Payments under section 195 of the I.T. Act

JB Nagar Study
Circle of WIRC

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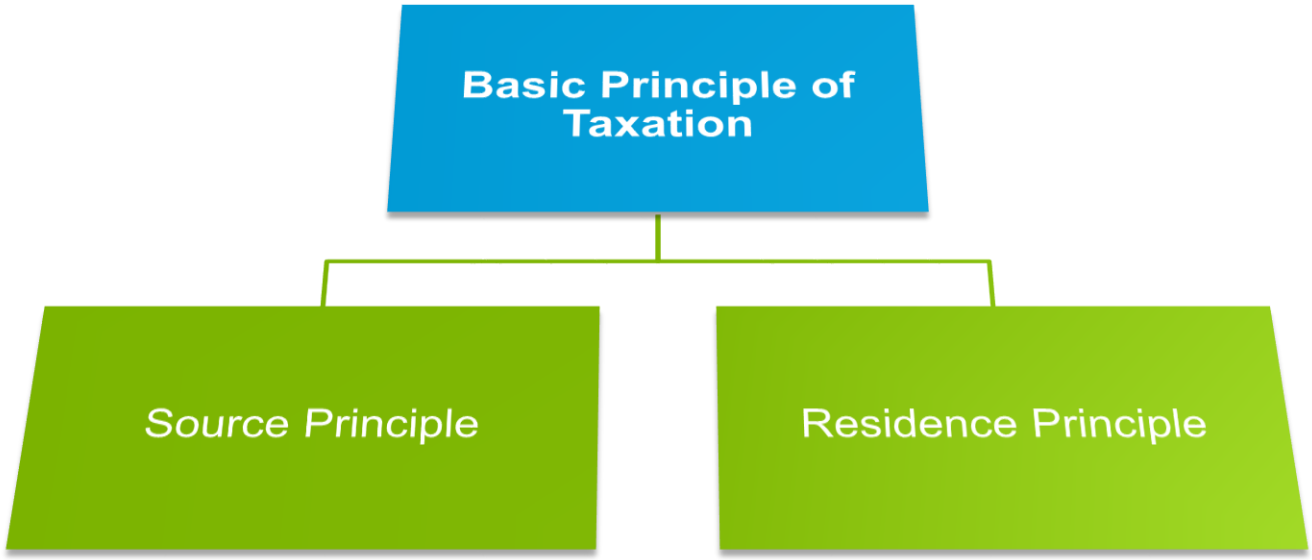
Table of content

Section 195 of the Income Tax Act

Taxation of international transactions



Scope of taxation in India - combination of “residence rule” & “source rule”
(GVK Industries)(SC) (371 ITR 453)

Section 195 of the Income Tax Act

- Provides for the deduction of tax at source on payments made to Non – Residents
- **Features of Section 195:**
  - **Payer:** Any person
  - **Payee:** A non-resident, not being a Company, or a Foreign Company.
  - **Subject Matter:** Deduction of Income-Tax at Source (TDS)
  - **Payments:** Interest or any other sum chargeable under the provisions of Income Tax Act.
  - **Rate of TDS:** At the Rates in Force

Section 195 of the Income Tax Act

195(1)

- payment by any person responsible / to a non resident
- interest or any other sum chargeable to tax
- payment or credit which ever is earlier / at rates in force
- other than Salary and dividend referred in section 115-O

195(2)

- Application by “Payer” if it considers whole of sum is not income chargeable

195(3), (4) and (5)

- Application by “Payee” viz. Foreign Banking Company or non-resident having branch in India for lower or Nil Withholding
- Powers to CBDT to issue notification

195(6)

- Furnishing of information in prescribed form viz. 15CA/15CB **whether sum chargeable or not chargeable under the Act**

Chargeability to income tax

Chargeability under the Income Tax Act

Under the Act

Section 5: Scope of Total Income

Section 9: Income Deemed to Accrue or Arise in India

Exceptions to Sec 9(1)(vi) & 9(1)(vii)

Kotak Mahindra Bank [2016] Mumbai Tribunal

Under DTAA

Royalty or Fees for Technical Services

Business Income

Independent Personal Services

Other Income

Chargeability under the Income Tax Act

- Section 5: Scope of Total Income - In case of Non – Resident
  - Income received or deemed to be received in India; or
  - Income accrues or arises or deemed to accrue or arise to him in India.
- Section 9: Income Deemed to Accrue or Arise in India.
- An income is said to be deemed to accrue or arise in India if the same is accruing or arising directly or indirectly, through
  - a business connection in India or
  - from any property in India or
  - from any asset or source of income in India or
  - the transfer of a capital asset in India
  - It also includes any share or interest in a company or entity registered or incorporated outside India, which derives its value substantially from assets in India.

