

# TDS provisions for payments to non-residents

CA Rajesh Patil  
July 2016

# Contents

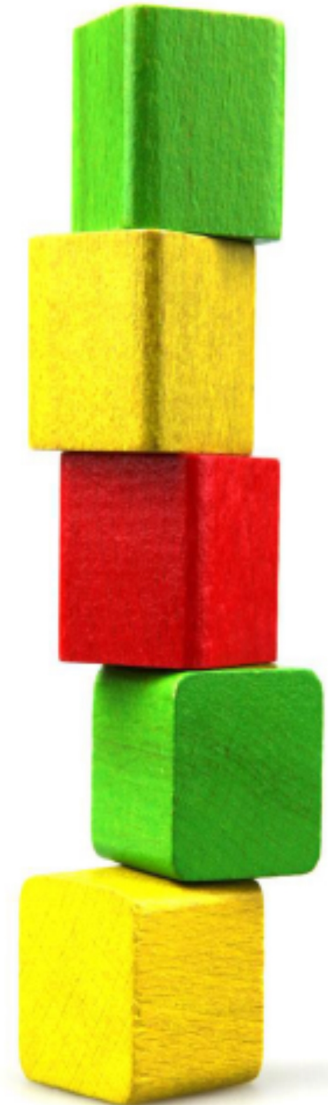
## I. Payments to non-residents

- Section 195 of the Income Tax Act
- Chargeability of Income
- Payments - Important aspects
- Remedies available to the payer
- Remedies available to the payee

## II. APPENDIX

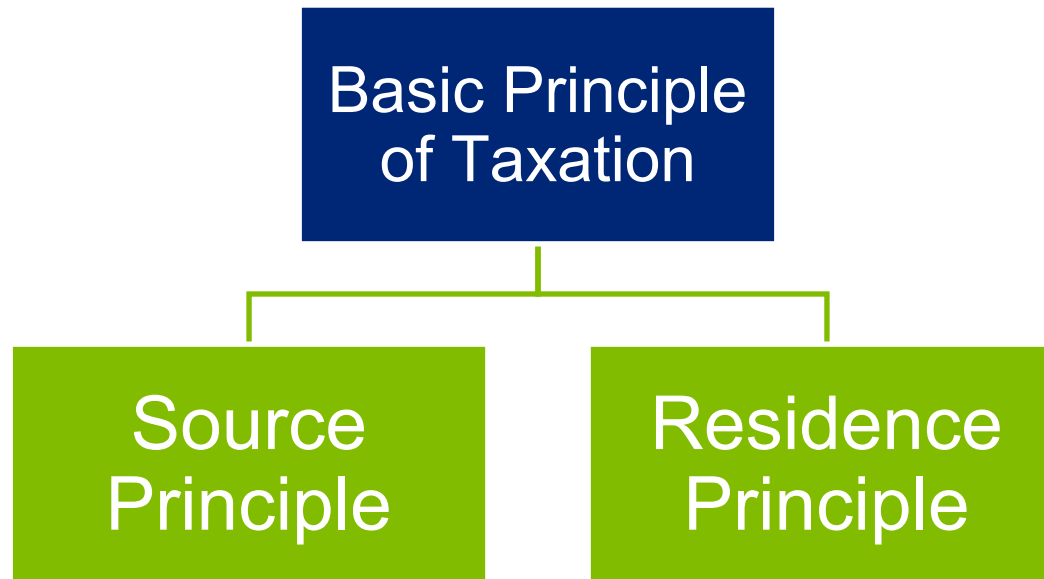
Income deemed to accrue or arise in India

- Taxation of Royalty
- Taxation of Fees for Technical Service
- Taxation of Commission paid to Overseas  
Non - Resident Agent.



# Section 195 of the Income Tax Act

# Taxation of international transactions



## **Scope of taxation under Indian Tax law**

Combination of “residence rule” & “source rule”

# 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

# A Glimpse of Section 195

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

# Chargeability of Income

# Chargeability of Income

## Determine - Chargeability under Income Tax Act

- Section 5: Scope of Total Income
- Section 9: Income Deemed to Accrue or Arise in India

## Determine - Chargeability as per DTAA

- Royalty or Fees for Technical Services
- Business Income
- Independent Personal Services
- Dependent Personal Services
- Other Incomes





## 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\* any other which derives its value from assets in India.
- It also includes any share or interest in a company or entity registered or incorporated outside India which derives its value from assets in India.

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

## Any sum chargeable to tax

### **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.

### **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.

## Any sum chargeable to tax - Payments not included

- 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 principle 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 - Some 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 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 - Intermediary?

## Payment made through an intermediary

### **ITO vs. Abu Dhabi Commercial Bank 65 SOT 43 (Mum)**

- The assessee bank made remittance on behalf of brokers in respect of gains on the basis of NIL certificate issued by a CA.
- The bank was only acting as an authorised dealer in transferring the funds on behalf of the broker and is not liable to deduct tax under section 195 and consequently is not an assessee in default.

### **Commissioner of Income-tax v. Hardarshan Singh 350 ITR 427 (Delhi HC)**

- Assessee carried on business of commission agent by arranging for transportation of goods through other transporters
- As contract was between clients and lorry owners/transporters assessee did not deduct tax at source while making payments to transporters
- Tribunal set aside orders holding that assessee acted only as a facilitator or intermediary and there was no privity of contract between assessee and client for carriage of goods - Accordingly, Tribunal concluded that assessee was not liable to deduct tax at source



# Payments - Important Decisions

## Section 172 vs. 195

**Raj Girish Karia [2014] 48 taxmann.com 175 (Mumbai - Trib.)**

### **Facts:**

- The assessee was a dealer in marbles and granites which it imported from various countries
- In the process, the assessee paid freight and insurance charges to foreign shipping agents on the goods imported by it.
- The assessee did not deduct tax at source from the said payments placing reliance on the Circular No. 723 dated 19-9-1995 issued by CBDT wherein it has been stated that provisions of sections 194C and 195 relating to tax deduction at source were not applicable in respect of foreign shipping companies whose income was subjected to tax under section 172. The assessee submitted that it had made payments to either foreign shipping companies directly or to the agents of the foreign shipping companies.
- The Assessing Officer, however, held that assessee was liable to deduct tax at source on the payment in question and accordingly he disallowed the same by invoking the provisions of section 40(a)(i).

### **Held:**

- Circular No.172 issued by the CBDT has made it clear that the provisions of sec. 194C and 195 relating to tax deduction at source will not apply to the payments made to non-resident shipping companies only if their income is assessed u/s 172 of the Act.
- The assessee has to show that the shipping companies to whom payments were made are not only non-residents but also he has to show they were assessed under section 172. Only if the assessee is able to prove the above facts, then he will be relieved of from the liability to deduct tax at source from the payments made to them towards freight and insurance charges.

