

## CHAPTER

## 6

# E-Commerce Taxation : Real Problems in the Virtual World

**Syllabus Topic : A Tug of War on the Concept of 'Permanent Establishment'**

## 6.1 A Tug of War on the Concept of 'Permanent Establishment'

**Q. 6.1.1 Explain the term Permanent Establishment. (Ref. Sec. 6.1)**

(5 Marks)

- There are two basic principles of taxation internationally:
  1. Resident based taxation.
  2. Source based taxation.
- As per the Indian Income Tax Act, 1961, India taxes their residents on their global income under the resident based taxation. For non residents they charge tax on their income sourced in that country under source based taxation.
- At the point when a resident of one country gains salary from a source in another country, the likelihood of double taxation emerges on the grounds that one country may tax that income on the source principle while the other country may tax it on the residence principle. By and large, after the source based taxation, the Source Country is apportioned the privilege to tax the income emerging in that.
- While the Residence Country likewise taxes the pay following the habitation based taxation. The Residence Country mitigates the impact of double taxation either by method for tax exemption or by method for tax credit.
- To avoid the double taxation Double Taxation Avoidance Agreements (DTAAs) is introduced which includes the principle of permanent establishment. Where the non-residents are exempted from the permanent establishment.
- In simple words, if a person is earning money from country A and he is a resident of country B then that person cannot be taxed in country A unless a permanent establishment exists in country A.

The most imperative issue in the treaty based international fiscal law is the idea of Permanent Establishment (PE). All the three model traditions in particular, UN (United Nations) Model, OECD (Organization for Economic Co-operation and Development) Model and US (United States of America) Model use PE as the fundamental instrument to build up taxing purview over a foreigner's business exercises.

#### A similar should be comprehended top to bottom with the accompanying

As per the idea of PE, the benefits of an undertaking of one Contracting State are taxable in the other state, just if the venture keeps up a PE in the later state and just to the degree that benefits are owing to the PE.

In this way, a lawful idea, PE is a bargain between source state and residence state for motivations behind taxation of business benefits.

The term must be seen in order to land at that level of monetary entrance, which as indicated by treaty partners, legitimizes a country in treating a foreign person in indistinguishable way from residential people.

Benefit owing to a PE, in the State of Source are either exempted in State of Residence or the State of Residence permits credit of taxes paid by the PE on such benefits.

To this degree, the taxing jurisdiction by the State of Residence is said to be exchanged to the State of Source, where the individual needs to document his arrival of salary and consent to domestic tax laws.

#### Structure of Article 5

Article 5(1) defines a permanent establishment and lays down the basic rule that a business activity carried on through a fixed place of business would constitute the PE of the taxpayer.

Article 5(2) mentions several examples of fixed place of business. These examples could also be said to form the 'positive list'.

Article 5(3) includes certain construction related activities and service related activities within the scope of PE if such activities continue for certain period.

Article 5(4) mentions that a PE shall be deemed not to include certain activities. These could be said to form the 'negative list'.

Article 5(5) stipulates rules for determining when an enterprise represented by an agent would have a PE.



- Article 5(6) deals with the case of an enterprise carrying on insurance business. Article 5(7) and Article 5(8) set out rules in respect of enterprises represented by an agent or an enterprises related to it.

#### ☞ Article 5(1)- Basic Rule of PE

Article 5(1) defines PE as "a fixed place of business through which the business of an enterprise is wholly or partly carried on". This is what is commonly referred to as 'basic rule of PE'.

### Syllabus Topic : Finding the PE In Cross Border E-Commerce

#### 6.1.1 Finding the PE In Cross Border E-Commerce

**Q. 6.1.2** Write short note on finding PE in cross border e-commerce.  
(Ref. Sec. 6.1.1)

(5 Marks)

- The Fiscal Affairs of the OECD committee states that the principles underlined under the OECD Model Tax conventions can be capable to apply to ecommerce. But PE principles are struggling to cross border e-commerce as there is inappropriateness of the said principles. There are questions related to PE to cross-border e-commerce, website, server and ISP.

##### 6.1.1.1 Website as PE

- As per the definition of the PE it needs a fixed place to carry out the business of an enterprise. Article 5 of OECD model treaty defines place of business as, to cover premises facilitates or installations used for carrying on the business of the enterprise, whether or not they are used exclusively for that purpose.
- OECD model the following places are considered as permanent establishment they are: A place of Management, a branch, an office, factory, workshop, mine, and oil or gas well, and quarry or any other place of extraction of natural resources.

##### 6.1.1.2 Web Server as PE

- Geographical location of server has nothing to do with the business activity in a certain place. Website doing business in India may have its server anywhere on the globe.
- The location of server as a PE would lead to websites migrating to server in tax havens countries with low rates of taxation so as to minimize liabilities.

To minimize the cost change the server. For favorable tax treatment a website may locate itself on a foreign address giving an impression that its place of business is such an address.