Finance Act 2015 & DIT v. Copal Research Ltd., Mauritius
[2014] 49 taxmann.com 125 (Delhi HC)

Chargeability under the Income Tax Act

- GE India Technology Centre Pvt. Ltd (327 ITR 456) SC
  - Where payment, made by resident to non-resident, was an amount not chargeable to tax in India, no tax is deductible at source even though assessee has not made an application before the AO.
- Transmission Corporation (239 ITR 587) SC:
  - Sum chargeable to tax may include income or income hidden or embedded in gross sums.
  - TDS provisions may apply to gross sums, whole of which may not be income of recipient
  - Adequate safeguards provided in Section 195(2) / (3) / 197 where recipient can apply to AO to determine proportion of income liable to TDS
- CBDT Instruction No 2/2014
  - CBDT vide Instruction No 2/2014 instructed that in cases where the assessee does not withhold taxes under section 195 of the Act, the AO is required to determine the income component involved in the sum on which the withholding tax liability is to be computed and the payer would be considered as being in default for non-withholding of taxes only in relation to such income component.

Chargeability under the Income Tax Act

- If payment is not chargeable to tax, the provisions of section 195(1) are not attracted:
- Illustrative payments to Non-residents not chargeable under the Act:
  - Payments on capital account, for example, gifts, loans, repayment of loans, etc.
  - Sums which are on revenue account and which are not chargeable to tax at all under the Act in the hands of the recipient
  - Sums which fall within the scope of Section 5 of the Act, but which are expressly exempt under the Act. for example, dividend income

Payers

- Any person
  - Responsible for paying
  - Payer itself and in case of company, the company including the principal officer
  - Including an Individual and HUF (whether or not carrying business)
- Agent also liable to deduct tax at source from payments to non-resident principal.
- Whether payer includes a non resident?
- Whether payment by one non-resident to another non-resident is covered by section 195(1)?
  - Explanation 2 to sub-section (1) of the section 195 clarifies that the obligation to comply with sub-section (1) and make deduction thereunder applies and shall be deemed to have always applied and extends and shall be deemed to have always extended to all persons, resident or non-resident, whether or not the non-resident person has a residence or place of business or business connection in India or any other presence in any manner whatsoever in India.

Payments to NR – Important aspects

Payments – Who is a NR?

- **Address of the Non-resident**
  - Meena S. Patil vs ACIT(International Taxation, Circle19(1), [2008] 114 ITD 181 (Bangalore)/[2008] 113 TTJ 863

    Assessing Officer was correct in passing an order under section 201(1A) imposing interest liability on assessee. Assessee's contention that it was not and could not have been aware of fact that seller was a non-resident cannot be considered since in the sale agreement seller's address was clearly mentioned which showed that he was residing abroad.
  - Syed Alam Hashami 55 SOT 41 (Bangalore)

    Where seller of Indian property was NRI according to address given in sale deed, assessee-purchaser ought to have made TDS under section 195 on sale consideration payable to NRI seller, failing which he was to be treated as assessee-in-default under section 201(1).

Payments – Who is a NR?

- **Payments made to POA holder of Non-resident**
  - Rakesh Chauhan vs DDIT (International Taxation) [2010] 128 TTJ 116 (CHD.)

    Where payment is made by assessee to an individual Resident say (P) in India in respect of purchase of land which belonged to non-residents but rights therein were assigned unequivocally to said resident as power-of-attorney holder, such payment could not be regarded as payment to non-resident so as to require deduction of tax at source under section 195.

    When non-resident himself nominates a particular agent to whom payment should be made and pursuant to that direction, the assessee pays the sum to the agent so nominated, the provisions of section 195 of the Act will apply.

Payments

- **Payment in kind**
  - Kanchanganga Sea Foods Ltd. v. CIT, (SC) (2010 (6) SCALE 442

  The assessee is liable to deduct tax at source under section 195 on the payment made to the non-resident even though the payment is not made in cash but made in kind

- **Net payment received**
  - Raymond Ltd. v. DCIT, (86 ITD 791) Mumbai ITAT

  The assessee is liable to deduct tax at source under section 195, even under an arrangement where he receives only net payment from other party after deducting commission/ management fees etc.

Rates

- **Rates in force**
  - Sec. 195 refers to deduction of tax at the “rates in force”
  - “Rates in force” defined in sec.2(37A)
  - Rates of income-tax specified in the Finance Act or the rates specified in the DTAA, whichever is applicable by virtue of Section 90 or Section 90A – section 2(37A)(iii) - Circular No. 728 of 30 October 1995
  - M Far Hotels (Cochin Tribunal) 58 SOT 261

Non furnishing of PAN

Section 2(37A)

- Section 2(37) states that rate or rates in force would mean for the purpose of section 195 – rates of income tax specified in Finance Act or rates as per the agreement by Central Government u/s 90 of the Act.

