

# **TDS on Payments to Non Residents – Section 195 – Law and Procedures**

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# Scope & Methodology

# Scope & Methodology

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- ▶ TDS on payment to non-resident covered by Sections other than Section 195
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- ▶ Tax Residency Certificate
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# Scope of Section 195



<b>Who are covered?</b>	<ul style="list-style-type: none"><li>• <b>Any person</b> responsible for paying</li><li>• To a non-resident or a Foreign Company</li></ul>
<b>What is covered?</b>	<ul style="list-style-type: none"><li>• Any interest or any other sum</li><li>• <b>Chargeable to tax</b> under the provisions of this Act</li></ul>
<b>When is it applicable?</b>	<ul style="list-style-type: none"><li>• At the time of credit or at the time of payment</li><li>• <b>Whichever is earlier</b></li></ul>
<b>How is it to be applied?</b>	<ul style="list-style-type: none"><li>• Deduct income-tax thereon at the <b>rates in force</b></li></ul>

# Scope of Section 195 - What is covered?

- ▶ Sums chargeable to tax
  - ▶ Except for:
    - ▶ Salaries; Dividends; Interest [S.s 194LB, 194LC & 194LD]; Income from units of a business trust [S. 194LBA]; Payments to sportsman, entertainer or sports association [S. 194E]; Winnings from Lottery, etc. [S. 194B]; Income received by a unit holder of investment fund [S. 194LBB]; Payments u/s.s 115AB, 115AC, 115AD [S.s. 196B, 196C & 196D].
  - ▶ Exempt from TDS:
    - ▶ Shipping income u/s. 172; Interest paid by Offshore Banking unit to an NR or RNOR [S. 197A(1D)]; Capital Gain earned by FII [S. 196D(2)].
- ▶ Without any threshold limit
- ▶ Section 195(7) – whether or not chargeable to tax
  - ▶ No cases/persons prescribed yet

## Scope of Section 195 - What is not covered?

- ▶ Not every payment is covered u/s. 195. Not everything requires deduction – however, banks take a different stand.
- ▶ Exempt Incomes not covered - Hyderabad Industries Ltd. 188 ITR 749 Kar
- ▶ Income should accrue to Payee
- ▶ Void Agreement - **Ericsson Communications Ltd. - [2002] 81 ITD 77 (DELHI)**
- ▶ Agreement not concluded – **Income does not accrue as right to receive income not crystallised - no tax deductible - Motor Industries Co. [2001] 115 TAXMAN 222 (KAR.)**
- ▶ Whether TDS should be deducted excluding service tax/GST or including service tax/GST?
  - ▶ Service tax/GST is not income. Hence it is not a part of “income chargeable tax”. Hence no TDS.

## Sum chargeable to tax

- ▶ Tax is deductible on “**sum chargeable to tax**”. This is the basis of determining whether tax is to be deducted or not.
- ▶ Tax is to be deducted not just from payments which are wholly incomes; but also from payments where only a portion of the payment may be income [Income embedded in the payment.]
  - ▶ *Transmission Corp. 239 ITR 587 (SC).*
  - ▶ *GE India Technology Cen. Pvt. Ltd. - (193 Taxman 234) 2010 SC.*
- ▶ Circulars clarifying CBDT understanding:
  - ▶ *CBDT circular no. 02/2014 dated 26.2.2014* states that interest u/s. 201 will be on **portion representing income** (not the whole amount)
  - ▶ *CBDT circular no. 03/2015 dated 12.2.2015* states that disallowance u/s. 40(a)(i) will be on **sums chargeable to tax** (not the whole amount)



# Taxability – Steps

## Section 6

- *Residential Status*



## Section 5

- *Received or Deemed to be received*
- *Accrues or arises*

## Section 9

- *Is deemed to Accrue or Arise*

## DTAA

- *Exempt from Tax*
- *Lower tax rate*

Provisions of the Act or DTAA, whichever are more beneficial, prevail

# Scope of Section 195 - Who are covered?

- ▶ Payer - Any person
  - ▶ Even if NR?
    - ▶ Extraterritorial operation
    - ▶ GVK Industries
    - ▶ Vodafone
  - ▶ Retrospective amendment – Explanation 2 to S. 195(1)
    - ▶ Obligation to deduct whether or not NR has any presence in any manner whatsoever in India!
- ▶ Payee should be
  - ▶ Non-residents (other than companies); or
  - ▶ Foreign Co - whether or not NR!
    - ▶ If POEM is in India, foreign company is an Indian resident
    - ▶ Will Section 195 apply or other sections apply?
    - ▶ Section 195 is more specific to the payee.
    - ▶ Other sections are more specific to the incomes.
  - ▶ Payment by such foreign company – should it deduct TDS?  
(Notification u/s. 115JH awaited.)

## Scope of Section 195 - When is it applicable?

- ▶ On credit or payment whichever is earlier
  - ▶ From the point of view of payer
  - ▶ Exception for interest payable by Government, Public Sector Bank or Public Financial Institution
- ▶ Amount adjusted, not paid
  - ▶ Raymond Ltd. (80 TTJ 120)
- ▶ FEMA or RBI Approval
  - ▶ United Breweries Ltd. - [2002] 81 ITD 77 (Delhi)
- ▶ Govt. Approval
  - ▶ Pfizer Corpn. [2003] 129 TAXMAN 459 (BOM.)

