



Significant economic presence

under Income-tax Act, 1961

Chamber of Tax Consultants
International Taxation Study Circle

26 & 31 May 2021

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Business connection, in the classical sense

9(1) The following incomes shall be deemed to accrue or arise in India :—

(i) all income accruing or arising, whether directly or indirectly, **through or from any business connection in India**, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

- Business Connection not defined in the Act
- Judicially explained [*R. D. Aggarwal & Co. (1965) 56 ITR 20 (SC)*]
 - Relation between NR's business and some activity in India
 - A real and intimate relation between activity outside and activity inside India – the relation between the two contributing to the earning of the income by NR
 - Implies repeated, continuous activities, occasional activities not covered.
 - Readily established if there exists an element of agency between NR and India

BEPS – the road traveled

- Action 1 – Address the tax challenges of the digital economy

Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules.....

- Action 1 Report (July 2014)

The Task Force discussed and analysed a number of potential options proposed by delegate countries to address these challenges. Options discussed regarding nexus and data in particular range from changes to the definition of PE to the introduction of a new nexus based on a “significant presence” in a market, and also include the introduction of a withholding tax on sales of digital goods and services. (Conclusions, on page 158)

BEPS – the road traveled

- Action 1 Report (2015) – a ‘potential’ option

This option would create a taxable presence in a country when a non-resident enterprise has a significant economic presence in a country on the basis of factors that evidence a purposeful and sustained interaction with the economy of that country via technology and other automated tools. These factors would be combined with a factor based on the revenue derived from remote transactions into the country, in order to ensure that only cases of significant economic presence are covered, limit compliance costs of the taxpayers, and provide certainty for cross-border activities.

- Revenue not sufficient in isolation to establish a nexus; to be combined with-
 - digital factors (local domain name, local digital platform, local payment options) and
 - user-based factors (monthly active users, online contracts, data collected)
- A link required between the revenue-generating activity of the NR enterprise and its SEP in a country.

Pillar 1 Blueprint – Scope & Nexus

Automated digital services (ADS)

- Services that are automated (requiring minimum human involvement) and digital (provided over the Internet or electronic network).
 - Positive list
 - Online advertising services; Sale/alienation of user data; Online search engines; Social media platforms; Online intermediation platforms; Digital content services; Online gaming; Standardised online teaching services; Cloud computing
 - Negative list
 - Customised professional services; Customised online teaching services; Online sale of goods and services other than ADS; Revenue from sale of a physical good, irrespective of network connectivity (“Internet of things”); and Services providing access to Internet or another electronic network.
- Nexus
 - Only a revenue threshold
 - since ADS activities have potential to operate remotely and can be presumed to do so.

Consumer facing Businesses (CFB)

- Businesses that generate revenue from sale of goods and services of a type commonly sold to consumers, i.e. individuals that are purchasing items for personal use and not for commercial or professional purposes.
 - Includes businesses that sell consumer products indirectly through third-party intermediaries, franchise and licensing arrangements
- Nexus
 - A revenue threshold *and*
 - A **Plus factor** indicating significant and sustained engagement with the market
 - Physical presence or a group-PE
 - **A deemed engagement provision**
 - Unlikely that a group will be selling into a market with no supporting activities.
 - Any other factor (unconstrained by physical presence).

BEPS - Taxation of more than digital business

- Action 1 Report 2015

.... while the *ability of a company to earn revenue from customers in a country without having a PE in that country is not unique to digital businesses*, it is available at a greater scale in the digital economy than was previously the case. Where this ability, coupled with strategies that eliminate taxation in the State of residence, results in such revenue not being taxed anywhere, BEPS concerns are raised [para 185]

- Interim Report 2018

.. possibility to reach and interact with customers remotely through the Internet, together with the automation of some business functions have significantly *reduced the need for local infrastructure and personnel to perform sales activities in a specific jurisdiction (ie scale without mass)* [p 267]

- Public Consultation Document (Feb 2019)

“remote” participation in the domestic economy enabled by digital means but without a taxable physical presence is often seen as the key issue in the digital tax debate [para 12]

some MNE groups with highly digitalised business models were able to establish local affiliates in market jurisdictions, ... *However, the local affiliates are commonly structured to have no ownership interest in intangible assets, not to perform DEMPE functions, and not to assume any risks related to such assets. Accordingly, only a modest return may be allocated to these LRDs* [para 13]

- Tax Issues related to Digitalization of the Economy: Comm. Of Experts (Apr 19)(para 7)

However, with the advent of modern means of telecommunication and the spread of digitalization, *ability to effectively engage in substantial business activities in the market country without a fixed place of business there, or to conclude contracts remotely through technological means with no involvement of individual employees or dependent agents*, raises questions about continuing suitability of existing PE or nexus rules.

