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DIRECT TAX ALERT

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Working paper by NITI Aayog on PE
and profit attribution for foreign
investors in India

NITI Aayog releases working paper to improve certainty, transparency and uniformity in Permanent Establishment and profit attribution for foreign investors

Background

On 3 October 2025, NITI Aayog's Consultative Group on Tax Policy released its first working paper, focused on standardizing the taxation framework for foreign companies operating in India. The initiative aims at mitigating tax uncertainty, enhancing the ease of doing business, attracting greater Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI), and lay the groundwork for a more predictable, future-ready tax system. Acknowledging ongoing litigation over Permanent Establishment (PE) and profit attribution, the Consultative Group recommends expanding the scope of optional presumptive taxation to non-resident companies across a wider range of sectors, beyond those covered under the existing provisions¹ of the Income-tax Act, 1961.

The Consultative Group recognizes the various provisions that govern the principles of PE and profit attribution viz., business connection and the Significant Economic Presence (SEP) under domestic laws, the tax treaties and global tax reforms such as MLIs and the BEPS project². The Consultative Group also takes note of some of the leading judicial precedents related to PE attribution, the time taken to get dispute resolutions and the trend of tax authorities starting with higher profit attribution which get reduced by the judicial authorities. The overall trend has been a decline in the proportion of profits attributed over the decades: from assessing officers pushing 50%+ in

the late 1990s, tribunals cutting down to 30-35% to courts preferring the 10-20% range or even 0% if ALP was proven. With the draft rules³ as guidance and increased awareness, attributions are anticipated to standardize, perhaps around the 15-25% effective range for typical cases.

The Consultative Group has given certain strategic recommendations for enhancing tax certainty and predictability, recommendation for presumptive taxation and certain other recommendations for taxation of foreign companies.

Strategic Recommendations for enhancing tax certainty and predictability:

- Recognizing the need for legislative, administrative, and strategic alignment with global best practices, the Consultative Group gave the following key recommendations to ensure successful implementation of their proposals.
 - Legislative clarity and certainty – to codify PE and profit attribution principles within the domestic laws and align the same with internationally accepted interpretations. The Group also suggests limiting retrospective amendments to exceptional circumstances.
 - Enhanced stakeholder engagement – to seek and incorporate public consultation with industry bodies, tax experts and also foreign investor associations.

¹ Section 44B (Shipping), Section 44BB (Oil & gas services), Section 44BBA (Airline operators), Section 44BBB (Civil construction), Section 44BBC (Cruise ship operators), Section 44BBD (Electronics manufacturing services/technology)

² Action 7 on Prevention of Artificial Avoidance of PE, Pillar one and Pillar 2 providing for Profit Allocation Rules and Global Minimum Tax

³ Issued by a committee set up by CBDT in 2019 to amend rules for profit attribution to PE

- Robust dispute resolution mechanisms – to strengthen the APA and MAP programs and explore adoption of mandatory binding arbitration for unresolved cases.
- Capacity building and consistency – by implementing comprehensive training programs for the Tax authorities.
- Introduction of optional presumptive taxation scheme.

Presumptive taxation and its key advantages:

- With the objective of enhancing certainty, the Consultative Group has recommended adoption of presumptive taxation, i.e., simplified, formula based or deemed profit approach. Under this method typically a fixed percentage of the revenue is presumed to be taxable income. The Consultative Group stresses that while OECD's approach emphasizes arm's length principles based on FAR, presumptive methods are seen as a practical alternative when actual attribution is complex or contentious, reducing the risk of double taxation and disputes.
- The Consultative Group notes various advantages of the presumptive taxation:
 - Setting uniform standards by providing a consistent framework.
 - Simplification of compliance and administration in complex scenarios.
 - Mitigation of litigation and enhancement of tax certainty.
 - Protection of Revenue interests while promoting fairness.
 - Boost investor confidence, enhance ease of doing business in India.
 - Reduction in subjectivity and use of discretionary powers – in application of Rule 10 for profits attribution.

Key features of the proposed optional presumptive taxation scheme:

- Industry specific presumptive profit rate – determined on the basis of historical data,

industry profit trends and a margin of safety to protect revenue.