## Scope of Section 195 – How is it applicable?

- ▶ Rate or rates in force - Section 2(37A)(iii)
  - ▶ Part II to the First Schedule of Finance Act
  - ▶ DTAA rates
- ▶ Surcharge to be added to DTAA Rate?
  - ▶ No
- ▶ Education Cess to be added to DTAA Rate?
  - ▶ No
- ▶ Presumptive provisions: 44B, 44BB, 44BBA, 44BBB
- ▶ Section 44DA r.w. Section 115A
  - ▶ Only applicable for final payment of tax
  - ▶ Deductibility on basis of **Schedule I, Part II** to Finance Act

## Rate of tax – Grossing up

Payment of Rs. 100, tax deductible @ 10%	Without Gross Up of Tax (A)	With Gross up of Tax (B)
Invoice Amount	100	100
Tax Deductible @ Source	10	10
Net Amount payable	90	100
Amount/Grossed up amount	100	$100 + 100 / [(100/10) - 1]$ = 111.11
Less: Tax deducted	10	11.11
Net Payment	90	100

- ▶ If tax has to be borne by the payer, the same has to be grossed up – Sec. 195A.[This is clarificatory]
- ▶ Presumptive profit provisions – S. 44B, etc. – Grossing is not required (ONGC – 264 ITR 340).

# Tax Residency Certificate

- ▶ S. 90(4) – NR cannot avail benefit under Treaty without Tax Residency Certificate (TRC)
  - ▶ Applies to all NRs without any threshold limit
- ▶ S. 90(5) – The assessee has to provide such other details as may be prescribed
  - ▶ R. 21AB – specifies the information to be provided
  - ▶ To be provided in Form 10F – if the same are not covered in the TRC
  - ▶ Assessee should keep the relevant documents for the above information.
  - ▶ Thus TRC and Form 10F go together
  - ▶ Form 10F alone not sufficient
  - ▶ Self-attestation

# Tax Residency Certificate - Issues

- ▶ **Is TRC sufficient for claiming the DTA benefit?**
  - ▶ For conditions of DTA – like Beneficial ownership, Limitation of Benefits clause – TRC is not sufficient.
- ▶ **If TRC is not available at the time of deduction?**
  - ▶ Practical decision can be taken based on past facts after due diligence.
  - ▶ Once the TRC is obtained, the treaty benefit would be available for the whole year.
- ▶ **If the TRC is available, but it is for a different period?**
  - ▶ The deductor can rely on the TRC for the period during which the income is earned.
- ▶ **Is TRC required in case tax is not payable under the Act itself?**
  - ▶ As DTAA provisions are not exercised, provisions of Sections 90(4), 90(5) and the relevant rules will also not be applicable.

## Section 206AA - Submission of PAN

- ▶ Non-obstante provision –
  - ▶ “**Notwithstanding anything** contained in any other provisions of this act ...”
- ▶ Obligation to furnish PAN on **any person** receiving any sum or income or amount on which **tax is deductible**
- ▶ In absence of PAN, tax shall be deducted at the higher of the following rates:
  - ▶ At the rate specified in the relevant provision of the Act; or
  - ▶ At the rate or rates in force; or
  - ▶ At the rate of 20%
- ▶ Tentative tax, Refund of higher tax deducted available
- ▶ Section applicable also when PAN incorrect or invalid
- ▶ Certificate u/s. 197 will not be issued without PAN



## Section 206AA – Relaxation

- ▶ **From 1<sup>st</sup> June 2016, S. 206AA(7) introduced**
- ▶ **PAN not required** for payment of:
- ▶ Interest on Long Term Infrastructure bonds referred to in S. 194LC.
- ▶ **“Specified incomes”**:
  - ▶ Interest,
  - ▶ Royalty,
  - ▶ FTS, and
  - ▶ For transfer of capital asset (capital gain)
- ▶ **But only if non-resident provides specified information and documents** (Rule 37BC(2)).
- ▶ For “non-specified incomes” (business income, etc.), normal rate is higher than S. 206AA rate of 20%
  - ▶ S. 206AA anyways not relevant in such cases
- ▶ **Difficulties of S. 206AA gone down considerably**
- ▶ Most regular payments covered. However PAN requirement continues for:
  - ▶ all taxable payments up to 31.5.2016; and
  - ▶ payments other than in the nature of interest, royalty, FTS & Capital Gains after 31.5.2016

## Section 206AA - Relaxation

- ▶ Documents as per Rule 37BC include –
  - ▶ TRC - **IF** the foreign country's law provide for TRC; and
  - ▶ Tax Identification No. (TIN) OR Unique Identification No. (UIN).
- ▶ **TRC is however required to claim DTA relief as Secs 90 & 90A not similarly amended!**
  - ▶ If a country does not have a system of providing TRC, there will be difficulties to claim DTA relief, but relaxation from S. 206AA will be available
- ▶ Information includes:
  - ▶ Name, e-mail id & contact number;
  - ▶ Address in the country or specified territory outside India of which the deductor is a resident.

