% = 2%). Intended to ensure some tax until PE/attribution rules catch up.
Hospitality/ Franchise	***Hyatt*** (SC 2025) – ongoing attribution	AO likely to attribute profit based on India hotel revenues (TBD).	Principle set: Even if global accounts show loss, Indian operations to be treated independently. Profits to be computed per functions in India (likely a management fee percentage).	SC remanded for attribution, emphasizing separate enterprise approach. Expectation: attribute a reasonable management fee profit to Indian PE, ignoring global loss situation.

The above shows that attribution rates vary widely by industry, from as low as 0-5% of revenues in heavily regulated/low-margin sectors (airlines, shipping) up to ~35% of profits in cases of high-value marketing PEs (Rolls Royce). The reasoning often hinges on the functions performed in India versus abroad. Where Indian operations are auxiliary or already compensated (as in BPO services, or when a commission agent is paid), courts have been willing to say no further profit is taxable. But where Indian operations are pivotal to sales or customer acquisition (as in Rolls, or in many digital models with user base in India), courts have endorsed taxing a substantial share.

IV. Impact of PE and Profit Attribution Uncertainty on Foreign Investment in India

Uncertainty in India's tax rules for Permanent Establishment (PE) and profit attribution directly impacts the flow of foreign investment. Foreign investors want tax certainty and predictability. When the rules are ambiguous, it adds a significant risk that can discourage Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI).

For example, an unexpected PE classification could trigger substantial and unplanned tax liabilities on income earned in India. This lack of predictability makes India a less attractive destination for foreign capital and can push investors toward complicated structures just to minimize their tax burden.

Establishing a PE or being subject to India's tax jurisdiction due to Significant Economic Presence (SEP) significantly increases the compliance burden and costs for foreign entities. This includes obligations to file tax returns, maintain books of accounts, undergo audits, and adhere to complex transfer pricing regulations, which can be particularly onerous for smaller or new entrants. The differing views between tax authorities and companies on how much of the global profit should be allocated to the Indian PE frequently lead to disputes and the potential for higher tax demands.

The absence of clear, objective rules has resulted in a significant "litigation impact." PE disputes often take "10+ years to resolve in courts," tying up substantial resources for both the Income Tax Department and the foreign companies involved. For example, the ***Hyatt*** case, a recent landmark decision by the Supreme Court, took over a decade to conclude. Such prolonged disputes increase compliance costs, interest liabilities, and, crucially, deter foreign investors, thereby harming India's ease-of-doing-business image. The sheer duration and uncertainty of these processes represent a significant, often overlooked, cost. Beyond legal fees and potential tax liabilities, the opportunity cost for a business tied up in a decade-long dispute is immense. Management attention is diverted, strategic decisions are delayed or foregone, and capital is locked up in contingent liabilities. This "cost of time" is a powerful deterrent that goes beyond mere tax rates. Even if a foreign company eventually wins a dispute or secures a lower attribution, the sheer duration and uncertainty of the process itself erode investor confidence and make India a less attractive place to deploy capital.

Despite these complexities in its tax regime, India has witnessed a remarkable increase in FDI inflows over the last two decades, demonstrating its inherent attractiveness as an investment destination. This growth underscores the importance of addressing tax certainty and predictability issues to sustain and enhance this positive trend.

This consistent growth trajectory highlights India's inherent appeal, driven by its large market, demographic dividend, and economic reforms. However, the fluctuations and the desire for even greater inflows underscore the need to address the underlying tax challenges that could otherwise impede its full potential as a global investment hub. The data provides a crucial baseline, demonstrating that while India has attracted significant FDI, improvements in tax certainty and predictability are essential to sustain and enhance this growth, thereby strengthening the economic foundation for future prosperity.

