



DEEMED INCOME CONCEPT

SECTION 9 OF INCOME-TAX ACT, 1961

11 SEPTEMBER 2024



SECTION 9

BACKGROUND - SOURCE-BASED TAXATION - SEC. 9

Indian-Income tax law recognizes residential based taxation approach for taxing residents of India and source-based taxation approach for non-residents.

Source-based taxation is a principle in tax law where the taxation of income is determined based on the location or source from which the income is derived. That is ordinarily, the country, from where the income originates, has the primary right to tax, regardless of the taxpayer's residency.

This principle is relevant in the context of international taxation, where individuals and businesses may have income from multiple countries. Source-based taxation helps in preventing double taxation & tax avoidance and ensures that the income is taxed where it is generated.

The source-based approach of taxation is dealt in Section 9 of the Income-tax Act, 1961

SECTION 9 - CARDINAL PRINCIPLES

Creates a fiction as to the place of accrual - *the role of section 9 is only to shift the place of accrual based on various nexus*

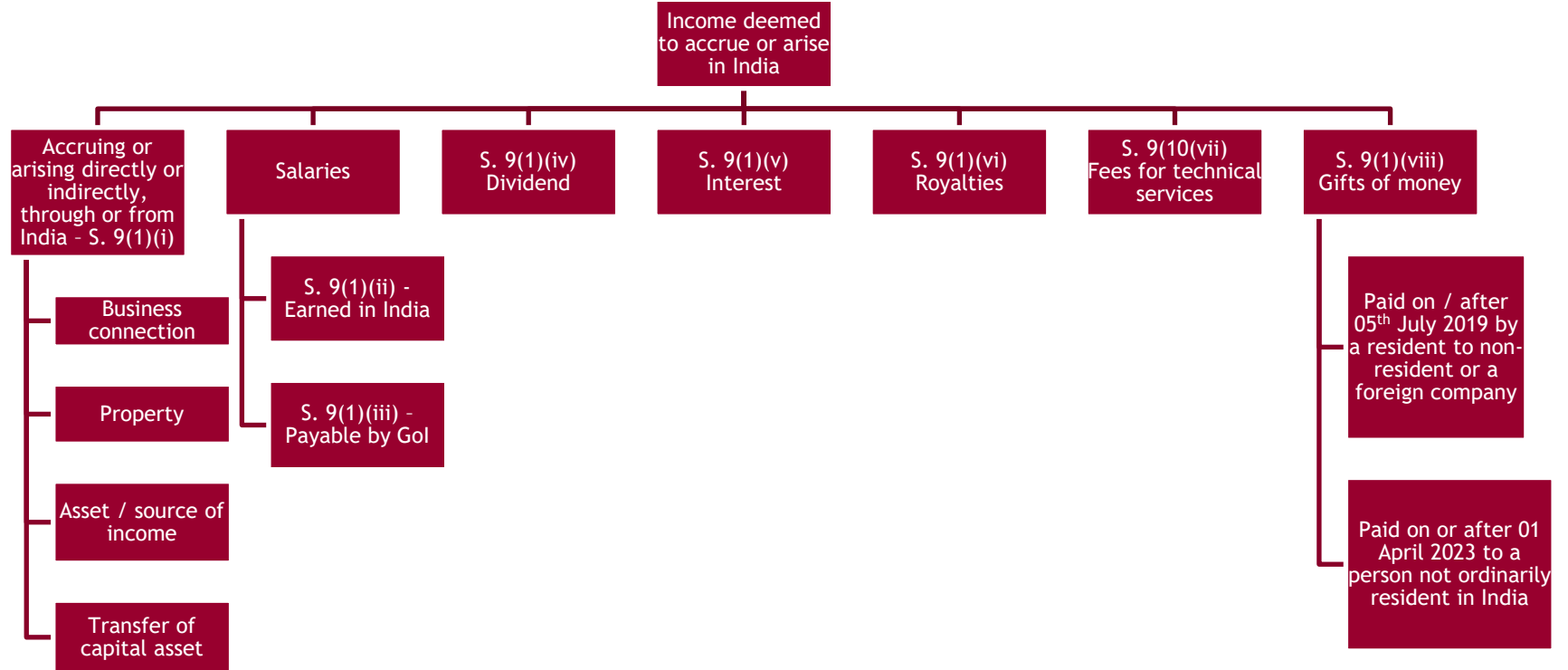
It cannot fasten accrual of income unlike provisions of deemed receipts.

