NITI Aayog Proposes Presumptive Taxation for Foreign Companies

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Presumptive Taxation Latest News

- NITI Aayog has proposed an **optional presumptive taxation regime for foreign companies** to reduce tax disputes, simplify compliance, and attract greater foreign direct investment into India.

Introduction

- India has emerged as one of the most attractive investment destinations in the world, with cumulative **foreign direct investment** (FDI) inflows crossing USD 1 trillion between April 2000 and March 2025.
- However, persistent taxation disputes, particularly around **Permanent Establishment (PE)** rules and profit attribution, have been a recurring concern for multinational companies.
- To address these issues, **NITI Aayog has proposed an optional presumptive taxation regime for foreign companies**, aiming to reduce litigation, improve compliance, and encourage higher FDI inflows.

Understanding Presumptive Taxation

- Presumptive taxation is a simplified tax regime where taxable income is calculated as a fixed percentage of gross revenue, rather than through detailed accounting.
- This mechanism reduces the compliance burden, avoids prolonged disputes, and provides certainty to businesses.
- India already uses presumptive taxation in limited sectors such as:
  - **Electronics manufacturing services**: 25% of gross payments are deemed as profit.
  - **Non-resident cruise operators**: 20% of gross receipts deemed as profit.
- NITI Aayog's proposal seeks to extend this principle across sectors, particularly those involving digital services, technology, and offshore supply, where disputes are more common.

Key Features of NITI Aayog's Proposal

- The proposed presumptive tax system introduces several reforms designed to simplify taxation for foreign companies:
  - **Optional Participation** – Foreign companies may choose between the presumptive regime and continue under the regular tax framework.
  - **Sector-Specific Rates** – Profit attribution percentages would vary across industries, ranging between 5% and 30%. For example, in technology, 5% of offshore supply and 20% of onshore services could be deemed profitable.
  - **Safe Harbour Protection** – Companies opting for presumptive taxation would not face litigation over the existence of a PE for those activities.
  - **Reduced Compliance Burden** – Firms would not need to maintain exhaustive local books or undergo prolonged audits.
  - **Flexibility** – Companies could revert to the regular regime if their actual profit is lower than the presumptive rate.

Rationale Behind the Proposal

- **Tackling PE and Profit Attribution Disputes**
  - Determining whether a foreign company has a **Permanent Establishment in India** has often been subjective, especially in the digital economy. Disputes on profit attribution can last 6-12 years, increasing costs for businesses. A presumptive taxation regime provides certainty and sidesteps prolonged litigation.
- **Aligning with Global Practices**
  - The proposal suggests codifying PE and profit attribution rules in domestic law while aligning them with **OECD and UN tax models**. This ensures India remains internationally competitive while protecting its source-based taxing rights.
- **Enhancing FDI and Ease of Doing Business**
  - By offering clarity, predictability, and a reduced compliance burden, the regime is expected to attract higher-quality FDI, particularly in digital and service-based industries.

Industry Reactions

- Experts say that the scheme provides a clear path forward by eliminating ambiguities around PEs, reducing disputes, and lowering the costs of doing business.
- Also, sector-specific benchmarks allow businesses to plan operations efficiently, offering both clarity and reduced litigation risks.

Challenges in Implementation

- **Revenue Concerns** – The government must ensure that the regime does not lead to significant revenue leakage.
- **Sector-Specific Rates** – Determining fair presumptive percentages for multiple industries will be complex.
- **Centre–State Coordination** – While direct taxes fall under the Centre, some coordination with states will be required.
- **Data Privacy Issues** – Safe harbour provisions may raise concerns about handling corporate financial data.

Way Forward

- The NITI Aayog report recommends a **multi-pronged approach**, including:
  - Expanding **Advance Pricing Agreements (APA)** and **Mutual Agreement Procedures (MAPs)** for quicker dispute resolution.
  - Establishing a formal consultation framework with industry bodies before major tax reforms.
  - Considering binding arbitration for international disputes.
- The Finance Ministry is expected to examine the proposal and may include it in future budgetary reforms, potentially constituting a working group to draft provisions and consult stakeholders.

Source : FE | BS
