CBDT plan a blow to loss-making companies with India connection

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Loss-making multinational companies with a permanent establishment (PE) or business connection in India could be adversely hit if the income-tax (I-T) department's recent proposals are implemented.

According to domestic laws, an MNC having a fixed place of business in India is considered as having PE and is taxed.

According to proposals, as contained in the draft report released for public consultation, for companies with global losses or global profit margin of less than 2 per cent, the Indian profits would be deemed to be 2 per cent of the revenue or turnover.

This, tax experts argue, is an incorrect way of taxation and could impact multinational companies engaged in projects with a long gestation period, say the infrastructure sector, for instance.

"This will impact several PEs. Assuming that if MNCs are continuing with Indian operations in spite of losses, the proposal to treat it as higher profits is not correct," said Amit Maheshwari, managing partner, Ashok Maheshwary & Associates.

The continuation of Indian operations justifies the presumption of higher profitability of Indian operations, and in such cases, a provision that deems profits of Indian operations at 2 per cent of the revenue or turnover derived from India should be introduced, the report, by a committee appointed by the Central Board of Direct Taxes (CBDT), said.

The CBDT committee proposed to change the methodology for taxing multinational companies, including digital firms, with PE in India, by giving weight to domestic sales, employee strength, assets, and user base.

Amit Singhania, partner, Shardul Amarchand Mangaldas & Co, said the approach by CBDT considered the Supreme Court judgment in the Morgan Stanley case, which said if the Indian subsidiary had already been compensated at arms' length, then no further attribution was to be made to PE in terms of profits.

"However, computationally, the report provides for increase in attribution of profits and hence, further attribution may be required," Singhania added.

As such, the approach may lead to more attribution of profits in India.

In case of digital companies, the weight will be on additional fourth criteria of "user" base, the report said.

Maheshwari suggested that the methodology may be flawed as, although these digital companies such as LinkedIn, Gmail etc, do have a high user base in India, the revenue generation from users is quite low. Rakesh Nangia, managing partner, Nangia & Co., said profit attribution had been the most controversial and more litigated matter in international taxation. Though the formula mentioned in the report was likely to give more certainty and reduce disputes litigations, "The overall intent seems to be positive", he added.

The Central Board of Direct Taxes (CBDT) had on Thursday invited comments from stakeholders on the report within 30 days.

same for everyday necessities like bread, and luxury goods like BMW cars would either mean raising taxes on the poor or sacrificing too much tax revenue.

"We don't want a single tax rate. It's not feasible in India. We don't think it's advisable also," the BJP's Agarwal said. The party is planning to have three rates but the final number could change, he said.

Congress didn't return a request for comment.

Practitioners are divided on whether a single GST rate is necessary. Rakesh Nangia, founder of accountancy firm Nangia Advisors LLP, said reducing the GST to a single rate isn't as important as boosting revenue. "This is not a big challenge today," he said. "The bigger challenge is the amount which is not being captured in the books of account, people who are misusing the machinery."

Foreign Investors

India's political parties have proposed other tax policies they say will help to attract foreign investment and boost India's standing in the World Bank's global Ease of Doing Business rankings.

The BJP and Congress both have vowed to discontinue the controversial practice of retrospective changes to tax laws, a tactic that has previously been used to levy substantial tax claims on companies such as Cairn Energy PLC and Vodafone Group PLC.

Vikas Vasal, national tax leader at Grant Thornton India LLP, said reducing tax litigation should be a priority. Practitioners argue that tax officers too often launch claims against foreign companies that have limited merit—over, say, their transfer pricing practices—which can spark years-long legal disputes, but are ultimately struck down.

"If we look today, the government is the biggest litigator in the country on the tax front," he said. "The focus should be on cases where a thought process has been undergone to make sure that the chances of revenue [officers] getting the final verdict in their favour are huge."

The parties disagree on how to improve the system. A government panel is currently working on an overhaul of the country's direct tax code, with a draft proposal expected as soon as next month.

Congress says in its manifesto that it will enact a new code with "reasonable and progressive rates" in its first year of government.

But Agarwal says BJP will opt instead to reform the existing income tax act. He said the BJP will continue its project of lowering corporate taxes to 25 percent from 30 percent. While around 99 percent already pay the new rate, large multinationals still incur the higher amount.

