

Amicus Alert: India Notifies 'Significant Economic Presence' Rules

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CBDT notifies threshold limits for Significant 'Economic Presence'

OECD under the BEPS Action Plan 1 discussed several options to tackle the direct tax challenges arising in digital businesses. One such option was a new nexus rule based on “significant economic presence”.

The Finance Act, 2018 expanded the concept of Business Connection (as provided under section 9 of the Income-Tax Act, 1961) through introduction of concept of Significant Economic Presence (hereinafter, 'SEP'). The definition of business connection has been expanded such that a non-resident would be deemed to have a Business Connection in India if it has SEP in India.

Under explanation 2A to section 9 of the Income Tax Act, SEP is defined to mean:

- A) Transaction in respect of any goods, services or property carried out by a non-resident in India, including the provision of download of data or software in India, subject to payment threshold to be prescribed; or
- B) Systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed;

Importantly the above-mentioned transactions or activities will constitute SEP in India irrespective of whether or not—

- 1) the agreement for such transactions or activities is entered in India; or
- 2) the non-resident has a residence or place of business in India; or
- 3) the non-resident renders services in India:

Thresholds for SEP

The Central Board of Direct Taxes (CBDT), vide a Notification dated 3rd May 2021¹, inserted Rule 11UD in the Indian Income-tax Rules, 1962. This rule is applicable from 1st April, 2022.

- Sub-rule (1) of Rule 11UD specifies that for the purposes of clause (a) of Explanation 2A above, the amount of aggregate of payments arising from transaction or transactions 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 during the previous year, shall be **two crore rupees**;
- Sub-rule (2) of Rule 11UD specifies that for the purposes of clause (b) of Explanation 2A above, the threshold for the number of users with whom systematic and continuous business activities are solicited or who are engaged in interaction shall be **three lakhs**.

1. Notification No. 41 /2021/ F. No. 370142/11/2018-TPL, dated 3rd May, 2021

Available at: https://www.incometaxindia.gov.in/communications/notification/notification_41_2021.pdf

Attribution of Income to Significant Economic Presence

Income from transactions in respect of any goods, services or property carried out by a non-resident in India, including the provision of download of data or software in India and systematic and continuous soliciting of business activities or engaging in interaction with Indian users is attributable to the SEP and shall be deemed to accrue or arise in India².

Further, income from following activities shall also be attributable to SEP³:-

- (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.

2.Proviso to Explanation 2A of Section 9, Income Tax Act,1961.

3.Proviso to Explanation 3A of Section 9, Income Tax Act,1961.

The above is the inclusive list and is not exhaustive. Any revenue generated from activities covered under the definition of significant economic presence would also be included.

Interplay between Significant Economic Presence and Equalisation Levy

The objective of both SEP and Equalisation Levy is to tax digital economy. Section 10(50) of the Income-Tax Act exempts from SEP Taxation those transactions on which Equalisation Levy is chargeable. Therefore, levy of taxes under SEP and Equalisation Levy have been made mutually exclusive and both cannot apply simultaneously.

Interplay Between Significant Economic Presence and Tax Treaty provisions

Unlike Equalization Levy, the provisions of SEP have been inserted in the Indian Tax Code itself. As taxpayer has the right to opt for more beneficial provision (between Tax Code and Treaty), the restrictive PE definition in various tax treaties would override the definition of 'business connection'. Hence, though SEP provisions will come into force from April 1st, 2022 there may not be any immediate impact in cases of non-residents with whose jurisdiction India has signed a Tax Treaty.

Conclusion

Once the rule becomes effective, several questions would arise on their applicability and enforceability. For instance, it could be a tedious job to calculate whether the number of users actually interacting with the non-resident has breached the threshold. This may also increase administrative burden on the non-resident taxpayers and enhance their documentation and audit compliances. Computation of the income attributable to SEP/ 'Business Connection' would also be a complex and highly subjective exercise and inviting similar kind of disputes as seen in case of PE Attribution.

The saving grace is the treaty protection available to taxpayers in most cases. SEP Rules shall have limited applicability in instances where no tax treaty exists with the transacting country. In all such cases, the Treaty provisions shall override and the limiting PE definition shall apply in lieu of SEP/ 'Business Connection'.

ABOUT AMICUS

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