V. Examining the Case for Presumptive Taxation and International Best Practices

With the objective to enhance certainty in matters related to permanent establishments (PEs) and the attribution of profits there is a case advanced for adopting presumptive taxation methods. Presumptive taxation, in this context, refers to simplified, formula-based or deemed-profit approaches (e.g., applying fixed percentages to turnover, revenue, or multi-factor apportionment formulas involving sales, assets, and manpower) rather than relying solely on detailed functional analyses or actual profit calculations. This approach is particularly advocated in jurisdictions where it addresses longstanding challenges in international tax rules, and has parallels in global practices such as U.S. state-level formulas or EU proposals. While the OECD's Authorized OECD Approach (AOA) emphasizes arm's length principles based on functions, assets, and risks (FAR), presumptive methods are seen as a practical alternative when actual attribution is complex or contentious, reducing the risk of double taxation and disputes.

The primary rationale for Presumptive Taxation approach stems from the inherent uncertainties in traditional PE profit attribution systems, which often lead to litigation, inconsistent outcomes, and tax unpredictability. The key reasons, drawn from tax policy discussions and proposals which emerge are:

a. **Reduces Discretionary Powers and Subjectivity:** Current rules, such as India's Rule 10 under the Income Tax Rules, grant broad discretion to tax authorities (e.g., assessing officers) to estimate profits when actual figures are hard to ascertain. This results in varied interpretations, arbitrary assessments, and frequent court challenges. Presumptive methods, like deeming profits at a fixed rate (e.g., 2% of Indian-sourced revenue if global margins are below that threshold), introduce objective formulas, minimizing bias and enhancing predictability for multinational enterprises.

b. **Addresses Lack of Uniform Standards:** Globally, there is no single standard for PE profit attribution, leading to "core problems" such as conceptual mismatches between domestic laws and treaties, and risks of double taxation. Presumptive approaches provide a consistent framework, such as fractional apportionment using weighted factors (e.g., 33% sales for demand-side, 33% manpower, and 33% assets for supply-side). CBDT Committee Report of 2019 similarly addresses this issue by proposing a presumptive approach based on fractional apportionment. This model, inspired by practices like the U.S. states' Massachusetts Formula, aims to bring uniformity and certainty. This uniformity helps align taxation with economic realities, especially in the digital economy where physical presence is minimal.

c. **Simplifies Compliance and Administration in Complex Scenarios:** Attributing profits to PEs is challenging when enterprises do not maintain separate India-centric (or jurisdiction-specific) accounts, or in cases involving intangibles, global supply chains, or significant economic presence (SEP) without traditional PEs. Presumptive taxation streamlines this by using proxies like turnover percentages or multi-factor formulas, reducing the need for exhaustive FAR analyses. For instance, in digital models with high user intensity, proposals add a "users" factor (10-20% weight) to the formula, making attribution more feasible and less prone to disputes.

d. **Mitigates Litigation and Enhances Tax Certainty:** Diverse methods under existing systems have led to locked revenue, prolonged disputes, and unpredictability, as seen in data from major Indian tax centers. By adopting presumptive rules, jurisdictions can foster a more stable environment, encouraging foreign investment. This aligns with broader goals under OECD/G20 initiatives to combat base erosion and profit shifting (BEPS), though some critics note potential deviations from arm's length principles could create new alignment issues if not coordinated internationally.

e. **Protects Revenue Interests While Promoting Fairness:** In low-margin or loss-making global scenarios, presumptive floors (e.g., minimum 2% profit on Indian revenue) ensure source countries like India capture a fair share, justifying higher presumed profitability in emerging markets. This balances taxpayer burdens with revenue protection, avoiding excessive taxation while providing rebuttal options in some proposals.

Overall, while presumptive taxation may not fully replace detailed methods in all cases (e.g., where reliable accounts exist), it offers a compelling solution for high-uncertainty contexts, as evidenced by reforms in India and analogous global models. However, successful implementation requires international alignment to avoid reciprocity issues or double taxation.

