

Study Course on International Taxation for Beginners

Organised by -

Western India Regional Council of the Institute Chartered Accountants of India

TDS on Payments to Non-residents under section 195 – Law and Procedures

CA Namrata Dedhia

Overview

- ▶ Objective
- ▶ Scope
- ▶ Chargeability
- ▶ Determination of Taxability
- ▶ Analysis of Sec. 195
- ▶ Alternative remedy for lower deduction
- ▶ Issues
- ▶ Grossing up - Sec. 195A
- ▶ Compliances
- ▶ Consequences of non-compliance
- ▶ Refunds
- ▶ Remittance Procedures
- ▶ Documentation
- ▶ Rates of tax under Income Tax Act, 1961

Objective

- ▶ To ensure tax liability is recovered through deduction at source itself.
- ▶ Tax Department is not troubled to recover tax from a non-resident
 - ▶ whose India connection may be transient, or
 - ▶ whose assets in India may not be sufficient.

Scope

- ▶ Increasing cross-border transactions in respect of –
 - ▶ Purchase and sale of goods by non-residents with business presence in India
 - ▶ Non-resident expatriates deputed / seconded to India
 - ▶ Borrowings by residents from non-residents
 - ▶ Purchase and sale of capital assets by non-residents
 - ▶ Services availed from non-residents
- ▶ Examining the applicability of Income-tax Act, 1961 and Tax Treaties.
- ▶ Certification requirements prior to remittances.

Chargeability

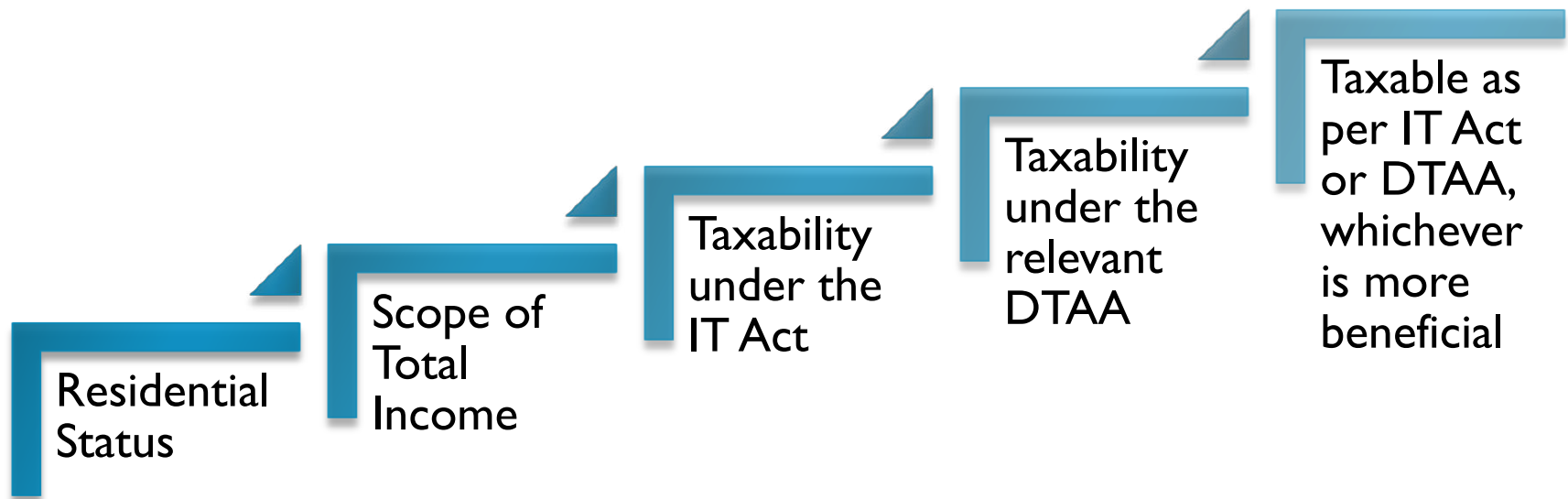
SC observed in Eli Lilly 312 ITR 225:

- ▶ The purpose of TDS provisions in Chapter XVII B is to see that the sum which is chargeable under Section 4 for levy and collection of income-tax, the payer should deduct tax thereon at the rates in force, if the amount is to be paid to a non-resident. *The said TDS provisions are meant for tentative deduction of income-tax subject to regular assessment.* (see Transmission Corporation of A.P. Ltd. and Anr. v. CIT reported in [1999] 239 ITR 587 at p. 594).