Section 90

- Section 90 states that an assessee can avail the provisions of the DTAA if the same are more beneficial

Section 206AA

- In case of non availability of the PAN, tax is to be deducted at higher of the following-
  - Rates specified in the Act,
  - Rates in force
  - 20%
- *The Finance Act 2016 has amended section 206AA so as to provide that effective 1 June 2016, tax shall not be deducted at a higher rate in case of non-residents not having PAN, subject to prescribed conditions*

Non-furnishing of PAN

Prescribed conditions for relaxation of deduction of tax at higher rate in case of non-residents under Section 206AA

- The deductee to furnish following details for non deduction of tax at higher rates:

i. name, e-mail id, contact number;

ii. address in the country or specified territory outside India of which deductee is a resident;

iii. a certificate of his being resident in any country or specified territory outside India from the Government of that country or specified territory if the law of that country or specified territory provides for issuance of such certificate

Non furnishing of PAN

Supreme Court in the case of Azadi Bachao Andolan

- It is upheld by the supreme court that the provisions made in the DTAAs will prevail over the general provisions contained in the Act to the extent they are beneficial to the assessee**.**

Serum Institute of India Limited [2015] (56 taxmann.com 1) Pune Tribunal

- It is held that where tax has been deducted on the strength of the beneficial provisions of DTAAs, the provisions of section 206AA of the Act cannot be invoked to insist on tax deduction @ 20%, having regards to the overriding nature of the provisions of section 90(2) of the Act

Bangalore Tribunal in the case of Infosys BPO Limited ((IT (IT) A No.: 1143B/2013))

- It is held that there is no scope of deduction of tax at the rate of 20% as per section 206AA (when assesse does not have tax identification number – PAN) of the Income-tax Act, 1961 ("the Act") when the benefit DTAA is available to the assessee.
- The Bangalore ITAT has reiterated the view recently in Wipro Ltd, ITA 1544-47/Bang/13

Thus, based on the above decisions, one may take a position that section 90 shall override section 206AA

Grossing up section 195A

- If payee bears the tax liability i.e. payment is “net of tax” then for computing TDS, income should be grossed up
- E.g. – Amount payable to NR is 100 and TDS rate is 10%; Gross amt. for TDS purpose would be 111.11 (100*100/90)
- Issues
  - Whether grossing up would be required to be done in case payment is made net of tax to a foreign company which does not have a PAN in India, considering the provisions of section 206AA
  - Income could be grossed up using the applicable rate e.g.10% and tax could be withheld at 20%
  - For e.g.. say total amount to be paid net of tax as per agreement be INR 100. Income increased to INR 111.11 (grossed by 10%). Tax needs to be withheld @ 20% on 111.11= 22.22.

Bosch Ltd. v. ITO (2013) 141 ITD 38/155 TTJ 354 (Bang.)(Trib.)

Key aspects

- Amendments provisions under the Act cannot override provisions of DTAA
  - CIT v. Siemens Aktiengesellschaft (310 ITR 320) Bombay HC
  - DIT v New Skies Satellite BV (ITA 473, 474/2012) Delhi HC
  - DIT v. Nokia Networks OY [2013] (358 ITR 259) Delhi HC
  - Sanofi Pasteur Holding SA [2013] (354 ITR 316) Andhra Pradesh HC
  - Infrasoft Ltd [2013] (220 Taxman 273) Delhi HC
  - B4U International Holdings Ltd. (52 SOT 545) Mumbai Tribunal
- Retrospective amendments made to the definition of ‘royalty’ in section 9(1)(vi) of the Finance Act, 2012 by inserting Explanations 4 and 5 with effect from 1 June 1976 applicable to India – Singapore DTAA
  - Verizon Communications Singapore Pte. Ltd. [2013] (361 ITR 575) Madras HC

Tax residence certificate (TRC)

Finance Act 2012

Non-residents to obtain TRC (in prescribed format) from resident tax authorities.

Finance Act 2013

Did away the format, stated that it would be enough if tax payer obtains TRC and maintains prescribed documents/information

Notification No. 57 of 2013

Additional documents and information – Form 10F

Remedies available to the payer

Comparative Analysis of section 195(2), 195(3) and 197

Particulars	195(2)	195(3)	197
Application by	Payer	Payee	Payee
Purpose	To determine the appropriate proportion of sum chargeable	No deduction of tax	No deduction/ deduction at lower rate
Whether appealable?	Appeal u/s 248 denying liability to deduct tax after payment of tax under a 'net of tax' arrangement	No appeal	No appeal
Whether a revision petition under section 264 would lie against such orders?	Yes	Yes	Yes

Remedy available to the payer – Section 195(2)

- Application to be made to Assessing Officer (AO) when the payer considers whole income not to be chargeable
- AO to determine the portion of payment chargeable to tax and to issue a certificate accordingly
- The permission granted by the AO would be in force for the period as specified
- On determination, tax to be deducted on the sum chargeable to tax
- Mangalore Refinery & Petrochemicals Ltd. V. DDIT (113 ITD 85) (Mum.)
- The assessee cannot be treated in default under s. 201 of the Act because it has applied under s. 195(2) of the IT Act before the AO, prior to remitting the payment

Order under section 195(2) – Not Conclusive

- Decision under section 195(2) should not be treated as a conclusion in the determination of income in the case of a foreign company
  - CIT vs. TELCO [2000] 245 ITR 823 (Bom.)
  - CIT vs. Elbee Services P. Ltd. [2001] 247 ITR 109 (Bom.)
  - Dodsal Pvt. Ltd. Vs. CIT [2003] 260 ITR 507 (Bom.)
  - DCIT vs. Arthur Andersen ITA No. 9125/Mum/1995 dated 29-07-2003 (ITAT, Mumbai)

- Aditya Birla Nuvo v. DDIT 342 ITR 308 (Bombay)

  The order under sec. 195(2) is tentative in nature and does not have any effect beyond providing immunity under sec. 201 and does not preclude the assessing officer to either reexamine the chargeability of income in regular assessment proceedings or to recover the taxes from the payer in his representative capacity.