So, there are following views on the subject that whether the web server serves as a PE is given by the working party of the OECD:

1. Website is a combination of software and electronics data, which does not, in itself involve any tangible property and hence cannot itself constitute a fixed place of business.
  2. The server used for Website may constitute its place of business of the enterprise that operates it.
  3. Website enters into a hosting arrangement, it does not follow by itself that the enterprise operating the website has acquired a place of business. However, if the enterprise carrying on business through website also owns and operates the server on which website is stored and used then the enterprise could constitute a PE if the other requirements of the concept are satisfied.
  4. E-Commerce is distinguishable from gaming and vending machine, and therefore they cannot be fitted with each other for taxation purposes. Such machines are fixed in the place and enter into a completed transaction with the customers to provide goods or services and thus the PE by themselves. The machines that independently generate business and profits fall within the PE concept since they undertake every activity which regular PE does. In E-Commerce transactions, on the other hand, the business is not carried on through the server but through the Enterprises office, warehouses etc. in which its income generating activities take place.
  5. Computer equipment may constitute a PE only if it is fixed, that is located at a certain place for a sufficient period of time.
- There are different views expressed related to the automated equipments some feel that there should be human intervention for operations may constitute a PE and some fields that should not be human intervention.
- If the human intervention is anyone then it must be by a person who is present for that purpose in the country where the equipment is located.
  - Novelty working party of OCED considers the activities of preparatory or auxiliary nature. The following are the activities which are generally preparatory or auxiliary:
    1. Advertising of goods or services
    2. Providing the communication link between suppliers and customers.



- 3. Collecting market data for the enterprise and supplying information.
- 4. Relaying information through a mirror server for security and efficiency.
- The activities where the core functions of the enterprise are carried on through computer equipment are considered to constitute a permanent establishment.
- If server is fully handling relevant transaction then a PE is created.

#### 6.1.1.3 Internet Service Provider Provide a PE

- The working party of the OECD also considered the issue as to whether the location of the internet service provider may constitute place of business and hence a PE in respect of the websites hosted by the ISP.
- ISP is not an agent of the Enterprise to which the website belongs as it does not have the authority to conclude contracts for an on behalf of the Enterprise hence it was agreed that the concept of PE cannot apply to ISPs.
- As per article 5 of model treaty, an agency that constitutes PE there must be a relationship where by the foreign enterprise relies on the domestic agent to conclude binding contracts.
- An ISP merely provides Technical Services websites like the telephone exchange and does not in any way participate in the business activities of the websites hosted by it.
- If the hosting company is an independent agent then PE is created. ISPs are only providers of Technical Services and are economically as well as legally independent of their customers.

---

#### Syllabus Topic : The United Nations Model Tax Treaty

---

#### 6.2 The United Nations Model Tax Treaty

**Q. 6.2.1 Write short note on The United Nations Model Tax Treaty.  
(Ref. Sec. 6.2)**

**(5 Marks)**

- The United Nations Treaty based on an ideology that developing countries are mostly net importers. So, in taxation of cross border transactions priority must be given to them.
- For drafting the UN Model Treaty the OECD Model Treaty is used as a guide.
- UN Model gives more scope than the OECD Model for the country in which income has its source to assume the sole or prior right to tax that income.

In UN model the source of income forms the basis for taxation, and permanent establishment term found in the OECD model, though accepted by the UN model generally encompasses and expanded list of activities.

The UN model is easy as compared to OECD model.

There are four distinctive features between OECD model and Article 5 and 7 of the UN model they are as follows:

1. The word 'or delivery' do not appear in the exclusion provision of the UN model. Where is the OECD model pretty exempt business which maintains facilities strictly for purposes of storage, display, or delivery, the UN wording qualifies those engaging in delivery as PE. The commentary to the UN model states that Deletion of the word 'delivery' means that a warehouse use solely for that purpose will be deemed permanent establishment.
  2. Agents for only deliver goods for non-resident Enterprise qualify as permanent establishment under the UN model. The UN model Treaty holds agent to be a PE if he is dependent on the company but also if he is independent but all his work is done for the company. The OECD model in contrast would not find PE when an agent simply delivers goods, or when the agent is independent.
  3. The basic difference related to the definition of PE between the two model treaties concerns situation where there is no formal PE, yet the income of enterprise is still held to be taxable under article 7 of the UN model treaty. The principal permit an existing permanent establishment to attract income that would not be attributable to the permanent establishment according to the arm's length principle. There is no need to find an independent permanent establishment if the business activities are sufficiently similar.
- Although the UN model is liberal as compared to OECD model but it cannot be said to be appropriate for cross border e-commerce. Under the force of attraction rule, source based taxation could be imposed on internet transactions where there is an existing PE performing the same business activities in the source country.
  - The businesses which are performing all their activities electronically on the internet and do not have any agent Augmenting any facilities within the source country, the force of attraction rule would not apply and they would not be subject to taxation in the source country.