The Parliament's posit for SEP

- Memorandum FB 2018

*“The oranges upon the trees in California are not acquired wealth until they are picked, not even at that stage until they are packed, and not even at that stage until they are transported to the place where demand exists and until they are put where the consumer can use them. **These stages, upto the point where wealth reached fruition, may be shared in by different territorial authorities.**”* (excerpts from a report on double taxation submitted to League of Nations in early 1920s). Accordingly, both the residence and source countries claim the right to taxation.

Taxation of business profits on the basis of economic allegiance has always been the underlying basis of existing international taxation rules. Economists gave **primacy to the economic allegiance rather than physical location** and made it clear that physical presence was important only to the extent it represented the economic location.

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.

OECD under its **BEPS Action Plan 1 addressed the tax challenges in a digital economy** wherein it has discussed several options to tackle the direct tax challenges arising in digital businesses. One such option is a new nexus rule based on “significant economic presence”. As per the Action Plan 1 Report, a non-resident enterprise would create a taxable presence in a country if it **has a significance economic presence in that country on the basis of factors that have a purposeful and sustained interaction with the economy by the aid of technology and other automated tools.** It further recommended that **revenue factor may be used in combination with the aforesaid factors to determine 'significance economic presence'.**

Extra-territorial operation of law – Constitutionality*

*Is the Parliament constitutionally restricted from enacting legislation with respect to extra-territorial aspects or causes that do not have, nor expected to have any, **direct or indirect, tangible or intangible impact(s) on or effect(s) in or consequences for** : (a) the territory of India, or any part of India; or (b) the interests of, welfare of, well being of, or security of inhabitants of India, and Indians?*

- Parliament's powers to enact legislation pursuant to Art. 245(1) **may not extend to those extra-territorial aspects or causes that have no impact on or nexus with India.**
- All that would be required would be that **the connection to India be real or expected to be real, and not illusory or fanciful** - a mixed matter of facts and of law.
- where the **Parliament itself posits a degree of such relationship**, beyond the constitutional requirement that it be **real and not fanciful**, then the Courts would have to enforce such a requirement in the operation of the law as a matter of that law itself, and not of the Constitution.
- **Ought not to be subjected to some a-priori quantitative tests, such as "sufficiency" or "significance"** or in any other manner requiring a pre-determined degree of strength.

Nexus – Being present, virtually

- *South Dakota v Wayfair, Inc 585 US (2018)*
 - Whether an out-of-state seller without physical presence can be held responsible for payment of sales-tax and is in accordance with the Commerce Clause (or burdensome on inter-state commerce) - Imposition of sales tax by State not in doubt
 - Held,
 - *Between targeted advertising and instant access to most consumers via any internet-enabled device, a business may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term.*
 - *“Such a nexus is established when the taxpayer [or collector] ‘avails itself of the substantial privilege of carrying on business’ in that jurisdiction.”* [quoting *Polar Tankers Inc* 557 US 1 (2009)]
 - *This quantity of business could not have occurred unless the seller availed itself of the substantial privilege of carrying on business in South Dakota.*
 - Nexus to impose liability to collect sales-tax, whether determinative of territorial nexus to impose a tax on income?
- *World Wrestling Entertainment, Inc v Reshma Collections (2014) SCC Online Del 2031*
 - Whether Delhi High Court had **territorial jurisdiction** to entertain infringement suit under Trade Marks Act & Copyright Act
 - Plaintiff's programmes broadcast at Delhi, its merchandising goods and books available in Delhi, sold to consumers in Delhi through its websites accessible in India and Delhi
 - Held,
 - *transacting through website at a particular place virtually same as a seller having shops in that place in physical world*
 - *if transactions concluded in Delhi, the essential part of business of the plaintiff, insofar as its transactions with customers in Delhi are concerned, takes place in Delhi*
 - *plaintiff regarded as carrying on business in Delhi u/s 134(2) of Trademarks Act, 1999 & 62 of Copyright Act, 1957.*
 - Issue relate to determining jurisdiction, whether determinative of a territorial nexus to impose a tax on income?