Not applicable in case of income received or deemed to be received in India

If the income is already accrued in India by virtue of Section 5, then deeming fiction does not come into play

Relevant for Non-resident and RNOR - in the case of ROR - accrued outside India is already covered in Section 5.

SECTION 9 - BIRD'S EYE VIEW



BUSINESS CONNECTION

Business connection is NOT DEFINED EXHAUSTIVELY in the Act but explained in an inclusive manner - *definition is similar to dependent agency definition*

Business connection definition is wider in scope

Not all business transactions between a non-resident and a resident involves a business connection - *some activity has to be undertaken in India to trigger a business connection.*

Element of continuity is a must to establish 'business connection' and an isolated transaction or occasional activity cannot be regarded as business connection.

Professional connection is also covered for the purpose of business connection - *Barendra Prasad Roy vs ITO (1981) 129 ITR 295 (SC)*

BUSINESS CONNECTION

PRINCIPLES OF BUSINESS CONNECTION

IN THE CASE OF *G.V.K.
Industries Ltd (1998)*
(SUPREME COURT) &
*Volkswagen Finance
Pvt. Ltd [TS-172-ITAT-
2020(Mum)]*

Whether there is a BC between an Indian person and a non-resident is a mixed question of fact and law (To be determined on the facts and circumstances of each case)

The expression BC is too wide to admit of any precise definition, however, it has some well-known attributes

The essence of 'BC' is the existence of close, real, intimate relationship and commonness of interest between the non-resident and the Indian person;

Whether there is control or management or finances or substantial holding of equity shares or sharing of profits by the non-resident of the Indian person, the above requirement is fulfilled;

To constitute 'BC', there must be continuity of activity or operation of the nonresident with the Indian party, and a stray or isolated transaction is not enough to establish a BC.

Intangible Business Connection

Virtual business connections are just as vital as physical ones, which leads to income earned by non-residents from India. -
Volkswagen Finance Pvt. Ltd [TS-172-ITAT-2020(Mum)]

BUSINESS CONNECTION - EXCEPTIONS

01 Income from operations derived by NR confined to purchase of goods in India for the purpose of export.

02 Income from activities derived by non-resident confined to the collection of news and views for transmission out of India

03 Income from operations, confined to shooting of cinematograph films in India only if:

- Individual - Not a resident & not a citizen.
- Firm - all partners, Not a resident & not a citizen.
- Company - all shareholders, Not a resident & not a citizen

04 Foreign company- engaged in the business of mining- income from - display of uncut and unassorted diamonds- in any zone notified by CG.

CONCEPT OF AGENCY BC - EXPL 2 TO 9(1)(i)

Business activities, carried out through a person, acting on behalf of a non-resident:

Has and habitually exercises in India, an authority to conclude contracts on behalf of NR or *habitually concludes contracts or habitually plays the principle role leading to conclusion of contracts by NR and the contracts are -*

- (i) *in the name of NR; or*
- (ii) *for the transfer of the ownership of, or for the granting of the right to use, property owned by that NR or that NR has the right to use; or*
- (iii) *for the provision of services by the NR; or*

Having no such authority, HABITUALLY maintains a stock of goods and regularly delivers them on behalf of the NR.

HABITUALLY secures orders in India, mainly or wholly for the non-resident.

An agent acting independently does not establish a business connection.

However, if the agent secures orders for other non-residents under the control of the principal non-resident, or vice versa or if both are under a common control, a business connection exists.

AGENCY BUSINESS CONNECTION - EXPL 2 TO 9(1)(i)

Key Terms

‘Acting on behalf’

When that person involves the enterprise to a particular extent in business activities in a state concerned. A person cannot be said to be acting on behalf of an enterprise if the enterprise is not directly or indirectly affected by the action performed by that person.

“Habitually”

The presence which an enterprise maintains in the contracting state should be more than a transitional.

The extent and frequency of activity necessary to conclude that the agent is “habitually” concluding contracts will depend on the nature of contracts and the business of the principal.