## Syllabus Topic : The Law of Double Taxation Avoidance Agreements and Taxable Jurisdiction over Non-Residents, Under the Income Tax Act, 1961

### 6.3 The Law of Double Taxation Avoidance Agreements and Taxable Jurisdiction over Non-Residents, Under the Income Tax Act, 1961

**Q. 6.3.1 Explain the law of Double Taxation Avoidance Agreements and Taxable Jurisdiction over Non-Residents, under the Income Tax Act, 1961.**  
(Ref. Sec. 6.3)

(5 Marks)

The Double Tax Avoidance Agreement (DTAA) is essentially a bilateral agreement entered into between two countries. The basic objective is to promote and foster economic trade and investment between two Countries by avoiding double taxation.

#### 6.3.1 Objective of Tax Treaties

- International double taxation has adverse effects on the trade and services and on movement of capital and people. Taxation of the same income by two or more countries would constitute a prohibitive burden on the tax-payer.
- The domestic laws of most countries, including India, mitigate this difficulty by affording unilateral relief in respect of such doubly taxed income (Section 91 of the Income Tax Act). But as this is not a satisfactory solution in view of the divergence in the rules for determining sources of income in various countries, the tax treaties try to remove tax obstacles that inhibit trade and services and movement of capital and persons between the countries concerned.
- It helps in improving the general investment climate.
- The double tax treaties (also called Double Taxation Avoidance Agreements or "DTAA") are negotiated under public international law and governed by the principles laid down under the Vienna Convention on the Law of Treaties.

#### 6.3.2 Need for DTAA

- The need for Agreement for Double Tax Avoidance arises because of conflicting rules in two different countries regarding chargeability of income based on receipt and accrual, residential status etc. As there is no clear definition of income and taxability thereof, which is accepted internationally, an income may become liable to tax in two countries.

In such a case, the two countries have an Agreement for Double Tax Avoidance, in which case the possibilities are :

1. The income is taxed only in one country.
2. The income is exempt in both countries.
3. The income is taxed in both countries, but credit for tax paid in one country is given against tax payable in the other country.

In India, The Central Government, acting under Section 90 of the Income Tax Act, has been authorized to enter into double tax avoidance agreements (hereinafter referred to as tax treaties) with other countries.

### 6.3.3 Types of DTAA

DTAA can be of two types.

- i. Comprehensive.
- ii. Limited.

Comprehensive DTAAAs are those which cover almost all types of incomes covered by any model convention. Many a time a treaty covers wealth tax, gift tax, surtax. Etc. too. Limited DTAAAs are those which are limited to certain types of incomes only, e.g. DTAA between India and Pakistan is limited to shipping and aircraft profits only.

### 6.3.4 Role of Tax Treaties In International Tax Planning

A tax treaty plays the following role :

1. Facilitates investment and trade flow, preventing discrimination between tax payers;
2. Adds fiscal certainty to cross border operations;
3. Prevents international evasion and avoidance of tax;
4. Facilitates collection of international tax;
5. Contributes attainment of international development goal, and
6. Avoids double taxation of income by allocating taxing rights between the source country where income arises and the country of residence of the recipient; thereby promoting cooperation between or amongst States in carrying out their obligations and guaranteeing the stability of tax burden.



### 6.3.5 Choice of Beneficial Provisions under DTAA/Tax Laws

- The Provisions of DTAA override the general provisions of taxing statute of a particular country. It is now well settled that in India the provisions of the DTAA override the provisions of the domestic statute.
- Moreover, with the insertion of Sec.90 (2) in the Indian Income Tax Act, it is clear that assessed have an option of choosing to be governed either by the provisions of particular DTAA or the provisions of the Income Tax Act, whichever are more beneficial.
- For example under DTAA between India and Germany, tax on interest is specified @ 10% whereas under Income Tax Act it is 20%. Hence, one can follow DTAA and pay tax @ 10%.
- Further if Income tax Act itself does not levy any tax on some income then Tax Treaty has no power to levy any tax on such income. Section 90(2) of the Income Tax Act recognizes this principle.

### 6.3.6 Models of DTAA

- There are different models developed over a period of time based on which treaties are drafted and negotiated between two nations. These models assist in maintaining uniformity in the format of tax treaties. They also serve as checklist for ensuring exhaustiveness of provisions to the two negotiating countries.
- OECD Model, UN Model, the US Model and the Andean Model are few of such models. Of these the first three are the most prominent and often used models. However, a final agreement could be combination of different models.

#### OECD Model

- Organization of Economic Co-operation and Development (OECD) Model Double Taxation Convention on Income and on Capital, issued in 1977, 1992 and 1995.
- OECD Model is essentially a model treaty between two developed nations. This model advocates residence principle, that is to say, it lays emphasis on the right of state of residence to tax.