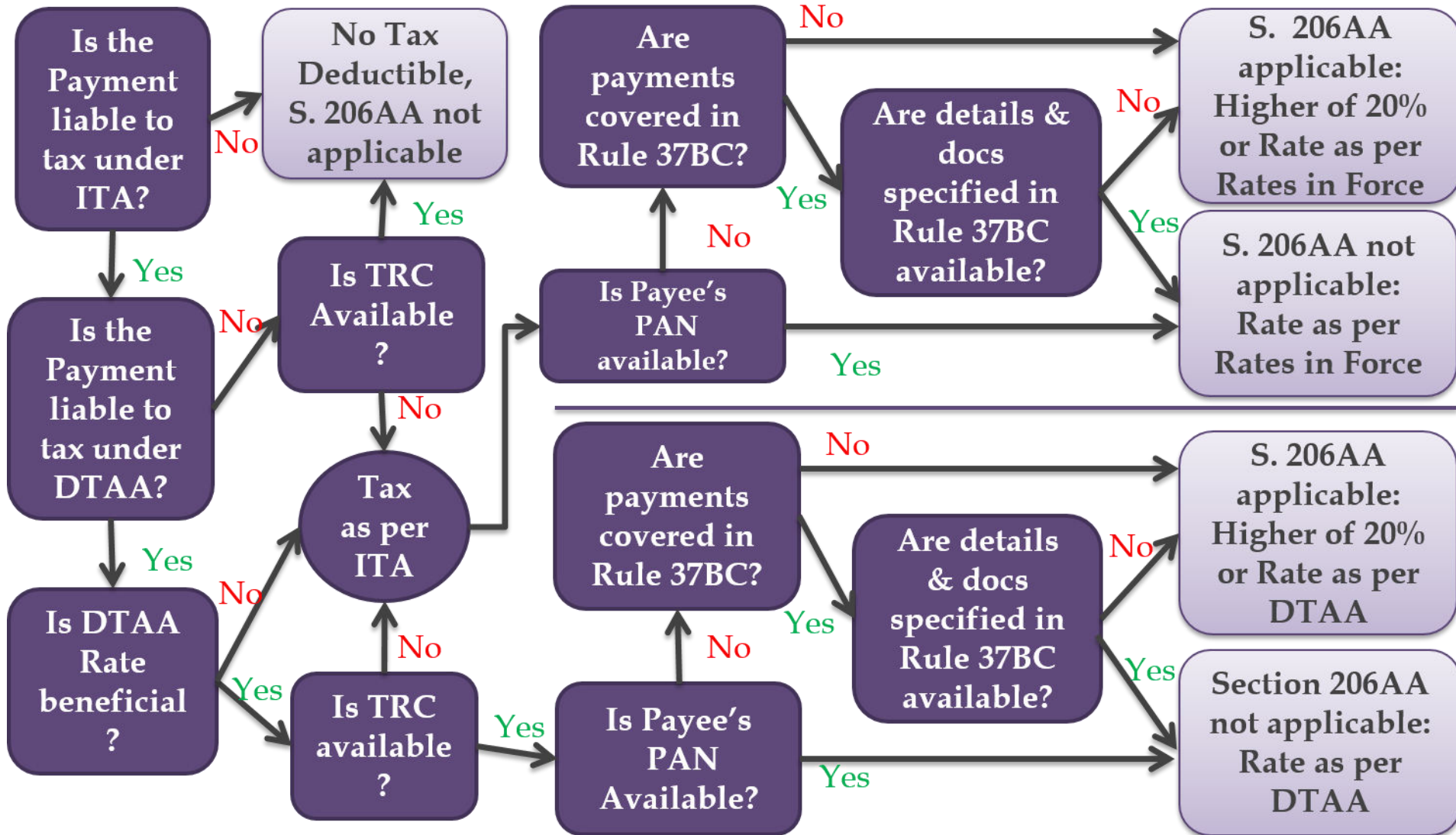
## Section 206AA - Issues

- ▶ Applicable where no tax payable?
  - ▶ No, as provision applicable only on sum or income or amount on which **tax is deductible**
  - ▶ Under section 195, tax is deductible only if income is **chargeable to tax**.
    - ▶ S. 206AA not applicable even in cases where income not taxable under DTAA if TRC available
- ▶ If DTAA rate (cap) is lower than rate as per Sec. 206AA?
  - ▶ Treaty provisions override both charging and machinery provisions of Section 206AA
  - ▶ Irrespective of the non-obstante clause contained in Section 206AA
  - ▶ View upheld by Special Bench of Hyderabad Tribunal in Nagarjuna Fertilizers and Chemicals Limited [2017] 78 taxmann.com 264 and other decisions
  - ▶ **Alternate view:** DTA strictly does not apply to TDS provisions. DTA applies only to final taxes. TDS is only provisional. Domestic law can permit a higher TDS and then a refund later.
    - ▶ The non-resident may not get credit in his home country as TDS may be higher than the DTA rate.
    - ▶ NR would have to file a return in India and claim refund.

# Interplay of DTAA, PAN and TRC – Before 1<sup>st</sup> June 2016

Are DTAA provisions beneficial?	Is TRC available?	Is PAN available?	Result
Yes	Yes	Yes	The beneficial DTAA rate can be applied as TRC is available. Section 206AA will not have any effect as PAN is available.
Yes	No	Yes	As TRC is not available, benefit of DTAA will not be available. Rate will be as per ITA. Section 206AA will not have any effect as PAN is available.
Yes	Yes	No	While the payer can take benefit of the DTA provisions, as PAN is not available, higher of 20% or DTA rate will be applicable.
Yes	No	No	As TRC is not available, benefit of DTAA will not be available. As PAN is not available, higher of 20% or ITA rate will be applicable.
No or DTAA not applicable	NA	Yes	Rate will be determined as per “rates in force” provided in Part II of First Schedule to the Finance Act of the relevant year. As PAN is available, Section 206AA will not be applicable.
No or DTAA not applicable	NA	No	Rate will be determined as per “rates in force”. If this rate is lower than 20%, tax would be deductible at 20% as PAN is not available.

# Interplay of DTAA, PAN & TRC – Post 1<sup>st</sup> June 2016



## Section 206AA – Grossing up

- ▶ Is **grossing up** required if tax has to be borne by the payer?
- ▶ No grossing up required as u/s. 195-A grossing up is **for tax deducted at “rates in force” and not Sec. 206AA rate**
  - ▶ Bosch (28 Taxmann.com 228 – Bangalore ITAT)
- ▶ For example, Rate u/s. 115A from AY 2016-17 is 10%. S. 206AA rate of 20% applies. No grossing up required as per Bosch case.