Chargeability

- ▶ Sec. 195 is only a machinery section which enables collection of tax.
- ▶ Charge of tax on income is created by Sec. 4 read with Sec. 5
- ▶ Thus, in absence of taxability of any amount under the Income-tax Act, question of TDS does not arise.

Determination of Taxability



Applicability – Sec. 195(1)

- ▶ Payment by any person
 - ▶ Including Individuals and HUFs not liable to Tax Audit.
 - ▶ Payer may be Resident or Non-Resident.
 - ▶ Expl. 2 inserted by Finance Act 2012 clarifies that obligation to deduct tax at source applies to all persons, resident or non-resident, whether or not the non-resident has a residence or place of business or business connection or any other presence in India.
- ▶ Payment to a non-resident, not being a company or a foreign company.
 - ▶ Resident but not ordinarily resident?
 - ▶ Residential status at the time of payment / credit?
 - ▶ Status of Dual residents?

Applicability – Sec. 195(1)

- ▶ Payment of any sum chargeable under the Act, excluding –
 - ▶ Interest from Infrastructure Debt Fund (S. 194LB)
 - ▶ Interest on foreign Currency Borrowings of an Indian company (S. 194LC)
 - ▶ Interest on Rupee denominated bonds and Government securities to FIIs / QFIs (S. 194LD)
 - ▶ Income chargeable under the head “Salaries”
 - ▶ Dividends covered in Sec. 115-O
- ▶ Payments for personal purposes not excluded

Applicability – Sec. 195(1)

- ▶ Other payments covered by specific TDS sections
 - ▶ Income from units of a business trust (S. 194LBA)
 - ▶ Payment to sportsperson, entertainer or sports association (S. 194E)
 - ▶ Winnings from lottery etc. (S. 194B)
 - ▶ Income received by a unit holder of investment funds (S. 194LBB)
 - ▶ Payments u/ss. 115AB, 115AC, 115AD (S. 196C, 196C, 196D)
- ▶ Payments not subject to TDS
 - ▶ Shipping income – S. 172
 - ▶ Interest paid by Offshore Banking unit to NR or RNOR – S. 197A(1D)
 - ▶ Capital Gain earned by FII – S. 196D(2)

Applicability – Sec. 195(1)

- ▶ At time of credit or payment, whichever is earlier –
 - ▶ Credit to any account, whether called Interest payable account or Suspense account or by any other name is covered.
 - ▶ Tax deductible at the time of actual payment only for interest payable by the Government or a public sector bank or a public financial institution.
- ▶ Tax deduction at rates in force as per the Finance Act or as per the applicable DTAA, whichever is more beneficial
 - ▶ Sec. 206AA would prevail over DTAA rates
- ▶ No threshold limit
- ▶ Applicable even to Rupee payments

Application to A.O. – Sec. 195(2)

- ▶ Where *payer* feels that only a part of the gross amount payable is in the nature of income, he shall apply to the Assessing Officer *to determine the proportion of gross amount which is chargeable* to tax.
- ▶ Tax shall accordingly be deducted only on that part of the gross amount as determined by the A.O.
- ▶ Order u/s. 195(2) is appealable.

Assessee cannot deduct tax at a lower rate without obtaining an order u/s. 195(2) – Chennai Metropolitan Water Supply & Sewerage Board 348 ITR 530 (Mad.)

Application to A.O. – Sec. 195(2)

- ❧ Karnataka HC in case of Samsung Electronics Co. Ltd. held that payments made to non-residents are liable for withholding tax unless there is a specific order by the tax authorities exempting such withholding requirements.
- ❧ In case of GE India Technology Cen. (P.) Ltd., the Supreme Court reversed this judgment by observing that section 195(2) gets attracted in cases where payment made is a composite payment in which certain proportion of payment has an element of 'income' chargeable to tax in India and payer seeks a determination of appropriate proportion of sum chargeable.

