



Significant Economic Presence (SEP) on Non Resident in India

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(A) Introduction on Applicability of SEP on Non Resident in India

1. Applicability's reasons for insertion of SEP regulations on Non Resident in India

- (i) Now ways of doing business are 100% changed in last 10 years where digitization + E-commerce (both) have become the ways of doing business across the world.*
- (ii) Now physical presence is not considered as benchmark or evidence for doing business across the world.*
- (iii) Now new business models are emerging every day across the world.*
- (iv) Now 100% countries are trying to re-align their tax laws to avoid obsolescence + cope up with changes across the world*
- (v) Now Govt. of India (Govt.) is re-aligning its tax laws to avoid revenue leakage through digital business + E-commerce business (both) by non-resident with Indian resident buyer (customer) in India.*
- (vi) Now Govt. has introduced in 2016 the Equalization Levy (EL) on non-resident as doing business with Indian resident buyer (customer) for reducing the leakage of revenue by non-resident till further avenues are found by Govt. for avoiding of leakage of revenue in India.*
 - (a) Now EL @ 6% is levied on payment to non-resident against online advertisement + digital advertisement (both) as provided by non-resident to resident in India*
 - (b) Now EL @ 2% is levied on payment to non-resident against E-commerce supply of goods + supply of services (both) by non-resident to resident in India*
 - (c) However EL @ 0% is levied on payment to non-resident against E-commerce supply of goods + supply of services (both) by non-resident to resident where annual aggregate payments against E-commerce supply of goods + supply of services (both) are not exceeding INR 1 lac in Previous Year (PY)*

2. Applicability of SEP as introduced in 2018 on Non Resident in India

- (i) India is following a source based income tax system for non-resident where income tax*

is levied at originating point or having its source under section 9(1)(i) of Income Tax Act (ITA) 1961 in India

- (ii) Hence income as accruing or arising to non-resident through business connection is considered as originating point under section 9(1)(i) of ITA, 1961 in India*
- (iii) (a) Meaning of business connection up to March 31st 2021 under section 9(1)(i) of ITA, 1961 was considered as restrictive for physical presence (only) for taxation of business income of non-resident in India.*
 - (b) However with advancements in Information Technology (IT) in last 10 years as new models for operating remotely through digital medium are emerged across the world*
 - (c) Under new business models a non-resident is interacting with customers without having any physical presence in India*
 - (d) Hence new business models are avoiding to levy income tax in India.*
 - (e) Therefore rules as based on physical presence were not sufficient for taxation of business profits of non-resident where non-resident was doing business through digital mode in India*
- (iv) India has adopted SEP regulations through Finance Act, 2018.*
- (v) SEP is concept as borrowed from Base Erosion and Profit Shifting (BEPS) Action Plan 1 of Organization for Economic Co-operation and Development (OECD).*
- (vi) OECD is international forum of 38 countries as founded in 1961 to stimulate the economic progress + world trade (both).*
- (vii) BEPS is referring the tax planning strategies as used by non-resident to exploit the gaps + mismatches in tax rules to avoid income tax in India.*
- (viii) OECD under BEPS Action Plan 1 is addressing tax challenges in digital economy where several options were discussed to tackle direct tax challenges as arising in digital business.*
- (ix) (a) SEP is 1 option under BEPS Action Plan 1 + new rules as based on Significant Economic Presence (SEP) in India*
 - (b) Hence physical presence of non-resident is not needed for taxation of business income in India*

3. Applicability of income tax on Non Resident in India

- *Income tax on non-resident is source based in India:*
 - (i) *On income against business connection through Permanent Establishment (PE) under section 9(1)(i) of ITA, 1961 in India.*
 - (ii) *On PE through physical presence + Significant Economic Presence (SEP) both*
 - (iii) (a) *On SEP where annual turnover or gross receipts as exceeding INR 200 Lac or Users as exceeding 3 Lac in India.*
 - (b) *Hence SEP is not applicable where turnover or gross receipt as not exceeding INR 200 lac or users as not exceeding 3 lac in India*
 - (iv) *On PE includes:*
 - (a) *Fixed PE*
 - (b) *Service PE*
 - (c) *Agency PE*
 - (d) *Supervisory PE*
 - (v) *Non-resident is permitted to avail the benefits as available through article in DTAA (treaty)*

(B) Applicability of SEP as Business Connection on Non Resident in India

1. Widening of Scope of Business Connection through inclusion of SEP in India

- (i) Now SEP is included in definition of business connection under section 9(1)(i) of ITA, 1961 through finance Act 2018 in India.
- (ii) Now SEP is applicable from Financial Year (FY) ending on March 31st 2022 + Assessment Year (AY) 2022-23 in India

2. Liability of Income tax on income based on SEP as included under PE in India

- (i) Now 100% profit as attributable to SEP is taxed in India.
- (ii) Now draft rules for profit attribution are released in April 2019,
- (iii) Now draft rules for profit attribution are not notified.
- (iv) Now 2 criteria's (revenue + user) for applicability of SEP are inserted under Rule 11UD of Income Tax Rules (ITR), 1962.

