

Provisions relating to Significant Economic Presence

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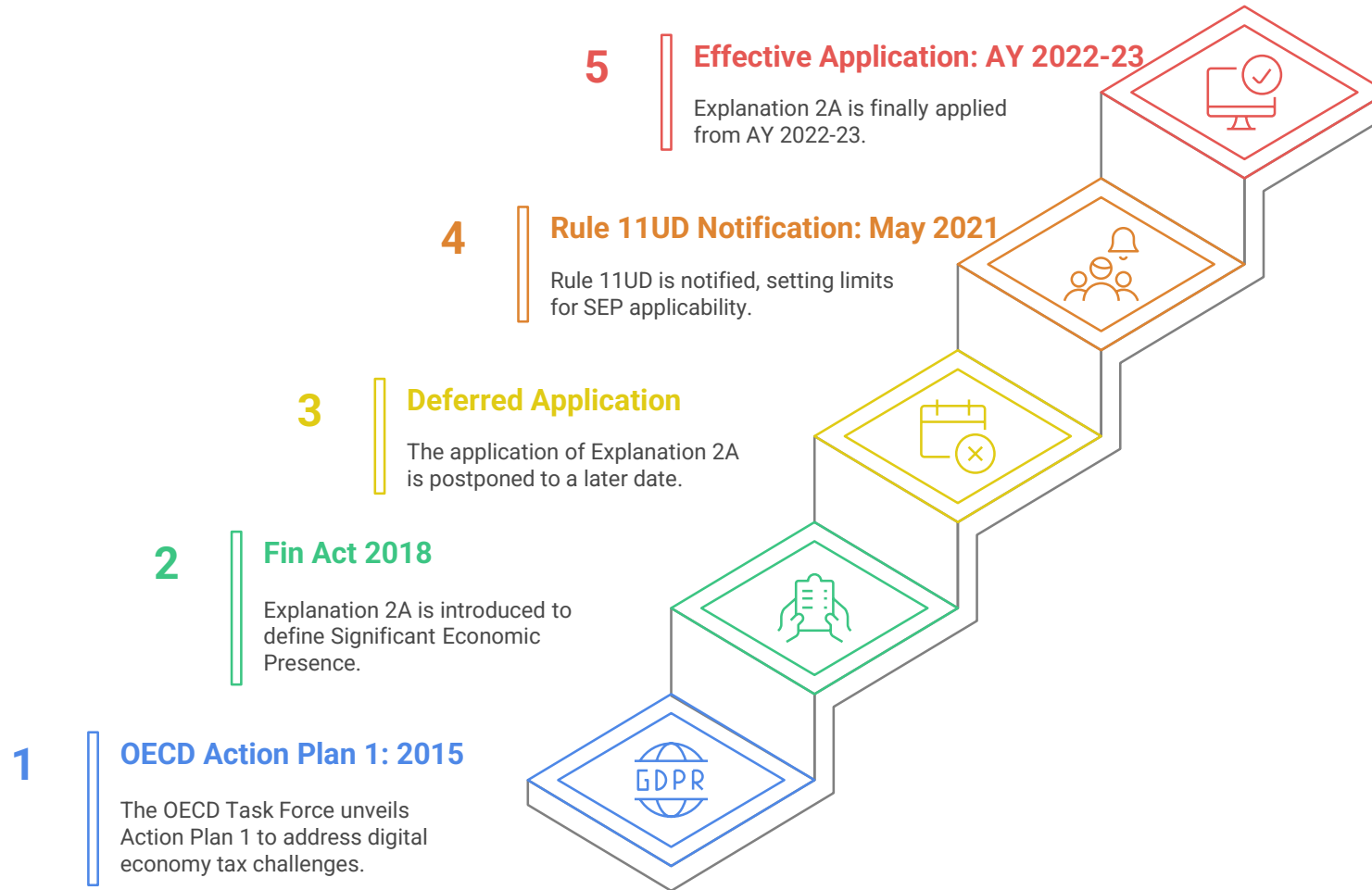
Agenda

| Sl. No | Particulars |
|--------|---|
| 1 | Origin of the concept of SEP |
| 2 | Explanation 2A to Sec 9(1)(i) and Rule 11UD |
| 3 | Special Aspects related to SEP |
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ORIGIN

