Deloitte.

Tax alert: NITI Aayog releases working paper on PE and profit attribution

10 October 2025

The NITI Aayog has released the first working paper '**NITI Tax Policy Working Paper Series–I** - *"Enhancing Tax Certainty in Permanent Establishment and Profit Attribution for Foreign Investors in India."*

Background

As India advances towards its 2047 vision of a Viksit Bharat, creating a transparent, predictable and efficient regulatory and tax architecture is a critical pillar for sustaining long-term economic growth. The Niti Aayog[1] established a 'Consultative Group on Tax Policy' (CGTP) with a strong emphasis on collaborative governance. Through the consultative approach, various themes have been identified to facilitate the Ease of Doing Business, promote FDI, simplify tax laws and processes, and make the system future ready.

As a part of these themes, the NITI Aayog has issued its first working paper[2] - **NITI Tax Policy Working Paper Series–I**, titled *"Enhancing Tax Certainty in Permanent Establishment and Profit Attribution for Foreign Investors in India"* (Paper).

The Paper presents a picture of the opportunities available in refining the government's approach to Permanent Establishments (PE). The findings of the Paper emphasize the importance of clear, consistent and internally aligned PE regulations.

The key findings of the Paper are discussed below:

- **The Critical Nexus of Permanent Establishment, Profit Attribution, and India's Investment Climate**
  Foreign direct investment (FDI) and foreign portfolio investment (FPI) are vital catalysts for India's economic growth. A stable, predictable, and transparent tax regime is fundamental to instilling confidence in foreign investors, enabling them to accurately assess risks and returns.
  The taxation of foreign enterprises operating within a jurisdiction is fundamentally governed by the concepts of PE and the attribution of profits thereto. A critical implication of PE determination is that if a foreign enterprise is deemed to have a PE in India, only the portion of its business income that is "attributable" to that PE, is taxable in India, typically governed by Article 7 of DTAAs and principles of transfer

[1] NITI Aayog serves as the apex public policy think tank of the Government of India, and the nodal agency tasked with catalysing economic development, and fostering cooperative federalism through the involvement of State Governments in the economic policy-making process using a bottom-up approach.

[2] https://niti.gov.in/sites/default/files/2025-10/Tax_Policy_Paper_WEB.pdf

pricing. The complex task of attributing profits to a PE, leads to differing views between tax authorities and companies and potential for higher tax demands.

A transparent, stable, and reasonable tax regime concerning PE and profit appropriation is fundamental to attracting and retaining FDI, allowing foreign investors to accurately assess risks and returns and fostering confidence.

- **Evolution of PE Law in India: A jurisprudential review**

  India's approach to PE has evolved significantly, reflecting its status as a capital-importing country keen on source-based taxation. This journey from the broad concept of "business connection" to the more nuanced modern PE interpretations, has been shaped by a series of landmark court rulings. The Paper discusses certain PE rulings[3] on issues relating to constitution of a PE and how profits should be attributed to the PE.

- **Evolution of profit attribution law in India: Addressing historical inconsistencies**

  Profit attribution has proven to be highly litigious and inconsistent over time, largely due to the absence of specific rules in Indian law, which often lead tax officers to resort to rough estimates under Rule 10 of the Income-tax Rules, 1962 (Rules).

  The trajectory of profit attribution in India indicates a shifting philosophy: from arbitrary and aggressive demands to a more nuanced, yet firm assertion of source-based taxation, particularly emphasizing market contribution. The ruling in the case of Hyatt, marked a shift by treating Indian PEs as independent entities, allowing India to tax locally created value even if the global enterprise is unprofitable.

  Based on the rulings referred, attribution rates varied widely by industry, from as low as 0-5% of revenues in heavily regulated/low-margin sectors (airlines, shipping) up to 35% of profits in cases of high-value marketing PEs. The reasoning often hinged on the functions performed in India versus that abroad. Where Indian operations were auxiliary or already compensated (as in BPO services, or when a commission agent is paid), courts were willing to say that no further profit was taxable. But where Indian operations were pivotal to sales or customer acquisition, courts had endorsed taxing a substantial share.