Application to A.O. – Sec. 195(3)

- ▶ Application to the A.O. by the *payee* in Form 15C / 15D to receive payment *without any deduction of tax.*
- ▶ Persons eligible to make application –
 - ▶ Non-Indian banking company, operating in India through a branch, in respect of interest or any other sum;
 - ▶ Any other person carrying on business in India through a branch, in respect of any sum (other than interest)
- ▶ Conditions in Rule 29B to be satisfied.
- ▶ Certificate to be valid for specified financial year only.
- ▶ This certificate is non-appealable.

Application to A.O. – Sec. 195(3)

- ▶ Prescribed conditions under Rule 29B –
 - ▶ Applicant has been regularly assessed to income-tax in India and has furnished returns for all asst. years.
 - ▶ Not an assessee in default or not deemed to be so in respect of any tax, interest, penalty, fine or any other sum.
 - ▶ Not subjected to penalty u/s. 271(1)(iii)
 - ▶ In case of a person other than a foreign banking company –
 - ▶ Has been carrying only business in India continuously for at least 5 years.
 - ▶ Book value of fixed assets in India for the immediately preceding P.Y. exceeds Rs. 50 lakhs.

Application to A.O. – Sec. 195(7)

- ▶ Inserted by Finance Act 2012 w.e.f. 1st July 2012.
- ▶ CBDT has been given the powers to prescribe a class of persons or cases, where the payer would be required to make an application to the AO to determine the proportion of the amount which is chargeable to tax.
- ▶ Application would be required to be made whether or not the sum is chargeable under the Act.
- ▶ Once the A.O. determines the appropriate proportion, tax shall be deducted on such proportion.

Alternative Remedy u/s. 197

- ▶ Application may be made by the Non-Resident payee to the A.O. in Form 13 for tax deduction at a lower rate or nil rate.
- ▶ The A.O. shall issue a certificate prescribing appropriate rate of tax.
- ▶ The same shall be valid only for the specified assessment year.

Tax Residency Certificate

- ▶ Sec. 90(4) – NR cannot avail DTAA benefit without Tax Residency Certificate (TRC)
- ▶ Sec. 90(5) – The assessee to provide prescribed details –
 - ▶ Rule 21AB provides list of information to be provided
 - ▶ Self-attested Form 10F to be provided if all the information is not covered in the TRC.
 - ▶ Form 10F alone is not sufficient
- ▶ If TRC is not available at the time of deduction?
- ▶ If TRC is available for a different period?

Issues

- ▶ Withdrawal of following circulars by CBDT vide Circular 7/2009 dt 22nd October 2009 –
 - ▶ Circular 23 dt. 23rd July 1969
 - ▶ Circular 163 dt. 29th May 1975
 - ▶ Circular 786 dt. 7th February 2000
- ▶ Impact of withdrawal
 - ▶ The above circulars aided in proper interpretation of provisions applicable to Non-Residents.
 - ▶ Withdrawal does not necessarily mean that a Non-Resident is automatically taxable in India in the situation described circulars. However, the clarity provided by these circulars is lost.

Issues

- ▶ Payments made by a branch of a foreign entity to its HO or other branches –
 - ▶ Circular 649 dt 31st March 1993 and Circular 740 dt 17th April 1996
 - ▶ ABN Amro Bank – 97 ITD 89 (Cal.)
 - ▶ Sumitomo Mitsui Banking Corporation - 2012 (16) ITR (Trib) 116
- ▶ Payments made by a resident to Indian branch of a foreign entity –
 - ▶ Circular 20 dt 3rd August 1961
- ▶ Remuneration payable by a firm to Non-Resident partner
- ▶ Payments to agents of Non-Resident ship owners
 - ▶ Circular 723 dt 19th Sept 1995

Issues

- ▶ Payment made to agent of Non-Resident in India
- ▶ Payment made to Non-Resident agent outside India
 - ▶ Rajiv Malhotra – 284 ITR 564 (AAR)
 - ▶ Lady Kanchanbai – 77 ITR 123 (SC)
 - ▶ Kusumben Mahadevia – 47 ITR 214 (Bom)
- ▶ Payments to Non-Residents in kind
 - ▶ Kanchanganga Sea foods Ltd. v/s. CIT 265 ITR 664 (AP)
- ▶ Secondment of Employee
 - ▶ Target Corpn. India (P.) Ltd. 348 ITR 61 (AAR)