- In case of a 'net of tax' arrangement under which tax on income other than interest is borne by the payer, and the payer having paid such tax claims that tax was not deductible, he may file an appeal under section 248 even though he may have not approached the AO under section 195(2). It has been held in the case of Kotak Mahindra Bank Ltd., ITA No. 345/Mum/2008 for AY 2007- 08, order dated 30th June 2010 that section 248 does not refer to any order being passed by the Assessing Officer as a condition precedent for filing an appeal by a person who denies the liability to deduct tax.

Remedy available to the Payer – Refund of TDS

Circular Nos. 7/2007 dt 23 October 2007 & 7/2011 dt 27 September 2011

- ***Cases covered:***
  - The contract is cancelled and no remittance is made to the non-resident
  - The remittance is made but the contract is cancelled and the remitted amount has been returned by the non-resident
  - The contract is cancelled after partial execution and no remittance is made for the non-executed part
  - The contract is cancelled after partial execution and remittance related to non-executed part is made to the non-resident but the remitted amount has been returned to the payer or where no remittance is made but tax was deducted and deposited when the amount was credited to the account of the non-resident
  - The remitted amount becomes tax exempt due to amendment in law
  - The tax deduction liability is reduced due to an order under section 154 or 248 or 264
  - Tax is deduced twice from the same income by mistake
  - Tax is deducted on account of grossing up which was not required
  - Tax is paid at a higher rate under the domestic law while a lower rate is prescribed in the relevant double taxation avoidance treaty or vice versa

- Prior approval of CCIT/DGIT required.

Remedy available to the Payer – Refund of TDS

Circular Nos. 7/2007 dt 23 October 2007 & 7/2011 dt 27 September 2011

- The claim for refund should be made within 2 years from the end of the financial year in which the tax was deducted.
- Excess tax can be adjusted against any existing liability of deductor and the balance if any would be refunded.
- An undertaking that no TDS certificate was issued to the non-resident and if issued the same shall be recalled. Indemnity bond to be given for any loss to the department.
- Refund can be granted only if the payee has not filed a return or the time for filing return has expired.
- The Circular provides that no interest u/s 244A is admissible. However the Apex Court has held that such interest is payable by the Govt. – UOI vs Tata Chemicals Ltd [2014] 43 taxmann.com 240 (SC).

Remittance Procedure – Section 195(6) read with Rule 37BB

Section 195(6) and Rule 37BB

- Finance Act 2008 inserted sub-section (6) of section 195 to provide that any person responsible for paying to a non-resident, a sum which is chargeable to tax in India, shall furnish prescribed information. Rule 37BB was hence introduced to detail the reporting requirement. The Rule (as amended from time to time) interalia:
  - Required a person making any taxable remittance to a non-resident, to electronically furnish information in Form 15CA based on a certificate from a Chartered Accountant (CA) in Form 15CB;
  - Specified a list of 28 remittances to which the reporting did not apply.

  Reporting thus applied only to taxable remittances.

- With effect from 1 June 2015, Finance Act 2015:
  - Amended section 195(6) to extend the scope of the reporting to any payment to a non-resident, whether or not chargeable to tax in India.
  - Introduced a new section 271-I to provide penalty of INR 1lakh for failure to report or for inaccurate reporting.

  The amendment was brought in to identify taxable remittances on which tax was deductible, but was not deducted, and also to set a penal mechanism in case of default. Consequential changes were hence required to Rule 37BB.

Section 195(6) and Rule 37BB

Accordingly, the following changes have been made in Rule 37BB to align it with the amendment in section 195(6). The amended Rule is effective from 1 April 2016.

1. Information has to be furnished in relation to any payment to a non-resident, whether chargeable to tax in India or not.
2. The list of payments which are exempt from reporting, has been expanded from 28 to 33 to include five more categories of payments, mainly in relation to imports.
3. Exemption from reporting has also been extended to payment by an individual which does not require approval under the Liberalized Remittance Scheme of the RBI.
4. The following additional information has to be provided in Form 15CA:- Relevant purpose code as per RBI; Residential status of the remitter
5. Quarterly statements in a new Form 15CC have to be furnished by the authorized dealer (AD) banks in respect of remittances made for a quarter.