- **Impact of PE and profit attribution uncertainty on foreign investment in India**

  Uncertainty in India's tax rules for PE and profit attribution directly impacts the flow of foreign investment. Foreign investors want tax certainty and predictability. When the rules are ambiguous, it adds a significant risk that can discourage FDI and FPI.

  While India attracted significant FDI inflows, improvements in tax certainty and predictability are essential to sustain and enhance this growth.

- **Examining the case for presumptive taxation and international best practices**

  The primary rationale for presumptive taxation approach stems from the inherent uncertainties in traditional PE profit attribution systems, which often lead to litigation, inconsistent outcomes, and tax unpredictability. The key reasons, drawn from tax policy discussions and proposals emerge as follows:

  - Reduces discretionary powers and subjectivity
  - Addresses lack of uniform standards

---

[3] Motorola Inc. v Deputy Commissioner of Income-tax, Non-Resident Circle, [2005] 147 Taxman 39 [Delhi-Trib (SB)], Director of Income-tax (International Taxation) vs. Morgan Stanley & Co. [2007] 162 Taxman 165 (SC), Rolls Royce Plc. vs. Deputy Director of Income-tax [2009] 34 SOT 508 (Delhi-Trib), Set Satellite (Singapore) Pte. Ltd. vs. Deputy Director of Income-tax, International Taxation [2008] 173 Taxman 475 (Bombay HC), Amadeus Global Travel Distribution S.A. vs. Deputy Commissioner of Income-tax Non-resident Circle [2011] 11 taxmann.com 153 (Delhi-Trib), Director of Income-tax vs. Galileo International Inc. [2009] 180 Taxman 357 (Delhi HC),
Assistant Director of Income-tax-1, New Delhi vs. E-Funds IT Solution Inc. [2017] 86 taxmann.com 240 (SC), Formula One World Championship Ltd. vs. Commissioner of Income-tax, (International Taxation)-3, Delhi [2017] 80 taxmann.com 347 (SC), Hyatt International Southwest Asia Ltd. vs. Additional Director of Income-tax [2025] 176 taxmann.com 783 (SC)

- Simplifies compliance and administration in complex scenarios
- Mitigates litigation and enhances tax certainty
- Protects Revenue interests while promoting fairness

Overall, while presumptive taxation may not fully replace detailed methods in all cases (e.g., where reliable accounts exist), it offers a compelling solution for high-uncertainty contexts, as evidenced by reforms in India and analogous global models. However, successful implementation requires international alignment to avoid reciprocity issues or double taxation.

The existing sections of presumptive taxation like sections 44AD, 44ADA of the ITA for small domestic taxpayers (businesses and professionals) and for certain non-resident sectors (shipping– section 44B, oil & gas services – section 44BB, airlines – section 44BBA, cruise ship operators-section 44BBC, electronics manufacturing services-44BBD), show that India has successfully used presumptive taxation to simplify compliance and ensure revenue from sectors with unique operational challenges, such as highly mobile assets like ships or complex project-based services like oil and gas.

- **Strategic recommendations for enhancing tax certainty and predictability**
  Below are the key steps, which are discussed in detail in the Paper, to create a more attractive investment climate through a virtuous cycle where clearer laws lead to fewer disputes, better administration that builds trust, and effective dispute resolution which provides finality, all contributing to a more attractive investment climate.
  - Legislative clarity and certainty
  - Enhanced stakeholder engagement
  - Robust dispute resolution mechanisms
  - Capacity building and consistency
  - Introduction of optional presumptive taxation scheme
- **Proposed optional Presumptive taxation scheme - Key Features**
  - The proposed scheme includes several key features designed to enhance certainty and simplify compliance, which are as follows:
    - **Industry-specific presumptive profit rates**: The scheme will list specific sectors or business models and assign a deemed profit percentage on gross receipts earned in India for each which will represent the profit attributable to Indian operations subject to Indian corporate tax.
    - **Optional regime (rebuttable presumption):** The presumptive regime will be optional for the taxpayer. A foreign company can choose to opt in for a given financial year, declare income as per the presumptive percentage, and pay tax. If it believes its actual profits attributable to India are lower than the presumptive figure, it can opt out and file a normal tax return with supporting audited Indian books.
    - **No separate PE determination needed (Safe Harbour):** A critical aspect is that if a foreign company opts for presumptive taxation for a particular activity, the tax authorities would not separately litigate the existence of a PE for that activity.
    - **Safe Harbour for PE Attribution:** Existing safe harbour rules (section 92CB of the ITA) should be expanded to include transaction and remuneration approaches, along with arm's length rates for PE attribution, providing greater clarity and streamlining compliance.
    - **Advanced Pricing Agreement (APA) for PE attribution:** The CBDT should actively promote bilateral APA negotiations involving PE attribution, particularly in cases where foreign enterprises operate in India through branches or project offices.