“Person said to have authority to conclude contracts”

- Has sufficient authority to bind FE and decide the final terms
- Can act independently, without control from the principal
- Is authorized to negotiate all elements and details of the contract
- Where approval of contract by foreign enterprise is mere formality
- Lack of active involvement by an enterprise in a transactions is indicative of a grant of authority (Para 32.1 of OECD MC 2014)

INDEPENDENT AGENT - CHARACTERISTICS & TEST

Legal independence	Economic independence	Ordinary course of business
<ul style="list-style-type: none">• The degree of control exerted by principals on the conduct of the businesses of agents determines whether or not the agents are legally independent. This control should not be of a degree as that in an employer-employee relationship.• Agents must not be subject to detailed instructions and control with respect to the conduct of their business.• Principals should not be in a position to exert a decisive influence on the business of their agents.• Agents must be able to conduct their business according to their own viewpoints, competence and methodologies.	<ul style="list-style-type: none">• Agents should be able to conduct their businesses independently and not be dependent on their principals for their economic viability.• They should bear the risk of loss arising from their activities.• They should not be wholly and exclusively dependent on their principals. The number of principals represented by an agent determines its economic independence.	<p>Where an agent undertakes to conduct the activities of the principal in its normal course of business, this should not constitute a PE of the agent (foreign company) in India.</p> <p>The key principles:</p> <ul style="list-style-type: none">• Conduct of an agent vis-à-vis that of the principal• Comparison of an agent's activities with those of other agents undertaking similar agency functions• Whether activities engaged in by agents are customary to their trade as brokers, commission agents, etc. <p>Agents should not undertake activities that form an economic component of the range of activities engaged in by their principals.</p>

INDEPENDENT AGENTS - PRECEDENTS

- Test of Dependence - To be looked at from the perspective of agent - **Speciality Magazines (144 Taxman 153 [2005] [AAR]); Morgan Stanley & Co International Ltd - 142 Taxman 630 (AAR).** Contrary in **DHL Operations BV (142 Taxman 1).**
- Which business to be considered for test of independence - Entire business of the Agent to considered - **B4U International Holding Ltd (Bombay);** Contrary **Galileo International Inc.**
- A newspaper company, collecting advertisements for other foreign newspapers, acts in the “ordinary course” of its business when it enters into a solicitation agreement with foreign principals [**Al Nisr Publishing, In re, 239 ITR 879 (AAR)**]
- The Department of Posts accepts money orders for the transfer of funds within India, Engaging itself in the same type of business with international ramifications, i.e., money transfer services across international borders, is just an extension of its business and hence, is in the “ordinary course of its business” [**Western Union Financial Services Inc., 101 TTJ 56 (Del)**]

SIGNIFICANT ECONOMIC PRESENCE (SEP)

- Provision of SEP was introduced in 2018
- Expands the scope of income of a non-resident which accrues or arises in India that results in a 'business connection' in India for that non-resident. The resulting income, attributable to the SEP, is taxable in India.

- **Location Irrelevance:** SEP can exist regardless of where the agreement is signed or where the non-resident has a physical presence.
- **Service Provision:** Rendering services in India can also establish SEP.
- **Income Attribution:** Only income directly attributable to SEP transactions or activities is taxable in India.
- **Agent Presence:** Physical presence of an agent is not required to establish a business connection.
- **SEP Implication:** Confirmation of SEP automatically establishes a business connection.

SEP is defined to mean:

Transaction in respect of any goods, services or property carried out by a non-resident in India, including the provision of download of data or software in India, subject to a payment threshold exceeding two crore rupees; or

Systematic and continuous soliciting of business activities or engaging in interaction with such number of three lakhs or more may be prescribed, in India through digital means.

NEED FOR SIGNIFICANT ECONOMIC PRESENCE - MEMORANDUM 2018

Underlying Principle

Economic allegiance, not physical location, is the foundation of international taxation.

OECD's BEPS Action Plan 1

- Addresses tax challenges in the digital economy.
- Proposes a new nexus rule based on SEP.

Evolution of Nexus

- Physical presence was initially a proxy for economic allegiance.
- Digital business models have challenged this traditional nexus.

SEP Definition

- A significant economic presence is created through purposeful and sustained interactions with a country's economy using technology and other automated tools.
- Revenue factors may be considered in conjunction with other SEP factors.

Tax Avoidance Concerns

Remote interactions through digital mediums can lead to tax avoidance in the source country.

