

MNCs in India may face higher taxes

CBDT Panel's Proposals Cover Offshoring Ops

Lubna.Kably@timesgroup.com

Mumbai: The rules for attributing profits to multinational enterprises having a permanent establishment (PE) or business connection in India are set to significantly change if the draft report issued on Thursday night by a committee — appointed by the Central Board of Direct Taxes (CBDT) — is adopted.

According to tax experts, MNCs carrying offshore operations in India, which also have sales revenue from the country, may find that higher profits that are attributed to Indian operations — under the prescribed formula-driven approach — will result in a higher tax outgo.

If a foreign enterprise has a PE in India (In general, it refers to a fixed place of business and is defined in tax treaties), then India can tax the business profits of the entity. However, tax can be imposed only on the profits 'attributed' to the operations carried out in India.

Where detailed accounts are not available to determine this attribution, rule 10 empowers the income tax (I-T) officer to do so by indirect apportionment — say, a percentage of the turnover. However, lack of uniformity in this approach results in litigation.

In its report, the CBDT-appointed committee states that it is not appropriate to attribute profits to the PE exclusively on the basis of functions, assets and risks (FAR) alone.

Public comments have been invited for the 84-page document within 30 days



"This is a game changer. The panel's report outlines a formula for calculating profits attributed to operations in India, giving equal weightage assigned to sales, manpower and assets. This three-factor approach will be a challenge where there is significant manpower deployed in India and sales revenue is also generated from here. A lot of offshore centres in India, which provide technical services to their overseas head office and group companies, could be adversely impacted as it could result in a higher tax outgo," says Girish Vanvari, founder of a boutique advi-

sory firm TransactionSquare.

However, the report adds that profits derived from Indian operations that have already been subjected to tax in India — say, in the hands of a subsidiary — should be deducted from the apportioned profits.

A floor rate for profits derived from India has been set to protect revenue interests. The committee further suggests a minimum 2% of the turnover derived from here as deemed 'profits derived from India' in certain circumstances — say, when the foreign enterprise is incurring global losses. It also provides that where no sale has taken place in India and the profits that can be apportioned to the supply activities are already taxed in the hands of an Indian subsidiary, there may be no further taxes payable by the foreign enterprise.

The panel has also considered emerging business models. "For business models in which users contribute significantly to the profits of the foreign enterprise, the user base could be taken into account for the purpose of profit attribution as the fourth factor for apportionment, in addition to sales, manpower and assets. Weightage in the range of 10-20% has been assigned to the user base," points out Nangia Advisors director Sandeep Jhunjunwala.

I-T Dept proposes new norms for taxing MNCs with permanent India base

ENS ECONOMIC BUREAU

NEW DELHI, APRIL 18

INVITING PUBLIC comments on draft report of taxation methodology for multinational companies (MNCs) having permanent establishment in India, the Income-Tax Department on Thursday said MNCs that are incurring global loss, or profit margin of less than 2 per cent, will be deemed to have made a profit of 2 per cent of Indian revenue or turnover and will be taxed accordingly.

Giving weightage to factors like domestic sales, employee strength, assets and user base to determine taxation of MNCs, the CBDT Committee's report on 'Profit Attribution to Permanent Establishment (PE) in India' is expected to impact several permanent establishments especially of infrastructure projects which have incurred losses recently, tax experts said. "The committee noted the need to protect India's revenue interests in cases where an enterprise having global losses or a global profit margin of less than 2 per cent, continues with the Indian operations, which could be more profitable than its operations elsewhere... the continuation of Indian operations justifies the presumption of higher profitability of Indian operations, and in such cases, a deeming provision that deems profits of Indian operations at 2 per cent of revenue or turnover derived from India should be introduced," the report said.

The CBDT committee report has proposed that sales, employ-

The Income-Tax Department said multinational companies that are incurring global loss, or profit margin of less than 2%, will be deemed to have made a profit of 2% of Indian revenue or turnover and will be taxed accordingly

ees (manpower and wages) and assets in India of a MNC should be taken into account for determining domestic tax liability. In case of digital companies, the weightage will be given to an additional fourth criteria of 'user' base, the report said. An MNC having a fixed place of business in India is considered as having PE in India and is taxed as per domestic laws. The stakeholders will have to submit their comments on the report within 30 days.

The report provides different weightage for digital companies categorising them as "high" and "low or medium" user base with significant economic presence in India. In case of 'high user intensity', the weight of users should be 20 per cent, share of assets and employees 25 per cent each and sales at 30 per cent, while for 'low and medium user intensity', users should be assigned a weight of 10 per cent while three factors would have a weight of 30 per cent each.

Ashok Maheshwary & Associates LLP partner Amit Maheshwari said the report by the CBDT committee on profit attribution to PE deems 2 per cent of revenue derived from India as profit attributable to Indian operations in spite of having losses on a global level. "This will impact

several loss-making PEs especially in infrastructure projects which have been into chronic losses lately. Assuming that if MNCs are continuing with Indian operations in spite of losses, there has to be higher profits in India, is not correct," Moheshwari said.

Nangia Advisors (Andersen Global) director Sandeep Jhunjhunwalasaid the committee, in its report, has observed a major deviation from generally accepted accounting principles. He added that the deviation is in cases where business profits could not be readily determined on the basis of accounts, completely ignoring the sales receipts derived from a tax jurisdiction, and attribution done on the basis of function, assets and risk (FAR) analysis.

The report suggested "amendments to Rule 10 of income tax rules to provide that in the case of an assessee who is not a resident of India, has a business connection in India and derives sales revenue from India... the income from such business that is attributable to the operations carried out in India and deemed to accrue or arise in India shall be determined by apportioning the profits derived from India by a three equally weighted factors of sales, employees (manpower & wages) and assets".