Many countries have adopted various forms of presumptive taxation regimes to simplify tax administration and reduce disputes. These regimes typically replace complex profit calculations with a straightforward proxy, such as a percentage of turnover, and are often used for small domestic businesses or hard-to-tax sectors.

From the perspective of the UN Model Tax Treaty, which India generally favours, source countries are implicitly allowed more leeway in taxation. However, tax treaties generally require that only profits attributable to a PE can be taxed. To navigate this legal constraint, **presumptive methods are often made "rebuttable,"** meaning the taxpayer can opt out by demonstrating actual lower profits. This ensures treaty compatibility and fairness, as it allows for taxation of only actual income if it is genuinely lower than the presumptive rate. The OECD traditionally advocates the arm's length principle for profit attribution, and pure presumptive approaches not grounded in functional analysis are not favoured for large taxpayers. Nevertheless, even the OECD recognizes that safe harbours and simplified measures can play a role in easing compliance.

The Shift in Global Discourse Post-BEPS

The post-BEPS discussions, while not abandoning the ALP entirely, have acknowledged its shortcomings. The global discourse has opened up to new ideas that can complement or supplement the ALP, particularly for situations where it is not a good fit. This is where "formulary elements" and "safe harbours" come in.

a. **Formulary Elements:** Instead of a case-by-case FAR analysis, this approach uses a pre-determined formula to allocate a multinational's global profits to different jurisdictions. The formula would use objective factors like sales, assets, and payroll to approximate the economic activity in each location. This is what the CBDT Committee Report of 2019 proposed for India. It offers a more objective and predictable way to attribute profits, especially for businesses with a significant market presence but a minimal physical one.

b. **Safe Harbours:** A "safe harbour" as a pre-agreed set of rules that, if met, a taxpayer can follow to be deemed compliant without needing to go through a full-blown transfer pricing analysis, has proven to be a very useful innovation for Pes as a simplified method for profit attribution. For example, it could be a fixed percentage of revenue (e.g., a 5% or 10% profit margin) that a small PE is presumed to have earned. By agreeing to this simplified method, the company avoids the risk of a tax audit and litigation. This provides a high degree of certainty for both the taxpayer and the tax administration.

In essence, the post-BEPS global consensus is that while the ALP remains the foundational principle, a one-size-fits-all approach is no longer tenable. The international community is exploring complementary mechanisms like formulary apportionment and safe harbours to provide much-needed **certainty, simplicity, and administrative efficiency**, especially for the digital economy and smaller PEs, thereby ensuring that profits are taxed where economic value is truly created.

The benefits of presumptive taxation are well-documented by organizations like the IMF. Such regimes are justified to combat avoidance, ease compliance, and bring certainty. They are particularly useful where auditing actual accounts is difficult or where a compliance culture is still developing. Rebuttable presumptions also incentivize taxpayers to maintain better books if their real profits are lower, as they can prove and pay less. In India's context, offering an easy route could significantly reduce the incentive for aggressive tax planning and lengthy litigation, an observation consistent with global experiences.

India already employs presumptive approaches for certain domestic small taxpayers (Sections 44AD, 44ADA for small businesses and professionals) and for certain non-resident sectors (shipping – Section 44B, oil & gas services – Section 44BB, airlines – Section 44BBA). This demonstrates a long-standing, incremental, and pragmatic approach to tax policy. The existing sections show that India has successfully used presumptive taxation to simplify compliance and ensure some revenue from sectors with unique operational challenges, such as highly mobile assets like ships or complex project-based services like oil and gas. The Finance Act 2024 and 2025 further reinforced this by introducing new presumptive sections: Section 44BBC (effective AY 2025-26) for Non-resident Cruise Ship Operators, deeming 20% of gross receipts as taxable profits, aimed at encouraging cruise tourism by providing clarity. Similarly, Section 44BBD (proposed from AY 2025-26) for Foreign Companies providing certain Electronics Manufacturing Services, deems 25% of gross payments as profit, specifically targeting technical service providers to resolve confusion between business profit and "fees for technical services," thereby simplifying and lowering the burden and promoting ease of doing business. These examples buttress the recommendation for a broader sectoral presumptive taxation scheme, increasingly seen as a viable tool globally and one that India has started embracing for specific needs. The key is to calibrate the presumptive profit rate to approximate typical profit margins, high enough to protect revenue but low enough to be attractive as a simple alternative, with an opt-out option to maintain fairness. This historical precedent provides a strong foundation and internal justification for extending the presumptive taxation concept more broadly to address general PE and profit attribution challenges. It suggests that the Indian government is already comfortable with the mechanism and its benefits, making the proposed comprehensive scheme a logical, albeit larger, extension of existing policy, rather than a completely novel or untested approach.

