Taxation of non-residents through a Significant Economic Presence
Widened scope under the Indian Income tax law
Significant Economic Presence (SEP)
Scope, applicability and safeguards

- SEP introduced in the Income-Tax Act, 1961 (‘ITA’) from April 1, 2018
- It expands the scope of income of a non-resident which accrues or arises in India that results in a ‘business connection’ in India for that non-resident. The resulting income, attributable to the SEP, is taxable in India.
- SEP is defined to mean:
  - 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
  - Systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means

Safeguards:

- India’s existing treaties contain the conventional concept of permanent establishment (PE) for taxing business profits of a non-resident and the inclusion of SEP in the ITA will not be read into the tax treaties unless they are amended.
- Revenues and users not exceeding thresholds as may be prescribed, to remain outside of SEP

Who is impacted?

- Non-resident carrying on specified activities beyond thresholds may be prescribed
  - Non-residents who do not have tax treaty benefits are directly impacted
  - Non-residents who have tax treaty benefits need to consider consequential obligation, if any

Illustratively, which transactions may be covered?

- Sale or purchase of goods, services or property through digital means
- Any transaction involving download of data or software in India (like in-app purchases)
- Provision of online training / gaming services
- Provision of services of streaming of e-content (audio / video)
- Interaction with customers such as for trouble shooting, etc
- Websites, online database, cloud storage and computing services, with significant user base in India

SEP – some recent developments
Around the world

Israel’s step towards SEP
Israel Tax Authority have prescribed various illustrative ‘digital factors’ to constitute SEP for foreign e-commerce and online services companies that operate in Israel.

European Union (EU)’s proposal for taxation of Significant Digital Presence (SDP)
EU proposes to establish a taxable nexus of a digital business based on revenue, number of users / contracts for digital services
Key considerations

Points to ponder

Coverage – both digital and physical goods or services to be covered?

Coverage – all activities whether revenue generating to be covered?

Meaning of undefined phrases – ‘digital means’, ‘systematic and continuous soliciting’?

Attributing the profits – methodology undefined; application of Rule 10?

Implementation – potentially significant interpretational, administrative and operational challenges

Solving for overlap – SEP and Equalisation Levy cover online advertising services

Way forward

Areas to look out for

Interpretation of SEP provisions in the backdrop of the intent

Thresholds of ‘revenues’ and ‘users’ to be prescribed; consider business structure

Impact on non-treaty jurisdictions and non-residents not eligible for treaty benefit, by introduction of SEP

Clarity on the method(s) of profit attribution in case of SEP

Re-negotiation of existing tax treaties by India for inclusion of SEP

Key takeaways

Summing up

Widely worded provision – covers in its ambit all provision of goods / services by a non-resident

Administrative and practical challenges on implementation

Non-residents carrying on business activities in /with India, should review their position on taxability and compliances

Heightened scrutiny assessment risk and a clarification on potential prosecution risk for non-filing of tax return is required

Clarifications required on several operational aspects and compliance obligation set to rise, like filing of tax return in case the transaction is covered by SEP, but not taxable under the treaty