# 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
  - Whether the rate of 20% is to be increased by surcharge and Cess

## Non furnishing of PAN

- Sec.206AA - overrides the entire Act
  - Applicability of 206AA for payments where tax is not required to be withheld under the Act or the tax treaty

DCIT v. Infosys BPO Ltd. (2015) 154 ITD 816  
(Bang.)(Trib.) &  
Dy. DIT v. Serum Institute of India Ltd. (2015)  
68 SOT 254 (Pune)

# Rates

## Non furnishing of PAN

- Amendment by Finance Act 2016 w.e.f. 1 June 2016.
- Notification No. 53/2016 – dated 24 June 2016.
- Rule 37BC – Relaxation from deduction of tax at higher rate under section 206AA
  - Non-resident not being a company, or a foreign company (“deductee”)
  - Payments in the nature of interest, royalty, fees for technical services and payments on transfer of any capital asset.
  - If deductee furnishes details and documents as prescribed;
  - Consequential amendments in Form No. 27Q

## Grossing up - Sec. 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 ( $100 \times 100 / 90$ )

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 eg. 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.)**

# Tax residence certificate (TRC)

- Finance Act 2012 mandated non-residents to obtain TRC (in prescribed format) from resident tax authorities.
- Finance Act 2013 which 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 (applicable w.e.f 1 April 2013) - additional documents
- Issues
  - Stage / time limit to obtain TRC
  - Different tax years
  - TRC not obtainable / delay

# Remedies available to the payer

# Remedy available to 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.)
- Dodsai 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.

# Remedy available to the Payer

## Section 195(6) - CA Certificate

- Information on remittance of amount to be furnished by the payer in Form 15CA
- Certificate from Chartered Accountant may be obtained in Form 15CB
- Procedure prescribed in Rule 37BB of the Income Tax Rules
- Points to be factored
  - Examination of PE and attribution of profit to PE
  - Beneficial ownership/ Tax residency, whether TRC is sufficient evidence to claim Tax Treaty Benefits.
  - Classification of Income : Royalty, FTS, etc.
  - Issuance of certificate in absence of complete information about payee

# Chartered Accountants Certificate - Important issues

If person responsible considers that the sum payable would not be income, would he be required to go to the A.O every time or will a CA certificate suffice?

## **DCIT vs. Rediff.com India Ltd. (ITA No. 3061/Mum/2009)**

- Chartered Accountant's certificate for TDS on payments to non-residents had no decisive impact on determination of taxability of payments to non-residents. It is only prima facie evidence about taxability status and cannot substitute adjudication of taxability by the AO

## **ADIT vs. Tata Communications Ltd (ITA No. 3061/Mum/2009)**

- Where the assessee had duly obtained the Chartered Accountant's certification regarding applicability of tax withholding and based on the certification, made the remittance for deduction at source. A demand u/s.201(1A) cannot be raised on the assessee merely because he had not obtained prior approval of the Assessing Officer u/s.195(2) of the Act.

# Procedure for remittances...

Revised Rule 37BB with effect from 1 October 2013

<b>Sl. No</b>	<b>Information</b>	<b>Part A</b>	<b>Part B</b>	<b>Part C</b>
1.	Nature of Remittance	Small payments <= INR 50000 and aggregate of such payments during the tax year <= INR 250000. Remittance may or may not be subject to tax.	Specified Payments not subject to tax in India (List of 39 payments incl. payments for loans, outbound investments, personal transactions, etc)	Any other payments subject to tax
2.	Requirement of CA Certificate	No	No, with a declaration from Remitter of bona fide belief about non-taxability of the payment under the IT laws	Yes, if tax withholding order not obtained from tax authority.

# Procedure for remittances...

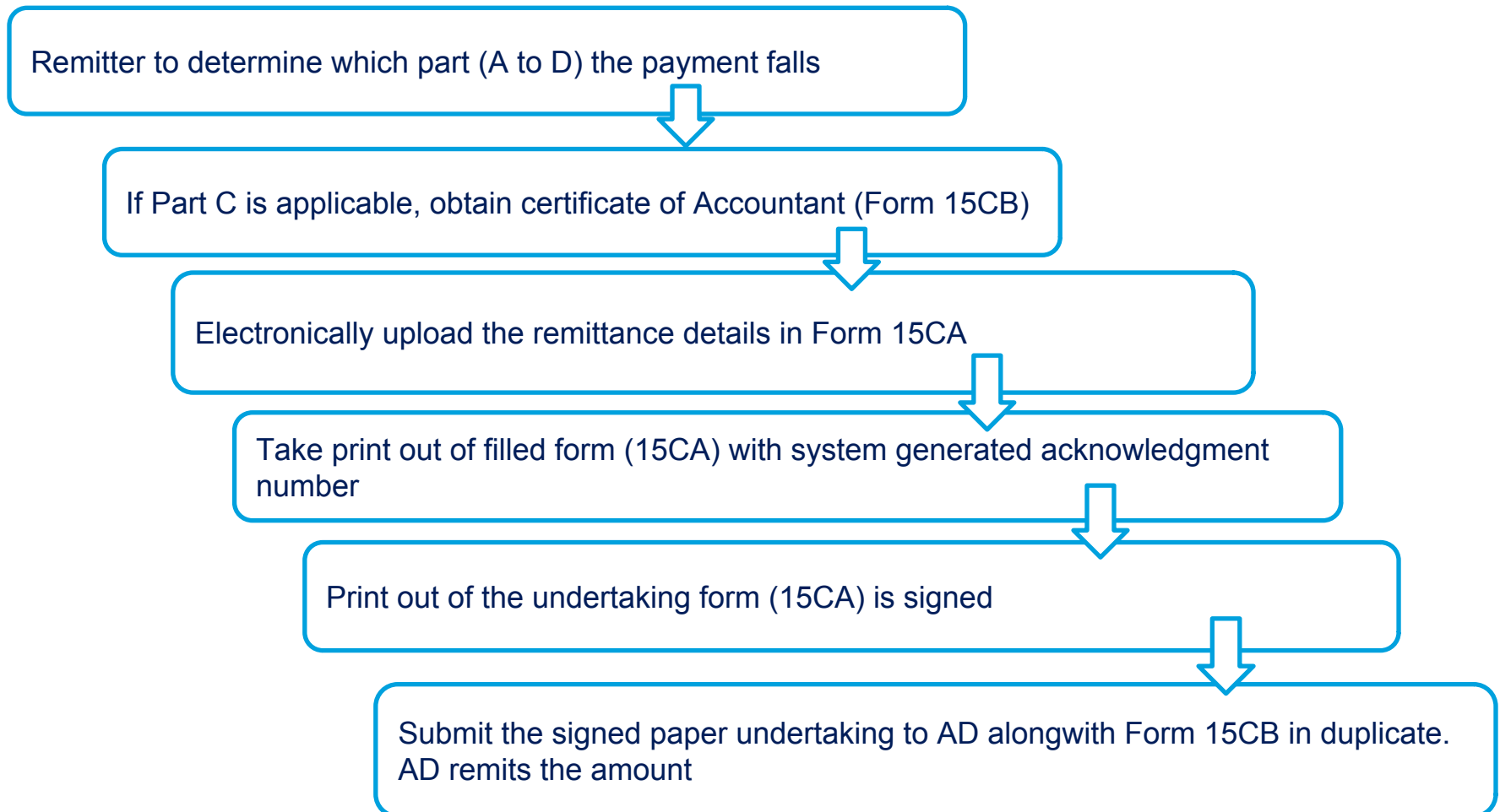
Revised Rule 37BB with effect from 1 April 2016

Sl. No	Information	Part A	Part B	Part C	Part D
1.	Nature of Remittance	Payments during the financial year does not exceed Rs. 5 Lacs and Remittance is subject to tax.	Payments during the financial year does not exceed Rs. 5 Lacs and Remittance is subject to tax and an order / certificate u/s 195(2)/(3) / 197 of the Act has been obtained from AO	Payments during the year exceeds Rs. 5 Lacs and Remittance is subject to tax.	Payments not chargeable to tax
2.	Requirement of CA Certificate	No	No	Yes	No

Press release dated 17 December 2015 issued by CBDT:

1. Remittance under LRS
2. List of payments of specified nature mentioned in Rule 37BB expanded from 28 to 33
3. Certificate of CA in Form 15CB required where payment is chargeable to tax and payment to NR exceeds Rs. 5 Lacs.