Several other countries implement presumptive profit schemes for non-resident businesses. Brazil, for instance, offers a Presumptive Profit Method where companies can choose to be taxed on a fixed profit percentage of revenue, varying by sector (e.g., 8% for commerce/industry, 32% for most services). This system is optional but widely used by mid-size firms for simplicity, demonstrating that even fairly large businesses can be taxed on fixed margins administratively. Indonesia and Mexico have also used deemed profit rates for certain industries in treaty arrangements or domestic law. Many African countries impose final withholding taxes on services, such as 5% of gross fees, which effectively presume a profit and tax it in lieu of net profit determination.

VI. Strategic Recommendations for Enhancing Tax Certainty and Predictability

Addressing the challenges posed by PE and profit attribution requires a multi-faceted approach, integrating legislative reforms, administrative enhancements, and a strategic alignment with international best practices. This comprehensive strategy aims to create a virtuous cycle where clearer laws lead to fewer disputes, better administration builds trust, and effective dispute resolution provides finality, all contributing to a more attractive investment climate.

A. Legislative Clarity and Certainty

To foster a predictable tax environment, it is crucial to codify clear PE and profit attribution principles within domestic tax law. These definitions should align with internationally accepted interpretations from OECD and UN Models while strategically retaining India's source-based taxing rights where appropriate to protect its tax base. The proposed template for legislative provisions, such as Article 1.2 on Core Conditions for Fixed Place PE (emphasizing economic substance and operational disposal) and Article 2.1 on the Principle of Separate Entity for profit attribution, provides a strong foundation for this codification. Furthermore, India must maintain and reinforce its policy against retrospective tax amendments. Implementing legislative safeguards and establishing clear due process criteria for any exceptional circumstances where retrospective application might be deemed necessary will ensure such instances are rare and narrowly defined, aligning with principles of fairness and predictability for investors.

B. Enhanced Stakeholder Engagement

Formal and transparent mechanisms for mandatory public consultation with industry bodies, tax experts, and foreign investor associations should be instituted for all significant tax policy changes affecting international investors. This approach fosters transparency, allows for comprehensive feedback, and builds trust in the policymaking process. Additionally, implementing a comprehensive and legally enforceable Taxpayer Charter that clearly delineates the rights of taxpayers and the obligations of tax authorities will foster a cooperative relationship and enhance fairness in tax administration.

C. Robust Dispute Resolution Mechanisms

Significant investment is needed to expand the capacity of Advance Pricing Agreement (APA) and Mutual Agreement Procedure (MAP) programs, with the aim of drastically reducing resolution timelines for both prospective certainty (APAs) and existing disputes (MAPs). Actively promoting bilateral APA negotiations involving PE attribution, particularly where foreign enterprises operate through branches or project offices, is essential. Exploring and considering the adoption of mandatory binding arbitration for unresolved MAP cases would provide a definitive mechanism for dispute closure, minimizing prolonged uncertainty and the risk of double taxation. Moreover, adopting standardized systems, such as the OECD's TRACE, can streamline withholding tax collection and treaty relief procedures for cross-border investments, enhancing certainty for portfolio investors and improving compliance.