- Optional Regime – with an option to a foreign taxpayer to opt out when it believes its actual profits attributable to India are lower than the presumptive profits.
- Elimination of separate determination of PE by tax authorities in cases where the presumptive scheme is opted for (safe harbour).
- Scope of taxation – when income is offered under the presumptive scheme, the same shall not be subject to any other provision of the domestic laws.
- Administrative simplicity by elimination for the need to maintain detailed accounts and get them audited when presumption scheme is adopted.

Sample presumptive rates

- The Consultative Group proposes some sample provisional presumptive profit rates⁴ for key industries along with the rationale as follows:

Industry / Sector	Proposed Presumptive Profit Rate (on gross receipts)	Rationale
Telecom/ Technology Equipment Supply with Installation	5% (supply portion), 20% (services portion)	Recognizes lower profit margins on offshore equipment supply (5%) and higher margins for onshore services/installation (20%). Aims to avoid litigation over contract splitting.
Infrastructure Construction/ EPC	10%	Aligned with existing Section 44BBB (10% for power project construction). Provides certainty for long-term projects, balancing revenue protection with administrative ease.
Engineering Services/Oilfield Services	10%	Aligned with Section 44BB (10% for oil/ gas services). Extends similar workable

⁴ These rates need to be fine-tuned by an expert panel, empowered by the CBDT to revise them prospectively with periodic review (e.g., every 5 years) to ensure alignment with economic reality.

Industry / Sector	Proposed Presumptive Profit Rate (on gross receipts)	Rationale
		treatment to other engineering services.
Marketing and Distribution Support	15% of gross revenue from India	A moderate rate between extremes, acknowledging the critical role of Indian marketing operations. Provides certainty to avoid larger attribution risks in audits.
General Services (Consultancy, Management, Software)	20% of gross fees	Mirrors new Section 44BBD (25% for specific electronics services). Offers a broader safe harbour, making it attractive to opt in while ensuring corporate tax contribution.
Digital / E-commerce (Online platforms, Streaming, etc.)	30% of gross revenue from Indian users	Reflects generally high profit ratios in digital businesses. Ensures India receives a fair share of digital economy profits without endless nexus debates.

partners to include clauses or protocols acknowledging the presumptive regime.

- The Presumptive Schemes effectiveness need to be measured periodically to recalibrate the scheme or withdraw it depending on evolution of new rules at global level.

Other recommendations

- Expansion of safe harbour rules to include transaction and remuneration approaches, along with arm's length rates for PE attribution.
- APA for PE Attribution – with a framework for outlining modalities, including acceptable attribution methods, documentation standards, etc.
- Clarity on eligibility of India-US tax treaty to fiscally transparent US LLCs in order to facilitate access to the dispute resolution mechanism as available under the tax treaty.

Other aspects

- The Consultative Group recommends that India may also consider negotiating with major treaty

DHRUVA INSIGHT

It is important to note that the paper is released by NITI Aayog as a policy recommendation and would require amendment to the provisions of the Income Tax Act. In 2019, a committee set up by CBDT issued draft profit attribution rules for public comments, which have not yet been finalized.

The Consultative Group addresses long-standing concerns over uncertainties surrounding PE and profit attribution. Assurance that opting for the presumptive scheme will prevent challenges to the constitution of a PE or demands for higher taxes from tax authorities would provide significant relief to foreign investors.

The prescribed rates of transfer pricing safe harbours by the Indian government are considered to be on the higher side by various stakeholders. Similarly, it is possible that the presumptive rates proposed by the Consultative Group are also considered to be on the higher side by the foreign companies.

The foreign companies are entitled to claim tax treaty benefits which will override the provisions of the domestic law (including the proposed presumptive scheme). The presumptive scheme may not create a conflict with the tax treaty provisions as it is proposed to be an optional scheme.

While the Consultative Group recommends presumptive method for attribution of profits to PE, it also makes recommendations related to APA for PE attribution. This may be mainly relevant from the perspective of cases where presumptive taxation scheme is not adopted by the foreign company.

The Consultative Group suggests that the foreign company need not maintain books of account when presumptive taxation is adopted. However, the foreign company may still be required to maintain financial statements for the India branch from the perspective of the corporate law.

It is interesting to note the recommendation of considering mandatory arbitration to resolve disputes for the reason that historically, at various international forums, India has consistently taken a stand against adopting mandatory arbitration.

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