# Step wise procedure for foreign remittance



## Procedure for remittances...

Additional details required from 1 October 2013:

- Application of Section 206AA if remittance is chargeable to tax and PAN of the recipient is not available
- Details about the Tax Residency Certificate/other particulars of the recipient if DTAA benefits are claimed
- Detailed information on the taxability of payment under the IT Act as well as tax treaty.
- Basis of treating income as not subject to tax as also for non-withholding

# Guidance Note on Audit Reports and Certificates for Special Purposes

- Specific elements, accounts or items covered by the report or certificate should be clearly identified and indicated.
- The report or certificate should indicate the manner in which its audit was conducted.
- If the report or certificate is subject to any limitations, then such limitation should be clearly mentioned.
- Assumptions on which the special purpose statement is based should be clearly indicated if they are fundamental to the appreciation of the statement.
- References obtained should be included in the report or certificate i.e. any specific information or explanations on which is relied upon.



## Guidance Note on Audit Reports and Certificates for Special Purposes ....

- The language should be unambiguous.
- If the special purpose statement is based on general purpose financial statements, the report or certificate should contain a reference to such statements and the said statements should also form part of annexure.
- An report or certificate should ordinarily be a self-contained document.
- The issuing authority should clearly indicate in his report or certificate, the extent of responsibility which he assumes.
- Any modification in form of report or certificate from the manner as prescribed by statue should be clearly indicated.

## Other Key Issues - Form 15CA and CB

- *Sums not chargeable to tax*  
Lack of clarity as to whether compliance required in situations where sum is not chargeable to tax in India
- *Import Payments*  
CBDT vide notification no. GSR 21(E) [NO.1/2016 (F.NO. 133/41/2015-TPL)] dated 12 January 2016 has included import payments in the specified list. There still exists ambiguity with regards to taxable import payments.
- *Personal Payments*  
Obtain Tax Deduction Account Number ('TAN') in case of small remittances.
- Comply with the procedural formalities to furnish form 15CA in situations where payments made to non-residents operating in within India.

## Obligation of the payer

Onerous requirement to determine the taxability of the payment:

- Evaluate application of provisions of the Act for taxability after characterisation
- 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

# Remedies available to the payee

# Remedy available to the Payee

## Section 195 (3)

- Application to be made by payee
- Application to AO for grant of certificate for receipt of income without deduction of tax at source

## Section 197 (1)

- Application for lower rate or no deduction of income-tax

Differences between sections 195 (3) and 197 (1)

**Circular No. 774: No certificate after payment**

## Remedy available to the Payee

### Conditions for certificate under section 197 - Rule 28AA

- AO to issue certificate indicating the rate / rates of tax, which is higher of the following:
  - Average rate determined on the basis of advance tax
  - Average of the average rates of tax paid by the assessee in the last three years
- The certificate is issued to the specified payer

**The certificate is valid for the specified assessment year**

# Appeal against order under section 195/197

Appeal against the order under section 195

- Can be filed before the Commissioner of Income-tax (Appeals) under section 248 against the order passed by the Assessing Officer

Order under section 197 is not appealable

- A revision petition under section 264 would lie against such an order

# Appendix

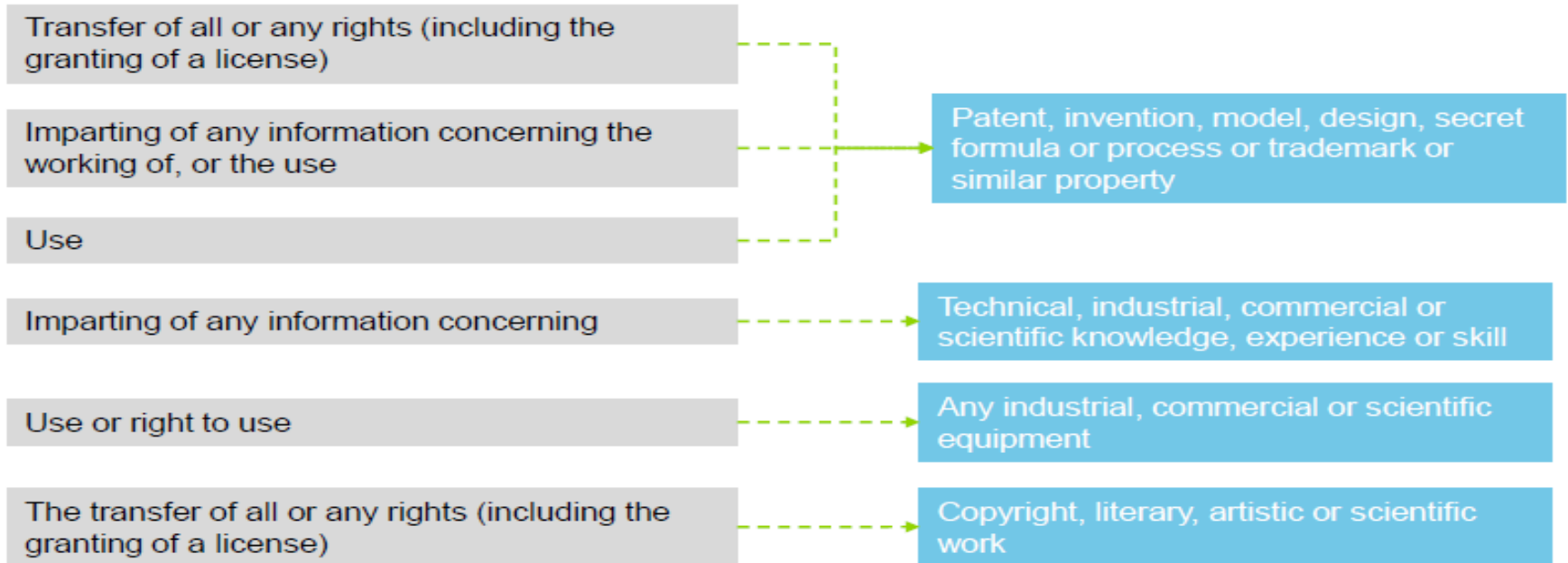


# Taxation of Royalties

# Royalty definition - Section 9(1)(vi) of the Act

Consideration paid for –

- a) includes lump sum payments
- b) excludes income chargeable as capital gains
- c) includes services in relation to any of the following



## Royalty - Retrospective amendments

Finance Act 2012 inserted following explanations with retrospective effect from April 1, 1976:

