



Newsflash: CBDT Notifies Rule 11UD for the Purpose of Significant Economic Presence

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CBDT Notifies Rule 11UD for the Purpose of Significant Economic Presence

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1.0 Background

- 1.1 The Finance Act of 2018 had inserted Explanation 2A to section 9(1)(i) of the Income Tax Act so as to provide that the Significant Economic Presence ('SEP') of a non-resident in India shall constitute a "business connection" in India. Such SEP would 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 of payments arising from such transactions during the financial 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 in India, as may be prescribed.
- 1.2 The transactions or activities shall constitute SEP in India, whether or not, the agreement for such transactions is entered in India; or the non-resident has a residence or place of business in India; or the non-resident renders services in India. Further, only so much of income as is attributable to the transactions mentioned above shall be deemed to accrue or arise in India.
- 1.3 The CBDT had vide **Circular dated 13 July 2018** sought for comments and suggestions from stakeholders and general public regarding the framing of Income-tax rules conserving the revenue and number of users thresholds for SEP.
- 1.4 Recently, the rules for "Significant Economic Presence" were notified by the **CBDT vide Notification No. 41/2021** dated 3rd May 2021 which would come into effect from 1st April 2022 (i.e. Assessment Year 2022-23 relevant to the Financial Year 2021-22 and onwards). In this Newsflash, we provide an overview of these Rules as notified by the CBDT.

2.0 Rules Notified – Rule 11UD of the Income Tax Rules, 1962

- 2.1 The CBDT notified Rule 11UD in order to provide for the threshold limits for applicability of SEP as follows:

2.1.1 Revenue Threshold:

Any non-resident deriving a revenue **exceeding the threshold limit of Rs. 2 crores** in a particular financial year in respect of any transaction of goods, services or property carried out by such non-resident with any person in India. Such transaction would also include transactions of download of data or software in India.

2.1.2 Number of User Threshold:

Any non-resident entity which is engaged in systematic and continuous soliciting of business activities or engaging in interaction with 3 lakh or more users in India.

In case of a non-resident entity fulfilling either of the above mentioned conditions with their respective threshold, their business profits may be charged to tax in India subject to the tax treaty provisions (Refer to Point 3.2 for details).

3.0 **Our Comments**

- 3.1 With the setting up of threshold for determination of 'Significant Economic Presence' ('SEP'), the Income Tax Department has spelled out specific criteria's to tax foreign entities earning significant revenue through their digital footprints in India.
- 3.2 The above-mentioned rules would further be subjected to the provisions of the tax treaty, if any, existing between India and other country. Considering the fact that business profits can be taxed in India only in case of existence of Permanent Establishment ('PE') and many of the tax treaties still contain provisions for recognition of only conventional PE model (such as Fixed PE, Service PE, Agency PE, Installation PE, etc), the impact of the said rules may be limited unless the tax treaties are revised accordingly to incorporate the SEP provisions. However, the said rules would have a significant impact on businesses from non-treaty countries, wherein their profits attributable to India on account of SEP would be subjected to tax @ 40%.
- 3.3 It is pertinent to note that the Finance Act, 2020 had deferred the applicability of SEP to assessment year (AY) 2022-23 and subsequent years owing to the reason of the ongoing discussions amongst the G20-OECD member nations to reach consensus on taxation on digital economy and the G-20 OECD report on the Taxation of digital economy was expected by December 2020 which got delayed.

However, considering that India has notified the rules ahead of the said report, it would be interesting to watch whether India, being a member of G20, would further revise the SEP Rules in order to further realign with the G-20 OECD report and other global developments on digital taxation.

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This newsflash summarizes the Significant Economic Presence Rules as notified by the Government of India. It may be noted that nothing contained in this newsflash should be regarded as our opinion and facts of each case will need to be analyzed to ascertain applicability or otherwise of the said judgement and appropriate professional advice should be sought for applicability of legal provisions based on specific facts. We are not responsible for any liability arising from any statements or errors contained in this newsflash.

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