D. Capacity Building and Consistency

Implementing comprehensive and continuous training programs for Assessing Officers is crucial to enhance their technical capacity. This is vital for ensuring consistent, fair, and nuanced application of complex international tax rules, particularly concerning PE and transfer pricing, in line with the "substance-over-form" approach. Furthermore, India must continue to actively engage in the ongoing Pillar One and Pillar Two discussions[4] to shape the global tax landscape. Adapting India's domestic framework (e.g., SEP, Equalisation Levy) to ensure coherence with evolving international consensus, while leveraging opportunities to expand India's tax base as a market jurisdiction, is a strategic imperative.

F. Introduction of Optional Presumptive Taxation Scheme

The core recommendation is the introduction of an optional Presumptive Taxation Scheme for foreign companies, with industry-specific profit rates deemed as taxable.[1] This scheme aims to resolve PE profit attribution disputes by pre-emptively defining a fair profit rate for taxation, thereby providing certainty to taxpayers and tax authorities alike.[1] This pragmatic approach represents a strategic compromise for market jurisdiction taxing rights. Instead of engaging in endless battles over complex attribution, India offers a simplified, pre-defined tax burden. This ensures a guaranteed and predictable share of revenue from foreign enterprises operating within its market, without the administrative burden and delays of audits and litigation. The rates are calibrated to reflect typical industry profits, ensuring "revenue safeguard with potential upside".[1] For foreign investors, it provides "certainty, simplicity, and reduced litigation" [1], allowing them to budget for taxes, avoid costly disputes, and operate with greater predictability, even if the presumptive rate is slightly higher than what they might theoretically argue for under a complex ALP analysis. The rebuttable nature ensures treaty compatibility and fairness for genuinely low-margin businesses. India effectively foregoes the potential for extremely high attributions (which rarely materialize after litigation) in exchange for guaranteed, stable, and administratively efficient revenue. This is a sophisticated policy move that balances sovereign taxing rights with the need for a conducive investment climate.

4 The ongoing global tax reform discussions under the OECD/G20 Inclusive Framework on BEPS are centred around two pillars: Pillar One and Pillar Two. These initiatives are a direct response to the challenges of taxing multinational enterprises (MNEs) in the modern, digitalized, and globalized economy, where physical presence no longer correlates with value creation. Pillar One: Reallocation of Taxing Rights and Pillar Two: Global Minimum Tax

Proposed Optional Presumptive Taxation Scheme – Key Features

The proposed scheme includes several key features designed to enhance certainty and simplify compliance:

a. **Industry-Specific Presumptive Profit Rates:** The scheme will list specific sectors or business models and assign a deemed profit percentage on gross receipts earned in India for each. This percentage will represent the profit attributable to Indian operations which will be subject to Indian corporate tax. The rates should be determined based on historical data, industry profit trends, and a margin of safety to protect revenue.

b. **Optional Regime (Rebuttable Presumption):** The presumptive regime will be optional for the taxpayer. A foreign company can choose to opt in for a given financial year, declare income as per the 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.

c. **No Separate PE Determination Needed (Safe Harbour):** A critical aspect is that if a foreign company opts for presumptive taxation for a particular activity, the tax authorities would not separately litigate the existence of a PE for that activity. This offers certainty by sidestepping the PE threshold debate, providing foreign investors with a clear path forward.

d. **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)5 should be expanded to include transaction and remuneration approaches, along with arm's length rates for PE attribution, providing greater clarity and streamlining compliance.

e. **Advanced Pricing Agreement (APA) for PE Attribution:** 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.

f. **Coverage of Taxation Scope:** 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. This removal of ambiguity is vital to avoid concurrent litigation under different labels.