- Transfer of all or any rights in respect of any right, property or information, includes and has always included transfer of all or any right to use or right to use a computer software (including granting of a license) irrespective of the medium through which such right is transferred. [Explanation 4]
- Royalty shall include consideration in respect of any right, property or information whether or not such right, property or information (a) is under the control of the payer, (b) is used by the payer, (c) is located in India. [Explanation 5]
- The expression “process” includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fiber or by any other similar technology, whether or not such process is secret. [Explanation 6]

# Taxation of royalties under the treaty - Typical structure of royalty article

Article Para	Subject matter
1	Clarification that the royalty arising in a source country may be taxed in the country of residence.
2	Taxability rights also given to source country, but with restriction on rate of tax.
3	Definition of Royalty
4	Provides that this Article would not be applicable in case royalty is effectively connected with PE / fixed base in source country
5	Source rules
6	Concessional rate applicable only to portion of royalty which satisfies the arms length test

# Royalty - Definition under model conventions

## OECD Model

- payments of any kind received
- as a consideration
- for the use of, or the right to use
  - any copyright of literary, artistic or scientific work
    - including cinematograph films
  - any patent, trademark, design or model, plan, secret formula or process
- for information concerning industrial, commercial or scientific experience
  - Article 12.2

## UN Model

- payments of any kind received
- as a consideration
- for the use of, or the right to use
  - any copyright of literary, artistic or scientific work
    - including cinematograph films, or films or tapes used for radio or television broadcasting
  - any patent, trademark, design or model, plan, secret formula or process
- for the use of, or the right to use, industrial, commercial or scientific equipment
- for information concerning industrial, commercial or scientific experience
  - Article 12.3

## US Model

- payments of any kind received
- as a consideration
- For the use of, or right to use:
  - copy right of literary, artistic or scientific or other work (including, computer software, cinematograph films, audio or video tapes or disks, and other means of image or sound reproduction)
  - any patent, trademark, design or model, plan, secret formula or other like property
- Information concerning
  - industrial, commercial or scientific experience

## Differences in the various definitions

### OECD Model

- Income from equipment leasing would fall under rules for taxation of business profits - Article 5 and Article 7

### UN Model

- Consideration for use of, or the right to use, industrial, commercial or scientific equipment covered within the meaning of Royalties

### US Model

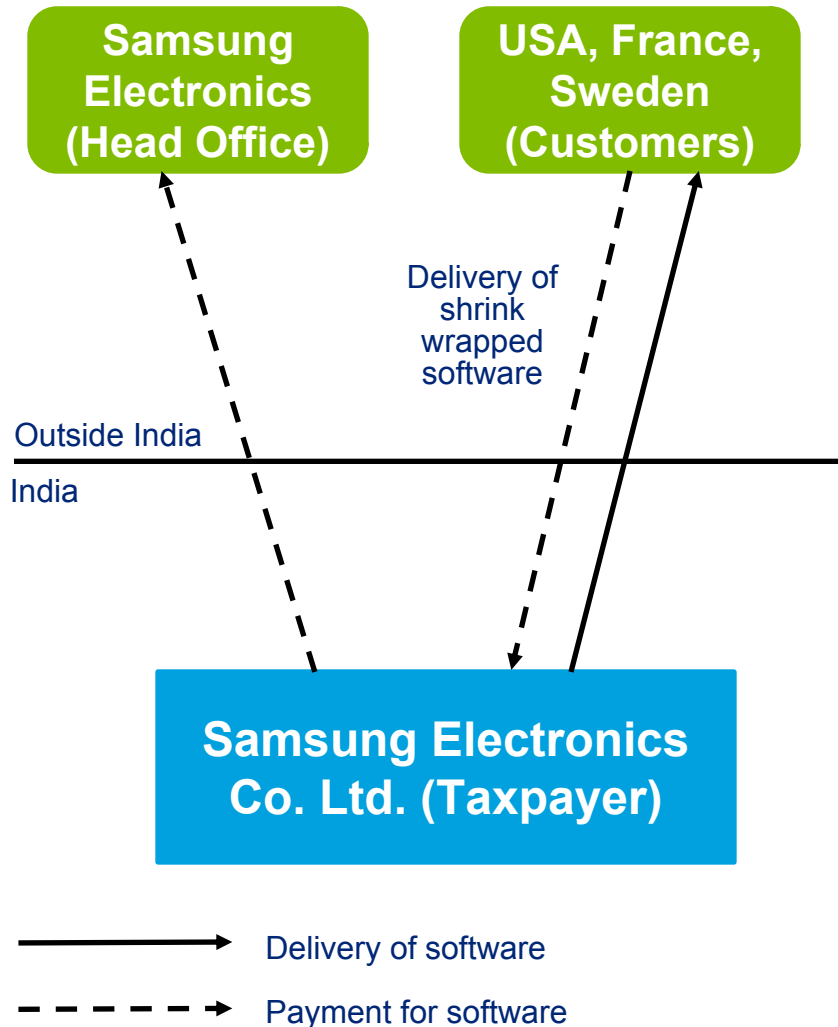
- Specifically includes consideration for use or the right to use copyright of computer software

### Income Tax Act

- Specifically excludes consideration for sale, distribution and exhibition of cinematographic films

# Judicial Precedents - Royalty (Software)

Samsung Electronics Co Ltd (345 ITR 494) (Kar.)

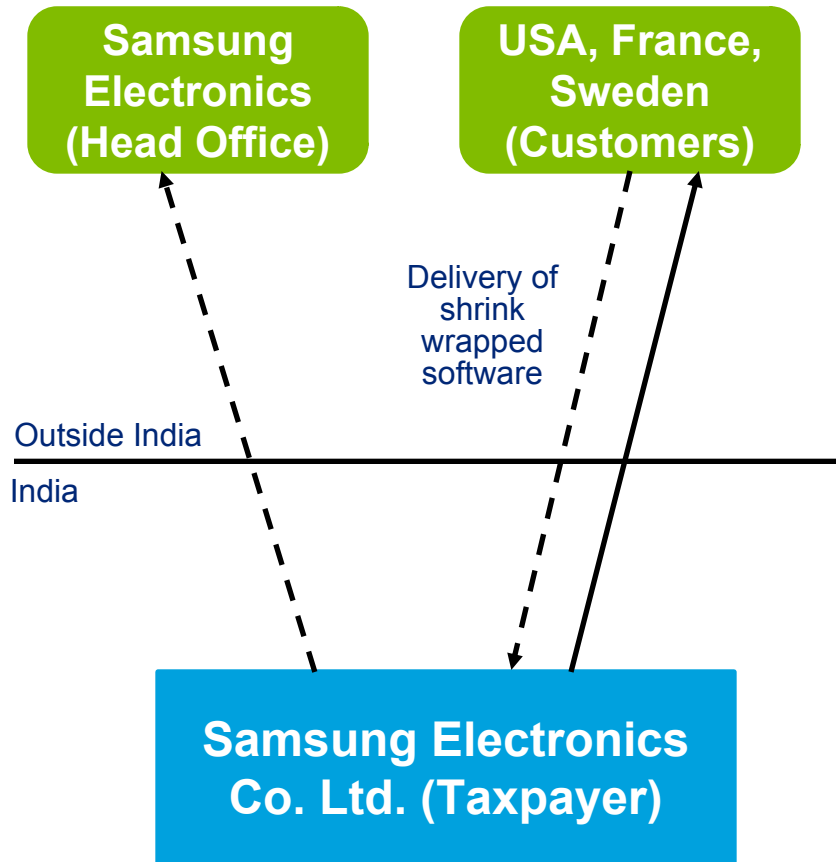


## Facts

- Taxpayer developed and exported computer software to its HO
- Taxpayer imported software from USA, France, Sweden and made payments without deducting tax at source
- AO and CIT(A) taxed such payments 'royalty'. However, the Tribunal held that payments for shrink wrap software did not amount to 'royalty'.
- The HC held that all payments made to non-residents should attract tax withholding unless a certificate from tax officer is obtained.
- On appeal to the Apex Court, the Apex Court observed that HC did not go into the merits of the case and thereby remanded the matter back to HC.

