



## Bombay Chartered Accountants' Society

7, Jolly Bhavan 2, Ground Floor, New Marine Lines, Mumbai - 400 020  
Tel. : + 91 22 6137 7600 Website : www.bcasonline.org  
E-Journal : www.bcajonline.org E-mail : bca@bcasonline.org  
www.elearning.bcasonline.org

**President**  
Sunil Gabhawalla  
**Vice President**  
Manish Sampat  
**Hon. Jt. Secretaries**  
Abhay Mehta  
Mihir Sheth  
**Hon. Treasurer**  
Suhas Paranjpe

09<sup>th</sup> August 2018

To,

The DCIT (OSD)(TPL) -III

Ministry of Finance,

Central Board of Direct Taxes

New Delhi

Dear Sir,

Ref.: Notification No. F. No. 370142 / 11 / 2018 – TPL dated 13th July 2018

**Subject: Comments and Suggestions with regard to framing of Income-tax rules relating to Significant Economic Presence as per Explanation 2A to Section 9(1)(i) of the Income-tax Act, 1961 (the Act).**

This is with reference to captioned Notification inviting suggestions regarding drafting of Income-tax rules for the purpose of determining Significant Economic Presence ('SEP') of a non-resident in India as mentioned in Explanation 2A to Section 9(1)(i) of the Act.

At the outset, the International Taxation Committee of the Bombay Chartered Accountants Society congratulates the Finance Minister and the CBDT for adopting a critical aspect of SEP in the domestic tax legislation, thereby setting an example that the Indian law evolves with dynamic business models and consists of a set of rules that match the need of the hour.

The Finance Act, 2018 introduced the concept of 'Significant Economic Presence' (SEP) in the Income-tax Act, 1961 ('the Act') for taxation of non-residents in India by amplifying the scope of the definition of "business connection" through Explanation 2A to Section 9(1)(i) of the Act to establish taxable nexus for new business models which are operating remotely through digital medium. Therefore now CBDT, through above mentioned notification, has invited comments and suggestions on threshold to be set up for following:

- 1 Revenue threshold of transaction in respect of physical goods or services carried out by a non-resident in India.*
- 2 Revenue threshold of transaction in respect of digital goods or services or property including provision of download data or software carried out by a non-resident in India.*
- 3 Threshold for number of 'user' with whom a non-resident engages in interaction or carries out systematic and continuous soliciting of business activity in India through digital mean.*

Our suggestions below are considering the background of SEP being a very new legal concept, with minimal or no traction in most other countries. Further, while Non-residents can resort to a beneficial treaty, there would be incomes earned by non-residents who come from countries with which India does not have a treaty. Therefore, while we welcome the provisions, we have suggested that they become applicable to the very few and mighty who would be able to garner the required resources for complying with this provision.

Our suggestions and comments on above are as follows:

1. *Revenue threshold of transaction in respect of physical goods or services carried out by a non-resident in India.*

In respect of transactions covering physical goods or services carried out by a non-resident in India, the provision is too wide in its impact. For example, Saudi Aramco which sells crude oil to India of billions of dollars would get covered under the new provision. Therefore, the current definition of Business Connection under Section 9 of the Act would better serve the purpose for taxation of physical goods and non-digital services. The concept of Business Connection is a settled law now and therefore, it would not be advisable to disturb it. **In view of the above, it is suggested that the same practice of Business Connection should be continued and transaction covering physical goods and services carried out by a non-resident in India, should be kept out of SEP test.**

2. *Revenue threshold of transaction in respect of digital goods or services or property including provision of download data or software carried out by a non-resident in India.*

Base Erosion and Profit Shifting (BEPS) Action Plan No. 1 as drafted by the OECD suggested use of nexus approach to bring in the source income from digital economy under the purview of taxation. Such nexus approach could be established by adopting a concept of SEP.