5 Safe Harbour Rules in India, as defined under Section 92CB of the Income-tax Act, 1961, are a critical component of the country's transfer pricing framework. They were introduced to provide certainty and reduce litigation by offering a pre-determined, simplified method for determining the Arm's Length Price (ALP) for certain specified international transactions.

g. **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.1

h. **Treaty Eligibility for US LLCs:** Treaty eligibility under the India US DTAA should be explicitly extended to fiscally transparent US LLCs6 that meet Limitation of Benefits (LOB) criteria7, facilitating dispute resolution access to APA and MAP mechanisms for such entities. Extending DTAA benefits to these LLCs would formalize a position that has been largely upheld by Indian tax tribunals but is still a source of uncertainty. It would align India's tax policy with the global trend of recognizing fiscally transparent entities and provide a stable framework for dispute resolution.

i. **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.

Illustrative Presumptive Tax Rates for Select Industries

The following table proposes some sample presumptive profit rates for key industries, based on typical profit margins and existing analogous provisions:

Industry / Sector	Proposed Presumptive Profit Rate (on gross receipts)	Rationale
Infrastructure Construction/EPC	10%	Aligned with existing Section 44BBB (10% for power project construction). Provides certainty for long-term projects, balancing revenue protection with administrative ease.
Engineering Services/Oilfield Services	10%	Aligned with Section 44BB (10% for oil/ gas services). Extends similar workable treatment to other engineering services.
Telecom/Technology Equipment Supply with Installation	5% (supply portion), 20% (services portion)	Recognizes lower profit margins on offshore equipment supply (5%) and higher margins for onshore services/installation (20%). Aims to avoid litigation over contract splitting.
Digital / E-commerce (Online platforms, Streaming, etc.)	30% of gross revenue from Indian users	Reflects generally high profit ratios in digital businesses. Ensures India receives a fair share of digital economy profits without endless nexus debates.
General Services (Consultancy, Management, Software)	20% of gross fees	Mirrors new Section 44BBD (25% for specific electronics services). Offers a broader safe harbour, making it attractive to opt in while ensuring corporate tax contribution.
Marketing and Distribution Support	15% of gross revenue from India	A moderate rate between extremes, acknowledging the critical role of Indian marketing operations. Provides certainty to avoid larger attribution risks in audits.

6 A fiscally transparent US LLC is an entity that, for US federal income tax purposes, is not taxed at the entity level. Instead, its income, gains, losses, and deductions "pass through" to its owners or members, who are then individually taxed on their share of the income. This is in contrast to a corporation, which is taxed on its profits at the entity level.

7 The India-US DTAA has a robust LOB clause (Article 24) that checks for aspects like ownership by residents and a connection to an active business.

These rates are provisional and aim to initiate discussion. They need to be fine-tuned by an expert panel, empowered by the CBDT to revise them prospectively with periodic review (e.g., every 5 years) to ensure alignment with economic reality.

Anticipated Benefits

Implementing this presumptive regime is expected to yield several significant benefits:

a. **Dramatic Reduction in Litigation:** By providing a clear, agreed basis for taxation, the endless disputes over PE existence and profit attribution would significantly diminish. This redirection of resources for both the Income Tax Department and companies to more productive matters is a crucial gain.

b. **Boost to Investor Confidence and Ease of Doing Business:** Foreign companies highly value predictability. A presumptive scheme provides investors with a clear framework, allowing them to budget for Indian taxes with certainty, thereby making India a more attractive investment destination in sectors like infrastructure and technology.

c. **Administrative Efficiency:** Tax officers would no longer need to perform complex audits and gather extensive evidence to litigate PEs for those who opt in. This significantly lessens the compliance burden on taxpayers, particularly new entrants, and allows the department to focus on high-risk cases or those not opting in.

d. **Revenue Safeguard with Potential Upside:** The government need not fear a revenue loss. Many taxpayers may willingly pay a slightly higher amount under a presumptive rate in exchange for certainty, potentially leading to increased revenue. The scheme also broadens the tax net by encouraging companies that might otherwise avoid a formal PE to register and pay a reasonable tax, ensuring some tax from all rather than theoretically high tax from a few that often remains tied up in courts.

e. **Alignment with "Make in India" and Market Facilitation:** Certain presumptive provisions, like those for technical services in manufacturing, directly support India's strategic goals by removing tax roadblocks for foreign contributors, encouraging knowledge transfer and collaboration.

f. **Encouraging Compliance:** The optional nature of the scheme, coupled with a slightly higher tax burden if records are not kept, encourages taxpayers to either maintain good accounts or pay a bit extra for the convenience of not doing so. This enhances overall compliance and minimizes opportunities for corruption or subjective assessments.