Form and manner of reporting – A comparison

Sr No	Particulars	Earlier Rule 37BB	Amended Rule 37BB
1	Small value taxable payments (simple reporting format)	Form 15CA - Part A	Form 15CA - Part A
		Threshold - Payments not exceeding INR 50,000 and aggregate of INR 2,50,000 in a financial year (FY)	Threshold - Payments upto INR 5,00,000 in a FY
		CA Certificate is not required	CA Certificate is not required
2	Small value taxable payments where certificate / order has been obtained u/s 197, 195(2) or 195(3) (simple reporting format)	Same as above	Form 15CA - Part B
			Threshold - Payments exceeding INR 5,00,000 in a FY
			CA Certificate is not required
3	High value taxable payments (detailed reporting format)	Form 15CA - Part B	Form 15CA - Part C
		Threshold - Payments exceeding INR 50,000 and aggregate of INR 2,50,000 in a FY	Threshold - Payments exceeding INR 5,00,000 in a FY
		CA certificate not required where certificate / order has been obtained u/s 197, 195(2) or 195(3)	CA certificate required if certificate / order has not been obtained u/s 197, 195(2) or 195(3)

Form and manner of reporting – A comparison

Sr No	Particulars	Earlier Rule 37BB	Amended Rule 37BB
4	Payments not taxable under the Act (other than the “specified payments” which are exempt from reporting) (simple reporting format)	No reporting requirement	Form 15CA - Part D
5	Quarterly reporting by AD making the remittance	No reporting requirement	New Form 15CC To be furnished within 15 days from the end of the quarter of the FY

New Form 15CA – A Snapshot

Part A	Part B	Part C	Part D
Applicable if • Remittance is taxable • Remittance or aggregate thereof does not exceed INR 5lakhs in FY CA certificate (Form 15CB) is not required	Applicable if • Remittance is taxable • Remittance or aggregate thereof exceeds INR 5lakhs in FY • Order/ certificate is obtained u/s 195(2)/195(3)/197 CA certificate (Form 15CB) is not required	Applicable if • Remittance is taxable • Remittance or aggregate thereof exceeds INR 5lakhs in FY • CA certificate (Form 15CB) is obtained	Applicable if • Remittance is not taxable under the Act CA certificate (Form 15CB) is not required

Form 15CB not required if remittance is not taxable under the Act or if aggregate value does not exceed INR 5lakhs in FY

About Form 15CB

What is Form 15CB and its requirements

- A certificate issued by a Chartered Accountant (CA) which specifies the documents verified by him and provides -
  - Detailed enumeration of the taxability of the amount under the Income-tax Act, without giving any effect to the DTAA.
  - Where DTAA provisions are sought to be applied, details of the Tax Residency Certificate (TRC), applicable DTAA and its relevant Article, as also tax liability under the DTAA are to be furnished. The nature of remittance is divided as — for royalties, FTS, interest, dividend; on account of business income; on account of short-term and long-term capital gains; and any other remittance.
- Following documents are required while issuing form 15CB –
  - Agreement entered between the parties (payee and payer)
  - Invoice / documentary evidence
  - Challan evidencing payment of withholding tax (if tax payable)
  - TRC (in case of claiming DTAA benefit)
  - Form 10F (where specific details as required by the Government of India are not mentioned in TRC) (in case of claiming DTAA benefit)
  - No PE certificate

With effect from 1 April 2016, CA have to electronically submit Form 15CB

About Form 15CB

Requirements for Form 10F and TRC

- Name of the beneficiary
- Status of the beneficiary
- Address of the beneficiary
- Nationality
- TIN of the beneficiary in the home country
- Period of residential status
- PAN(if allotted)

Whilst the prescribed format of TRC was done away with by the Finance Act, 2013, it did provide that additional information and documentation shall be furnished separately. Rule 21AB was consequently amended, which provides that aforesaid information of the foreign assessee is required to be furnished (10F), and sufficient documentation to substantiate the same shall be maintained.

It is to be noted here that Form 10F is only an ad hoc requirement in order to enable the non-residents to disclose certain information which is not mentioned in the TRC. If the TRC is inclusive of all the requisite information, there is no need to furnish the Form 10F.

Revised Guidance Note on Audit Reports and Certificates for Special Purposes

- A practitioner is expected to provide either a reasonable assurance (about whether the subject matter of examination is materially misstated) or a limited assurance (stating that nothing has come to the practitioner's attention that causes the practitioner to believe that the subject matter is materially misstated).
- Where appropriate, a description of any significant inherent limitations associated with the measurement or evaluation of the underlying subject matter against applicable criteria
- The practitioner should agree regarding the engagement terms including objective, scope and responsibilities of both the parties with the engaging party.
- Report to express opinion (in a reasonable assurance engagement)/ a conclusion(in a limited assurance engagement)
- 'Criteria' are applicable benchmarks used to measure or evaluate the underlying subject matter and they provide a suitable frame of reference
- Criteria for preparation of subject matter include relevance, completeness, reliability, neutrality and understandability
- The assurance report should be in writing and should contain a clear expression of the practitioner's opinion/conclusion about the subject matter of information.
- In all cases where reasonable assurance or limited assurance cannot be obtained and a qualified opinion/conclusion is insufficient the practitioner to disclaim the opinion/withdraw from the engagement.

