

MNCs with permanent establishment to pay tax on pre-negotiated income

Shrimi Choudhary | New Delhi Last Updated at February 10, 2020 01:14 IST

Budget 2020 has expanded transfer pricing provision to PEs' profit.

Multinational companies (MNCs) having a permanent establishment (PE) in India could soon get clarity on taxes they are supposed to pay.

In the Union Budget 2020, the government allowed these firms to enter into advance pricing agreements (APAs) with the income-tax authorities. In those they can negotiate how much of the margins on profits accrued in India would be taxed for having a PE in India.

Until now, such an arrangement was possible only in transfer-pricing matters. Tax experts say the move will improve MNCs' compliance with Indian laws on PEs. In the absence of tax clarity, foreign firms avoided being qualified as such.

The new provision will allow about 3,500 foreign firms and 1,400 PEs to access APAs, or a safe harbour regime in which they can pre-decide the income for at least nine years (including the roll-back of four years) and accordingly pay tax. At present, the rate of tax on PEs is 43 per cent, including cess and surcharge, while subsidiaries of MNCs come under the corporate tax structure, which stipulates 25 per cent (under the new corporate tax regime).

Safe harbour refers to circumstances under which the income-tax authorities accept the transfer price declared by the assessee without any question or scrutiny. An APA is an agreement between taxpayer and tax authority for transactions over a fixed period.

"This is for greater tax certainty. A large number of disputes in international taxation are on the amount of profits that should be attributable to a PE in India and hence be taxed in India. Taxpayers can now enter into APAs, which will pre-decide an agreed amount of profit," said an official privy to transfer-pricing matters.

The provision would also give an opportunity to foreign subsidiaries that do not have a PE though some of their services mandate entering into an APA, the official added.

For instance, certain segments of foreign subsidiaries deal with royalty payments to headquarters because they involve technical and consultancy services. These segments come under the purview of PE. In that case, the parent company (based overseas) can enter into an APA, the official said.

Making Corporate India Comply

- New provisions would cover MNCs in the form of PE, foreign subsidiary
- Allow them to ascertain profit attributable to Indian presence
- Applicable on all services rendered in India which trigger PE tax status
- Gillette, IBM, Sony, Oracle, Philips, HUL, Audi operate in India as foreign subsidiary
- Tax litigation arises over foreign firms' operations
- At present, tax rate on PE status attracts 43%, foreign subsidiary pays 25%
- Tax status of digital firms such as Amazon, Netflix, Facebook under deliberation
- India awaiting OECD final outcome, to activate tax on these

While the concept of PE is there in the double tax avoidance agreement, attributing an appropriate amount of profit to such PEs has always been a contentious issue. Experts say identifying a PE often results in tax disputes.

Shilpa Bhatia, director, direct taxes, Ashok Maheshwary & Associates LLP, said: "Earlier APAs were possible in the case of determining arm's length price or the manner in which arm's price was to be determined in relation to international transactions to be entered into by the person. Now the government has covered determining attribution to PE within the scope of APA."

The Central Board of Direct Taxes (CBDT) had last year proposed a draft to deal with profit attribution concerning PEs. The body observed business profits were a result of both supply- as well as demand-side factors. It also took into consideration the guidance under international best practices, judicial precedents, and the data gathered from the field, and has accordingly recommended adopting a fractional apportionment approach. The apex body also talked about the margin under the safe harbour regime.

"The margin they are going to prescribe under the safe harbour regime should not be unreasonably high. The approach recommended by the CBDT has a high mark-up margin, which foreign players may not accept," said Nikhil Rohera, partner, PwC.

Meanwhile, the government's tax framework under a "significant economic presence" or digital permanent establishment was introduced in 2018 and was supposed to be operative in April next year.

The government has postponed this because it is waiting for the Organisation for Economic Co-operation Development to come up with final guidelines on taxing foreign firms. The OECD will finalise the rules by the end of this year.