EXPLANATION 3A AND RAMIFICATIONS

Income Attribution for Digital Activities Pointers

- ❑ **Targeted Advertising:** Income from advertisements targeting Indian residents or accessed through Indian IP addresses is taxable.
- ❑ **Data Sale:** Income from selling data collected from Indian residents or through Indian IP addresses is taxable.
- ❑ **Goods and Services:** Income from selling goods or services using data collected from Indian residents or through Indian IP addresses is taxable.

SUMMARY OF BUSINESS CONNECTION

Income accrued outside India w.r.t. PGBP

Business connection

Not proved

Not taxable for a resident

proved

Agent

- Concludes Contract
- Maintain Stock
- Secures Contracts

SEP

- Sales of goods or services > INR 2 Cr
- No of users \geq 3 lakhs

Or

Only incomes attributable to business connection in India will be taxable

Includes

- Income from ads targeting Indians
- Sale of data
- Sale of goods or services making use of data

Excludes

- Purchase of goods for export
- News and views
- Shooting of films
- Foreign co - uncut and unsorted diamonds

PROPERTY OR ASSET OR SOURCE OF INCOME IN INDIA

PROPERTY IN INDIA

- ❖ Covers both movable & immovable property
- ❖ Covers all class of income as mentioned in Sec. 14
- ❖ Income from hiring of furniture in India - arising from property in India
- ❖ Positives and negatives of films of motion pictures will be property, and the income derived from hiring of such films will fall under this section.

ASSETS IN INDIA

- ❖ Asset is to be understood more broadly than property
- ❖ Idea may be to leave no gap in the coverage
- ❖ Will also cover intangible property
- ❖ merely because the debtor is in India, the situs of the debt due by him to a non-resident is not an asset or source in India

SOURCE OF INCOME

- ❖ Covers Section 56 or otherwise
- ❖ Idea being that all incomes payable to a non-resident arising in a primary sense from Indian sources should be subjected to taxation in India - Lakhmichand Muchhal v CIT (1961) 43 ITR 315

TRANSFER OF CAPITAL ASSET IN INDIA

- ❖ Transfer of capital asset situated in India by a non-resident is taxable in India; Capital Asset - Section 2(14); Transfer - 2(47)
- ❖ Situs of Shares - place where the company is incorporated
- ❖ Situs of intangible property? - Delhi High Court in CUB Pty Ltd - (2016) 388 ITR 617 (Del) - '*mabilia sequuntur personam*'
- ❖ Indirect transfer provisions were introduced in 2012.
- ❖ Introduction of Explanation 5 - 7 and relevant rules
- ❖ Overseas Dividend paid by Foreign Company deriving substantial value from India? - Circular 4/2015
- ❖ Valuation for determining FMV is prescribed under Rule 11UB
- ❖ Attribution of Income - Rule 11UC - in proportion to value derived from India

TRANSFER OF CAPITAL ASSET IN INDIA

Explanation 5

- ❖ Tax the gains derived from transfer of capital asset that derives its value substantially from assets located in India. Asset located in India also includes assets located outside India (i.e. owned by Indian entity)
- ❖ Proviso to Explanation 5 - Exclude investment held by non-residents in a FII or in a Category-I or Category-II FPI.

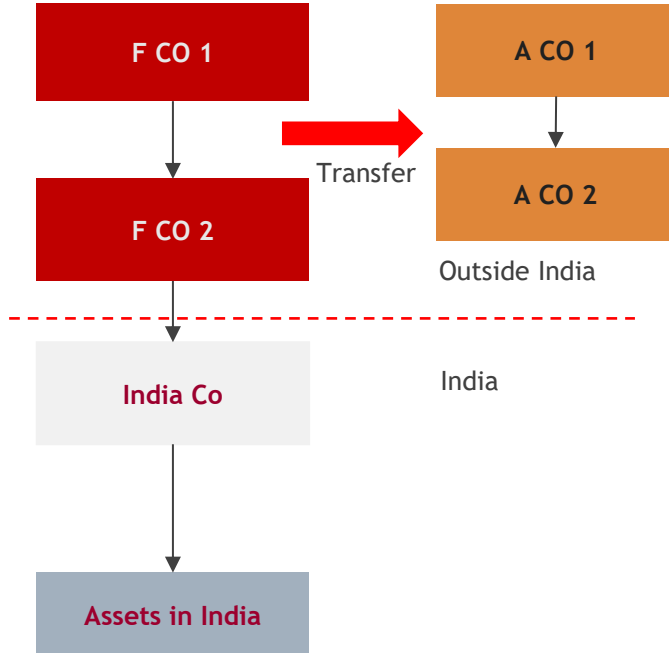
Explanation 6

- ❖ Substantial value is explained - (i) value of asset located in India > 10 Crores and (ii) value of Indian assets represent atleast 50% of total assets of the Company -
- ❖ Specified date for determination of value

