

# Impact of Significant Economic Presence (SEP) on Indian businesses:

## Backdrop:

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Traditionally your physical place of business determines your tax jurisdiction. However, in the current era of the digital economy, your physical place, for conducting business anywhere across the globe, is immaterial now. This change has created problems for the policymakers, as to how tax this type of businesses? Many digital giants, may not have a physical presence in India, however they have a large consumer base in India through which they generate huge revenue out of it. However, it is found that they do not pay the due taxes on such revenue to the Indian exchequer. With a view to address this issue The Organisation for Economic Co-operation and Development (OECD) is working towards achieving a global consensus-based solution to the tax challenges arising from the digitalisation of the economy.

## Equalisation Levy:

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India was one of the first countries in the world to introduce a 6% equalisation levy in 2016, but the levy was restricted to online advertisement services. Scope of equalisation levy has been expanded by the Finance Act, 2020 to cover e-commerce supply. Let's recapitulate equalisation levy provisions in brief:

Section of FA, 2016	Nature of Services covered	Onus to deposit equalisation levy	Rate of equalisation levy	Threshold limit	Practical Example :
<b>165</b>	Online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement to resident Indian or non-resident having a permanent establishment in India	Onus is on payer to deduct equalisation levy. (Just like normal TDS provisions)	6%	INR 100 thousand for aggregate payment during the year by each payer	M/s ABC Limited (resident Indian) has paid INR 200 thousand to Instagram Inc, USA for advertisement of its product. Now, M/s ABC Limited need to deduct INR 12 thousand as the equalisation levy and pay to the Indian exchequer.
<b>165A</b>	<ul style="list-style-type: none"> <li>- online sale of goods owned by the e-commerce operator; or</li> <li>- online provision of services provided by the e-commerce operator; or</li> <li>- online sale of goods or provision of services or both, facilitated by the e-commerce operator; or</li> </ul> to a person resident in India, irrespective of his IP address or to a person who buys such goods or services using IP address located in India.	Onus is on payee i.e. e-commerce operator, to deposit equalisation levy. (Just like paying self - assessment tax)	2%	If the sale, turnover or gross receipts of the e-commerce operator from the e-commerce supply or services is less than INR 20 Million, then equalisation levy will not be charged.	If Netflix earns INR 100 Million as subscription income from the resident Indians, then Netflix need to deposit INR 2 Million as equalisation levy to the credit of Indian Government.

**It is pertinent to note that, equalisation levy is not the part of Income Tax Act, 1961 hence non-resident e-commerce operator will not get the credit of the same in their home county.**

Further, Incomes chargeable to equalisation levy are exempt from income-tax u/s 10(50) the Income Tax Act, 1961.

### **Objective to introduce Significant Economic Presence:**

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The objective of introducing the **Significant Economic Presence** could well be understood from the Memorandum explaining the provisions of the Finance Act, 2018, wherein is stated that;

*For a long time, nexus based on physical presence was used as a proxy to regular economic allegiance of a non-resident. However, with the advancement in information and communication technology in the last few decades, new business models operating remotely through digital medium have emerged. **Under these new business models, the non-resident enterprises interact with customers in another country without having any physical presence in that country resulting in avoidance of taxation in the source country. Therefore, the existing nexus rule based on physical presence do not hold good anymore for taxation of business profits in source country. As a result, the rights of the source country to tax business profits that are derived from its economy is unfairly and unreasonably eroded.***

Thus, the intention of the lawmaker was to tax digital transactions through SEP. However, one may argue that the lawmaker is already taxing these digital transactions, through the Equalisation levy.

## What constitutes SEP?

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A non-resident will be considered to have SEP in India in either of the following cases:

- I. Transaction in respect of any goods, services or property are 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(s) exceed the specified amount; or
  
- II. Systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India as may be prescribed

Non-residents having SEP in India would be now deemed to have a 'business connection' in India, and income attributable to the SEP would now be taxable in India (except in cases where a tax-treaty is applicable).

## Threshold limit of SEP as prescribed by the CBDT:

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CBDT vide notification no. 41/2021 dated 03<sup>rd</sup> May, 2021<sup>1</sup>, prescribed the following limits for SEP:

Sr. No	Nature	Threshold prescribed by CBDT
1	Transaction in respect of any goods, services or property are carried out by a non-resident with any person in India (including provision of download of data or software in India)	INR 20 Million
2	Systematic and continuous soliciting of business activities or engaging in interaction with exceeding number of users in India	300 thousand users