For establishing taxable nexus of digital business, digital goods or services and Digital PE should be define under the Act. In short this means, SEP should apply to determine digital presence and for non-digital business, as discussed above, current definition of Business Connection would serve the purpose. At no point of time, principles applicable to digital business should be applied to non-digital businesses. Therefore, it is of utmost importance to define Digital Business or Digital PE with clarity considering little left for different interpretation.

Digital economy to include all businesses earning profits and gains from the significant use of Information and Communication Technology which include Software, Digital Content, Purchase of Data, Cloud Based Processing, Internet of Things, Virtual Currency, Advance Robotics, 3D Printing and also include income from profit and gains through digital business model including but not limited to Electronic Commerce, Business to Business, Business to Customer, Customer to Customer business models, payment services like cash payments, e-wallets and mobile payments. App stores, Online Advertising, Cloud Computing such as Software as a Service (SaaS), Platform as a Service (PaaS), Infrastructure as a Service (IaaS), Data as a Services (DaaS), High Frequency Trading, Participative network platform and similar model like this. It is suggested that all the abovementioned terms are defined taking a clue from the final Action Plan 1 of BEPS on Addressing the Tax Challenges of the Digital Economy.

Dwelling on the question of threshold, it is suggested that a non-resident entity carrying on a business in India through a digital means shall have SEP in India if the revenue in the previous year from transactions in respect of digital goods or services or property including provision of download of data or software in India, to users in India is more than Rupees **Fifty Crore**.

Further, there could be a possibility to circumvent the provision through operations via multiple Associates Enterprise. Therefore, to close the probable loophole one may apply the abovementioned threshold to a Constituent Entities of a MNE Group as defined in Section 286 of the Act of non-resident providing similar/same/fragmented services in India.

3. *Threshold for number of 'user' with whom a non-resident engages in interaction or carries out systematic and continuous soliciting of business activity in India through digital mean.*

In the Digital Economy the number of user is often considered as a critical mass for the operation of the digital business. Therefore, an appropriate number of users that create a critical mass needs to be determined. An important factor in this is the definition of "user". The provision clearly intends to tax only such non-residents who are interacting or carrying out systematic and continuous soliciting of business in India. In most cases, while there could be millions of users for a service, only a small percentage of them would be considered as "active users" based on their usage of the particular service. Further, even from active users, there would be many who would not be making any payment for the service but could be allowing use of their data for advertising by the service provider. In such a case, only a very high threshold of active users would approximate earning of income by a non-resident from India. As per a recent report on "Internet in India" by Internet and Mobile Association of India, there are an estimated 481 million internet users in India, out of which only 183 million users use the internet frequently. In our view, 10% of such active user base, i.e., 18 million users, should be a threshold for constitution of SEP in India. Being a dynamic industry, this threshold can be revisited every year.

Another point of importance to be considered is the aspect of valuation in the SEP.

Assuming due to certain reason, the tech company is not able to capitalise on high current revenues or assuming that due to niche business model the total number of critical mass to achieve is less than the suggested user base, one may look at the aspect of valuation that the company may derive at the time of sale of substantial stake by the investor of the tech company.

If the revenue from India or the user base in India, in the exercise of valuation is more than 25% of the global revenue project or the user base, the capital gains accruing to the existing investor is suggested to be attributable to the Indian operations.

Apart from the above suggestions, we request you to consider the fact that the rules for these provisions are yet to be finalised, with already 4 months having passed in the current financial year. Further, the existing rules for profit attribution may not be enough to compute non-resident's income from digital services. Therefore, we recommend that the applicability of SEP provisions be postponed to AY 2019-20. This will also give enough time to Non-residents to be prepared for the compliance tasks they will need to undertake from the coming year.

We request you to kindly take into considerations our suggestions while finalising the income-tax rules to be issued.

Yours Faithfully,

**For Bombay Chartered Accountants' Society**

A handwritten signature in black ink, appearing to read 'Sunil Gabhawalla', with a horizontal line underneath the name.

**Sunil Gabhawalla**

President