3. Revenue Criteria's for applicability of SEP as included under PE in India

- (i) Includes transaction for good + service + property (all together) as carried out by non-resident with Indian resident buyer (customer) including related party in India
- +
- (ii) Includes downloading of data + software (both) during the year where aggregate annual payments against transactions are exceeding INR 200 Lac in India

Or

4. User's Criteria's for applicability of SEP as included under PE in India

- (i) Includes systematic + continuous soliciting of business (both) activities in India
- +
- (ii) Includes engaged in interaction with users during year where aggregate annual user's against business activities are exceeding INR 3 Lac in India

5. Additional Criteria's for applicability of SEP as included under PE in India

- (i) Includes agreement for transaction or activity is entered in India
- Or
- (ii) Includes residence or place of business of non-resident is located in India
- Or
- (iii) Includes rendering of service by non-resident in India

6. Nature of transaction or activity for applicability of SEP on non-resident

- (i) **Includes** Sale + Purchase of Good + Service + Property (all) through digital mode in India
- (ii) **Includes** Downloading of data + software like training module + online game + in-app purchase + etc. in India
- (iii) **Includes** website + online database + cloud Storage + Computing Service + etc.

(C) Applicability of SEP + undesirable consequences on Non Resident

1. Challenges for applicability of SEP on non-resident in India

- (i) **Now** 100% transactions against good + service + property (all) carried through Digital + conventional (both) modes by non-resident are covered for taxing under ITA , 1961 in India
- (ii) **Now** definition of SEP is wide + stretched for taxing of digital business + traditional business + conventional business (all) modes without involving e-commerce like high-seas sales + off-shore supplies (both) by non-resident to resident buyer (customer) in India
- (iii) **Now** goods sold + services rendered (both) from outside India are covered under SEP where non-resident is not undertaking any activity in India + following the traditional method without any substantial change with digital advancement.
- (iv) (a) **Now** meaning of systematic + continuous soliciting of business or engaging in interaction with user is not clearly explained.

(b) It's suggested that CBDT should issue a circular on meaning of systematic + continuous soliciting of business.
- (v) **Now** CBDT is required to clarify through circular about royalty + fee for technical service + cost recharge (all) are covered under Equalization Levy or SEP + method of profit attribution where SEP is applicable in India
- (vi) **Now** non-resident is required additional compliances under ITA, 1961 in India like:

 - (a) Determination of volume of transactions where SEP is applicable in India
 - (b) Maintenance of books of accounts for Indian operations in India
 - (c) Required to obtain a Permanent Account Number (PAN) in India
 - (d) Required to prepare + filing of income tax return (ITR) + facing the income tax scrutiny assessment proceedings + tax + statutory (both) audits in India
- (vii) **Now** non-resident is required to face significant challenges in implementation of SEP regulations against the interpretational differences + operation + administration (all)
- (viii) **Now** resident is required to withhold + to deposit income tax at source (both) before making any payment against cross border transaction.

2. Applicability of SEP on high-seas sales + off-shore supplies by non-resident

- (i) (a) **Now SEP is applicable on high-seas sales + off-shore supplies (both) by non-resident to resident buyer (customer) where turnover or gross receipts (both) are exceeding INR 200 lac.**
- (b) **Hence SEP is not applicable on high-seas sales + off-shore supplies (both) by non-resident to Indian resident buyer (customer) where turnover or gross receipts (both) are not exceeding INR 200 lac.**
- (ii) (a) **Now SEP is applicable on high-seas sales + off-shore supplies (both) by non-resident to resident in India customers where high-seas sales + off-shore supplies (both) by non-resident to resident buyer (customer) was not taxable under section 9(1)(i) of ITA, 1961 before applicability of SEP like up to YE March 31st 2021 – AY 2021-22 in India**
- (b) **Hence SEP is not applicable on high-seas sales + off-shore supplies (both) by non-resident to Indian resident buyer (customer) under section 9(1)(i) of ITA, 1961 in India before applicability of SEP like up to YE March 31st 2021 – AY 2021-22 in India.**