Issues

Reimbursements

- ▶ Only income liable to tax in India can be subject to TDS
 - ▶ Transmission Corporation (1999) 239 ITR 587 (SC)
 - ▶ Superintending Engineer, Upper Sileru (1985) 152 ITR 753 (AP)
 - ▶ Van Oord ACZ India (P) Ltd. v. CIT (2010) 323 ITR 130 (Del.)
 - ▶ Expeditors International (India) (P.) Ltd. (2012) 209 Taxman 18 (Del.)
- ▶ Where no income element is included in reimbursements
 - ▶ Tata Engg. & Locomotive – 245 ITR 823 (Mum HC)
 - ▶ Clifford Chance UK – 82 ITD 106 (Mum)
 - ▶ Mahindra & Mahindra – 1 SOT 896 (Mum)

Issues

Reimbursements

- ▶ Reimbursement made with FTS is considered as a part of FTS
 - ▶ Cochin Refineries – 222 ITR 354 (Kerala HC)
 - ▶ SRK Consulting Engg. & Scientists – 230 ITR 206 (AAR)
 - ▶ Hindalco Industries 278 ITR 125 (Mum ITAT)
 - ▶ XYZ Ltd. 348 ITR 20 (AAR)

Grossing up – Section 195A

- ▶ Applicable in cases where withholding tax is to be borne by the payer under an agreement entered into on or after 1st June 2002.
- ▶ Net amount payable should be increased to such amount as would after deduction of tax at the rates in force be equal to the net amount.

$$\text{Gross amount} = \frac{\text{Net amount payable} * 100}{(100 - \text{Rate of TDS})}$$

- ▶ Grossing up is not to be done in cases of presumptive taxation – ONGC, 264 ITR 340 (Uttaranchal)

Compliances

- ▶ Deposit of tax deducted –
 - ▶ If amount is credited on 31st March, on or before 30th April.
 - ▶ In any other case, within seven days of the end of the month of deduction.
- ▶ TDS Certificate in Form 16A –
 - ▶ Within fifteen days from the due date for furnishing the statement of tax deducted at source under rule 31A, i.e., TDS Returns
- ▶ TDS Returns – Quarterly statement in Form 27Q to be submitted as under:
 - ▶ For amounts credited on 31st March, by 15th May.
 - ▶ In all other cases, within fifteen days from the end of the quarter.

Consequences of Non-Compliance

- ▶ Disallowance of the expenses u/s. 40(a)(i)
- ▶ Disallowance u/s. 58(1)(a)(ii) & 58(1)(a)(iii)
- ▶ Simple interest u/s. 201(1A) @ 1% p.m. till the date of deduction and 1.5% p.m. from date of deduction till date of payment.
 - ▶ Interest cannot be levied if recipient has paid tax on the amount – Hindustan Coca Cola Beverages Pvt. Ltd. 293 ITR 226 (SC)
- ▶ Levy of penalty
 - ▶ U/s. 221 - Failure to pay tax deducted
 - ▶ U/s. 271C - Failure to deduct tax at source
 - ▶ U/s. 272A – Failure to file TDS return
 - ▶ U/s. 271-I – Failure to furnish information or furnishing inaccurate information under section 195
 - ▶ S. 271J – Penalty on CA for furnishing incorrect information in certificate
- ▶ Invoking of prosecution u/s. 276B

Refunds

- ▶ CBDT Circular No. 7 of 2007 dated 23rd Oct 2007
- ▶ Payer is entitled to claim refund in the following cases –
 - ▶ Contract is cancelled and no remittance is made to Non Resident or amount remitted is duly refunded.
 - ▶ Contract is cancelled after partial execution and no remittance is made to Non Resident for non-executed portion or amount remitted is duly refunded.
 - ▶ The amount remitted becomes exempt due to an amendment in law.
 - ▶ Tax liability gets reduced upon an order passed by the Tax Authorities.
- ▶ Prior approval of Chief Commissioner or Director General of Income Tax is required.
- ▶ Application in form 26B

Refunds

- ▶ Refund cannot be claimed in case of excess tax deduction. The same can only be claimed by the payee by filing return of income.
- ▶ Refund is first adjusted against any income-tax, wealth tax or any direct tax liability
- ▶ No Interest u/s. 244A is payable on such refunds.
- ▶ No TDS certificate should have been issued to Non Resident.
- ▶ Claim for refund should be made within 2 years from the end of the financial year in which tax is deducted.