## Section 206AA – Surcharge and Education Cess

- ▶ No **surcharge or education cess** if 20% tax rate u/s. 206AA applicable.
- ▶ S. 2 of Finance Act covers applicability of Surcharge & Education cess – S. 206AA is not covered therein.
- ▶ Support found from:
  - ▶ Para 4.8 of Circular No. 01 of 2017 dated 2nd January 2017
  - ▶ Honourable Delhi Tribunal in Computer Sciences Corporation India (P.) Ltd. [2017] 77 taxmann.com 306 (Delhi - Trib.)
- ▶ If tax is as per rates in force under the Finance Act, Surcharge and Education Cess will apply.

# TDS vis-à-vis certain payments to Non-residents



# Interplay between the Act & DTAA

## Business Income

- Section 9(1)(i)
- Article 7 r.w. Article 5

## Royalties/FTS

- Section 9(1)(vi) & (vii)
- Article 12

## Capital Gains

- Section 9(1)(i)
- Article 13

## Interest

- Section 9(1)(v)
- Article 10

# TDS on Business payments or Professional fees

- ▶ 'Business Connection'
  - ▶ Professional Connection
- ▶ PE – Article 5
  - ▶ Agency PE, Service PE, Construction PE
- ▶ Fixed Base – Article 14
  - ▶ Number of days
- ▶ Offshore supply of goods
  - ▶ Port of shipment & Bearing of risk
- ▶ Payment to Foreign Agents of exporters
- ▶ Withdrawal of Circular 23 of 1969 – impact?
- ▶ 'Force of Attraction' clause in DTAA
  - ▶ Scope under ITA may be narrower

# Business Connection

- ▶ Business Connection has been explained by the Courts.
- ▶ Occasional activity is not covered. Any activity which is regular is considered as Business Connection.
- ▶ It is a subjective concept
  
- ▶ Income attributable **only to Operations carried out in India** is deemed to accrue in India.
- ▶ No income shall be deemed to accrue from operations confined to **purchase of goods** for the purpose of export. However income on,
  - ▶ Purchase - for sale in India;
  - ▶ Purchase operations in India - for purchase of goods from outside India;are taxable in India
  - ▶ Purchase of services – logically should also be exempt. However there is no specific exemption

## Business Connection

- ▶ Income due to activities of **Dependent agent** are deemed to accrue in India. Income to the extent attributable to operations carried out in India is deemed to accrue in India.
- ▶ Income due to activities of (truly) **Independent agent** are not deemed to accrue in India.