- **Coverage of taxation scope:** The presumptive provisions should clarify that when income is offered to tax under them, such income shall not be subject to any other provision of the ITA that could yield a higher tax.
- **Administrative simplicity and audit:** For those opting in, compliance should be straighforward, exempting foreign entities from detailed Indian accounting. Opting out requires maintaining and auditing India-related accounts, discouraging misuse.
- **Treaty Eligibility for US Limited Liability Companies (LLCs)[4]:** Treaty eligibility under the India-USA tax treaty should be explicitly extended to fiscally transparent US LLCs that meet Limitation of Benefits (LOB) criteria, facilitating dispute resolution access to APA and MAP mechanisms for such entities. Extending tax treaty benefits to these LLCs would formalize a position that has been largely upheld by Indian tax tribunals but is still a source of uncertainty. It would align India's tax policy with the global trend of recognizing fiscally transparent entities and provide a stable framework for dispute resolution.
- **Scope of activities and nexus:** The rules should enumerate the types of Indian activities and income each presumptive rate applies to, aligning with common dispute scenarios.

– **Anticipated benefits**

Implementing this presumptive regime is expected to yield several significant benefits which are as follows:

- Dramatic reduction in litigation
- Boost to Investor confidence and ease of doing business
- Administrative efficiency
- Revenue safeguard with Potential upside
- Alignment with "Make in India" and market facilitation
- Encouraging compliance

– **Implementation Considerations**

While the presumptive scheme offers substantial benefits, careful implementation is required:

- Legislative changes
- Treaty Override or compatibility
- Rate setting authority
- Anti-abuse measures
- Awareness and guidance
- Sunset clause or review

- **Conclusion: Paving the way for sustainable foreign investment**

India has demonstrated remarkable success in attracting foreign investment over the past two decades, a testament to its inherent economic potential. However, persistent challenges related to the interpretation of PE, the complexities of profit attribution and lingering regulatory uncertainty, continue to pose significant risks for foreign investors. The global shift towards substance-based taxation, exemplified by recent SC rulings, and the ongoing evolution of international tax norms under the BEPS project, necessitate a proactive and adaptive approach from India. A stable, transparent, and predictable tax regime is not merely a compliance issue; it is a fundamental driver of sustainable economic growth and attracts high-quality, value-adding FDI.

The next steps would involve the Ministry of Finance considering these recommendations, possibly

[4] fiscally transparent US LLC is an entity that, for US federal income tax purposes, is not taxed at the entity level. Instead, its income, gains, losses, and deductions "pass through" to its owners or members, who are then individually taxed on their share of the income. This is in contrast to a corporation, which is taxed on its profits at the entity level

constituting a working group to draft the legal provisions, consulting with stakeholders (industry bodies, tax professionals, treaty partners), and including the final proposals in an upcoming Finance Bill.

Comment:

In a competitive, globalized world, tax schemes are also essential distinguishing criteria that can induce foreign investment by significantly contributing to the ease of doing business. The Paper is aimed at marking a step towards transparent and predictable tax architecture.

One would now look forward to the Paper's recommendations being taken up for discussion, legislation and implementation by the Ministry of Finance. Also, this being one of the first working Paper, one can look forward to the framework which may be recommended in the upcoming papers by NITI Aayog.