#### UN Model

- United Nations Model Double Taxation Convention between Developed and Developing Countries, 1980.
- The UN Model gives more weight to the source principle as against the residence principle of the OECD model. As a correlative to the principle of taxation at source the

articles of the Model Convention are predicated on the premise of the recognition by the source country that :

- (a) Taxation of income from foreign capital would take into account expenses allocable to the earnings of the income so that such income would be taxed on a net basis, that
- (b) Taxation would not be so high as to discourage investment and that
- (c) It would take into account the appropriateness of the sharing of revenue with the country providing the capital.

In addition, the United Nations Model Convention embodies the idea that it would be appropriate for the residence country to extend a measure of relief from double taxation through either foreign tax credit or exemption as in the OECD Model Convention.

Most of India's treaties are based on the UN Model.

### 6.3.7 United States Model Income Tax Convention of September, 1996

The US Model is different from OECD and UN Models in many respects. US Model has established its individuality through radical departure from usual treaty clauses under OECD Model and UN Model.

#### Syllabus Topic : Tax Agents of Non-Residents under the Income Tax Act, 1961 and the Relevance to E-Commerce

### 6.4 Tax Agents of Non-Residents under the Income Tax Act, 1961 and the Relevance to E-Commerce

#### Q.6.4.1 Explain the Tax Agents of Non-Residents under the Income Tax Act, 1961 and the Relevance to E-Commerce. (Ref. Sec. 6.4) (5 Marks)

- As there is increase in cross border business transaction facilitated by e-commerce, Taxation of non residents has gain the significance. Under the Income Tax Act 1961, non-resident are also liable to be tax .a non resident it taxable on income sourced in India.
- The double taxation avoidance agreement has been evolved as a principle of international taxation; it is governed by Section 90 of the Income-Tax which states about the agreement with the foreign countries, it is given as follows:

#### 6.4.1 Section 90 Agreement with Foreign Countries

The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India, :



- (a) for the granting of relief in respect of income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or
- (b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, as the case may be, or
- (c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory, as the case may be, or investigation of cases of such evasion or avoidance, or
- (d) for recovery of income-tax under this Act and under the corresponding law in force in that country

Section 91 of Income Tax Act comes into action when there is no agreement under Section 90 of the act .Section 91 provides information related to countries with which no agreement exist

#### 6.4.2 Countries with which no Agreement Exists

- If any person who is resident in India in any previous year proves that, in respect of his income which accrued or arose during that previous year outside India (and which is not deemed to accrue or arise in India), he has paid in any country with which there is no agreement under Section 90 for the relief or avoidance of double taxation, income-tax, by deduction or otherwise, under the law in force in that country, he shall be entitled to the deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.
- If any person who is resident in India in any previous year proves that in respect of his Income which accrued or arose to him during that previous year in Pakistan he has paid in that country, by deduction or otherwise, tax payable to the Government under any law for the time being in force in that country relating to taxation of agricultural income, he shall be entitled to a deduction from the Indian income-tax payable by him :
  - (a) Of the amount of the tax paid in Pakistan under any law aforesaid on such income which is liable to tax under this Act also; or
  - (b) Of a sum calculated on that income at the Indian rate of tax; whichever is less.
- If any non-resident person is assessed on his share in the income of a registered firm assessed as resident in India in any previous year and such share includes any income accruing or arising outside India during that previous year (and which is not deemed to

accrue or arise in India) in a country with which there is no agreement under Section 90 for the relief or avoidance of double taxation and he proves that he has paid income-tax by deduction or otherwise under the law in force in that country in respect of the income so included he shall be entitled to a deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income so included at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.

#### **Explanation :**

- (i) The expression "Indian income-tax" means income-tax and super-tax charged in accordance with the provisions of this Act;
- (ii) The expression "Indian rate of tax" means the rate determined by dividing the amount of Indian income-tax after deduction of any relief due under the provisions of this Act but before deduction of any relief due under this Section, by the total income;
- (iii) The expression "rate of tax of the said country" means income-tax and super-tax actually paid in the said country in accordance with the corresponding laws in force in the said country after deduction of all relief due, but before deduction of any relief due in the said country in respect of double taxation, divided by the whole amount of the income as assessed in the said country.
- (iv) The expression "income-tax" in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country.

THE NEXT LEVEL OF EDUCATION

The incidence of taxation varies with the factor of residence, there are three categories of taxable entities they are:

1. Resident
2. Resident but not ordinarily resident
3. Non resident

#### **6.4.2.1 Residence in India**

The residence in India is given in Section 6 of Indian Income Tax Act, it is given as follows:

- (1) An individual is said to be resident in India in any previous year, if he-
  - (i) Is in India in that year for a period or periods amounting in all to one hundred and eighty - two days or more; or