Implementation Considerations

While the presumptive scheme offers substantial benefits, careful implementation is required:

a. **Legislative Changes:** New sections, similar to existing presumptive provisions, need to

be inserted for each category, or a single omnibus section with sub-sections per industry. Amendments ensuring the non-applicability of other sections (e.g., Section 9(1)(i) or 115A for Fees for Technical Services) when presumptive tax is applied are vital to avoid overlapping claims.

b. **Treaty Override or Compatibility:** Ideally, the scheme should operate within the bounds of tax treaties. Its optional nature helps mitigate treaty non-discrimination issues. India may also consider negotiating with major treaty partners to include clauses or protocols acknowledging the presumptive regime.

c. **Rate Setting Authority:** Empowering the CBDT to prescribe rates and conditions via notification (with proper review and checks) will ensure flexibility and responsiveness to evolving business models.

d. **Anti-abuse Measures:** Conditions should be set to prevent abuse, such as restrictions on cherry-picking years or frequent switching between opting in and out (e.g., a multi-year lock-in or prior approval for reversion).

e. **Awareness and Guidance:** Clear Guidance Notes (circulars, FAQs) and comprehensive training for tax officers are crucial for smooth implementation and to ensure presumptive filings are accepted without undue challenge.

f. **Sunset Clause or Review:** Including a clause to review the scheme's effectiveness after 5-10 years will allow for recalibration or withdrawal of parts of the scheme if international tax rules evolve (e.g., under OECD Pillar One) or if economic realities shift.

VII. Conclusion: Paving the Way for Sustainable Foreign Investment

India has demonstrated remarkable success in attracting foreign investment over the past two decades, a testament to its inherent economic potential. However, persistent challenges related to the interpretation of Permanent Establishment (PE), the complexities of profit attribution, and lingering regulatory uncertainty continue to pose significant risks for foreign investors. The global shift towards substance-based taxation, exemplified by recent Supreme Court rulings, and the ongoing evolution of international tax norms under the BEPS project, necessitate a proactive and adaptive approach from India. A stable, transparent, and predictable tax regime is not merely a compliance issue; it is a fundamental driver of sustainable economic growth and the attraction of high-quality, value-adding foreign direct investment.

The proposed multi-faceted approach, particularly the optional presumptive taxation scheme, offers a balanced solution to this long-standing quagmire. It protects India's tax base while providing predictability and simplicity to taxpayers. This framework ensures that foreign companies "pay tax – but fair and reasonable" and do not waste resources in litigation, while the Government "does not lose revenue" and, in fact, gains goodwill and likely higher voluntary compliance. The tax administration can thus focus its enforcement on outliers, evaders, or those complex cases where actual profits far exceed presumptive norms.

The next steps would involve the Ministry of Finance considering these recommendations, possibly constituting a working group to draft the legal provisions, consulting with stakeholders (industry bodies, tax professionals, treaty partners), and including the final proposals in an upcoming Finance Bill. Given that some groundwork is already laid with the introduction of sections 44BBC and 44BBD, and the CBDT draft report, the time is opportune to implement a comprehensive presumptive regime. Such a bold reform, presented as part of the government's commitment to improving the business climate, would be a marquee achievement, aligning tax policy with the larger economic vision. If executed well, this will markedly improve India's standing in global indices and in boardrooms worldwide, positioning India as a country where tax is a well-lit path, not a minefield.

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