CNK & Associates LLP

News Flash – Significant Economic Presence

Significant Economic Presence (SEP) - CBDT notifies threshold limits for triggering business connection of a non-resident in India through SEP (Notification 41/2021 dated 3 May 2021)

Under the Indian tax law, business income of non-residents is deemed to accrue or arise in India (and therefore, taxable in India), if it is through or from a 'business connection' in India. Generally, in cases of business connection, the income is taxable in India only to the extent of operations carried-out in India i.e., the taxing provisions contemplate some element of the non-resident's physical presence / operations in India. Resultantly, the traditional business connection provisions do not adequately capture cases of non-residents systematically and continuously doing business in India (e.g., through digital means) without establishing physical presence / operations in India.

Following the global discussion regarding the taxation of such transactions and activities, India introduced 'significant economic presence' ('SEP') concept by the Finance Act, 2018. SEP will constitute a business connection of a non-resident in India. The SEP provisions are applicable from AY 2022-23 (FY 2021-22) i.e., for transactions undertaken on or after 1 April 2021. By the above notification the thresholds have now been prescribed to constitute SEP.

SEP has been defined to 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 payments during the year exceeded such amounts as may be prescribed; ***or***
b. Systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India, as may be prescribed.

It has been clarified that transactions or activities shall constitute SEP in India even if:

a. the agreement for such transactions or activities is entered into outside India; or
b. the non-resident does not have a residence or place of business in India; or
c. the non-resident does not render services in India.

If a non-resident has SEP in India, the income attributable to the transactions or activities referred above shall be deemed to accrue or arise in India, and hence taxable in India. The SEP provisions do not bifurcate between income pertaining to operations carried-out in India and outside India.

Despite the concept of SEP being introduced by the Finance Act, 2018 and subsequently replaced to be made effective from AY 2022-23 (FY 2021-22), the threshold for the payments and the number of users were not prescribed. The Central Board of Direct Taxes (CBDT) vide Notification 41/2021 dated 3 May 2021 has now prescribed these limits as follows:

Sr. No.	Transactions / activities	Threshold prescribed
1	Aggregate annual payments from transaction 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)	INR 2 crore per year i.e., INR 20 million per year
2	Number of users in India with whom non-resident systematically and continuously solicits business activities or engages in interaction	3 lakh users i.e., 0.3 million users

Accordingly, if the transactions / activities of the non-resident in India exceed the above-mentioned thresholds, the SEP provisions would be triggered and the income of the non-resident from these transactions / activities would be deemed to accrue or arise in India i.e., taxable in India.

CNK Comments

- *The thresholds prescribed are significantly low and could result in various non-residents being held to have SEP in India. Having said that, the SEP provisions may not have a practical impact in cases where benefit of a bilateral Indian tax treaty is available to the non-resident and the non-resident does not have a Permanent Establishment (PE) in India. This is because the concept of PE under Indian tax treaties has not been updated to include SEP transactions / activities and continues to require an element of physical presence / operations in India. Non-residents claiming tax treaty benefit may need to furnish tax residency certificate, form 10F, etc. to the Indian payer. This protection would however not be available for non-residents whose country of residence does not have a tax treaty with India or the non-resident is not eligible to claim tax treaty benefits in India.*
- *It is important to note that, while Action Plan 1 of the Base Erosion and Profit Shifting Project of the OECD indicated for SEP to be established in case of transactions undertaken through digital means, the SEP provisions of India seem to apply to all transactions of goods, services or property carried-out by a non-resident with any person in India, irrespective of whether any activity is undertaken online or not. Therefore, if the thresholds are exceeded, the SEP provisions may also possibly apply in case of offshore sale of goods, the income from which, was not taxable in India earlier.*
- *Action Plan 1 of the BEPS Project of the OECD provides that in the case of SEP being constituted in a country, only part of the profits as determined on the basis of various methods (such as game theory, deemed profits or fractional apportionment method) should be taxed in that country. However, as the SEP provisions enacted by India do not provide for the method of attribution of profit, one may need to evaluate the profits arising out of the transaction being deemed to accrue or arise in India.*
- *Going forward the following points should be considered:*
  - *The provisions of SEP are extremely wide and will cover various transactions which were not taxable in India earlier, including download of software. Therefore, it is imperative to now analyse the applicability of SEP in respect of all foreign remittances, especially those where tax treaty benefit is not being claimed. Even one-off transactions which exceed the thresholds prescribed could trigger the SEP provisions.*
  - *Where applicability of SEP is missed / overlooked and the same results in the resident payer not withholding applicable tax on payment of taxable income to non-residents, it could result in various*

implications on the resident payer such as payment of such tax with interest, disallowance of expenditure, penalty, etc.

- *Especially with regard to import of goods, the same does not require compliance in respect of Form 15CA and Form 15CB, etc. However, such remittances, which now exceed the SEP thresholds, may require undertaking the above compliances. This would entail obtaining various documents from the non-resident party such as tax residency certificate, form 10F, PAN, etc. Further, the 'No PE' declaration would need to be updated to include reference to SEP.*

DISCLAIMER AND STATUTORY NOTICE

This e-publication is published by CNK & Associates, LLP, Chartered Accountants, India, solely for the purposes of providing necessary information to employees, clients and other business associates. Whilst every care has been taken in the preparation of this publication, it may contain inadvertent errors for which we shall not be held responsible.

This publication is not intended for advertisement and/or for solicitation of work.

Our Offices in India

Mumbai
Mistry Bhavan, 3rd Floor,
Dinshaw Vachha Road, Churchgate
Mumbai 400020
Tel No. +91 22 6623 0600

Mumbai (Suburban Office)
501/502, Narain Chambers,
M.G. Road, Vile Parle (East)
Mumbai 400 057
Tel No: +91 22 6457 7600/01/02

Bengaluru
96, 7th Cross,
Domlur,
Bengaluru 560 071
Tel. No.+91 80 2535 1353

Chennai
Kochu Bhavan,
Ground Floor, Old No 62/1, New No 57,
McNichols Road, Chetpet
Chennai 600 031
Tel No. +91 44 4384 9695

Vadodara
C-201/202, Shree Siddhi Vinayak Complex,
Faramji Road, Alkapuri,
Vadodara 390 005
Tel. No. +91 265 234 3483

CNK RK & Co. - New Delhi
Suite 1101,
KLJ Towers,NSP
New Delhi 110 034
Tel No.+91 11 2735 7350

CNK Khandwala & Associates - Gujarat
2nd Floor, 'Hrishikesh'
Vasantbaug Society,
Opposite Water Tank, Gulbai Tekra
Ahmedabad 380 006
Tel No. +91 79 2630 6530

CNK Khandwala & Associates - Gujarat
Unit No. 629, Signature Building,
Block 13B, Zone-I,
GIFT SEZ, GIFT City,
Gandhinagar 382 355
Tel No. +91 79 2630 6530

Our Overseas Office

Dubai
1701, Nassima Tower, Trade Centre 1,
Shaikh Zayed Road, Dubai, P.O. Box.454442
Tel. No. +971 04 355 9533

Sharjah
Q1-07-143/C, Sharjah Airport International Free Zone,
Sharjah
Tel No. +971 04 355 9544