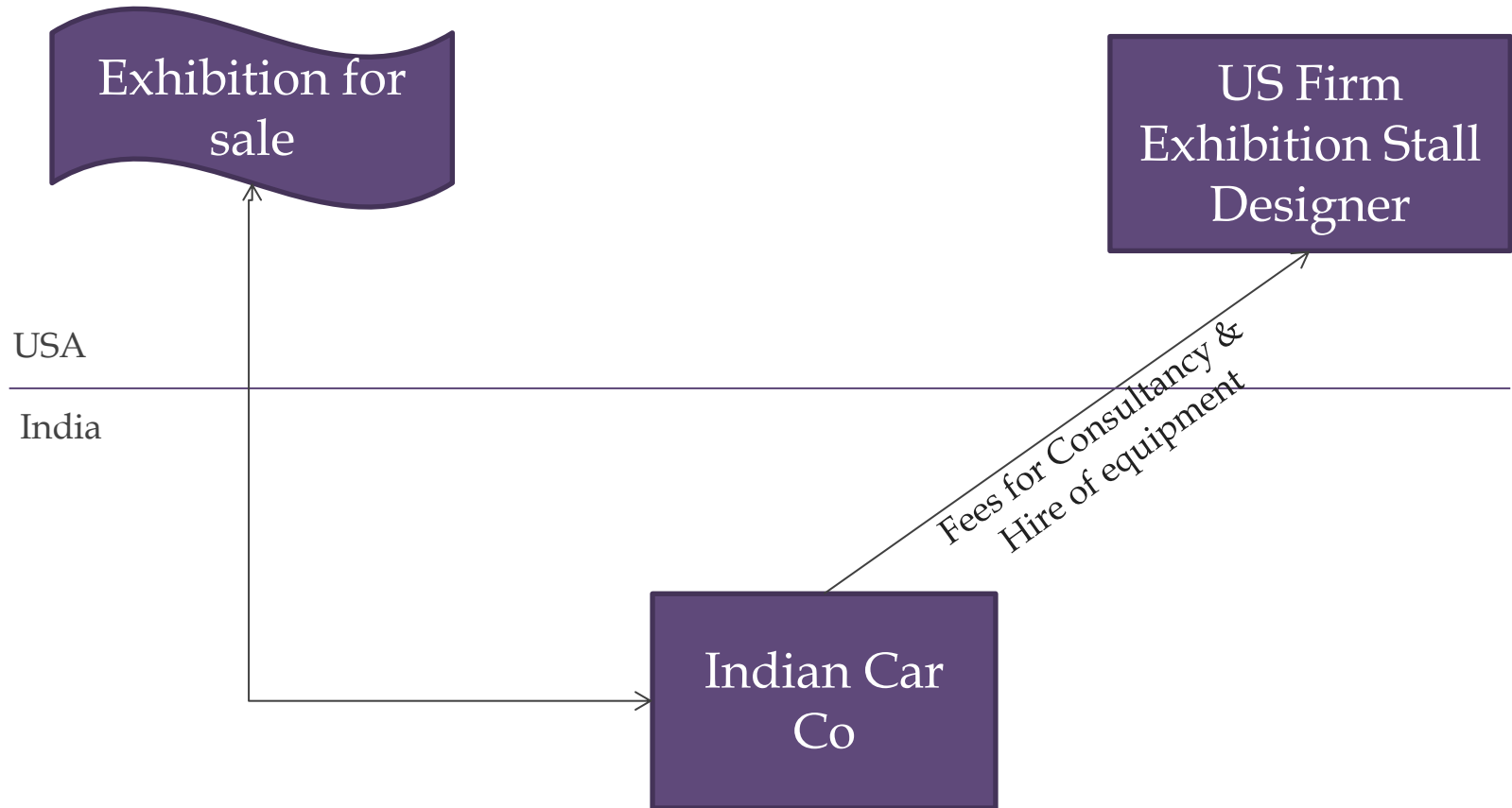
## TDS on commission abroad

- ▶ Indian resident pays commission abroad for getting export orders.
- ▶ Does income accrue in India?
- ▶ Does withdrawal of Circulars 23 (1969), 163 (1975), 786 (2000) have any implication?
  
- ▶ Activities performed outside India are not taxable in India. No TDS.
- ▶ The activities should not amount to FTS.

# TDS on Royalties & FTS

- ▶ Retrospective Expansion in definition under Act
- ▶ ‘Most Favoured Nation’ Clause
- ▶ Deemed accrual u/s. 9 - “Source Rule”
  - ▶ Treaty source rule wider
  - ▶ Taxable if payer is resident except for
    - ▶ Used for the purposes of a business or profession carried on by such person outside India; or
    - ▶ Used for the purposes of making or earning any income from any source outside India
  - ▶ Taxable if payer is non-resident only if
    - ▶ Used for the purposes of a business or profession carried on by such person in India; or
    - ▶ Used for the purposes of making or earning any income from any source in India