Intangible business connection

- Volkswagen Finance P Ltd (2020) 115 taxmann.com 386 (Mum Trib)

Principles laid down in context of rather primitive trade, commerce or services are not of much relevance; business models are constantly evolving, and as the rapid communication modes such as internet and social media have completely transformed the way businesses communicate, it is time that the law is seen in tandem with the ground realities of the business world, rather than in the strict confines of what was decided in the judicial precedents, in the context of a different business world when these ground realities did not exist. *Today, virtual and intangible business connections are perhaps far more critical, important and commonplace* than the conventional brick and mortar business connections half a century ago...

.... when we examine relation between Indian business and participation in an event by the celebrity at Dubai launch event, we have no doubt that *it is because of this relationship between event in Dubai and business of the assessee in India that the income has accrued and arisen to the celebrity making appearance in Dubai launch event.* There cannot be any justification for an assessee in India, doing business only in India, paying money to a celebrity to make an appearance in an event in Dubai unless such an appearance benefits the business of the assessee in India, and the fact that it did benefit the business interests of the assessee in India is not even in doubt or controversy.

Expenses by payer for holding overseas event is in connection with business in India, a natural corollary that income from participation in this event to a non-resident has a business connection in India.

- Issues
 - Intangible versus tangible business connection – example of tangible BC?
 - Echoes of SEP – transaction with a person in India!!

SEP – Expln 2A vide FA 2020

Explanation 2A.—For the removal of doubts, it is hereby ~~clarified~~ *declared* that the significant economic presence of a non-resident in India shall constitute “business connection” in India and “significant economic presence” for this purpose, shall mean-

(a) transaction in respect of any goods, services or property carried out by a non-resident ~~in India~~ *with any person in India* including provision of download of data or software in India,

[] if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or

(b) systematic and continuous soliciting of business activities or engaging in interaction with such number of users ~~as may be prescribed~~, in India, *as may be prescribed through digital means*:

Provided that the transactions or activities shall constitute significant economic presence in India, whether or not

(i) the agreement for such transactions or activities is entered in India; or

(ii) the non-resident has a residence or place of business in India or

(iii) renders services in India:

Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.

Expln 2A – the chapeaux

*“For the removal of doubts, it is hereby **clarified** declared that the significant economic presence of a non-resident in India shall constitute “business connection” in India and “significant economic presence” for this purpose, shall mean-.”*

- Declaratory not clarificatory, prospective; Applies from AY 2022-23.
- SEP of a NR in India to constitute business connection
 - SEP of ‘NR in India’ or ‘SEP in India’ of a NR?
 - Later the appropriate expression!
- SEP in addition to the classical business connection
- SEP meaning exhaustive
- Clause (a) and (b) operate independently; thresholds to be applied separately
- No requirement in law that the transaction with a person in India has to be through technology and automated tools or other digital means
- SEP provisions do not have an impact if the NR is entitled to a Treaty
 - Risk of non-entitlement of a Treaty due to GAAR or MLI (Art. 3 Dual residents, Art 6, Preamble, Art. 7 PPT or Art. 10-3rd Country PE)

Expln 2A Limb (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 of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; *or*”

- Transaction in respect of goods, services or property
 - The term “*in respect of*”
 - Equivalent to “attributable”; said words could mean more than “consisting of” or “namely” [Swastik Tobacco Factory, (1966) 3 SCR 79, Engineering Analysis (2021) 125 taxmann.com 42 (SC)]
 - Not only sales transactions covered
 - Only digital goods or covers physical goods?
 - Invitation for comments for threshold refers to physical goods also [F. No. 370142/11/2018-TPL dt 13th July 2018]
 - *Transactions in respect of rights in goods, services or property*
 - Rights themselves could qualify as goods or property
- Carried out
 - Carried out by NR in India [old Expln 2A since amended]
 - Term also used in Expln 1 (a) “*attributable to the operations carried out in India*”
 - Carry out versus carry on
 - ‘Carry out’ meaning - ‘to put into operation; execute; to effect or accomplish; complete [Dictionary.com]; to bring to a successful issue : complete, accomplish; to put into execution; to carry out a plan [Merriam Webster]