- (ii) Having within the four years preceding that year been in India for a period or periods amounting in all to three hundred and sixty-five days or more, is in India for a period or periods amounting in all to sixty days or more in that year.<sup>3</sup> Explanation.—In the case of an individual,—
- Being a citizen of India, who leaves India in any previous year<sup>4</sup> as a member of the crew of an Indian ship as defined in clause (18) of Section 3 of the Merchant Shipping Act, 1958 (44 of 1958), or] for the purposes of employment outside India, the provisions of subclause (c) shall apply in relation to that year as if for the words "sixty days", occurring therein, the words "one hundred and eighty two days" had been substituted;
  - Being a citizen of India, or a person of Indian origin within the meaning of Explanation to clause (e) of Section 115C, who, being outside India, comes on a visit to India in any previous year, the provisions of sub-clause (c) shall apply in relation to that year as if for the words "sixty days", occurring therein, the words one hundred and eighty- two days" had been substituted.
- (2) A Hindu undivided family, firm or other association of persons is said to be resident in India in any previous year in every case except where during that year the control and management of its affairs is situated wholly outside India.
- (3) A company is said to be resident in India in any previous year, if :
- It is an Indian company; or
  - During that year, the control and management of its affairs is situated wholly in India.
- (4) Every other person is said to be resident in India in any previous year in every case, except where during that year the control and management of his affairs is situated wholly outside India.
- (5) If a person is resident in India in a previous year relevant to an assessment year in respect of any source of income, he shall be deemed to be resident in India in the previous year relevant to the assessment year in respect of each of his other sources of income.
- (6) A person is said to be "not ordinarily resident" in India in any previous year if such person is :
- An individual who has not been resident in India in nine out of the ten previous years preceding that year, or has not during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and thirty days or more; or

- (b) A Hindu undivided family whose manager has not been resident in India in nine out of the ten previous years preceding that year, or has not during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and thirty days or more.

A non resident means a person who is not a resident under Section 6 and Includes a person who is not ordinarily resident.

The two alternative test of residence For individuals required the personal presence of the assessed in India for the specific period.

A Hindu undivided family, firm or other occasions of persons is resident in India if the control and the management of its affairs is situated wholly or in part in India. It is only when the control and the management is situated wholly outside India that these units of assessment are regarded as non residents.

The residence of partners in India normally raises a presumption that the firm is resident in India, but the presentation may be reported by showing that the control and management of the affairs of the form is situated wholly outside India. to determine the residence of a company there are two alternative is given. a company is resident in India if :

- o It is an Indian company.
- o The control and management of its affairs is situated only in India in that previous year.
- o Every Indian company is a resident in India even though its control and Management is situated fully or partly abroad, whereas a non-resident company is considered a resident only if its control and management is situated wholly in India.

#### 6.4.3 Indian Company

The Indian company is defined under Section 2(26) as follows :

"Indian Company" means a company formed and registered under the Companies Act, 1956 (1 of 1956), and includes :

- (i) A company formed and registered under any law relating to companies formerly in force in any part of India (other than the State of Jammu and Kashmir and the Union territories specified in sub- clause (iii) of this clause;
- (ia) A corporation established by or under a Central, State or Provincial Act;
- (ib) Any institution, association or body which is declared by the Board to be a company under clause (17);



- (ii) In the case of the State of Jammu and Kashmir, a company formed and registered under any law for the time being in force in that State;
- (iii) In the case of any of the Union territories of Dadra and Nagar Haveli, Goa, Daman and Diu, and Pondicherry, a company formed and registered under any law for the time being in force in that Union territory:
- Provided that the registered or, as the case may be, principal office of the company, corporation, institution, association or body in all cases is in India;

#### 6.4.4 Scope of Total Income

- Section -5 of Income Tax Act, 1961 provides Scope of total Income in case of person who is a resident, in the case of a person not ordinarily resident in India and person who is a non-resident which includes.
- Income can be Income from any source which (a) is received or is deemed to be received in India in such year by or on behalf of such person; or (b) accrues or arises or is deemed to accrue or arise to him in India during such year ; or (c) accrues or arises to him outside India during such year .
- The words accrue and arise are used in contradistinction with the word receive and indicate right to receive.
- Income Deemed to accrue or arise in India is given in Section 9 of Indian Income Tax.

#### 6.4.5 Income Deemed to Accrue or Arise in India

Section 9 provides the information on Income deemed to accrue or arise in India. 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.

#### Explanation : for the purposes of this clause

- (a) In the case of a business 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 ;
- (b) In the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export ;

- (c) In the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India;
- (d) In the case of a non-resident, being :
- An individual who is not a citizen of India; or
  - A firm which does not have any partner who is a citizen of India or who is resident in India; or
  - A company which does not have any shareholder who is a citizen of India or who is resident in India,

No income shall be deemed to accrue or arise in India to such individual, firm or company through or from operations which are confined to the shooting of any cinematograph film in India.