Refund must be given, along with interest, where Indian company had erroneously deducted and deposited tax twice – Fag Bearings India Ltd. 209 Taxman 360 (Guj.)

Remittance Procedures

RBI perspective

- ▶ No remittance can be made to Non-Resident unless NOC from IT dept. is furnished, except when specifically exempted.
- ▶ RBI (A.P. Dir Series) Circular No. 27 dt. 28th Sept. 2002 – Person making payment to Non-Resident can furnish undertaking in the prescribed format instead of NOC from IT dept (Circular 759 of 1997 by CBDT).
- ▶ RBI (A.P. Dir Series) Circular No. 56 dt. 26th Nov. 2002 – Format of furnishing undertaking and CA Certificate revised as prescribed by CBDT in Circular 10 of 2002.
- ▶ Circular No. 3 dated 19th July 2007 – CA certification mandatory for every payment made to Non-Residents including import payments.

Remittance Procedures

Income Tax Department perspective

- ▶ Insertion of Sec. 195(6) w.e.f. 1st April 2008 empowering board to prescribe furnishing of information, whether or not payment is chargeable to tax
- ▶ Rule 37BB lays down the procedures for remittance to Non-Residents.
 - ▶ Four parts in Form 15CA –
 - ▶ Part A – Aggregate remittance less than Rs. 5 lakhs during the year
 - ▶ Part B – Certificate or order u/s. 195 / 197 has been obtained
 - ▶ Part C – CA certificate in Form 15CB has been obtained
 - ▶ Part D – Payment not taxable or is covered under list of 33 payments specified in Rule 37BB

Remittance Procedures

- ▶ CA certificate in Form 15CB – to be filed electronically with digital signature using login of CA
- ▶ Electronically file appropriate part of Form 15CA from login of payer
 - ▶ With or without digital signature
- ▶ Submit Form 15CA along with Form 15CB and Form A-2 to AD.

Documentation

- ▶ Should evidence “application of due care and skill”
- ▶ General documentation principles would apply :
 - ▶ Management Representation Letter wherever relied upon
 - ▶ Tax Opinions / Expert Opinions
 - ▶ External Confirmations, etc.
- ▶ Identify Legal Status of the payee
- ▶ Obtain Tax Residency Certificate (TRC) of the Non Resident
- ▶ Ascertain existence of PE in India of the payee
- ▶ Ascertain Nature of Income and its characterisation from the agreement / underlying documents
- ▶ Extracts from the website of the payee
- ▶ Other Audit Evidences

Rate of Deduction of Tax

Nature of Income	Rate of tax (%)
On any investment income*	20
On Long Term Capital gains referred to in section 115E*	10
On short term capital gains referred to in section 111A	15
On income by way of long term capital gains (not being long-term capital gains referred to in clauses (33), (36) and (38) of Sec 10)	20
On income by way of interest payable by Govt, or an Indian concern on moneys borrowed or debt incurred by Govt, or the Indian concern in foreign Currency	20
On income by way of winnings from lotteries, crossword puzzles, card games and other games of any sort	30
* Special provisions, applicable only to NRIs	

Rate of Deduction of Tax

Nature of Income	Rate of tax (%)
On income by way of winning from horse races	30
On the whole of the other Income**	30
Royalty / Fees for Technical Services	10
Income in respect of Units of Non-residents	20
Income and Long-term Capital gain from units of an Off shore fund	10
Income and Long-term Capital Gain from Foreign Currency Bonds or shares of Indian companies	10
Income of Foreign Institutional Investors for Securities	20
** Rate will be 40% in case of foreign companies	



THANK YOU

**SHAH DEDHIA
& ASSOCIATES**
CHARTERED ACCOUNTANTS



CA Namrata Dedhia