Expln 2A Limb (a)

- Isolated or sporadic transactions also covered
- Aggregate pf payments arising from such transactions exceeding Rs. 2 crore annually
- “any person in India”, not “any person resident in India”
- Transactions to be carried out by NR ‘with any person in India’
 - “any person in India”, not “any person resident in India”
 - EL: “to a person resident in India”
 - Situs of the transaction, place of supply or place where consideration received not relevant

✓	SEP
×	No SEP

Trxn with a person who is a	Resident	Non-resident
<i>when he is in India at the time of the txn</i>	✓✓✓	✓✓✓
<i>when he is not in India at the time of the txn</i>	××	××
<i>at any time in India, even if not in India at the time of the txn</i>	×	×
<i>having a branch in India, though txn not relating to the branch</i>	-	✓×
<i>having a dependent agent in India, though txn not relating to the branch</i>	-	××
<i>having a BC in India, though txn not relating to the BC</i>	-	×××

Literal and purposive construction

- *Cape Brady Syndicate v. IRC, (1921) 1 KB 64*

'... in a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.'

- *Customs (Import) v. Dilip Kumar & Co. [2018] 95 taxmann.com 327/69 GST 239 (SC) :*

is well accepted that a statute must be construed according to the intention of the legislature and the courts should act upon the true intention of the legislation while applying law and while interpreting law. If a statutory provision is open to more than one meaning, the Court has to choose the interpretation which represents the intention of the legislature.

.... Legislation in a modern State is actuated with some policy to curb some public evil or to effectuate some public benefit. The legislation is primarily directed to the problems before the legislature based on information derived from past and present experience. The process of construction combines both literal and purposive approaches. In other words, **the legislative intention i.e. the true or legal meaning of an enactment is derived by considering the meaning of the words used in the enactment in the light of any discernible purpose or object which comprehends the mischief and its remedy to which the enactment is directed.**

- *K P Varghese (1981) 7 Taxman 13 (SC)*

The primary objection against the literal construction of section 52(2) is that it leads to manifestly unreasonable and absurd consequences. It is true that the consequences of a suggested construction cannot alter the meaning of a statutory provision but it can certainly help to fix its meaning. It is a well-recognised rule of construction that **a statutory provision must be so construed, if possible, that absurdity and mischief may be avoided.**

Posers

- Business with India and business in India – is the position changed?
 - No, that is for accrual of income, while SEP is for deemed accrual- if the title to goods have passed abroad and the income from sales has not accrued in India, deemed accrual rules to be examined (incl SEP)
- Does SEP also drag in other income (like capital gains, interest) or it attracts only business income?

Download of data or software

Includes transaction for *provision of* download of data or software in India

- Inclusive portion whether expands scope [in respect of goods, services or property]?
 - Or it characterizes the transaction in respect of goods, services or property as one **that includes provision of data or software in India!!**
- Provision in India
 - Implies only PUSH operations, not passive websites?
 - transaction implies two parties, consideration
 - Where access to download is available
- Download
 - Software in the Cloud
 - Software when 'downloaded' on computer memory is transient. User's computer reads the storage media and *rearranges its memory* to create a corresponding pattern of magnetic impulses which are lost forever on closing of the application [*Equitable Tr Co. 464 A.2d 248 (Md. 1983)*]
 - Progressive download versus true streaming
 - Progressive downloads- data is downloaded in stages- may not be permanently stored on client's device
 - In True streaming - temporary storage in client buffer to compensate for potential difference in rate data is received and rate it is processed; buffer as little as 2 to 5 seconds
 - whether content permanently stored relevant?
 - Whether download on client's device relevant?
 - Where technology captured broadcasters' TV signals using thousands of remote antennas and content made available in the cloud [*American Broadcasting Cos. V Aereo, Inc (573 U.S. 2014)*]

Download of data or software

- Download of data
 - Sold or licensed
 - Transaction ‘in respect of goods, services or property’ – Is data goods?
 - Transaction in respect of copyright in data?
 - Whether data available for download in India, or merely exploited by NR buyer outside India
 - Whether royalty
 - Right, property or information includes
 - Imparting of data relating to patent, etc
 - Imparting of information concerning technical, industrial, commercial, or scientific knowledge, experience or skill
- Download of software -
 - Not limited to **computer software**