Explanation 7

- ❖ Small shareholder exemption - upto 5% - Augustus Capital Pte. Ltd [2024] 296 Taxman 398 (Del) - to be read retrospectively along with the Explanation 5

INDIRECT TRANSFER - MECHANICS IN NUTSHELL



Step1: Determination of Specified Date:

- To be determined on the basis of book value of assets of F.Co.2 of which shares are being transferred

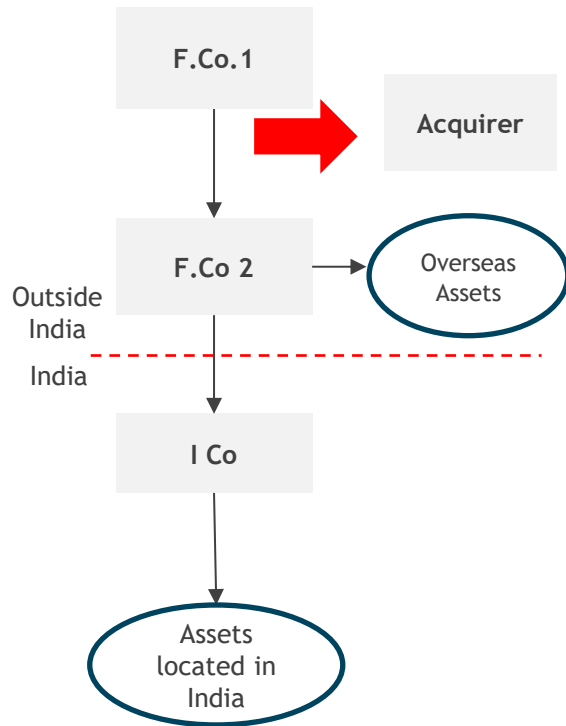
Step 2: Determination of Fair Market Value (FMV):

- Determination of FMV of India located assets and FMV of all assets of F Co.2 as on specified date
- Determine if FMV of assets located in India is more than Rs 10 crores and represents $\geq 50\%$ of FMV of all assets of F.Co2 as on specified date, as determined in Step 1

Step3: Proportionality Test

- If Step2 satisfied, amount reasonably attributed to assets located in India to be determined as per prescribed method to determine taxability

SPECIFIED DATE - DETERMINATION



➤ Specified Date means

The last date of the accounting period of the company / entity immediately preceding the date of transfer;

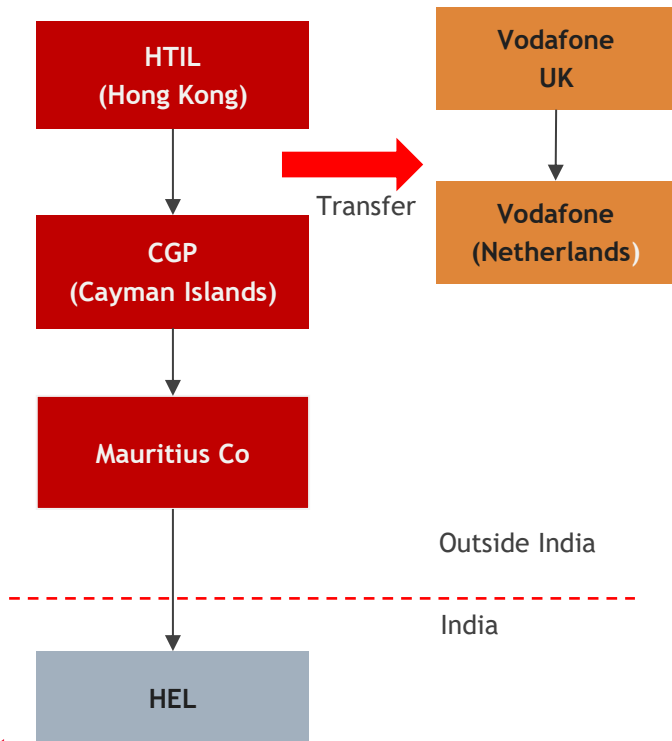
OR

Date of transfer, if the book value ('BV') of assets of the company / entity on the date of transfer exceeds BV as on the last date of the immediately preceding accounting period by 15%