**Section 9 covers following categories as deemed to accrue or arise in India**

- Income which falls under the head "Salaries", if it is earned

**Explanation :**

For the removal of doubts, it is hereby declared that the income of the nature referred to in this clause payable for:

- Service rendered in India; and
  - The rest period or leave period which is preceded and succeeded by services rendered in India and forms part of the service contract of employment, shall be regarded as income earned in India;
- Income chargeable under the head "Salaries" payable by the Government to a citizen of India for service outside India;
- A dividend paid by an Indian company outside India ; income by way of interest payable by :
- The Government; or
  - A person who is a resident, except where the interest is payable in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or
  - A person who is a non-resident, where the interest is payable in respect of any debt



incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person in India ;

- Income by way of royalty payable by :
  - (a) The Government; or
  - (b) A person who is a resident, except where the royalty is payable in respect of any right, property or information used or services utilized for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or
  - (c) A person who is a non-resident, where the royalty is payable in respect of any right, property or information used or services utilized for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India :
- Provided that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property, if such income is payable in pursuance of an agreement made before the 1st day of April, 1976, and the agreement is approved by the Central Government
- Provided further that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum payment made by a person, who is a resident, for the transfer of all or any rights (including the granting of a license) in respect of computer software supplied by a non-resident manufacturer along with a computer or computer-based equipment under any scheme approved under the Policy on Computer Software Export, Software Development and Training, 1986 of the Government of India.
- For the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for :
  - (i) The transfer of all or any rights (including the granting of a license) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;

- (ii) The imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;
- (iii) The use of any patent, invention, model, design, secret formula or process or trade mark or similar property;
- (iv) The imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;
- (v) The transfer of all or any rights (including the granting of a license) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films ; or
- (vi) The rendering of any services in connection with the activities referred to in sub-clauses (i) to (v)

"Computer software" means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data.

Income by way of fees for technical services payable by :

- (a) The Government; or
- (b) A person who is a resident, except where the fees are payable in respect of services utilized in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or
- (c) A person who is a non-resident, where the fees are payable in respect of services utilized in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India.

Provided that nothing contained in this clause shall apply in relation to any income by way of fees for technical services payable in pursuance of an agreement made before the 1st day of April, 1976, and approved by the Central Government.

### Syllabus Topic : Source versus Residence and Classification between Business Income and Royalty

#### 6.5 Source versus Residence and Classification between Business Income and Royalty

**Q. 6.5.1 Write short note on Source versus Residence and Classification between Business Income and Royalty. (Ref. Sec. 6.5) (5 Marks)**

- Internet facilitates business it is necessary to recover taxes from non-resident E-Commerce players, The Section 160 and 161 of Income Tax Act 1961 provide a mechanism for collecting income tax.
- The Section 160 defines the term representative assessed and Section 161 define the liabilities of a representative assessed.

### 6.5.1 Representative Assessee

Section 160 defines the term representative assessee as follows:

Representative assessee means, in respect of the income of a non-resident specified in subsection (1) of Section 9, the agent of the non-resident, including a person who is treated as an agent under Section 163.

### 6.5.2 Liabilities of Representative

As given in Section 161 liabilities of representative assessee are :

- (1) Every representative assessee, as regards the income in respect of which he is a representative assessee, shall be subject to the same duties, responsibilities and liabilities as if the income were income received by or accruing to or in favor of him beneficially, and shall be liable to assessment in his own name in respect of that income; but any such assessment shall be deemed to be made upon him in his representative capacity only, and the tax shall, subject to the other provisions contained in this Chapter, be levied upon and recovered from him in like manner and to the same extent as it would be payable upon and recoverable from the person represented by him.
- (1A) Notwithstanding anything contained in sub-section (1), where any income in respect of which the person mentioned in clause (iv) of sub-section (1) of Section 160 is liable as representative assessee consists of, or includes, profits and gains of business, tax shall be charged on the whole of the income in respect of which such person is so liable at the maximum marginal rate :  
Provided that the provisions of this subsection shall not apply where such profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance, and such trust is the only trust so declared by him.
- (2) Where any person is, in respect of any income, assessable under this Chapter in the capacity of a representative assessee, he shall not, in respect of that income, be assessed under any other provision of this Act.

As you can tax to nonresident, the law provides for system to tax such a non resident

through his agent.

Who may be regarded as agent?

The Section 163 of Income Tax Act provides that who can be regarded as agents, It is given as follows :

- (1) For the purposes of this Act, "agent", in relation to a non-resident, includes any person in India :
- Who is employed by or on behalf of the non-resident; or
  - Who has any business connection with the non-resident; or
  - From or through whom the non-resident is in receipt of any income, whether directly or indirectly; or
  - Who is the trustee of the non-resident; and includes also any other person who, whether a resident or non-resident, has acquired by means of a transfer, a capital asset in India: Provided that a broker in India who, in respect of any transactions, does not deal directly with or on behalf of a non-resident principal but deals with or through a non-resident broker shall not be deemed to be an agent under this Section in respect of such transactions, if the following conditions are fulfilled, namely :

- The transactions are carried on in the ordinary course of business through the first-mentioned broker; and
- The non-resident broker is carrying on such transactions in the ordinary course of his business and not as a principal.