Royalty/FTS and SEP inter se

- Expln 4 to s. 9(1)(vi) versus Expln 2A to s. 9(1)(i)
 - right for use or right to use computer software vs. provision of download of software
 - Contract-based as against mode of delivery
 - Sale of software
 - Expln 4 inapplicable, Expln 2A applies if a download
 - Licence of software
 - Both Expln 4 and Expln 2A (if download) applies
 - Priority? Clause (vi) *Lex specialis* [*Meteor Satellite* (1979) 2 Taxman 424 (Guj); *Copes Vulcan* (1987) 30 Taxman 549 (Mad)]
 - No bar on applying other clauses of s. 9 when txn falls out of definition [*Neo Sports Broadcast* [2011] 133 ITD 468 (Mum); *Warner Bros* (2014) 39 CCH 247 (Mum-Trib)]
 - Exclusion from definition versus exclusion from rule
 - If for the purposes of business carried on outside India by a resident [*sub-clause (b)*] or not for business carried on in India by a NR [*sub-clause c*] of sec. 9(1)(vi) /(vii)
 - Rule relating to specified category self-contained, no occasion to apply other clauses

Computer software – EL & SEP

Trxn with a resident	Treaty	Royalty under Act	EL	SEP
Licence to end user	Not available	s. 9(1)(vi), Expln 4	NA	s. 9(1)(vi) lex specialis, SEP NA
Licence to end user	Available	Business income	EL	S. 10(50); SEP NA
Sale of copy to end user	Irrespective	Business income	EL	S. 10(50); SEP NA
To intermediary - case 1	Irrespective	Business income	EL	S. 10(50); SEP NA
To intermediary - case 2¹	Irrespective	s. 9(1)(vi), Expln 2	NA	s. 9(1)(vi) lex specialis, SEP NA
Subscription-based	Not available	s. 9(1)(vi), Expln 4	NA	s. 9(1)(vi) lex specialis, SEP NA
Subscription-based	Available	Business income	EL	S. 10(50); SEP NA

¹ If for the distribution right, *Engineering Analysis* (2021) 125 taxmann.com 42 (SC).

Expln 2A Limb (b)

systematic and continuous soliciting of business activities or engaging in interaction with such number of users ~~as may be prescribed~~, in India, ~~as may be prescribed through digital means~~

- Systematic and continuous soliciting of business activities
 - With users?
 - Casual or sporadic activities not covered
- Engaging in interaction with users
 - Above a threshold prescribed [300000 users]
 - Casual or sporadic activities, if above threshold?
 - Letter [F.No. 370142/11/2018/TPL] dated 13.7.2018
 - Interaction impliedly two-way
 - passive user or website out of coverage?
 - Automated processes within scope
 - ‘Through digital means’ - omitted
 - Not necessarily online; through any means

The inconsequential

Provided that the transactions or activities shall constitute significant economic presence in India, whether or not—

- (i) the agreement for such transactions or activities is entered in India; or*
- (ii) the non-resident has a residence or place of business in India; or*
- (iii) the non-resident renders services in India:*

- Akin to Explanation to section 9 wrt clauses (v), (vi) and (viii).

Other Explanations to sec. 9(1)(i)

- Limitations from classical BC – whether covered under SEP
 - Purchase of goods for export
 - Shooting of cinematograph film
 - Diamond centre display
 - Sales through Independent agent
 - Sales by dependent agent who does not conclude contracts
- Explanation 5 (overseas company deriving value from India) with de minimis exemption (Expln 7)- Whether SEP applies?
 - **All income** accruing or arising through or from BC deemed to accrue or arise in India
 - Income from business a wider term than 'business income'
 - Expln 5 does not apply to dividends (Circular 4/2015 dated 26.3.2015
 - Applies to only the limb "through transfer of capital asset situate in India"
 - Sec. 9(1) clauses operate independently. *Lex specialis* should apply (for priority).

Attribution to operations in India

Explanation 1.—For the purposes of this clause—

(a) in the case of business, *other than the business having business connection in India on account of significant economic presence, of which all the operations are not carried out in India*, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income *as is reasonably attributable to the operations carried out in India*;

Expln 2A, 2nd Proviso - Provided further that only so much of income *as is attributable to the transactions or activities referred to in clause (a) or clause (b)* shall be deemed to accrue or arise in India.