Procedure for foreign remittance – a summary

Obtains (i.e. electronically receives) certificate of CA in Form 15CB only if the remittance is taxable and the remittance or aggregate thereof exceeds INR 5,00,000 during the financial year

Electronically uploads the remittance details in the applicable part i.e. A or B or C or D of Form 15CA

Takes printout of filled Form 15CA with system generated Acknowledgement Number

The verification in the printed Form 15CA is signed

Submits the signed printout of the form to the AD prior to remittance. The AD then remits the amount.

Except for the 33 specifically exempted payments & the payments permitted to individuals under the liberalized remittance scheme, all other remittances will have to comply with the reporting procedure

Obligation of the payer

- Onerous requirement to determine the taxability of the payment:
- Evaluate application of provisions of the Act for taxability after characterization
- Evaluate applicability of the tax treaty
- Get confirmation whether the payee has a PE in India
- Be aware of recent judicial precedents
- Observe the deadlines for withholding taxes and depositing the same
- Suffer disallowance if the tax is not withheld/ partly withheld if revenue believes that it should have been withheld

Taxation of certain overseas payments to non – residents-Important Rulings

Fees for Technical Services

Kotak Securities Ltd [2016] 67 taxmann.com 356(SC)

Facts:

- The assessee company (member of Bombay Stock Exchange) had paid transaction charges to Bombay Stock Exchange to transact business of sale and purchase of shares.
- The High Court had held that the transaction charges paid were ‘Fees for Technical Services’.

Issue:

- Whether the said payment of transaction charges could be considered as ‘Fees for Technical Services’ for applicability of Section 194J?

Held:

- It has been observed that the Stock Exchange provides facilities of faceless screen based transactions as well as constant upgradation of services with surveillance of essential parameters connected with trade.

Fees for Technical Services

Kotak Securities Ltd [2016] 67 taxmann.com 356(SC)

- All such fully automated services are available to all members of the stock exchange in respect of every transaction that is entered into. There, is nothing special, exclusive or customised that is rendered by Stock Exchange
- '**Technical Fees' would denote seeking of services to cater to the special needs of the consumer/user as maybe felt necessary and making the same available by the service provider. It is the above feature that would distinguish/identify a service provided from a facility offered.**
- The service provided by the Stock Exchange for which transaction charges are paid fails to satisfy the aforesaid test of specialized, exclusive and individual requirement of customer or user.
- Hence, it was held that above service not being a service of exclusive nature it would not fall within the ambit of "technical services" appearing in Explanation 2 of Section 9(1)(vii)of the Act.

Independent Professional Services

BSR & Co. [2016] 70 taxmann. com 69 (Mumbai Tribunal)

Facts:

- BSR & Co(Assessee Indian Company) availed different types of professional services from overseas/non-resident companies in relation to audit, taxation, transfer-pricing, information technology and background checks etc.
- These services were rendered outside India. No technical knowledge, skill etc. had been made available to the assessee.

Issue:

- Whether the said services were independent personal services and said payments were not fee for technical services?

Held:

- As these overseas companies had no fixed base or permanent establishment in India, payment made to them were not chargeable to tax in India so as to require deduction of tax at source.

Independent Professional Services

BSR & Co. [2016] 70 Taxmann. Com 69 (Mumbai Tribunal)

- Section 9,read with sections 195 and 40(a)(i) of the Income-Tax Act,1961 and article 15 of India and USA DTAA/article 14 of India and Canada DTAA/article 14 of India and Singapore DTAA/article 14 of India and Belgium DTAA/article 15 of India and UK DTAA/article 14 of India and Mauritius DTAA /article 15 of India and Egypt DTAA/article 14 of India and UAE DTAA and article 14 of India Sri Lanka
- According to the relevant clauses of these DTAA the services rendered do not fall in the ambit of ‘Fees for technical Services’ since there has been no material to establish that any technical knowledge, skill etc. has been made available to the assessee.
- Also the non resident recipients do not have permanent establishment in India and therefore, the services can be treated as Independent Professional Services and hence, the same cannot be brought to tax in India

Permanent Establishment

Brahmos Aerospace [2015] 74 taxmann.com191(Delhi Tribunal)

Facts:

- Brahmos Aerospace had made remittances to foreign countries towards rent for office accommodation, exhibitions outside India and advertisements in foreign journals towards display of its products
- Taxes were erroneously withheld by the assessee and paid to the government Hence, assessee filed a rectification application for the same.

Issue:

- Whether the said payments being business receipts in hands of foreign entities, were liable to pay tax in India?

Held:

- The payments being in the nature of rent, advertisement and exhibition expenses are business receipts in the hands of the payee. Such business receipts are only taxable in India if the payee had 'PE' in India within the meaning of relevant DTAA. From the facts it has been observed that foreign entities did not have PE in India and therefore the payments were not chargeable to tax in India.