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India's Parties Clash Over Cutting Good and Services Tax Rates

By Benjamin Parkin

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- *Ruling BJP wants three goods and services tax rates, while opposition Congress wants one*
- *Congress wants a new direct tax code, but BJP wants to reform existing act*

India's two major political parties say they will simplify the country's tax system and lower rates if they are voted into power next month, but they disagree on how to reform the troubled goods and services tax.

Prime Minister Narendra Modi's Bharatiya Janata Party (BJP), which in 2017 introduced goods and services tax (GST) reform, wants to consolidate the system's five tax rates into three, said Gopal Agarwal, the party's spokesman for economic affairs.

The BJP plan includes a 5 percent or lower tax rate for basic goods, a 12 percent to 18 percent rate for most other items, and a 28 percent rate for a handful of luxury and "sin" products.

Reducing the number of rates under the GST has been a key demand of businesses that say the tax system, while better than what existed before, is still too complicated. The International Monetary Fund and others have called for India to work towards fewer rates.

But the main opposition party, Rahul Gandhi's Indian National Congress—known simply as Congress—says it would leave only a single tax rate as part of its proposed "GST 2.0" reform, without specifying what that rate would be.

The two parties are facing off in national elections which run in several stages through May 19. Results are expected on May 23.

GST Debate

Broader tax reform is widely seen as a necessity in order to make India an easier place to do business, both by streamlining the GST and reforming existing income tax laws. Policy makers see this as key to attracting foreign investors and boosting sectors such as manufacturing, which they argue are needed to generate employment and export earnings. But party officials have clashed over how that should be achieved.

"Congress promises to review and replace the current GST laws with the GST 2.0 regime that will truly reflect the intent and purpose of a non-cascading, value-added, indirect tax," Congress says in its manifesto. "The GST 2.0 regime will be based on a single, moderate, standard rate of tax on all goods and services." The rate will be revenue-neutral, according to the manifesto.

But the BJP says that a single GST rate is only a pipe dream, given India's enormous size of around 1.3 billion people and rampant inequality. Opponents say a system that charged the same for everyday necessities like bread, and luxury goods like BMW cars would either mean

"Profit attribution to a Permanent Establishment (PE) is one of the most debatable issue. In the Indian context a number of disputes have arisen on the appropriate approach to attribution of profits to a PE. The Committee constituted by the CBDT to examine the existing provisions in

the domestic income tax law and tax treaties has recommended a balanced approach that allocates profits between the jurisdiction where sales take place and the jurisdiction from which supply happens. However, necessary safeguards have been put in place to ensure fair taxation by limiting excessive attribution on one hand. But at the same time, the rules are stringent enough to protect the interests of Indian revenue.

The detailed report of the Committee has considered various option for profit attribution and after much deliberation concluded that the option of 'fractional apportionment' based on apportionment of profits derived from India would be acceptable under the tax treaties as well as the Indian Income tax Act. The option of 'fractional apportionment' seems feasible since it is largely based on the information related to Indian operations. Pertinently, the Committee's recommendations have given due consideration to the fact that India is a capital-importing country and hence, it would be suitable to develop a new source principle to tax profits derived from the 'market jurisdiction'.

The three-factor method based on equal weight accorded to sales, manpower and assets, has been given due merit by the committee. Interestingly, in case of attribution of profits to a 'significant economic presence', the Committee has recommended user contribution as a substitute to assets or employees. Further, the committee has duly considered the option of following the approach of the EU in Common Consolidated Corporate Tax Base.

Overall, the report is a well thought and comprehensive document considering all the possible option of profit attribution of a PE. This collaborative approach is a move in the right direction to sort out the contentious issue of profit attribution in case of PE constitution. The report recommends far reaching changes to the current rules on profit attribution. The suggestion of the Committee to bring an amendment in the Income tax Act itself to incorporate a provision for PE profit attribution needs to be well-thought-out conjointly with the upcoming Direct Taxes Code.

However, the final rules should be aligned with the international tax principles emerging from the Organization for Economic Co-operation and Development (OECD) guidance on PE attribution as well as the OECD Transfer Pricing Guidelines for Multi-National Enterprises and Tax Administrations (OECD TPG). It is also important to consider the potential risk of double taxation if the final rules are not consistent with the tax treaty under consideration. An active participation from the industry in this reason-governed deliberation process would ensure that the final rules on PE profit attribution are fair in all ways."