# Judicial Precedents - Royalty (Software)

Samsung Electronics Co Ltd (345 ITR 494) (Kar.)



## Issue before HC

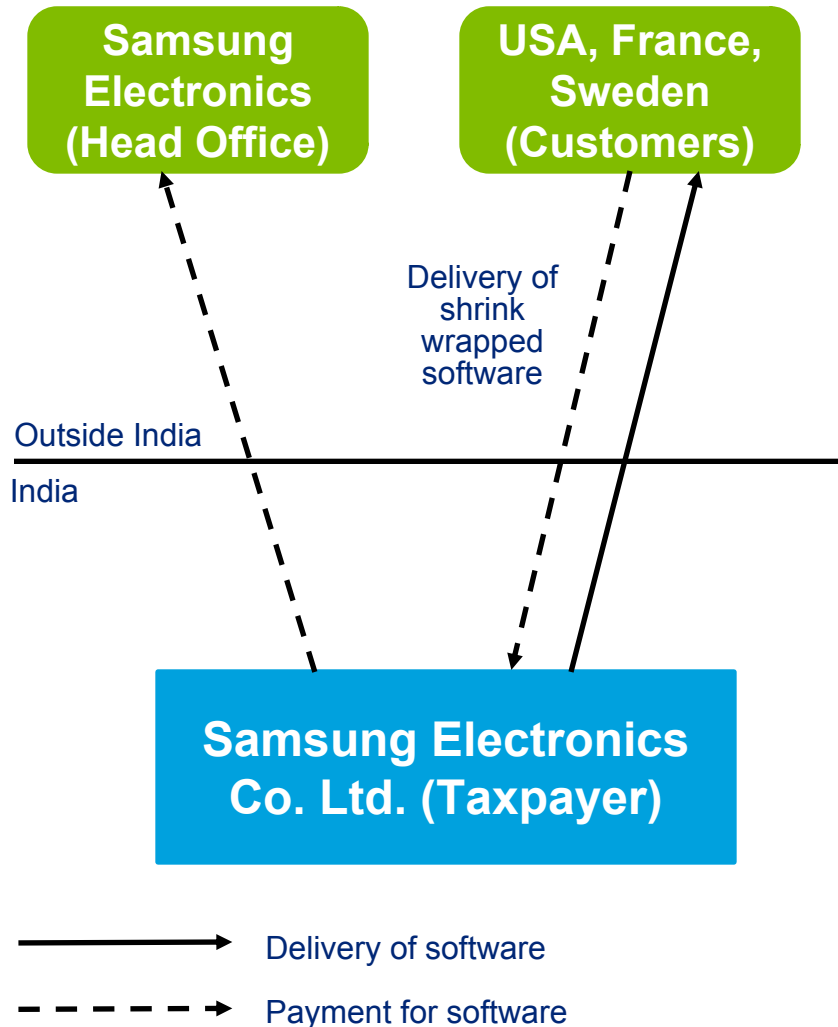
- Whether payment to foreign software suppliers for shrink-wrap software was in the nature of 'royalty' under ITA and under the DTAAs

—————→ Delivery of software  
- - - - -→ Payment for software



# Judicial Precedents - Royalty (Software)

## Samsung Electronics Co Ltd (345 ITR 494) (Kar.)

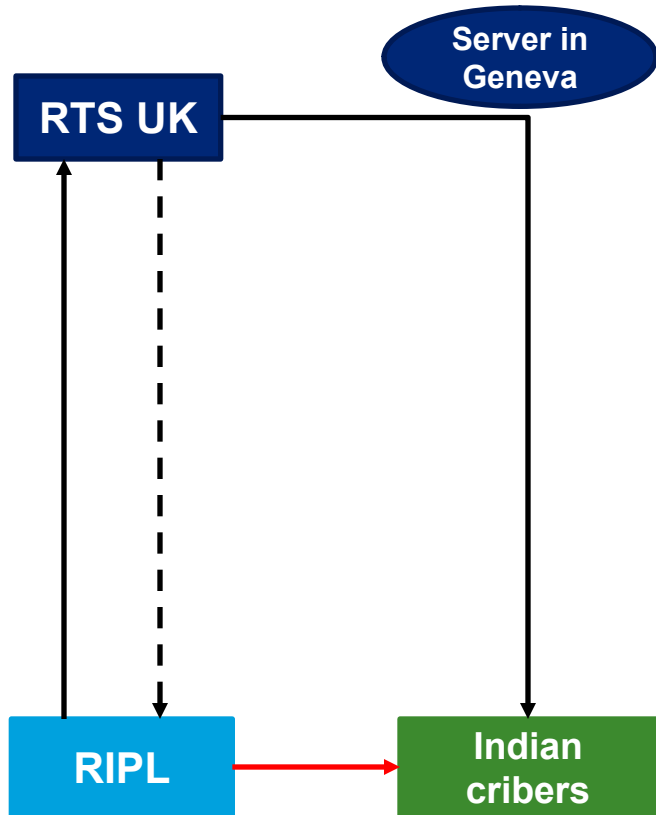


### Ruling of the HC

- What is transferred is only license to use copyright while the suppliers continue to be owners of copyright and other IPRs
- License is granted for use of copyright contained in shrink-wrapped software or off the shelf software
- Intent of legislature in imposing sales tax and income-tax are entirely different – levy of sales tax on software does not preclude payments from amounting to ‘royalty’
- Right to make a copy and use it for internal business would amount to copyright under Section 14(1) of Copyright Act
- Price paid towards shrink software is for combination of CD along with software and the license granted
- Transfer of copyright including right to make copy of software for internal business and payment made in that regard would constitute ‘royalty’, both under ITA and respective DTAA.

# Judicial Precedents - Royalty (Software)

Reuters Transaction Services [2014] 47 taxmann.com 10 (Mum. Trib.)



→ Agreement for obtaining & installing of computer system with pre-loaded software at their locations and obtaining connectivity to have access to matching portal in Geneva.