Profit attribution to PE: CBDT invites public comments on panel's draft

OUR BUREAU

New Delhi, April 18

The Central Board of Direct Taxes (CBDT) has invited stakeholders' comments on a draft committee report on attribution of profits in case of a permanent establishment (PE).

Suggestions and comments on the 85-page report — which has been made public — will have to be furnished electronically within 30 days from the date of its publication on the department's website, the CBDT has said.

Commenting on the draft report, Sandeep Jhunjhunwala, Director, Nangia Advisors (Andersen Global), said: "The report submitted by the committee is an exhaustive report, which provides insights into the economic basis for allocation of taxing rights in respect of business profits by looking at how economies contribute to business profits of multinational enterprises and also documents various international

practices for profit attribution". "Overall, the report looks detailed and is a move in the right direction to sort out the contentious issue of profit attribution in case of PE constitution. An active participation from the industry in the reason-governed deliberation process would ensure that the final rules are fair in all ways," Jhunjhunwala said.

Amit Maheshwari, Partner, Ashok Maheshwary & Associates, said that the draft report by the CBDT committee on profit attribution to PE deems 2 percent of revenue derived from India as profit attributable to Indian operations inspite of having losses on a global level.

This will impact several PE especially of infrastructure projects which have been into chronic losses lately, he said. Assuming that if MNEs are continuing with Indian operations inspite of losses, there has to be higher profits is not correct, Maheshwari said.

Govt panel submits report on taxing foreign companies

INDIVIAL DHASMANA

New Delhi, 18 April

A Central Board of Direct Taxes (CBDT)-appointed committee has submitted a report on taxing the profits of non-residents, including multinational corporations, with a permanent establishment (PE). A PE is a fixed place of business that generally gives rise to tax liability in a particular jurisdiction.

The board has invited suggestions from stakeholders within a month. India deals with the issue under the provisions of the Income Tax Act, and the Double Taxation Avoidance Agreements (DTAAs) with individual countries. There are various ways suggested by the panel to attribute profits to companies operating in India.

On profit attribution, the report states that profits derived from India need to be defined objectively. The same could be arrived at by multiplying the revenue derived from India with the global operational profit margin, it

said. A deeming global operational profit of 2 per cent has also been acknowledged by the committee for this purpose. For business models in which users contribute significantly to profits of the enterprise, the user base could be taken into account for profit attribution as the fourth factor for apportionment — in addition to sales, manpower and assets — the report said.

Weightage in the range of 10-20 per cent has been assigned to the user base. The Committee has recommended that profits derived from Indian operations should be the higher of — amount arrived at by multiplying revenue derived from India with the global operational profit margin, or 2 per cent of the revenue derived from India.

“Overall, the report looks detailed and is a move in the right direction to sort out contentious issues of profit attribution in the case of permanent establishment,” said Sandeep Jhunjhunwala, director at Nangia Advisors.



India proposes to broaden its tax laws to include "users" when determining what share of a company's profits can be attributed to its Indian operations and claimed as tax.

Photographer: Oli Scarff/AFP/Getty Images

India Proposes Changing Tax Rules to Catch Digital Companies

By Benjamin Parkin

Apr. 18, 2019 12:33PM

- *Report proposes considering company's "users" when calculating tax*
- *Changes would boost tax claims on foreign digital multinationals*

India wants to broaden its tax calculation rules to include the number of individuals using a foreign company's services, advancing its quest to boost taxation of large digital companies.

In an April 18 report, the tax office proposed including users—alongside established metrics like employees and assets—when determining what share of a multinational's profits are attributable to their Indian operations and can therefore be claimed as tax.

If the change goes ahead it will give India a new tool with which to pursue digital giants, like Alphabet Inc.'s Google and Facebook Inc., for taxes that it says they are able to sidestep.

Governments like India are concerned that their revenue is suffering due to the rise of digital businesses that are able to do business in a country without setting up shop, and so escape the tax net.

The report is open to public consultation for 30 days following its release. Any changes to the law would only advance once a new government is in place after national elections ending late May.

"Given the rapid expansion of digital economy and the ongoing developments related to rules governing its taxation, it may be necessary to monitor the role of users and their contribution to profits in future and accordingly assess the need for considering a review of the weight assigned to users in subsequent years," the report said.

Very Significant Change'

India last year introduced into law the concept of "significant economic presence," which would allow officials to claim taxes on foreign companies that do substantial business in India even if they don't have a physical presence, or permanent establishment. The move came amid global efforts, coordinated at the Organization for Economic Cooperation and Development, to remake global tax rules in order to find new ways to tax digital companies—though other countries have disagreed with India's approach.

The significant economic presence rules aren't yet in effect, however, and the tax department hasn't released final rules on how they will be enforced.

Sandeep Jhunjhunwala, a director at Nangia Advisors LLP, said that, like the significant economic presence provision, the amendment proposed in the report broadens the scope of what revenue India can claim from foreign digital companies.

"This is going to be a very, very significant change in the tax rules," he said. "It is important for some of these companies that work on digital business models. Their billing entities could not be in India. But they will derive revenue based on users which will be very, very significant."

The amendment could help tax officers when it eventually comes to enforcing significant economic presence rules, as a foreign company's online Indian users could be one way of determining that their operations are "significant" enough to incur taxes.

To contact the reporter on this story: **Benjamin Parkin** in New Delhi at correspondents@bloomberglaw.com

To contact the editors responsible for this story: Meg Shreve at mshreve@bloombergtax.com; Megan Pannone at mpannone@bloombergtax.com