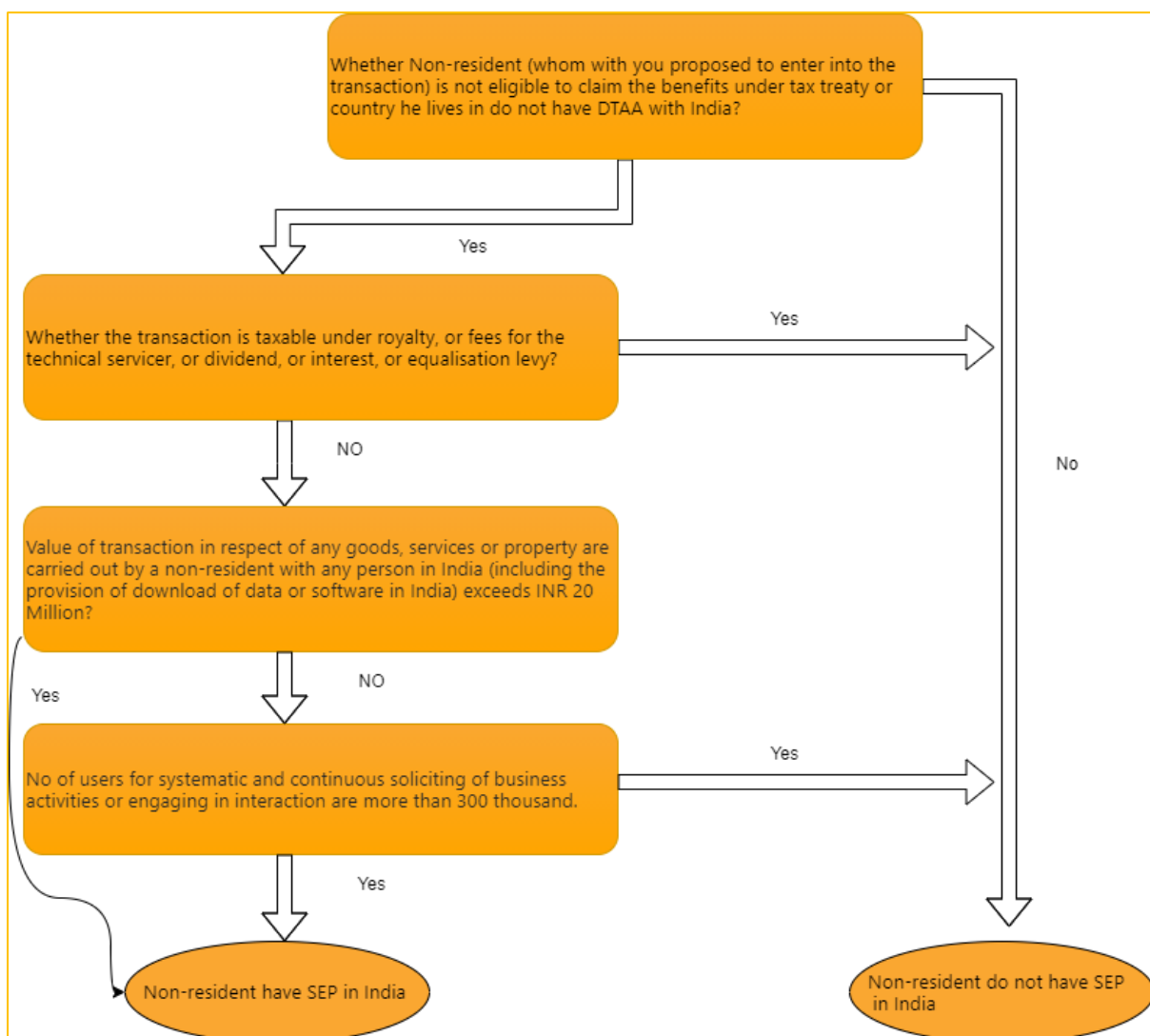
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<sup>1</sup> [https://incometaxindia.gov.in/communications/notification/notification\\_41\\_2021.pdf](https://incometaxindia.gov.in/communications/notification/notification_41_2021.pdf)

Please note that, if non-resident wants to avail the benefits of tax treaty, then above SEP will not be applicable. This is because if a tax treaty is applicable, foreign companies' income is taxable in India only if it has a 'Permanent Establishment' (PE) in India and the income is attributable to the PE.

### Relevance of SEP on your business:

Following flowchart will help you to understand, whether Non resident has SEP in India or not?



As per the provisions of Income Tax Act, 196, it is payer's responsibility to deduct TDS as per applicable rates on payment being made to non-resident. Consequently, if the non-resident has SEP in India, then non-resident's business income earned from India will be deemed to be accrued and arisen in India. **So, while making payment to those non residents who have SEP in India, Indian payer needs to deduct TDS @ 40% plus applicable surcharge and education cess on such income attributed to SEP in India.**

The comprehensive provisions on SEP seem to go beyond the stated objective of taxing digitized businesses as mentioned in Memorandum explaining the provisions of the Finance Act, 2018 and they may bring within its purview even non-digitized businesses. Furthermore, the prescribed thresholds for constituting SEP appear to be on the lower side, especially for the threshold on transaction in respect of goods, service or property of INR 20 Million. Lastly, the income attribution mechanism for non-residents constituting 'business connection' (including by way of SEP) remains blurred, it is hoped that the Government would provide guidance on this matter to provide certainty to foreign businesses.

#### **Appicability:**

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Above provisions will come in force from 01<sup>st</sup> April, 2022.

### Practicle Example:

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ABC Limited imported goods worth INR 5 Crores from DEF Limited which is situated at Azerbaijan (a Country situated at Western Asia). DEF Limited do not have any business connection in India.

- As Azerbaijan do not have any tax treaty with India, so DEF Limited is not eligible for taking benefit of Tax treaty.



- Importing of Goods will not be taxable under Royalty, Fees for technical services, Interest or dividend u/s 9 of Income Tax Act, 1961.



- DEF Limited is not e-commerce operator as per the Finance Act, 2016. Hence, on this transaction no tax payable under equalisation levy.



- Since, goods worth more than INR 20 Million limit, DEF Limited is said to have SEP in India.

Considering above, ABC Limited need to deducted TDS @ 40% plus applicable surcharge and education cess on the income attributed to SEP in India of DEF Limited.

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