## Facts:

- Reuters U.K. was engaged in the business of providing electronic deal matching systems enabling authorised dealers in foreign exchange, such as banks, etc. to effect deals in spot foreign exchange with other dealers
- Reuters U.K. entered into agreements with its Indian subsidiary to provide access to foreign deal matching system
- The Indian clients could avail the services of Reuters U.K. only through the equipments and connectivity provided by it though its Indian subsidiary namely RIPL.
- Reuters U.K. claimed that its revenue from the Indian subscribers is business profits and not taxable in absence of PE. Further, the same is not in the nature of royalty or FTS
- Revenue Authorities (RA) contended that:
  - income is towards royalty since it is for use

## Judicial Precedents - Royalty (Software)

Reuters Transaction Services [2014] 47 taxmann.com 10 (Mum. Trib.)

### **Held:**

- Payments by Reuters U.K. to RIPL includes consideration for installation and connectivity on behalf of Reuters U.K and thus, equipment and connectivity are installed and provided by Reuters U.K itself through RIPL and the entire charges for equipment and connectivity are paid to Reuters U.K
- Also terms of main agreement clarifies, Reuters U.K has provided equipment with pre- loaded software and network for provision of services to be used for business of subscriber and the subscriber can sub-license the software
- The matching portal on the server and computer installed at the site of subscriber constitutes integrated commercial equipment.
- Reuters U.K. has made available the equipment alongwith software for which license is granted which amounts to imparting of information concerning technical, industrial, commercial or scientific equipment

## Judicial Precedents - Royalty (Software)

Decision	Gist
<p>DCIT v. Nokia Networks OY (TS-700-HC-2012) Del.</p>	<ul style="list-style-type: none"> <li>Where assessee supplied both hardware and software manufactured in Finland to Indian telecom operators from outside India on a principal to principal basis under independent buyer/seller arrangements and installation activities were undertaken by its Indian subsidiary, consideration for supply of software was not taxable as 'royalty'</li> </ul>
<p>ADIT v. Antwerp Diamond Bank NV Engineering Centre [2014] 44 taxmann.com 175 (Mumbai - Trib.)</p>	<ul style="list-style-type: none"> <li>Where assessee, a Belgium based bank, having obtained a licence to use software, allowed its Indian branch to use same software by making it accessible through server located at Belgium, amount reimbursed by branch on pro rata basis for use of said resources was not liable to tax in India as royalty under section 9(1)(vi) or article 12(3) of India-Belgium DTAA</li> </ul>
<p>GECF Asia Ltd. vs. DDIT [2014] 48 taxmann.com 148 (Mumbai - Trib.)</p>	<ul style="list-style-type: none"> <li>Where a non-resident company renders services relating to industrial, commercial or scientific experience, in such a case, if those services do not involve imparting of know-how or transfer of any knowledge, experience or skill, then payment received in respect of same cannot be taxed as "royalty" within ambit of article 12 of India-Thailand DTAA</li> </ul>

# Taxation of Fees for Technical Service

## Fees for Technical Services as defined by section 9(1)(vii) of the Act

Explanation 2 to section 9(1)(vii) of the Act defines “fees for technical services” to mean any consideration (including any lump sum consideration) for the:

- Rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel)
- but does not include consideration for
  - any construction, assembly, mining or like project undertaken by the recipient or
  - consideration which would be income of the recipient chargeable under the head “Salaries”

Extra-territorial operation  
Validity upheld in Electronics Corporation of India Ltd. v.  
CIT (183 ITR 44)(SC)

## Fees for Technical services

FTS clause in most Indian tax treaties

### FTS clause

- FTS means
  - payments of any amount in consideration
  - for managerial, technical or consultancy services
  - including the provision of services of technical or other personnel
  - does not include payments for services mentioned in Independent / Dependent Personal Services

### FTS clause + Make available

- FTS means
  - payments of any amount in consideration
  - for managerial, technical or consultancy services
  - including the provision of services of technical or other personnel
  - - does not include payments for services mentioned in Independent / Dependent Personal Services
  - which **make available** technical knowledge, experience, skill know-how or processes

# Fees for Technical Services

## Key components of FTS

### Technical

- Expertise in technology
- Knowledge / skill related to technical field

### Consultancy

- Advisory services
- Overlaps with technical services

### Managerial

- Management functions
- Management of affairs / people

### Provision of services of technical or other personnel

- Providing personnel to render technical services
- For instance, engineers, technicians, consultants, etc. to furnish services for a fee
- May cover deputation arrangements

### Excludes payments for services mentioned in Independent / Dependent Personal Services

- Excludes payments made by Article 15



# Fees for Technical Services - Included Services

## Fees for Included Services

### Fees for Included Services

- FTS means
  - which are ancillary and subsidiary to the application or enjoyment of the right, property or information for which royalty is received
  - which **make available** technical knowledge, experience, skill know-how or processes or consist of the development and transfer of a technical plan or technical design

### Exclusions

- FTS does not include
  - for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property other than IPRs mentioned in royalty clause
  - for teaching in or by educational institutions
  - for services for the personal use of the individual or individuals making the payments
  - to an employee of the person making the payments or to any individual or firm of individuals (other than a company) for professional services as defined in Independent Personal Services

# Fees for Technical Services - Most Favoured Nation (MFN) clause

## India - France Tax Treaty

- Notification No. S.O. 650(E), dated July 10, 2000 -Treaties with Germany and United States referred.
- Tax rate reduced to 10 percent
- Protocol: “...if under any Convention, Agreement or Protocol signed after September 1, 1989, between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interests, royalties, fees for technical services or payments for the use of equipment to a rate lower or a scope more restricted than the rate or scope provided for in this Convention on the said items of income, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply under this Convention...”

## FTS - Judicial Precedents on “Make available”

Decision	Gist
Diamond Services International (P.) Ltd. v. UOI 304 ITR 201 (Bombay HC)	<ul style="list-style-type: none"><li>• In respect of payments for diamond grading and certification charges there is no imparting of experience.</li><li>• What is received is the report where commercial or technical knowledge is used.</li><li>• The assessee uses his experience and technical know-how for a consideration without parting with that information.</li></ul>
Guy Carpenter & Co Ltd v ADIT (2012) (346 ITR 504) (Delhi HC)	<ul style="list-style-type: none"><li>• The assessee, a UK based reinsurance broker, received commission from several Indian insurance companies for arranging reinsurance contracts.</li><li>• The consideration received by the assessee acting as an intermediary in the reinsurance process cannot, by any stretch of imagination, be qualified as a consideration received for rendering any financial analysis related consultancy services, rating agency advisory services, risk based capital analysis etc. as alleged by the A.O.”</li><li>• To “make available” technical knowledge, mere provision of service is not enough; the payer must be enabled to perform the service himself</li></ul>