- Income not revenue, essentially net income
- Priority to SEP over Classical BC
 - Classical BC only if not SEP? Or both should co-exist?
- Non-revenue factors indicating remote presence in Action 1 reports absent in law.
 - Can they be read into the provisions?
 - A purposive interpretation restricting attribution only to income accruing or arising *by virtue of digital transactions* of a NR who has an SEP [Kanga & Palkhivala 11th Edn].

Expln 3A

For the removal of doubts, it is hereby declared that the *income attributable to the operations carried out in India*, as referred to in Explanation 1, shall include income from—

(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.

Provided that the provisions contained in *this Explanation shall also apply to the income attributable to the transactions or activities referred to in Explanation 2A.*

- Business connection scope not expanded, only income from specified activities includible if there is a BC (classical or SEP)

Rule 10 - Determination of income in the case of non-residents

10. In any case in which the Assessing Officer is of opinion that the actual amount of the income accruing or arising to any non-resident person whether directly or indirectly, *through or from any business connection in India or through or from any property in India or through or from any asset or source of income in India or through or from any money lent at interest and brought into India in cash or in kind cannot be definitely ascertained*, the amount of such income for the purposes of assessment to income-tax may be calculated :—

(i) *at such percentage of the turnover so accruing or arising* as the Assessing Officer may consider to be reasonable, or

(ii) on any amount which bears *the same proportion to the total profits and gains* of the business of such person (such profits and gains being computed in accordance with the provisions of the Act), as the receipts so accruing or arising bear to the total receipts of the business, or

(iii) in such other manner as the Assessing Officer may deem suitable.”

Profit Attribution to PE

CBDT Committee Draft Report 2019

- Amendment of Rule 10 recommended
 - Possibly could be inserted into the ITA [para 200]
- Shift from supply side to demand side
 - UN Committee of Experts Report (April 2019)
- Formulary apportionment (of global profits) rejected
 - Data relating to global profits unavailable/unverifiable
- NR having Business Connection to be apportioned profits attributable to operations in India
 - Three factors equally weighed-
 - sales, employees (manpower & wages) and assets
- NR having business connection due to SEP constituted due to users beyond threshold
 - Four factors weighed-
 - sales, employees (manpower & wages), assets and users
- Global op margin floor at 2% - losses not recognised
 - *MNE likely to continue operations in India only if they are profitable* [para 160]