(2) No person shall be treated as the agent of a non-resident unless he had had an opportunity of being heard by the <sup>1</sup> Assessing Officer as to his liability to be treated as such.

If a person is not an agent under the general law of contract he can still act as an agent as per Section 163, provided that :

- He is employed by the nonresident,
  - He has any business connection with the nonresident,
  - From him the nonresident is in receipt of any income whether directly or indirectly,
  - Trustee of the nonresident,
  - He has acquired by means of a transfer from a nonresident a Capital Asset in India.
- Any person appointed as an agent under Section 163 is not necessarily assessable as a representative assessee in respect of the nonresident's income. It is only in relation to the



income covered by Section 160 that the status of the representative assessee emerges and the liability to be accessed under Section 161 arises.

- A person in India who has not received any income on behalf of nonresident but actually permanent resident the sums sought to be taxed, may be treated as an agent and access as a representative assessee under Section 163(1)(c).

### 6.5.3 Right of Representative Assessee to Recover Tax Paid

- Section 162 of IT Act permit the representative assessee to recover tax paid from the person on whose behalf it is paid and also permits other protection, it is given as follows :
- (1) Every representative assessee who, as such, pays any sum under this Act, shall be entitled to recover the sum so paid from the person on whose behalf it is paid, or to retain out of any moneys that may be in his possession or may come to him in his representative capacity, an amount equal to the sum so paid.
  - (2) Any representative assessee, or any person who apprehends that he may be assessed as a representative assessee, may retain out of any money payable by him to the person on whose behalf he is liable to pay tax (hereinafter in this Section referred to as the principal), a sum equal to his estimated liability under this Chapter, and in the event of any disagreement between the principal and such representative assessee or person as to the amount to be so retained, such representative assessee or person may secure from the Income-tax Officer a certificate stating the amount to be so retained pending final settlement of the liability, and the certificate so obtained shall be his warrant for retaining that amount.
  - (3) The amount recoverable from such representative assessee or person at the time of final settlement shall not exceed the amount specified in such certificate, except to the extent to which such representative assessee or person may at such time have in his hands additional assets of the principal.

### 6.5.4 Direct Assessment or Recovery not Barred

- In Section 166 the income tax authorities have the option to make an assessment on the representative assessee or a direct assessment on the person beneficially entitled to the income.
- With tax authority either accesses the agent for the non-resident. If assessment is done on representative assessee, the tax may be recovered from the person beneficially entitled to the income.

Nothing in the foregoing Sections in this Chapter shall prevent either the direct assessment of the person on whose behalf or for whose benefit income therein referred to is receivable, or the recovery from such person of the tax payable in respect of such income.

### **6.5.5 Remedies against Property In Cases of Representative Assesses**

Section 167 of Income Tax Act has given the remedies for recovering of taxes in cases of representative assessee it is given that, The Assessing Officer shall have the same remedies against all property of any kind vested in or under the control or management of any representative assessee as he would have against the property of any person liable to pay any tax, and in as full and ample a manner, whether the demand is raised against the representative assessee or against the beneficiary direct.

### **6.5.6 Recovery of Tax In Respect of Non- Resident from his Assets**

The Section 173 permits power of recovering taxes from the resident, it is given as, Without prejudice to the provisions of sub- section (1) of Section 161 or of Section 167, where the person entitled to the income referred to in clause (i) of sub- section (1) of Section 9 is a non-resident, the tax chargeable thereon, whether in his name or in the name of his agent who is liable as a representative assessee, may be recovered by deduction under any of the provisions of Chapter 17B and any arrears of tax may be recovered also in accordance with the provisions of this Act from any assets of the non- resident which are, or may at any time come, within India.

## **Syllabus Topic : The Impact of the Internet on Customer Duties**

### **6.6 The Impact of the Internet on Customer Duties**

**Q. 6.6.1 Write short note on the Impact of the Internet on Customer Duties?**

(Ref. Sec. 6.6)

**(5 Marks)**

- The nature of the internet has the effect of custom duty because it triggered imports and exports by Land, Sea or air. Internet does not recognize land customs barriers and check post on Borders Sea, ports and airports.
- Electronic deliverables do not need the traditional custom channels like Land and air for being transported from one place to another.