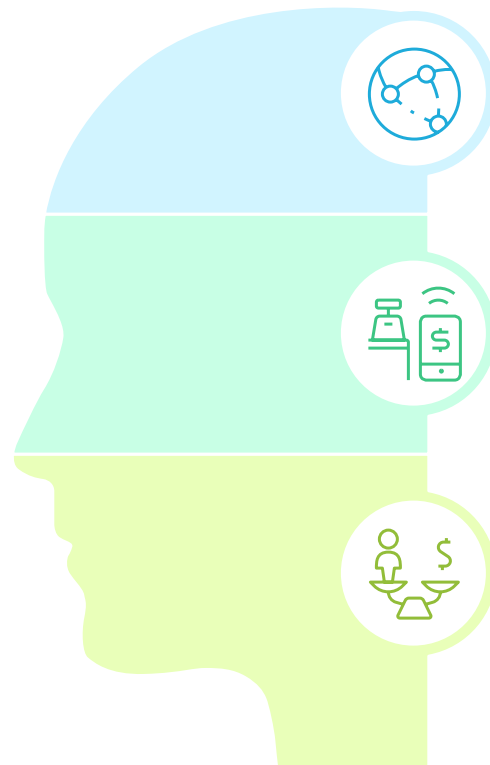
Origin of the Concept of SEP

Implementing Digital Economy Tax Measures



Origin of the Concept of SEP

Alternatives to address the taxation issues of the digital economy as suggested in BEPS Action Plan 1



Significant Economic Presence

Establishes a new nexus for taxation based on economic activity

Withholding Tax

Imposes taxes on digital transactions at the source

Equalization Levy

Introduces a levy to ensure fair taxation in the digital economy

Origin of the Concept of SEP

Action Plan 1 on BEPS 'Addressing the Tax Challenges of the Digital Economy': The Task Force on Digital Economy established by OECD unveiled Action Plan 1 in 2015 which proposed three alternatives to address the taxation issues of the digital economy, namely,

- (a) **Develop a new nexus based on the concept of Significant Economic Presence ('SEP');**
- (b) **Withholding tax on digital economy;**
- (c) **Introducing an Equalization Levy ('EL').**

SEP concept was introduced in the ITA, 1961 by the Fin Act, 2018 : Explanation 2A to Sec 9(1)(i) was introduced by the Fin Act, 2018 which dealt with the concept of Significant Economic Presence.

SEP concept in the ITA, 1961

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SEP concept was made applicable in India w.e.f AY 2022-23 : Even though Explanation 2A was introduced in Sec 9(1)(i) by the Fin Act, 2018 and originally planned to be applicable w.e.f AY 2019-20, its application was deferred and finally made applicable w.e.f AY 2022-23.

Rule 11UD notified Rs 2 Crores limit and 3 Lakhs subscribers vide notification 41/2021: Rule 11UD notified limit of Rs 2 Crores, 3 Lakh subscribers for the purpose of SEP vide notification number 41/2021 dated 03/05/2021. [Applicable from AY 2022-23]

Explanation 2A to Sec 9(1)(i) and Rule 11UD

Explanation 2A to Sec 9(1)(i)

Section 9 provides various incomes which are deemed to accrue / arise in India and hence they are taxable irrespective of the residential status. **[Extract of Sec 9(1)(i)----]**