(D) Applicability of Immunity from SEP through Amendment in DTAA

1. Immunity from SEP through applicability of DTAA's beneficial provisions

- (i) Now non-resident is permitted to avail the protection against applicability of SEP through favourable DTAA with India*
- (ii) Now non-resident is permitted to avail the benefits of DTAA against adverse effect of SEP regulations through favourable DTAA with exceeding 90 countries outside India*
- (iii) Now non-resident is permitted to avail the benefits of DTAA where definition of Permanent Establishment (PE) under Article 5 of DTAA is restricting the scope of business connection through physical presence (only) under section 9(1)(i) of ITA, 1961 in India*
- (iv) (a) Now in accordance with Indian tax law the provisions under section 9(1)(i) of ITA, 1961 or provisions under DTAA as more beneficial for non-resident is applied in India.*
 - (b) Hence non-resident is permitted to avail the provisions of DTAA as overriding the provisions for SEP regulations under section 9(1)(i) of ITA, 1961 for doing business with India*
 - (c) Therefore application of SEP under section 9(1)(i) of ITA, 1961 is not automatically applied. Hence SEP regulations are override the DTAA provisions where SEP regulations are already existed in DTAA with India*

2. Immunity from SEP through amendment in PE provisions in DTAA with India

- (i) (a) Now Govt. is required to amend the 100% DTAA's to include an applicability of SEP to impose income tax against SEP under section 9(1)(i) of ITA, 1961 on non-resident in India*
 - (b) Hence Govt. is not permitted to include an applicability of SEP under section 9(1)(i) of ITA, 1961 on non-resident in India without amending the DTAA's.*
- (ii) (a) Now Article no. 7 of DTAA's with foreign countries under allocation of taxing against business profit of non-resident is taxed in country of resident where business is carried through PE is situated in India through fixed place of business in physical presence (only)*

(b) Hence physical presence to be replaced with Significant Economic Presence (SEP) in Article no. 7 of DTAA with foreign countries under allocation of taxing against business profit of non-resident as based on SEP regulations on non-resident in India

3. Immunity from SEP though availing the DTAA benefits by non-resident in India

- *Now non-resident is required to prove treaty residency to avail the DTAA benefits through providing certain documents to avoid to withhold **income tax** by resident buyer in India:-*

(i) Tax Residency Certificate (TRC) issued by Govt. of home country of non-resident

+

(ii) Form 10F a self-declaration as equivalent to TRC

+

(iii) Declaration for No PE in India

+

(iv) Declaration for No SEP in India

(E) Applicability of legal Obligations on Non Resident in India

1. Consequence of SEP regulations on Non-Resident of non DTAA Country

- (i) *Now India has DTAA's as exceeding 90 countries. Hence India has not DTAA's as exceeding 110 countries (approx.)*
- (ii) *Now SEP regulations are applicable on DTAA's countries + non DTAA's countries (both) where aggregate annual turnover or gross receipts are exceeding INR 200 lac or users are exceeding 3 lac.*

2. Filing of Declaration by non-resident in Income Tax Return(ITR) from AY 22-23

- (i) *Now Non-resident is required to file an ITR + to declare in ITR having SEP or having non SEP in India.*
- (ii) (a) *Now Non-resident is required to mention the aggregate amount of payment as received from India + number of users (both) in ITR to enable tax authorities to check the threshold limit for applicability of SEP regulations like turnover or gross receipts are exceeding INR 200 lac or users are exceeding 3 lac.*
- (b) *Hence non-resident is required to compile the necessary informations + to analyse the transactions to be reported in ITR under SEP regulations.*

3. Filing of Income tax return (ITR) by non-resident in India from AY 22-23

- *Now Non-resident is required to file the ITR where SEP regulations are applicable to disclosed necessary details:*
 - (i) *Up to Oct 31st 2022 where Transfer Pricing (TP) regulations are not applicable*
 - (ii) *Up to Nov 30th 2022 where Transfer Pricing (TP) regulations are applicable*