➤ Illustration: Date of transfer is 24.03.2024

Particulars	Case 1	Case 2	Case 3
BV of assets of F.Co2 as on 31.03.2023	500	500	500
BV of assets of FCo2 as on 24.03.2024	525	600	450
Whether exceed 15% of BV	No	Yes	No
Specified Date	31.03.2023	24.03.2024	31.03.2023

INDIRECT TRANSFER - VODAFONE INTERNATIONAL 341 ITR 1 (SC)



- Vodafone International B.V., Netherlands (Vodafone), sought to expand its footprint in the Indian Telecom market by acquiring the entire stake in CGP which in turn held the stake in the Indian subsidiary, HEL
- The Indian Tax Authorities ('ITA') sought to bring the said transaction between two non-residents under India tax net by contending that effectively the interest in HEL got indirectly transferred and consequently, the same was chargeable to capital gains tax as per India tax laws
- Vodafone filed writ petition the Hon'ble High Court of Bombay ('BHC') challenging the notice issued to it by the ITA. BHC dismissed the writ petition stating deeming accrual provisions in the tax statute were wide enough to include within its ambit the said transaction
- Vodafone filed an appeal to the Hon'ble Supreme Court which delivered a landmark decision in favour of Vodafone

SECTION 9(1)(ii) - SALARY EARNED IN INDIA

- ❖ Interplay of Section 5, 6, 9 and 15
- ❖ Section 15 - due or paid basis depending on nature of salary
- ❖ Salary income of a non resident - Where is the source locality?
 - (a) the place where the contract is made, or*
 - (b) the place where the payment for the employment is to be made.*
- ❖ Connecting factor with India - Earned in India. Explanation was inserted to clarify what is earned in India - Equated with service rendered in India
- ❖ Subject to short stay exemption under Sec 10(6) - Exemption not applicable to Citizen of India
- ❖ Shifts place of accrual of salary for employment based outside India to India where the salary is earned in India, i.e., services are rendered in India

SECTION 9(1)(ii) - SALARY EARNED IN INDIA

Various Scenarios of Taxation for a Non Resident

Employer based	Services rendered	Salary Received	Taxability
In India	In India	In India and/or outside India	Taxable in India as per Section 5 and 9(1)(ii), credit of Indian taxes should be available in COR
Outside India	In India	In India and/or outside India	Taxable in India only in respect of services rendered in India as per Section 9(1)(ii) subject to short-stay exemption
Outside India	Outside India	Outside India	Not taxable in India
		In India in same year	Taxable in India on receipt basis
		In India in later year(s)	Not liable to tax in India in year of accrual; not taxable in year of receipt as already subject to tax
In India	Outside India	In and/or outside India	Taxable in India under Section 5

SECTION 9(1)(iii) - SALARY PAYABLE BY GOVERNMENT

Section. 9(1)(iii)-Salary payable by Govt. of India to an Indian Citizen for services rendered outside India.

- ❖ Targeted at citizens engaged in diplomatic service abroad or trade commissions or other official organisations of the Government
- ❖ Includes both Union and State Government [2. 3(23), General Clauses Act, 1897]
- ❖ Perquisites and allowances paid or allowed outside India to such employees exempt [Sec. 10(7)]
- ❖ Does not include foreign governments

Section 9(1)(iv) - DIVIDEND PAID BY INDIAN COMPANY

Any dividend paid by an Indian company outside India is deemed to accrue or arise in India

- ❖ Situs of accrual of dividend may be different from the situs of the shares
- ❖ Indian company as defined in sec. 2(26)

SECTION 9(1)(v) - INTEREST

Section 9(1)(v)- income by way of interest payable by:-

- The Govt
- Resident(for the purpose of business or profession or earning any income source in India.)
- Non resident(for the purpose of business or profession in India)

Is deemed to accrue or arise in India.

It is to be noted that interest payable by a NR in respect of any debt incurred or moneys borrowed and used, for the purposes of making or earning any income from any source, other than a business or profession carried on by him in India, will not be deemed to accrue or arise in India.

