



Indian national flags fly outside the North Block of the Central Secretariat buildings, which houses the Ministries of Finance and Home Affairs, in New Delhi.

Photographer: Anindito Mukherjee/Bloomberg

## India Physical Presence Tax Ruling Is Boon to Foreign Companies

By Benjamin Parkin

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- *Ruling helps multinationals defend against broad claims on their income*
- *India is finalizing guidelines to expand tax net to capture more foreign companies*

Multinationals looking to stay out of India's widening tax net may have a new tool: A recent ruling that quashed authorities' attempts to tax income from a company based outside India.

Practitioners said companies structuring their operations to remain abroad could use the recent case of Twenty-First Century Fox Inc.'s Hong Kong-based TV channel distributor to argue against claims on their income.

The case is a rare win for multinationals in India, where tax authorities have been increasingly aggressive in challenging their claims and finding that they have a physical presence—or permanent establishment—in the country. India is finalizing a provision to tax companies without a significant economic presence, considering factors such as the number of Indian users they interact with online.

Mumbai's Income Tax Appellate Tribunal said in a recent judgment that tax officers couldn't claim tax on income that Fox International Channel Asia Pacific Ltd. derived from business outside the country, reaffirming the importance of physical presence for taxation.

The ruling, released Feb. 28, applies only to the Mumbai tribunal's jurisdiction, Pune-based chartered accountant Chetan Daga said, but companies elsewhere can use this ruling to bolster their cases.

Foreign companies could draw on it to defend the position that they don't owe tax because they don't have a physical establishment, even if the significant economic presence provision brings an expanded definition of what can be taxed, said Rahul Garg, a partner at tax advisory firm Heads Up Consulting. "Through this ruling, they can still rely on the traditional concept of business connection," he said.

India and governments around the world argue "that taxing rights should stem from economic value addition, and not just from a physical nexus," Garg said.

## 'Territorial Nexus'

In its judgment, tax officers had argued that the law allowed them to tax Fox International on income worth 2.5 billion rupees (\$36 million), which was derived from business with both Indian and non-Indian entities. India's income tax act, the department said, "brings to tax any income accruing or arising whether directly or indirectly through or from any business connection in India."

The tribunal, however, held that Indian officers needed to show a "territorial nexus" before claiming tax on the income. It sent the case back to a tax officer for new assessment, which could prompt more appeals. Practitioners said the tax department's argument stretched the current law because profits need to come from Indian operations, but its position could carry more weight in the future.

"They tried to apply a very wide definition, which is not very applicable," said Nitin Narang, a transfer pricing partner at Nangia Advisors LLP. "Once the rules for significant economic presence come in, it'll be interesting to see these judgments in light of the rules."

"They will try to expand nexus or attribution whatever way they can argue," said Meyyappan Nagappan, a leader at law firm Nishith Desai Associates' international tax practice.

Fox International and India's income tax department didn't respond to requests for comment.

## More Cases

Practitioners say they expect this issue to become more contentious as concern about untapped tax revenue prompts India to pursue more claims against companies doing business without a physical presence.

India will release significant economic presence guidelines in the first half of 2019. The Organization for Economic Cooperation and Development last month started seeking public feedback on proposals for new ways to levy tax on digital businesses, including the significant economic presence concept, as part of a coordinated global effort.

"We'll see more and more rulings coming on this particular issue," Daga said. "As the concept of significant economic presence becomes operative, as we see more guidance come from the

OECD, this manner of attribution of profits to activity done in India could undergo significant changes.”

Cases last year involving General Electric Co. and Mastercard also lowered the bar for what constituted a permanent establishment, helping authorities to claim tax on their income.

## Coming Ashore?

The ruling gives ballast to those that opt to continue conducting business from abroad at a time when many others are setting up permanent establishments, allowing them to preempt potentially costly litigation. The OECD said last year that companies like Amazon.com Inc., Facebook Inc., and eBay Inc. were among multinationals restructuring to conduct sales locally instead of remotely.

“There could be allegations of permanent establishment in the future. So they have set up their presence in India, routing operations through that,” Narang said. “That would help keep it simple.”