- The products are transacted over the internet but delivered physically, such good is treated as physical import transported across Border by land, sea and air and cleared under the supervision of customs authorities.
- The problem lies in the regulation of import and export electronic transmission delivered through the internet. The internet allows digital products from anywhere to anywhere which in this information constitutes a large chunk of cross-border e-commerce.
- Many countries like United States, Australia Singapore Canada etc. have accepted the power of Internet and they have declared a moratorium on imposition of custom duties on electronic transmission.
- Electronic press machines are not chargeable to custom duties in India.
- Imposing of custom duties on electronic transmission has given rise to following issues:
  1. Administration of the regime of customs duties on electronic transmission;
  2. Impact of imposing such customs duties, upon the Internet; and
  3. Classification of goods and services from Electronic transmission or deliverables.
- Because of the nature of the internet it is impossible for customs authorities to regulate cross-border electronic transmission for imposing custom duties
- Electronic transmission is intangible in form and it travels through medium of the internet. The electronic deliverables are too large in number for the custom authorities.
- Cross border transmission creates three problems in terms of identification like:
  1. Importers and exporters of e-transmission.
  2. location of importers and exporters.
  3. E-transmission contents.
- The encryption technique makes the exercise of using custom duty on electronic transmission difficult. Due to this it is difficult for custom authority to track down cross border transactions of software etc.
- An attempt to regulate the import and export of electronic transmissions for imposing customs duties is likely to encourage Hawala payments across borders. As Electronic transmission is simple, risk free, user friendly so online smuggling is tempting and very easy.
- Imposition of custom duties on a transmission encourages evasion and increase cost of enforcement.

One more reason for many countries not imposing the custom duties on cross border a transmission is the difficulty in the classification between goods and services. For Example, a music CD is a product whereas same music enjoyed online is a service.

### Syllabus Topic : Taxation Policies In India : At a Glance

#### Taxation Policies In India : At a Glance

##### 6.7 Explain Taxation Policies in India? (Ref. Sec. 6.7)

(5 Marks)

IT sector is the potential market in India. So, several tax reliefs have been given to IT sector.

- There is nil rate of excise duty for computer software.

- The important IT software's are exempted from custom duty.

- There will be no special additional custom duty (SAD) on IT software's.

- In Income Tax Act 1961 certain tax relief is granted for IT sector. Under the Section 88 HHE detection of the profits derived from the following business has been granted to an assessee being an Indian company or person restaurant in India. These are:

1. Export out of India of computer software for its transmission from India to a place outside India by any means.
2. Providing Technical Services outside India in connection with the development of production of computer software.

- Section 10A of Income Tax Act, 1961 grants deduction from the total income of the assessee, of such profits and gains as are derived by the undertaking from the export of articles or things or computer software, for a period of 10 consecutive assessment year beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacturer produces articles or things or computer software as the case may be.

- Section 10B grants deduction from the total income of the assessee of such process and gains as a derived by 100% export oriented undertaking from the export of articles or things or computer software for a period of 10 consecutive assessment year beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or computer software, as the case may be.

- Tax holidays are introduced in IT enabled services which mean temporary reduction or elimination of tax. IT enabled services granted deduction under the Section 10A and 10B include medical transcription, call centers, back office operations, GIS, data digitization, animation, web content development, data processing, Web Services etc.



- To claim the tax holiday it is mandatory for you need to register under the Software Technology Parks (STP), 100% Export Oriented Units (EOU) or Export Processing Zones scheme (EPZ). Under Section 10A it is needed that the unit should be physically located in STP or EPZ. File under Section 10B, the unit can claim tax benefit even though it is not physically located at STP or FPZ.

## 6.8 Exam Pack (Review Questions)

☛ Syllabus Topic : A Tug of War on the Concept of 'Permanent Establishment'

Q. 1 Explain the term Permanent Establishment. (Refer Section 6.1)

(5 Marks)

☛ Syllabus Topic : Finding the PE In Cross Border E-Commerce

Q. 2 Write short note on finding PE in cross border e-commerce.  
(Refer Section 6.1.1)

(5 Marks)

☛ Syllabus Topic : The United Nations Model Tax Treaty

Q. 3 Write short note on The United Nations Model Tax Treaty.  
(Refer Section 6.2)

(5 Marks)

☛ Syllabus Topic :The Law of Double Taxation Avoidance Agreements and Taxable Jurisdiction over Non-Residents, under the Income Tax Act, 1961

Q. 4 Explain the law of Double Taxation Avoidance Agreements and Taxable Jurisdiction over Non-Residents, under the Income Tax Act, 1961. (Refer Section 6.3)

(5 Marks)

☛ Syllabus Topic : Tax Agents of Non-Residents under the Income Tax Act, 1961 and the Relevance to E-Commerce

Q. 5 Explain the Tax Agents of Non-Residents under the Income Tax Act, 1961 and the Relevance to E-Commerce. (Refer Section 6.4)

(5 Marks)

☛ Syllabus Topic : Source versus Residence and Classification between Business Income and Royalty

Q. 6 Write short note on Source versus Residence and Classification between Business Income and Royalty. (Refer Section 6.5)

(5 Marks)

☛ Syllabus Topic : The Impact of the Internet on Customer Duties

Q. 7 Write short note on the Impact of the Internet on Customer Duties?  
(Refer Section 6.6)

(5 Marks)

☛ Syllabus Topic : Taxation Policies In India : At a Glance

Q. 8 Explain Taxation Policies in India? (Refer Section 6.7)

(5 Marks)

Chapter Ends...