Example:

If a lead bank obtains loans outside India from a consortium of foreign banks and lends the same to an Indian concern, interest paid by the lead bank to the members of the consortium will not attract liability towards income-tax in India.

SECTION 9(1)(vi) - ROYALTY

Section 9(1)(vi)- income by way of royalty payable by:-

- The Govt
- Resident(purpose of business or profession or earning any income source in India.)
- Non-Resident(purpose of business or profession or earning any income source in India.)

Royalty means consideration, including lumpsum consideration, but excludes consideration which would be income chargeable under the head capital gains of the recipient, for the list matters as described under the relevant clause. Royalty includes consideration paid for transfer of all or any rights to use a computer software

Royalty includes consideration paid for transfer of all or any rights, property or information, whether or not,

- The possession or control is with the payer
- Is used directly by the payer
- Is located in India

SECTION 9(1)(vii) - FEES FOR TECHNICAL SERVICES

Section 9(1)(vii)- income by way of fees for technical srs payable by:-

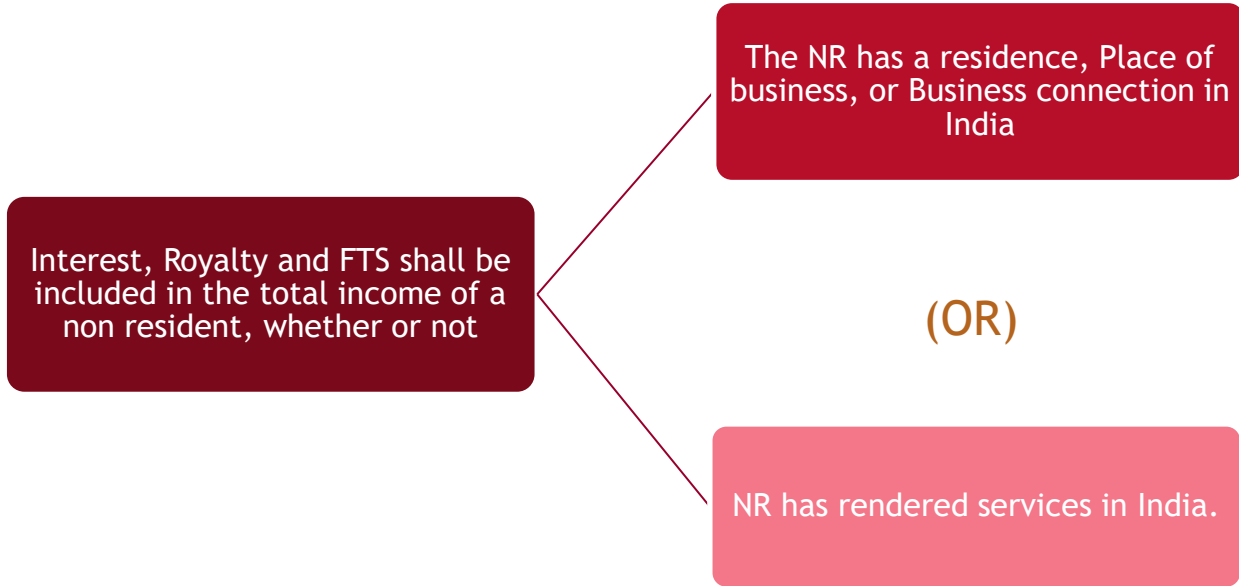
- The Govt
- Resident(for the purpose of business or profession or earning any income source in India.)
- Non Resident(for the purpose of business or profession or earning any income source in India.)

is deemed to accrue or arise in India.

Fees for technical services means any consideration (including lumpsum consideration) for the rendering of managerial, technical or consultancy services, including the provision of services of technical or other personnel.

It excludes consideration received for any construction, assembly, mining or like project undertaken by the recipient and transaction in nature of Salaries.

EXPLANATION TO SECTION 9(2)



SECTION 9(1)(vii) - GIFT OF MONEY

Section 9(1)(viii)

Income arising outside India, paid by a person resident in India (Gift):

- On or after 05-07-2019, to a non-resident or to a foreign company.
- On or after 01-04-2023 to a not ordinary resident.

is deemed to accrue or arise in India.



THANK YOU

RAGHUNATHAN PARTHASARATHY

email - raghunathanparthasarathy@bdo.in