# FTS - Judicial Precedents on “Make available”

Decision	Gist
De Beers India Minerals (P.) Ltd. 346 ITR 467 (Karnataka HC)	<ul style="list-style-type: none"><li>• Dutch company performed services using technical knowledge and expertise and it had given data, photographs and maps to assessee but they had not made available technical expertise, skill or knowledge in respect of collection or processing of data to assessee, which assessee could apply independently and without assistance and undertake such survey independently excluding Dutch company in future.</li><li>• Technology is not made available along with technical services whereas what is rendered is only technical services and technical knowledge is withheld, then, such a technical service would not fall within definition of technical services in DTAA and not liable to tax.</li><li>• In view of above, though Dutch company had rendered technical services as defined under section 9(1)(vii) Explanation 2, yet it did not satisfy requirements of technical services as contained in article 12 of Indo-Dutch DTAA and, therefore, assessee had no TDS liability qua said payment.</li></ul>
Mumbai ITAT in the case of IATA BSP India, In re [2014] 64 SOT 290 (Mum.)	<ul style="list-style-type: none"><li>• The assessee, a branch office of IATA Canada, in pursuance of an agreement entered into by IATA Canada, through its administrative office in Geneva, ADP-GSI (a corporation incorporated in France) developed a system called ‘BSP link’ to cater to the specific needs of the airlines and agents.</li><li>• BSP link enables manual operations such as issue of debit notes/ credit notes, issue of refund, billing statement and all the information relating to tickets to be carried out for agents as well as airlines who participated in the BSP link and were provided, amongst others, to the agents and airlines operating in India for which invoices were initially raised by ADP-GSI on the Geneva office of IATA, Canada, which in turn raised the invoices on the taxpayer.</li><li>• Relying on the decision of the Karnataka HC in the case of CIT v. De Beers India Minerals (P.) Ltd (346 ITR 467) (Kar) and the Kolkata Tribunal in the case of DCIT v. ITC Ltd (82 ITD 239) (Kol) explaining the concept of ‘technology being made available’, it was held that the services did not make available technology and are not in the nature of FTS.</li></ul>

## Cases where FTS not defined under Treaty

It is generally concluded that any sum paid which is in the nature of FTS to a tax resident of countries where term FTS is not defined or not included in royalty definition, then it should not be liable to tax in India in absence of a PE.

### Case relied on

- Tekniskil (Seniderian) Berhard vs. CIT [1996] (222 ITR 551) (AAR)
- GUJ Jaeger GMBH vs. ITO [1990] (37 ITD 64) (Mumbai ITAT),
- Christiani & Nielsen Copenhagen vs. ITO [1991] (39 ITD 355) (Mumbai ITAT)
- Golf in Dubai, LLC, vs. DIT [2008] (306 ITR 374) (AAR).
- Bangkok Glass Industry v ACIT (2013) 34 Taxmann.com 77 (Madras HC)

However, in case of Lanka Hydraulic Institute Limited [2011] (AAR) has held that such income would be covered within the ambit of the Article dealing with “Other Income” as opposed to the Article dealing with “Business Profits”.

## Judicial Precedents - FTS - Source Concept

CIT vs Havells India Ltd. [2012] 21 taxmann.com 476 (Delhi)

### Ruling

- The export contracts are concluded in India and tax payer products are sent outside India under such contracts. The manufacturing activity is located in India. The source of income is created at the moment when the export contracts are concluded in India.
- Export activity having place or having been fulfilled in India, source was in India
- Mere fact that the export proceeds earned from person situated outside India did not constitute them as the source of income.
- In order to fall within the second exception to section 9(1)(vii)(b), the source of income and not the source of receipt should be situated outside India.

Source of Income is activities which have earned  
income

## Judicial Precedents - FTS - Source Concept

Decision	Gist
Metro & Metro v. ACIT 147 ITD 207 (Agra Trib.)	<ul style="list-style-type: none"> <li>Prior to amendment in section 9(1) by Finance Act, 2010, testing charges paid by assessee, a manufacturer and exporter of leather goods, to a German company, could not be regarded as fee for technical services</li> </ul>
Aqua Omega Services (P.) Ltd v. ACIT [2013] 31 taxmann.com 179 (Chennai - Trib.)	<ul style="list-style-type: none"> <li>Fees paid for services utilized in business carried on outside India for purpose of earning income from any source outside India is not taxable</li> </ul>
ITO (International Taxation) vs. Bajaj Hindustan Ltd. (2011-TII-123- ITAT-Mum-Intl)	<ul style="list-style-type: none"> <li>The payment made to foreign consultant would be considered as payment made for creating a future source of income which would be covered by the exception, i.e. for the purpose of making or earning any income outside India and hence not taxable as FTS under the Act and accordingly the taxpayer was not liable to withhold tax under section 195 of the Act.</li> </ul>

## Judicial Precedents - FTS - Contract of work

Decision	Gist
Prithvi Information Solutions Ltd. v. ITO [2014] 47 taxmann.com 214 (Hyderabad - Trib.)	<ul style="list-style-type: none"><li>• Where amounts are paid outside India to persons outside Indian territory, who does not have any tax liability as far as I.T. Act, 1961 is concerned, said sum cannot be considered as 'sums chargeable' under provisions of this Act</li></ul>



## Judicial Precedents - FTS - Human Intervention

<b>Decision</b>	<b>Gist</b>
UPS SCS (Asia) Ltd. (ITA No. 2426 (Mum.) of 2010) (Mumbai Tribunal)	<ul style="list-style-type: none"><li>• Ability to use a computer in tracing the movement of the goods (though indirect, remote and not necessary) cannot bring the payment for freight and logistics services within the purview of "technical services"</li></ul>
Siemens Ltd. v. CIT(A) [2013] (142 ITD 1) (Mumbai ITAT)	<ul style="list-style-type: none"><li>• Any technology or machinery is developed by human and put to operation automatically, wherein it operates without much of human interface or intervention, then usage of such technology cannot per se be held as rendering of 'technical services' as contemplated in Explanation 2 to section 9(1)(vii).</li></ul>

## Other Key Judicial Precedents for FTS

Nature of Transaction	Decision	Gist
Referral Fees	CLSA Ltd. v. ITO [2013] (56 SOT 254) (Mumbai ITAT)	<ul style="list-style-type: none"> <li>Referral fees received by the assessee from Indian subsidiary for referring the subsidiary to overseas financial institution with which the assessee had business relations cannot be considered as technical, managerial or consultancy services as envisaged in Explanation 2 to section 9(1)(vii).</li> <li>Also, there did not exist any real and intimate relation between the activities carried on outside India by the applicant and the activities in India that contributed to the earning of income. Hence, the same cannot be considered as taxable as business income.</li> </ul>
Consultancy Fees	English Indian Clays Ltd. v ACIT(IT) [2013] ITA No 337 to 339 of 2013 (Cochin ITAT)	<ul style="list-style-type: none"> <li>Where the assessee company entered into an agreement with a foreign entity to identify potential customers and file a report regarding the market strategy and developmental studies would be in the nature of consultancy services taxable in India.</li> </ul>

## Other Key Judicial Precedents for FTS

Nature of Transaction	Decision	Gist
Seismic Surveys and related activities	Geofizyka Torun Sp. Zo. O. Chrobrego v/s DIT [2009] (320 ITR 268) (AAR)	<ul style="list-style-type: none"> <li>Income from services in connection with seismic surveys, data acquisition, processing and interpretation of such data is covered under Section 44BB of the Act (i.e. special provision applicable to non-residents for computing profits and gains in connection with the business of exploration, etc. of mineral oil) and cannot be regarded as “FTS” as defined in section 9(1)(vii) of the Act</li> </ul>
Reimbursement of salary and other cost	Temasek Holdings Advisors (I) (P.) Ltd. v. DCIT [2013] ITA NO 4203 & 6504 OF 2012 (Mumbai ITAT)	<ul style="list-style-type: none"> <li>It was held that payments made by the Indian company on account of reimbursement of salary of two employees and other costs, was not in the nature of 'fees for technical services', being rendering of managerial and consultancy services within the ambit of section 9(1)(vii) and also under article 12(4)(b) of the India Singapore DTAA.</li> </ul>
Dependent Agents	eBay International AG v. DDIT [2013] 40 taxmann.com 20 (Mumbai - Trib.)	<ul style="list-style-type: none"> <li>Revenues earned by foreign company through its dependent agents who were assisting said company in operating websites in India was in nature of business profits as per article 7 of Indo-Swiss DTAA but could not be taxed as assessee had no PE in India</li> </ul>