Exceptions to Section 9(1)(vi) & 9(1)(vii)

Kotak Mahindra Bank[2016] 74 taxmann.com 246(Mumbai Tribunal)

Facts:

- The assessee was engaged in the banking business and paid certain legal fees to a legal firm situated in U.K
- The assessee had remitted payments relating to education of its employees for understanding legal requirements for setting up of a Bank branch or acquisition of banking company etc.in USA.

Issue:

- Whether the said payments fell within the exceptions of Sections 9(1)(vi)/(vii) and accordingly not taxable under Domestic Law? Also in absence of a business connection or a PE in India and considering the fact that services were rendered outside India ,whether these payments were taxable under DTAA?

Held:

- The perusal of documents related to payments revealed that the payments were,in fact, being made for creating /earning a new source outside India by way of establishment of new Bank branch or acquisition of Bank.

Exceptions to Section 9(1)(vi)& 9(1)(vii)

Kotak Mahindra Bank[2016] 74 taxmann.com 246(Mumbai Tribunal)

- Therefore, the payment had been made with a view to carry on business outside India and create a new source of income outside India, and therefore these payments fell within the exceptions of sections 9(1)(vi)/(vii) and accordingly, not taxable under the domestic law.
- It was established that in absence of a business connection or a PE in India it does not Section 9(1)(i).
- Also, the said payment did not fall within the ambit of Article 13 of India UK treaty ie Fees for Technical Services but was rather ‘Independent Professional Services’ as per Article 15 of DTAA. Article 15 being more specific to the case.
- Therefore, in absence of business connection or PE in India and considering the fact that services rendered outside India, the payments are not taxable in India.

Reimbursement of Expenses – Decisions in favour

- Director IT vs. Krup Udhe GmbH. (2010) (38 DTR 251) Bombay
  - Amount received by assessee towards reimbursement of traveling expenses of its technicians who were deputed to the establishment of a customer is not chargeable to tax.
- CIT vs. Siemens Aktiongesellschaft (310 ITR 320)
  - The reimbursement of expenses incurred on behalf of payer was not income chargeable to tax in payee's hands.

Reimbursement of Expenses

- Pure Reimbursement of expenses to non-resident
- No TDS on reimbursement of actual expenditure to non-resident parent company since no element of income
  - CIT vs. Dunlop Pvt. Ltd. : 142 ITR 493 (Cal)
  - CIT vs. Industrial Engineering product Pvt. Ltd. : 202 ITR 1014 (Del)
  - Hyder Consulting Ltd. vs. CIT: 236 ITR 640 (AAR)
  - HNS India V. Set. Inc. vs. DCIT: 95 ITD 157 (ITAT Del)
  - United Hotels Ltd. vs. ITO : 93 TTJ 822 (ITAT Del)
  - Mahindra & Mahindra Ltd. v. Dy. CIT (2009) 30 SOT 374 (Mum),

Taxation of Commission paid to Overseas Non – Resident Agent

Commission paid to non resident - whether deemed to accrue or arise in India

- Section 9(1)(i): Business Connection in India: Commission paid to Non Resident

  - Section 9(1)(i) is applicable on the net profits of a non – resident which can reasonably be attributed to operations carried out in India.
  - The expression "business connection" nominates a real and intimate relation between trading activity carried on outside the taxable territories and trading activity within the territories, the relation between the two contributing to the earning of income by the nonresident in his trading activity. – SC in CIT vs. R. D. Aggarwal & co. (56 ITR 20)
  - Any activity carried on in India by Broker, General Commission Agent or any other agent having Independent Status in the ordinary course of business will not constitute Business Connection in India. [Explanation 2 to Section 9 (1) (i)]

CBDT Circulars

- Circular No. 23 dated 23rd July, 1969
  - A foreign agent of Indian exporter operates in his own country and no part of his income arises in India.
- Circular No. 786 dated 7th February 2000
  - The deduction of tax at source under section 195 would arise if the payment of commission to the non-resident agent is chargeable to tax in India.
  - Where the non-resident agent operates outside the country, no part of his income arises in India.
- Circular 7/2009 dated 22nd October 2009
  - Withdrawal of Circular 23 and 786 – As the interpretation of the circular by the taxpayers to claim relief is not in accordance with the provisions of section 9 or the intention of the Circular.

However, the principle still holds good that the payments to non-resident are liable for tax in Indian only if they satisfy the test of chargeability in India.

Judicial Precedents – Commission

Panalfa Autoelektrik Ltd. [2014] 49 Taxmann. Com 412 (Delhi HC)

Facts:

- Panalfa Autoelektrik Ltd. India, was engaged in manufacturing business and made an application to the Assessing Officer (AO) to decide the withholding tax as regards commission to be remitted to a non-resident company registered in Liechtenstein, for arranging export sales and realising payments.
- In absence of a tax treaty between India and Liechtenstein, the AO decided the taxability of commission under the ITA and held that the same to be taxable as FTS.