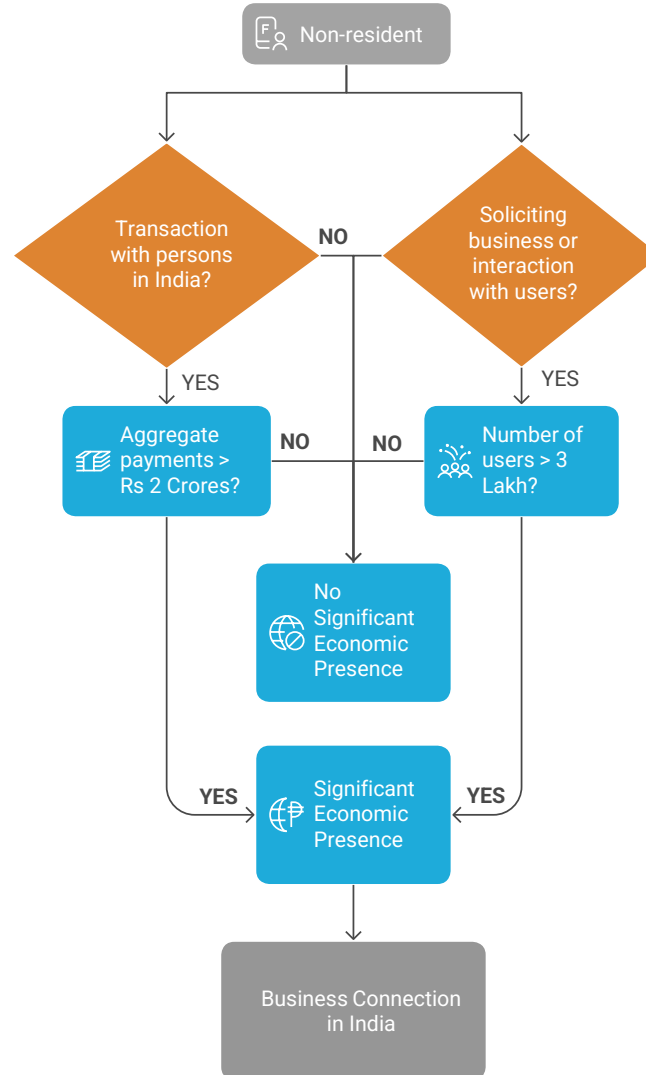
Sec 9(1):The following incomes shall be deemed to accrue or arise in India :-

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

- **Explanation 1 to Sec 9(1)(i): ----- [Contained exceptions: viz (a) Only attributable income is taxable; (b) purchase of goods for the purpose of export; (c) News agency; (d) shooting of cinematographic film in India; (e) Display of uncut & unsorted diamonds in any special zone;]**
- **Explanation 2 to Sec 9(1)(i): -----[Provided that certain agency relationships result in Business Connection]**
- **Explanation 2A to Sec 9(1)(i): SEP shall constitute Business Connection. Meaning of SEP provided.**

Explanation 2A to Sec 9(1)(i)

Significant Economic Presence Criteria



Explanation 2A to Sec 9(1)(i) [Contd....]

Explanation 2A to Sec 9(1)(i): For the removal of doubts, it is hereby declared that the significant economic presence of a non-resident in India shall constitute “business connection” in India and “significant economic presence” for this purpose, shall mean-

(a) Transaction in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; Or {Rs 2 Crores is prescribed vide Rule 11UD}

(b) systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India, as may be prescribed: {3 Lakh users are prescribed vide Rule 11UD}

Provided that the transactions or activities shall constitute significant economic presence in India, **whether or not-**

- (i) the agreement for such transactions or activities is entered in India; or
- (ii) the non-resident has a residence or place of business in India;
- (iii) the non-resident renders services in India:

Explanation 2A to Sec 9(1)(i) [Contd....]

- **Provided further that the transactions or activities which are confined to the purchase of goods in India for the purpose of export shall not constitute significant economic presence in India.**
- **Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.**

It is hereby declared that the income attributable to the operations carried out in India, shall include income from-

- (i) Such advertisement which targets a customer who resides in India or a customer who accesses the advertisement through internet protocol address located in India;**
- (ii) Sale of data collected from a person who resides in India or from a person who uses internet protocol address located in India; and**
- (iii) sale of goods or services using data collected from a person who resides in India or from a person who uses internet protocol address located in India.....**

Thus, where the non-resident earns income through advertisement, sale of data or e-commerce activities from a person residing in India or a person using Indian Internet Protocol address shall constitute 'Business Connection' in India.