# Source Rule – Payer Resident

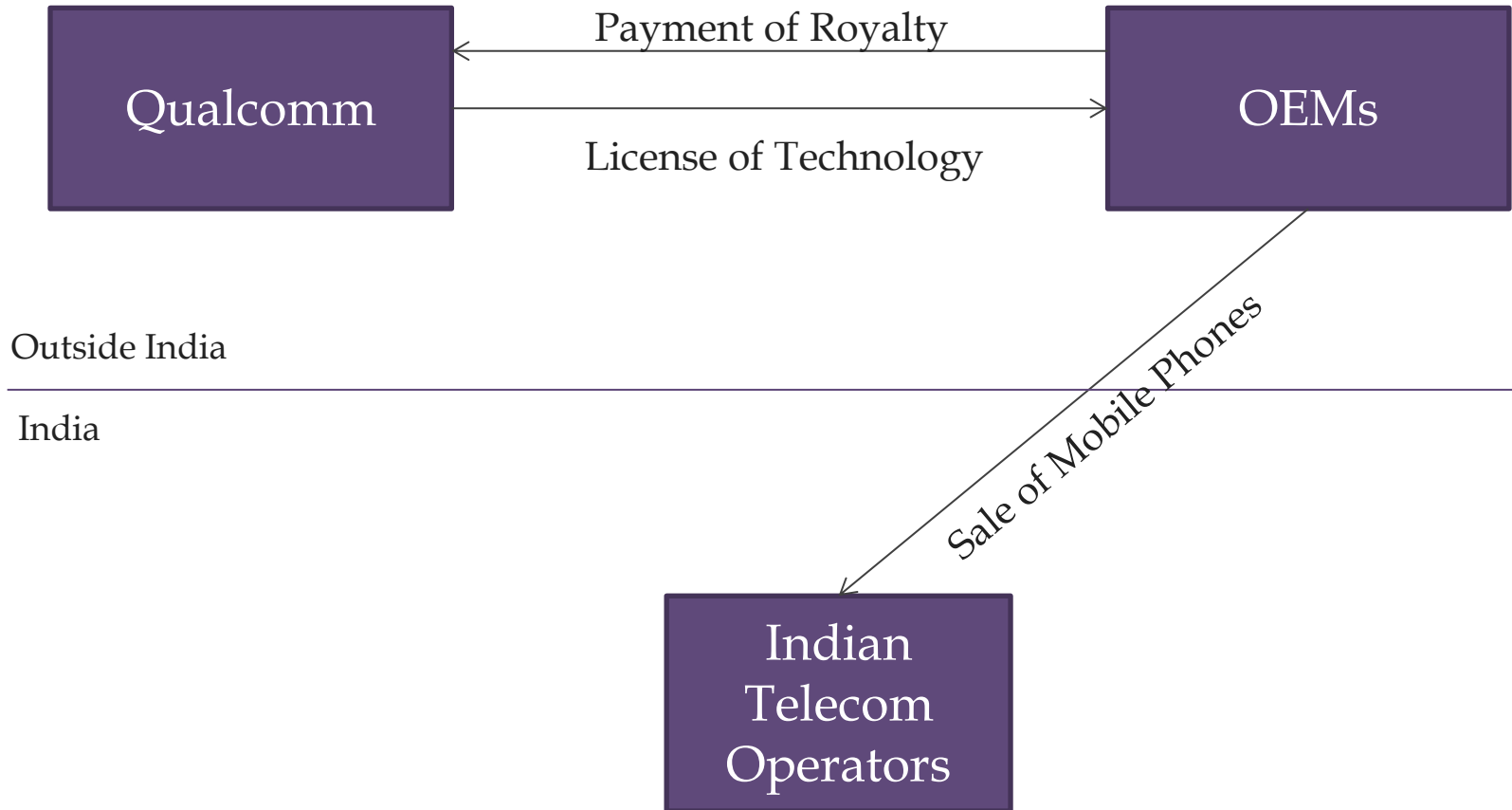


## Source Rule – Payer Resident ... contd.

- ▶ Section 9 to apply only if income does not accrue or arise in India
- ▶ Business or profession outside India
  - ▶ Office, Branch, PE
- ▶ Source of income outside India
  - ▶ Value addition
  - ▶ “Source” means not a legal concept but one which a practical man would regard as a real source of income
  - ▶ Source is the activity that gives rise to income
  - ▶ Customers not a source of income
    - ▶ Havells India Ltd.
  - ▶ Other than business income?



# Source Rule – Payer Non-Resident



# TDS on Royalties

- ▶ Software Payments
  - ▶ Royalty definition as per DTAA and Act
  - ▶ Standardized vs Customized – any difference?
  - ▶ E-commerce transactions
- ▶ Database subscriptions
- ▶ Transfer of know-how
- ▶ Use of industrial, commercial or scientific equipment

# TDS on Fees for Technical Services

- ▶ Rendering of service in India immaterial
- ▶ Technical services
  - ▶ Human element
- ▶ Managerial services
  - ▶ Not present in many DTAAAs
- ▶ Consultancy services
- ▶ “Make Available”
  - ▶ Enabled to apply the technology contained therein
    - ▶ For his own benefit
    - ▶ Without recourse to seller
    - ▶ In his own right
  - ▶ India-US Protocol

# TDS on Fees for Technical Services

- ▶ Design, Development, Supply of design & drawings
- ▶ Testing, Certification services, etc.
- ▶ Professional and Legal services
  - ▶ Article 12 vs. Article 14
- ▶ Participation in conferences, workshops, etc.
- ▶ Standard Facility payments
- ▶ Manpower Supply
- ▶ Section 44BB and Section 44DA
- ▶ Commission services
- ▶ Construction, assembly, mining or like project
  - ▶ Mineral oil included

# Impact of Section 115A

- ▶ Rate @ 10% u/s115A for Royalty and FTS
  - ▶ 25% between 1<sup>st</sup> April 2013 to 31<sup>st</sup> March 2015
  - ▶ Can this be rate be applied?
- ▶ At the rate specified in the relevant provision of the Act
  - ▶ Rate as per deduction provisions – 194J, 194C, 194I, etc.,
    - ▶ Not as per substantive tax provisions like S. 115A
- ▶ Section 195 refers to “rates in force”
  - ▶ Section 2(37A)(iii) "rates in force" means -
    - ▶ for the purposes of deduction of tax under section 195, the rate or rates of income-tax specified in this behalf in the **Finance Act** of the relevant year or the rate or rates of income-tax specified in an **agreement** entered into by the Central Government **under section 90**, whichever is applicable by virtue of the provisions of section 90
- ▶ 44DA r.w. Section 115A



# TDS on Capital gains

- ▶ On sale of shares
  - ▶ Mauritius & Singapore DTA reliefs withdrawn
    - ▶ But grandfathering provided
- ▶ On sale of property
  - ▶ Deduction on gross amount or capital gain?
  - ▶ Documents required to correctly compute gain
  - ▶ Can CA give certificate?
- ▶ On income earned by FIIs
  - ▶ Section 196D(2)
- ▶ On gains earned by NRIs
  - ▶ On non-repatriable capital gains earned by NRIs from PIS

# TDS on Reimbursement of expenses

- ▶ What is directly taxable is taxable even if reimbursed
- ▶ Facts & supporting very important
- ▶ Pure Reimbursement non-taxable payments with no mark-up – no TDS
  - ▶ A P Moller Maersk A S [2017] 392 ITR 186 (SC)
- ▶ Reimbursement with mark-up
- ▶ Allocation of Shared Costs
- ▶ Third-party services
- ▶ Incidental expenses
- ▶ Salary / Living Allowances

# TDS on Interest earned by NRIs

- ▶ Interest incomes earned by NRIs are taxable at normal rates
  - ▶ 20% under Chapter XIA
- ▶ Only NRO interest taxable
- ▶ NRE and FCNR interest exempt from tax
- ▶ NRE interest exempt if Non-resident under **FEMA**
  - ▶ Section 10(4)(ii)
- ▶ FCNR interest exempt if NR or RNOR under **Income-tax**
  - ▶ Section 10(15)(fa)



# TDS on Interest payments

## Leveraged FCNR deposits

- ▶ NRI takes a loan from foreign bank abroad.
- ▶ Funds are invested in FCNR deposits in India.
- ▶ Is interest paid to foreign bank taxable in India?
  
- ▶ Interest paid by non-resident to non-resident is taxable in India if income is covered u/s. 9(1)(v).
  
- ▶ Payment of interest is **not for doing business in India by the payer**. Hence interest paid is not taxable.

# TDS on Interest payments

## Leveraged FCNR deposits

- ▶ Mr. A, NRI holds FCNR deposits from November 2013:
  - ▶ USD 3 million on which loan of USD 2.5 million taken from Singapore Bank
  - ▶ USD 5 million on which loan of USD 4.5 million taken from foreign branch of Indian Bank
  - ▶ Spread of around 3%
  - ▶ Returns to India in May 2015 and is FEMA and tax resident from date of return
- ▶ Issues:
  - ▶ Can he maintain FCNR deposits on return to India?
  - ▶ Can he repay overseas loans out of FCNR deposits on maturity?
  - ▶ Tax on interest income
  - ▶ Will deduction be allowed of interest paid on overseas loans?