Issue:

Whether the commission payable to the non-resident agent could be Income accruing or arising, whether directly or indirectly, through or from any business connection in India or income by way of FTS payable by a person who is a resident

Held:

- As there was no allegation or argument from the revenue on the existence of 'business connection' or as regards any operations being carried on by the non-resident in India, the High Court concluded that no income can be taxed in India under this provision.

Judicial Precedents – Commission

Panalfa Autoelektrik Ltd. [2014] 49 Taxmann. Com 412 (Delhi HC)

Held:

- The High Court interpreted the terms ‘managerial’, ‘technical’ and ‘consultancy’ by placing reliance on various judicial precedents, Dictionary meanings as well as the OECD Report on e-commerce
- As regards the services provided by the non-resident agent, the High Court observed as under:
  - As per the agreement between the taxpayer and the non-resident agent, it was clear that the non-resident was acting as an agent for procuring orders and was not rendering managerial advice or management services.
  - The non-resident had not undertaken or performed ‘technical services’, where special skills or knowledge relating to a technical filed were required.
- The non-resident had acquired skills and expertise in the field of marketing and sale of automobiles. However, the same was used for own benefit and to secure their commission.
- The non-resident did not act as a consultant, who advised or rendered any counseling services. The High Court, accordingly, held that services rendered by the non-resident cannot be said to be in the nature of ‘managerial’, ‘technical’ or ‘consultancy’ services and hence, the commission cannot be treated as FTS.
- The High Court however added a note of caution that in case of selling agents, taxability would depend upon the nature of service rendered and, depending on the factual matrix, the services may fall in the category of consultancy services.

Judicial Precedents – Commission

CIT v. Eon Technology (P) Ltd. (2012) 246 CTR 40 (Delhi)(High Court)

Facts:

- The tax payer company was engaged in the business of development and export of software
- The tax payer paid commission to its parent company in the U.K. on the sales and amounts realised on export contracts procured by it for the tax payer and the same was claimed as deduction.

Issue: Whether income deemed to accrue or arise in India

Held:

When a non–resident agents operates outside the country, no part of income arises in India and since payment is remitted directly abroad and merely because an entry in the books of account is made in India, it does not mean that non-resident has received any payment in India, therefore, assessee is not liable to deduct tax at source hence, no disallowance can be made by applying the provision of section 40(a)(i).

Not Chargeable to tax in India pre-withdrawal of circular - Allied Nippon Ltd.; Angelique International Ltd. Capricorn Food Products India Ltd.

Chargeable to tax in India – Havells India Ltd. 352 ITR 376, SKF Boilers 343 ITR 325

Judicial Precedents – Commission

Dr. Reddy Laboratories Ltd [2016] 73 Taxmann. Com 114 (AAR-New Delhi)

Facts:

- The applicant DRL India, is a pharmaceutical company and in order to promote its sales in Russia and develop a local brand, it proposed to enter into a service agreement with its subsidiary DRL Russia, to avail product promotion services
- There being tax treaty between India and Russia, the AAR decided the taxability of product promotion services under the DTAA provisions as well as ITA .

Issue:

- Whether the service fees payable by DRL India to DRL Russia under Service Agreement will be regarded as 'Fees for Technical Services' under section 9(1)(vii) or under Article 12 of DTAA between India and Russia

Held:

- The services provided by DRL Russia merely promoted the goods by meeting doctors ie the activities were executory in nature and did not entail rendering advice to the applicant. Hence, it could not be said that DRL Russia was providing consultancy services.

Judicial Precedents – Commission

- There was no evidence suggesting that DRL India was consulting DRL Russia in pursuance of the agreement for promotion of goods, hence the, agreement could not be considered for providing consultancy services
- The sample reports submitted by medical representatives only disclosed the stock availability and demand . It could not be established that these reports were utilized for forming a strategy related to sales in Russia.
- Also, the view that the services could be considered as being managerial in nature was not justified since, the medical representatives merely met the doctors for various promotions and it could not be said that they were managing the affairs of DRL India in Russia.
- Therefore, it was held that the agreement for product promotion services was merely activity of promoting goods and did not fall within the ambit of definition of Fees for Technical Services as these were not managerial, technical or consultancy in nature.
- The definition of ‘Fees for Technical Services’ in the India-Russia DTAA is similar to that in the Income tax Act, hence the same would also not be covered as ‘Fees for Technical Services’ under DTAA.

Judicial Precedents – Commission

Freshtrop Fruits Ltd [2016] 73 taxmann.com 162(Gujarat HC)

Facts:

- Freshtrop Fruits, the assessee company was engaged in manufacturing, packing and processing of fresh products of juice conservatives
- It remitted commission to foreign agents for sale to foreign parties on which tax at source was not deducted

Issue:

- Whether commission paid to foreign agents outside India was deemed to accrue or arise in India for the purpose of tax deduction at source?

Held:

- .Payments made to foreign agents outside India which do not have any permanent establishment in India are not liable to tax . The income in absence of PE does not deem to accrue or arise in India, hence not taxable.

Thank You