## Examples of Payment Not Considered in Nature of FTS

Nature of Transactions	Decision
Freight and logistics services, loading and unloading	UPS SCS (Asia) Ltd vs ADIT (2012) 18 taxmann.com 302 ( Mumbai ITAT)
Sourcing services in relation to goods	Adidas Sourcing Ltd. v. ADIT (IT) [2012] (55 SOT 245) (Delhi ITAT)
Line production services	Endemol India Private Limited(2013) (AAR no 1083 of 2011); Yashraj Films (2013) (ITA No.4856 of 2008).
VSAT charges, Demat charges, etc. paid by members to the stock exchange for use of facilities	DCIT vs. Angel Broking Ltd [2009] (35 SOT 457) (Mumbai ITAT).
Provision of bandwidth/internet facilities	CIT vs. Estel Communications P. Ltd [2008] (318 ITR 185) (Delhi HC).

# 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 the 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 relating between trading activity carried on outside the taxable territories and trading activity within the territories, the relating 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 India only if they satisfy the test of chargeability in India.

# Judicial Precedents - Commission

Decision	Gist
Panalfa Autoelektrik Ltd. [2014] 49 Taxmann. Com 412 (Delhi HC)	<ul style="list-style-type: none"><li>• Commission paid by assessee to its foreign agent for arranging of export sales and recovery of payments could not be regarded as fee for technical services under section 9(1)(vii)</li></ul>
Southern Borewells v. CIT [2014] 43 taxmann.com 378 (HC - Kerala)	<ul style="list-style-type: none"><li>• Where assessee entered into a contract with an agent in foreign country who did not have PE in India, payment made to agent cannot be construed as income accrued in India</li></ul>
ITO vs Trident Exports [2014] 44 taxmann.com 297 (Chennai - Trib.)	<ul style="list-style-type: none"><li>• Where assessee made payments of commission to foreign agents for rendering services abroad, in view of fact that those agents did not have PE in India, commission was not taxable in India and, thus, assessee was not liable to deduct tax at source while making said payments</li></ul>
ACIT v. Avon Organics Ltd. (2013) 55 SOT 260 (Hyd.) (Trib.)	<ul style="list-style-type: none"><li>• Where assessee paid commission to its non-resident agents for rendering services outside India, said commission being in nature of a business profit, was not taxable in India in terms of article 7 of DTAA between India and UAE</li></ul>



## Judicial Precedents - Commission

Decision	Gist
Dy. CIT v. Angelique International Ltd. (2013) 55 SOT 226 (Delhi) (Trib.)	<ul style="list-style-type: none"><li>• Export commission paid to a non-resident agent for services rendered outside India is not chargeable to tax in India</li></ul>
CIT v. Eon Technology (P) Ltd. (2012) 246 CTR 40 (Delhi)(High Court)	<ul style="list-style-type: none"><li>• 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).</li></ul>

# Other Rulings - Commission Paid to Non Resident Agent

Decision	Gist
CIT vs Model Exims [2014] 42 taxmann.com 446 (Allahabad HC)	<ul style="list-style-type: none"><li>• Explanation added to section 9(1)(vii) by Finance Act, 2010 with effect from 1-6-1976 was not applicable in view of fact that agents had their offices situated in foreign country and they did not provide any managerial services to assessee.</li><li>• The agreement did not show the applicability or requirement of any technical expertise as functioning as selling agent, designer or any other technical services.</li></ul>
Allied Nippon Ltd vs Dy. CIT [2013] 37 taxmann.com 135 (Delhi - Trib.)	<ul style="list-style-type: none"><li>• Export commission, paid to foreign agent for procuring order and pursuing payment from foreign buyer, is not taxable as no services are rendered in India</li></ul>
Exotic Fruits (P.) Ltd vs ITO [2013] 40 taxmann.com 348 (Bangalore - Trib.)	<ul style="list-style-type: none"><li>• Export commission to its non-resident agent, services of non-resident agent were rendered outside India and commission was also paid outside India, income of such agent by way of commission could not be considered as accrued or arisen or deemed to be accrued or arisen in India</li></ul>

## Other Rulings - Commission Paid to Non Resident Agent

Decision	Gist
Gujarat Reclaim and Rubber Products Ltd. ITA No. 8868/Mum/2010 (Mum Trib)	<ul style="list-style-type: none"><li>• Amount not taxable as the services provided by agents were utilized outside India and the commission was also payable/paid outside India.</li></ul>
CIT v. Toshoku Ltd., (2002-TII-03 SC-INTL)	<ul style="list-style-type: none"><li>• As non-resident taxpayer did not carry on any business operations in India, amounts earned for services rendered outside India could not be deemed to be incomes which had either accrued or arisen in India.</li></ul>
Armayesh Global vs ACIT [2012] 21 taxmman.com 130 (Mum Trib.)	<ul style="list-style-type: none"><li>• Where services rendered by overseas commission agent were not of managerial/technical nature and, moreover, it did not have a PE in India, amount paid to said agent for rendering services did not accrue in India</li></ul>
DCIT v. Divi's Laboratories Ltd. (2011-TII-182-ITAT-HYD-INTL)	<ul style="list-style-type: none"><li>• Commission paid to a foreign agent for services rendered outside India is not taxable in India as an overseas agent of Indian exporter operates in his own country and no part of his income arises in India and amount is directly paid outside India.</li></ul>

## Judicial Precedents - Commission

Decision	Gist
AAR in case of SKF Boilers and Driers (P.) [2012] 18 taxmann.com 325 (AAR - New Delhi)	<ul style="list-style-type: none"><li>• The words 'accrue' or 'arise' occurring in section 5 have more or less a synonymous sense and income is said to accrue or arise when the right to receive it comes into existence.</li><li>• No doubt the agents rendered services abroad and have solicited orders, but the right to receive the commission arises in India when the order is executed by the applicant in India.</li><li>• The fact that the agents have rendered services abroad in the form of soliciting the orders and the commission is to be remitted to them abroad are wholly irrelevant for the purpose of determining the situs of their income.</li><li>• The provision of section 195 would apply since the right to receive the commission arises in India when the order is executed by the applicant in India</li></ul>

# Questions



# Thank you!

CA Rajesh Patil

The information contained in this document is intended to share information on a particular subject or subjects and are not exhaustive treatment of such subject(s).

This contents of this document are for sharing knowledge amongst professional colleagues and the presenter by means of this document is not rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This document is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your finances or your business. Before making any decision or taking any action that may affect your finances or business, you should consult a qualified professional advisor.

The presenter shall not be responsible for any loss whatsoever sustained by any person who relies on this document.