# TDS on Interest payments

## Leveraged FCNR deposits

- ▶ Issues:
- ▶ FCNR Deposits are Indian assets
- ▶ Can he maintain FCNR deposits on return to India?
  - ▶ FCNR deposits can be maintained till maturity
  - ▶ On maturity can be converted in to Resident Deposits or RFC account
- ▶ Can he repay overseas loans out of FCNR deposits on maturity?
  - ▶ In general, not allowed to repay overseas loans out of Indian funds
  - ▶ RFC account can be used to repay loans
- ▶ Tax on interest income at normal slab rates or 20% under Chapter XIIA
  - ▶ Exemption under Sec. 10(15)(fa) only for NR and RNOR
  - ▶ Taxable under the head 'income from other sources'

# TDS on Interest payments

## Leveraged FCNR deposits

- ▶ Issues:
- ▶ Will deduction be allowed of interest paid on overseas loans?
- ▶ Interest paid on funds borrowed for earning income allowable as a deduction – Section 57(iii)
  - ▶ No deduction allowed under Ch. XIIA (benefit of 20%)
  - ▶ Interest paid outside India allowed only after TDS - Section 58(ii)
    - ▶ Interest on overseas loans by foreign lender not taxable in India
    - ▶ Unless paid by a resident for earning income from a source within India (Interest on Indian FCNR Deposits)
    - ▶ Therefore, interest paid taxable in India
    - ▶ Without TDS, interest paid not allowed as a deduction
    - ▶ Double whammy!
    - ▶ Interest earned taxable without deduction of interest paid on loans!
  - ▶ Interest paid to branch of Indian bank
    - ▶ Payment to a resident covered under Sec. 194A
    - ▶ No tax to be deducted at source
    - ▶ Interest paid on loan allowed as deduction

# TDS on Interest Payments

## On investments abroad

- ▶ NRI has obtained loans abroad and invested abroad.
- ▶ He returns to India and becomes a resident.
- ▶ Is interest paid to foreign bank taxable in India?
  
- ▶ Interest paid by a resident to non-resident is taxable in India if income is covered u/s. 9(1)(v).
  
- ▶ **Source of income is outside India.** Hence interest paid is not taxable.

# Salary

- ▶ Salary is deemed to accrue in India if:
  - ▶ services are rendered in India. Rest period before and after the services are deemed to accrue in India.
  - ▶ salary is paid by Government to an Indian citizen for services outside India.

## Salary – some issues

- ▶ Salary received by a non-resident in India – is taxable in India u/s. 5. Only if there is a DTA, tax may be saved.
  - ▶ Salary received in NRE Account by non-resident seafarers
- ▶ Person employed by an Indian company, and posted in a country with which there is no DTA.
- ▶ ESOPs, Leave encashment – spread over a few years and across different countries. Should proportionate amounts be considered, or receipt in the final year should be considered?



## TDS on transfers by NRIs

- ▶ **Transfers from NRI's own NRO account to own NRE account:**
- ▶ Majority of remittances by an NRI are from his own NRO account
- ▶ Transfers from one's own bank account to another bank account
  - ▶ No element of income involved
  - ▶ Akin to transfer of money from one pocket to another
  - ▶ Deduction of tax at source is not required at all
- ▶ However, almost all banks want certainty that taxes are paid
  - ▶ Hence CA certificate becomes essential



## TDS on transfers by NRIs

- ▶ CA must look at the following before issuing a certificate for such a transfer:
- ▶ Find out the source of funds lying in NRO account
  - ▶ Trace them back to the incomes comprised therein
  - ▶ Can be a cumbersome task if funds are lying since years
- ▶ Income-tax returns filed by the NRI in India for the period concerned
- ▶ Relevant years' Form 26-AS or TDS certificates
- ▶ Documents and issues pertaining to each type of income
- ▶ Transfers directly from third-parties into NRI's NRE Account

## TDS on transfers to NRIs

- ▶ **Transfers directly from third-parties into NRI's NRE Account:**
- ▶ Apart from documents listed above, third-parties can ask for following additional documents depending on facts:
  - ▶ a certificate from the NRI's assessing officer under section 197;
  - ▶ an undertaking or indemnity bond from the NRI;
  - ▶ an opinion from a consultant in case of controversial issues; etc.
- ▶ Payer would also need to obtain a CA certificate and provide Forms 15CA & 15CB

## TDS on transfers to NRIs

- ▶ **Transfers from third-parties in to NRO Account of NRI:**
- ▶ Bank crediting the amount to the NRO account does not ask for compliance under Sec. 195(6) as no remittance is being made outside India
- ▶ However, as per Sec. 195(6), information is to be furnished by the payer - irrespective of whether the amount is remitted outside India or not
  - ▶ Payer must keep on record the Form 15CB or ITO certificate as the tax office can always call for it later
- ▶ Forms filed at this stage can be helpful in transferring the funds by NRI from NRO to NRE account
  - ▶ NRIs should ideally obtain and keep on record Forms filed by the payer at the time of payment to NRO account itself

# TDS from Other payments

- ▶ On payments to Agent of Non-resident as per Sec. 163
- ▶ On payment by a firm to NR partners
- ▶ On payments through credit cards, bitcoins, paypal
- ▶ On payments made by a branch to its HO
  - ▶ New explanation for interest inserted from AY 2016-17
- ▶ On payment in kind
- ▶ On payment without remittance
- ▶ On gifts to NR non-relatives

## TDS on payments covered by Sections other than Sec. 195

- ▶ Payment of salary (S. 192).
- ▶ Payment to sportsman, entertainer or sports association u/s. 115BBA (S. 194E).
- ▶ Income on units u/s. 115AB (S. 196B).
- ▶ Income on GDRs u/s. 115AC (S. 196C).
- ▶ Income of FIIs u/s. 115AD (S. 196D).
  