Profit Attribution to PE

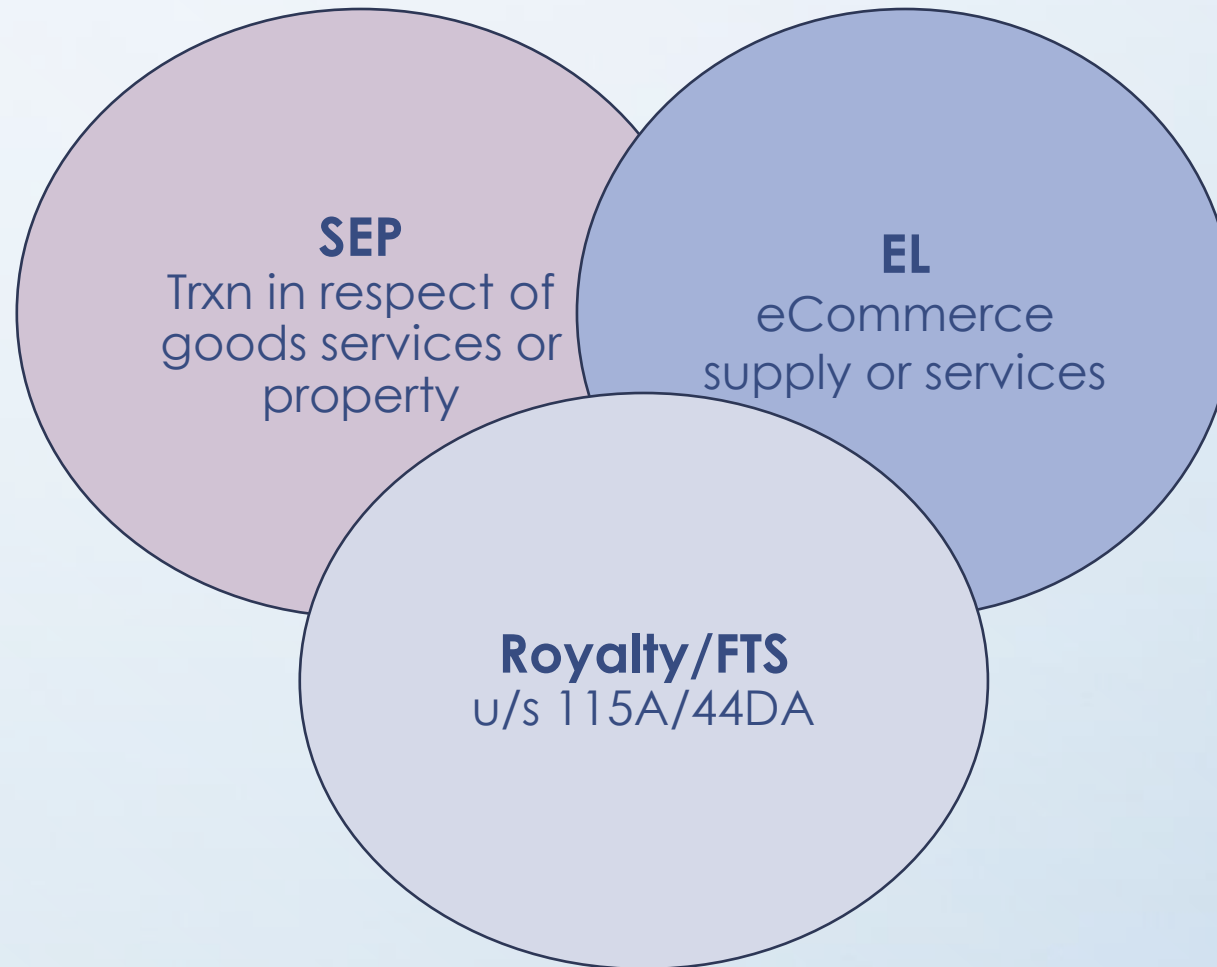
CBDT Committee Draft Report 2019

- Merits of fractional apportionment-
 - Considers both demand and supply side factors
 - Method simple, avoids litigation
- Modified rule to apply only when-
 - no India-centric accounts available
 - profits of India operations not correctly determinable

Profit attribution – an illustration

Digital models	Case 1 - Low and medium user intensity				Case 2 - High user intensity			
	Weight	In India	Outside India	Product	Weight	In India	Outside India	Product
Sales revenue derived by Indian operations	30%	80	20	0.24	30%	80	20	0.24
Employees with respect to Indian operations	15%	8	2	0.12	12.5%	8	2	0.10
Wages payable to employees with respect to Indian operations	15%	10	10	0.08	12.5%	10	10	0.06
Assets deployed for Indian operations	30%	15	15	0.15	25%	15	15	0.13
For users in India	10%			0.10	20%			0.20
Total	100%			0.69	100%			0.73
Revenue derived from India				80				80
Global Op. Profit Margin* (Min 2%)				5%				5%
Profits derived from India				4.00				4.00
Profit attributable to operations in India				2.74				2.91
Reduce therefrom any profits already taxed in India (eg subco)								

Royalty/FTS, EL and SEP scope



Royalty & FTS - SEP & Equalisation levy

	Royalty/FTS u/s 115A/44DA	Not covered u/s 115A/ 44DA	SEP
Treaty allocates taxing rights to India (u/Art. 12, 13 or 21, no PE)			
R to NR: Royalty/FTS article applies	Under Act rw Treaty; EL NA	-	9(1)(vi) or (vii) lex specialis; SEP NA
NR to NR: Royalty/FTS NA; Possibly, Other Income article	-	EL applies	S. 10(50) SEP NA
Treaty does not allocate taxing rights to India (u/Art. 12, 13 or 21, or 7 or 14)			
R to NR: Royalty/FTS article NA	EL applies	-	
NR to NR: Royalty/FTS/Other income article NA	-	EL applies	S. 10(50); SEP NA
Treaty allocates taxing rights to India (u/Art. 7 or 14, PE)			
R to NR: Royalty/FTS article to Art. 7	Under Act rw Treaty; EL NA	-	9(1)(vi) or (vii) lex specialis; SEP NA
NR to NR: Art 7	-	EL NA	SEP?