4. Penalty for failure to File ITR + to implement SEP regulations by non-resident

- *ITA, 1961 is providing several penalties + punishments (both) for failure to file the ITR + to implement SEP regulations by non-resident in India*
 - (i) *Interest + late filing fee on non-resident + resident (both) in India*
- *Interest + late filing fee for failure to file the ITR + to implement SEP regulations by non-resident like @ 1% per month under section 234A + 234B + 234C (all) to be levied in India.*

- (ii) *Penalty for unreported income + tax sought to be evaded by way of concealment of income + furnishing **inaccurate** particulars of income (all)*
- (a) *Penalty for unreported income as minimum @50% + maximum @200% of amount of tax payable on unreported income*
 - (b) *Penalty for tax sought to be evaded by way of concealment of income + furnishing **inaccurate** particulars of income as minimum @ 100% + maximum @300% of amount of tax payable on evaded income*
 - (c) *Penalty for late Furnishing + complete failure to furnish (both) ITR @ INR 5000 **per** return under section 234F of ITA, 1961*
 - (d) *Penalty for failure to withhold **income** tax at source on cross-**border** remittances by Indian resident buyer (customer)*
- (iii) *Imprisonment for wilful evasion of income tax where serious tax default is occurred as minimum **3** month or maximum **7** years*

(F) Applicability of SEP Outside India

1. Measures as adopted by countries outside India

- *Many countries have already adopted the Digital Services tax (DST) in accordance with OECD guidelines. Remaining countries have already started to implement the measures for taxing the digital + e-commerce (both) business + service + property (all)*

- (i) European Union (EU)*
 - *European Union has proposed to tax the Significant Digital Presence (SDP) based on revenue + number of users + number of contracts for digital services*

- (ii) Israel*
 - *Israel has prescribed SEP for digital e-commerce + online services (both)*

- (iii) United State of America (USA)*
 - *United State of America (USA) has passed the Amazon Tax Law long ago*

- (iv) Japan*
 - *Japan has introduced the Consumption tax on digital services as supplied to customers in Japan*

(G) Role of Professional for SEP on Non Resident + Resident (both) in India

1. Role of Professional for Non Resident in India

- (i) Analysing of impact of new SEP regulations for cross-border transactions with Indian resident buyer (customer) through digital + conventional (both) modes in India*
- (ii) Analysing + determining of volume of transactions to be affected by SEP regulations + assisting in quantification of income tax liability (all) in India*
- (iii) Analysing of PE exposure in India*
- (iv) Assisting for obtaining a PAN in India*
- (v) Assisting for preparing + filing of ITR in India*

2. Role of Professional for Indian Resident buyer (customer) in India

- (i) Analysing for withholding of tax at source on transactions with non-resident in India*
- (ii) Advising for documentation to be obtained from non-resident in India*
- (iii) Assisting for obtaining an order from Assessing Officer (AO) for 0% or lower withholding tax at source in India*
- (iv) Assisting for issuing a certificate for payment of cross-border remittances to non-resident in India*

(H) Conclusion for SEP on Non Resident in India

1. Non Resident from DTAA country + non DTAA country (both) in India

(i) *Non-Resident from non DTAA country*

- *SEP regulations are affecting the business by non-resident with Indian resident buyer (customer) where non-resident is from country as not having DTAA with India*

(ii) *Non-Resident from DTAA country*

(a) *SEP regulations are not effecting the business by non-resident with Indian resident buyer (customer) where non-resident is from the country as having DTAA with India*

(b) *Hence non-resident from country as having DTAA with India is permitted to avail the benefits + immunity (both) as available under DTAA where income tax department is not permitted to challenge the benefits + immunity (both) already availed by non-resident in India*

2. Legal obligations on Indian Resident buyer (customer) in India

(i) *Indian resident buyer (customer) + user (both) are required to withhold income tax at source + to deposit with income tax department (both) on cross-border remittances where SEP regulations are applicable.*

+

(ii) *Indian resident buyer (customer) + user (both) are required to withhold income tax at source + to deposit with income tax department (both) on cross-border remittances to non-resident related party (also) where SEP regulations are applicable.*

3. Legal obligations on Tax Auditor in India

- *Tax auditor is required to report for non-fulfilment of provisions of withholding income tax at source + deposit (both) with income tax department by Indian resident buyer (customer) on cross-border remittances to non-resident in India*

4. Challenges with Govt. for Leakages of Income tax under digital + E-commerce

(i) *Indian Govt. is facing the challenges in implementation the SEP regulations on non-resident doing digital + e-commerce (both) business in India.*

(ii) *Indian Govt. is required to clarify several interpretational legal issues*

Published By



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October -2022