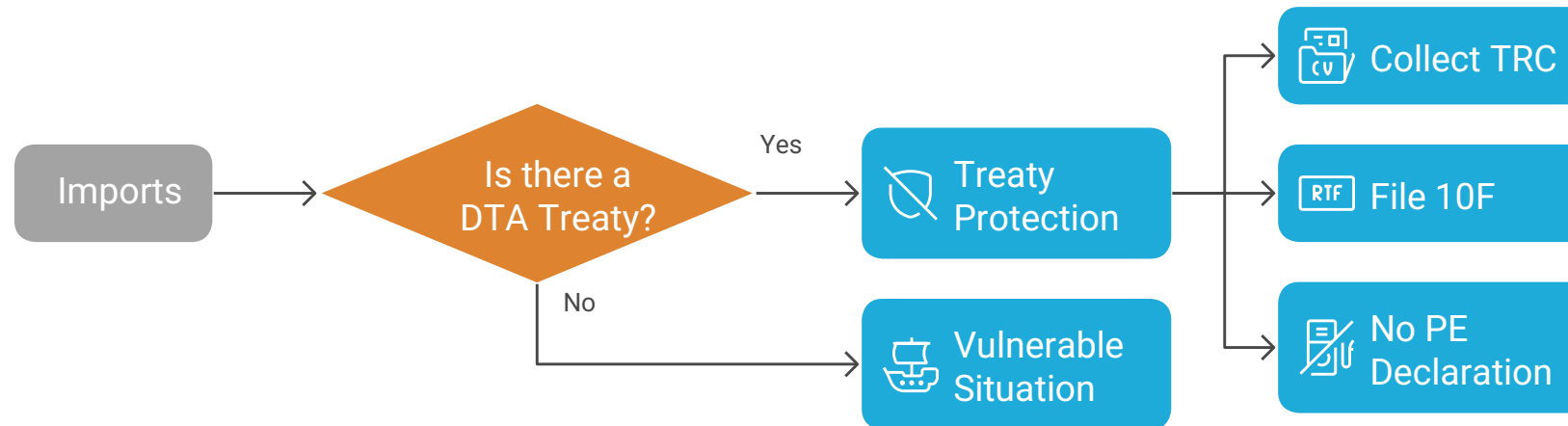
Special aspects related to SEP

Special Issues

Imports from a DTA country Vs Imports from a non DTA country

- Treaty protection is available where there is a Treaty. [But still one may need to collect TRC, File 10F, No PE Declaration];
- Results in a vulnerable situation for imports from non DTA countries.

DTA vs Non-DTA Imports



Special Issues

Attribution is a challenge: As of today, terms of Rule 10 are very broad in nature. [Percentage of turnover is treated as income (similar to presumptive taxation); Receipts Ratio; Other method as the AO may deem suitable]

Challenges in Attribution



Special Issues

Taxation of commission paid to non resident agent for services rendered outside India: Treaty protection may be taken where there is a treaty. {This is also subject to litigation}. In the absence of a Treaty, the commission stands taxed owing to SEP provisions.

Ambiguity in TDS rates: The rate at which tax is to be deducted U/s 195 is a challenge.

Special Issues

Operation of SEP should be confined to taxing the Digital Economy? The OECD has released a Statement on a Two-Pillar Solution to Address the Tax Challenges arising from the Digitalization of the Economy dated October 8, 2021 wherein 136 countries and jurisdiction, out of the 140 members of the OECD/G20 Inclusive Framework on BEPS have agreed that certain Multinational Enterprises ('MNEs') shall be subject to a minimum 15% tax rate, targeted effective from the Year 2023.

According to the said Statement released by the OECD, the agreement will reallocate certain taxing rights over MNEs from their home countries to the markets where they have business activities and earn profits, regardless of whether the MNEs have a physical presence there.

Further, Pillar 1 has a condition that all the parties to the agreement will have to withdraw their unilateral measures aimed at taxing the digital economy. {Please recollect India withdrew EL completely by the Fin Act, 2025}. {As regards SEP provisions are concerned, unless the Indian Revenue makes it unequivocally clear that the mandate of SEP prescription has application to businesses other than digital economy, there would equally be a legitimate expectation to amend/roll back the same post implementation of the above highlighted OECD's Two-Pillar Solution.}

Selected Case Laws

Case Laws

Business Connection: [R D Aggarwal & Co. v. CIT] [56 ITR 20] [1965] [The scope is increased post SEP]

B.C is a relation between the business of the Non-Resident and Activity of the Resident in India: A business connection involves a relation between a business carried on by a non-resident which yields profits or gains and some activity in India which contributes directly or indirectly to the earning of those profits or gains.

Rendition of services in India test is not required for SEP also {Ishikawajma-Harima Heavy Industries Ltd Vs DIT” [2007][158 Taxman 259] [SC]}.

The sine qua non for taxing interest, royalty and fees for technical services is

- They should be rendered in India and**
- They should be utilized in India**

as held by the Apex Court in “Ishikawajma-Harima Heavy Industries Ltd Vs DIT” [2007][158 Taxman 259] [SC].

However, after the amendment of Sec 9 by the Finance Act, 2010, it is enough if they have been utilized in India.

Rendering of services in India / having business connection is not necessary after the amendment. Similar analogy is extended to SEP.



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The Views / Comments in the above slides
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Thank You

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