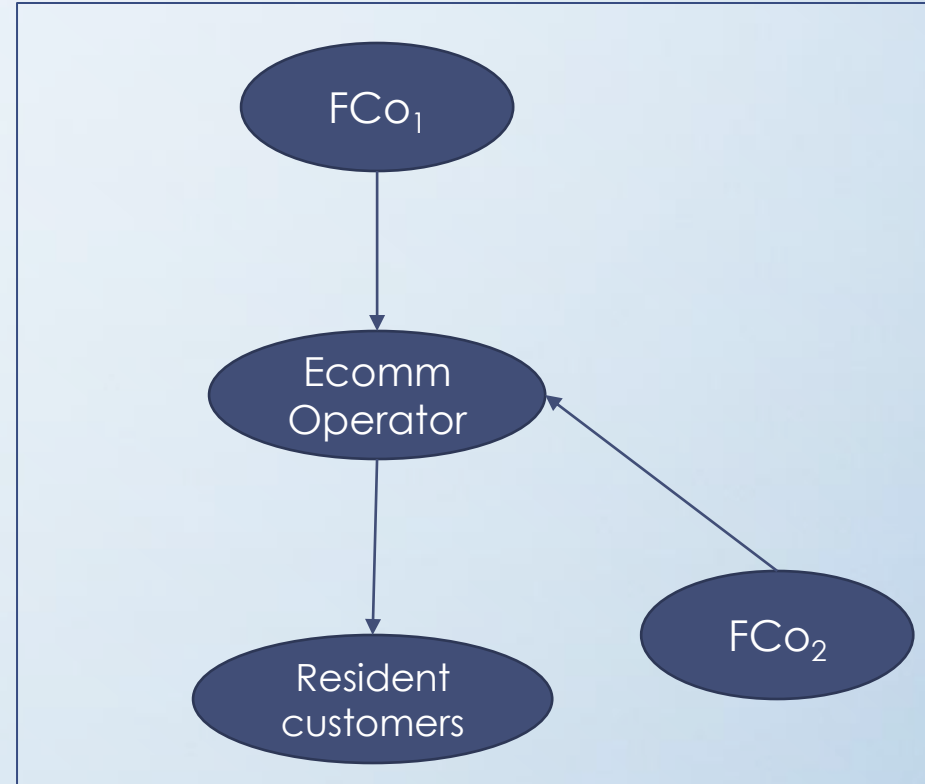
- FA 2016, Sec. 163 Proviso
Provided that the consideration received or receivable for specified services and for e-commerce supply or services shall not include the consideration, which are **taxable as royalty or fees for technical services** in India under the Income-tax Act, **read with the agreement notifiedu/s 90 or 90A ...**
- Sec. 10(50) Expn
..... the income referred to in this clause shall not include any income which is **chargeable to tax as royalty or fees for technical services** in India under this Act **read with the agreement notified ...u/s 90 or 90A.**
- Taxable vs. chargeable to tax
Taxable as Royalty/FTS **u/s 115A or 44DA**
- 'Read with treaty'** meaning
 - Allocation of taxing rights to India; whether falls under royalty/FTS Articles not relevant
- Exclusion from EL for NR having a PE, not for having a BC.

Impact on supply chains – SEP & EL

- Provisions
 - EL payable by ecommerce operator for facilitating online sale of goods or online provision of services
 - SEP payable by NR for transaction in respect of goods, services or property with any person in India.
- Sec. 10(50)

Any income arising from any specified service ... or arising from any e-commerce supply or services made or provided or facilitated and chargeable to equalisation levy under that Chapter.
- Sec. 165A(3)(i) and (ii)

(ii) consideration for provision of services irrespective of whether service is provided or facilitated by the e-commerce operator, so, however, that it shall not include consideration for provision of services which are provided by a person resident in India or by permanent establishment in India of a person non-resident in India, if provision of such services is effectively connected with such permanent establishment."
- Attribution if SEP applies to ECo? Only on its net profit but on both legs?



	ECo	FCo ₁	FCo ₂
FCo ₁ -ECo-Res	EL	s. 10(50)? no SEP	-
FCo ₂ -ECo-Res	No EL; SEP?	-	Net basis taxation

Thank you!