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Tax Flash News

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Operational cost incurred by foreign head office and cross-charged to the Indian branch is deductible while computing the branch's profits

Executive summary

In the case of *FCS Computer Systems*[1], an issue arose whether expenses incurred by an overseas head office ('HO') and cross-charged to the Indian branch (Permanent Establishment/ PE) were deductible while computing the branch's business profits. The Revenue denied the deduction on the ground that as the branch and HO were the same person, purchases from itself were not allowable.

The Delhi Bench of the Income-tax Appellate Tribunal ('the Tribunal') has held that the Indian branch is entitled to deduct such reimbursed operational expenses because the PE must be treated as a distinct and separate enterprise under Article 7 of the India–Singapore tax treaty ('the Treaty').

The Tribunal ruled that denying such costs would effectively tax gross receipts instead of business profits, which is contrary to the Treaty principles. PE profits must be computed independently after allowing all expenses incurred for the PE's business.

[1] *FCS Computer Systems S Pte Ltd.* v. *ACIT* (ITA No.1034/Del/2025)

Facts of the case

The taxpayer, a tax resident of Singapore, was engaged in providing hospitality technology solutions.

It established a branch office in India to sell hotel operations software and to provide support and maintenance services to the customers in India.

The taxpayer accepted that its Indian branch constituted a PE in India under the Treaty and had offered business profits attributable to the PE to tax in India.

During the relevant year, the Indian branch received debit memos from the Singapore HO, representing costs towards the following items:

- **Software procurement**: Indian branch sold software; it placed orders with Singapore HO, which sourced software from another Malaysian group company and supplied to the branch on a cost basis without markup.
- **Maintenance services:** Maintenance services to Indian customers was provided by the Malaysian group company. Charges were billed to Singapore HO and then cross-charged to India branch office without markup.
- **Call centre:** Group call centre was operating in the Philippines. Cost was charged to the Malaysian group company with markup, allocated across group entities; India's share was billed to the HO and then cross-charged to the Indian branch without markup.
- **Support subscriptions and courier charges:** HO paid certain subscription and courier costs for the branch and then cross-charged without markup.

The Revenue disallowed the above expenditure on the ground that as the branch/PE and HO were the same person, purchases from itself were not allowable.

Taxpayer's contentions

The payments were reimbursement in nature, supported by adequate documentation.

The branch's business necessarily required procurement of software products and support services. Without incurring the procurement and maintenance costs, the branch could not have sold the software or delivered services.

Article 7(2) of the Treaty[2] requires that profits be attributed to the PE as if it were a 'distinct and separate enterprise' dealing independently. Article 7 contemplates deduction of costs incurred for PE operations to compute those profits correctly. Taxing gross receipts while denying the corresponding costs would distort true business profits.

Tribunal's decision

The taxpayer was entitled to deduction while computing profits attributable to the Indian PE on the following grounds:

Business profits of PE must be taxed on net basis, not gross receipts.

Without purchase/procurement, the Indian sale would not be possible; therefore, the cost of procurement is inherently tied to earning revenue.

Denial of such costs would result in taxation of gross receipts, causing gross injustice and violating Article 7(2).

PE must be treated as a separate entity for profit attribution and therefore eligible for deduction of costs incurred for its business.

The Tribunal relied on the Supreme Court judgment in the case of *Hyatt International*[3] which reiterated that PE's activities are evaluated independently and the source state's right to tax does not depend on enterprise-level global profits/losses.

The Tribunal also referred to the Special Bench decision in *Mashreq Bank*[4], which emphasised that Article 7 requires allowing all expenses for PE business without importing domestic law restrictions unless the relevant tax treaty provides them.

Our comments

This ruling is particularly relevant where HO procures goods/services (including from other group entities) and recharges the Indian branch on a cost basis.

The taxpayers are advised to maintain adequate documentation to (a) support allocation workings, (b) evidence that expenses are cost-to-cost (no markup), and (c) substantiate linkage between costs and Indian revenues.

[2] Article 7 of the Treaty deals with the computation of business profits attributable to the PE

[3] *Hyatt International Southwest Asia Ltd.* v. *ADIT* [2025] 478 ITR 238 (SC)

[4] *Mashreq Bank PSC* v. *DCIT* [2025] 211 ITD 511 (Mumbai Tribunal)

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