- ▶ Winnings from horse racing, Lottery, puzzle, card games or any other game u/s. 115BB (S. 194B and S. 194BB). (R + NR)

## TDS on payments covered by Sections other than Sec. 195

- ▶ Interest on Infrastructure Debt Fund referred to in S. 10(47) (S. 194LB). (R + NR)
- ▶ Income (interest) distributed by a business trust to a non-resident unit holder (S. 194LBA(2)).
- ▶ Income (other than that referred to in S. 10(23FBB) received by a non-resident unit holder of investment fund) (S. 194LBB(ii)).
- ▶ Income in respect of investment in securitisation trust (S. 194LBC(2)).
  
- ▶ Interest to non-resident on Long-term infrastructure bond, loan approved by Central Government (S. 194LC). (R + business trust)
- ▶ Interest on rupee bonds payable to FII and QFI (S. 194LD).

# Equalisation Levy

- ▶ Result of BEPS Action Plan 1 Report
- ▶ Tax on income of Non-residents which was not liable to tax in India due to e-commerce
- ▶ EL forms part of Finance Act 2016 and is outside the IT Act
  - ▶ DTAA not applicable
- ▶ Covers Online advertisement; any provision for digital advertising space or facilities/ service for the purpose of online advertisement;
- ▶ EL not payable if NR has PE in India to which such payments are effectively connected
  
- ▶ 6% tax deductible on gross amount payable
  - ▶ By every resident or Indian PE of Non-resident
  - ▶ If payment exceeds Rs. 1,00,000
  - ▶ Same rate applicable with or without grossing up
- ▶ No double-taxation
  - ▶ Once EL paid, payment exempt from income-tax under Sec 10(50)

## Exemption from TDS

- ▶ Shipping income under S. 172 [Circular no. 723 dated 19.9.1995].
- ▶ Capital Gain earned by FII [S. 196D(2)].
- ▶ Payment of interest by Offshore Banking unit to a non-resident or not ordinarily resident [S. 197A(1D)].



# Foreign exchange rate

- ▶ Conversion rate has to be considered as on the date the tax is required to be deducted at source
  - ▶ Not when it is deducted at source [Rule 26]
- ▶ If the rate fluctuates between the date of deduction of tax, and payment to non-resident, the difference has to be ignored
  - ▶ Confirmed by Honda Motorcycles 56 taxmann.com 238 Delhi ITAT

# Consequences & Refund of TDS

## Implication of non deduction of tax

- ▶ Interest, penal & prosecution consequences
- ▶ Disallowance of expenses u/ ss. 40(a)(i) and 58(1)(a)(ii)
- ▶ Payer may be considered as representative assessee. [Ss. 160 & 163].
  
- ▶ Assessee in default - **Relief u/s. 201 not available** even if the non-resident pays tax on his own.

## Assessee in Default

- ▶ If a person does not deduct tax, or does not pay tax, or after deducting tax does not pay it, he is considered as Assessee in Default.
- ▶ Time limit for issuing an order u/s. 201 – 7 years from the end of the year in which payment is made or credit is given to NR.

# Representative Assessee

- ▶ S. 160(1)(i) – Agent of the non-resident in respect of income u/s. 9(1), including agent u/s. 163.
- ▶ Representative assessee is an assessee for Income-tax Act – S. 160(2).
- ▶ Sec. 163 - Agent in relation to a non-resident includes the following:
  - ▶ one who is employed by a non-resident.
  - ▶ one who has business connection with a non-resident.
  - ▶ from or through whom the non-resident is in receipt of any income directly or indirectly.
  - ▶ trustee of a non-resident.
  - ▶ resident or non-resident who has acquired by way of transfer, capital asset in India.

## Representative Assessee

- ▶ **Exceptions:**
- ▶ If a broker in India deals with a non-resident broker and not with the NR principal;
- ▶ Transactions are carried on in the ordinary course of business through the NR broker;
- ▶ The NR broker is carrying on transaction in the ordinary course of business and not as principal;
- ▶ the broker in India will **NOT** be considered as agent.

## Disallowance of expenditure – S. 40(a)(i)

### ▶ **Up to FY 2014-15:**

- ▶ If tax was deducted in one year but paid next year within the time allowed u/s. 200(1), expenditure was allowed in the year of incurring expenditure.
- ▶ If tax was paid after the due date, expenditure was allowed in the year of payment of tax.

### ▶ **With effect from FY 2015-16:**

- ▶ If tax is deducted in the year of payment of expenditure, and paid **before due date** of filing the income-tax return, expenditure will be allowed in the year of deduction.
- ▶ If tax is deducted in the year of payment of expenditure, and paid **after due date** of filing the income-tax return, expenditure will be allowed in the year of payment of tax.
- ▶ If tax is deducted in the year **subsequent to the year of payment of expenditure**, expenditure will be allowed in the year of payment of tax.

## Disallowance of expenses – S.40(a)(i)

- ▶ If tax is not deducted on payment of expenditure to non-resident, expenditure will not be allowed.
- ▶ Is Disallowance for amounts payable at year end; or expenses paid during the year also?
- ▶ After a lot of ping-pong in cases, latest **SC decision in Palam Gas Service** rules that “payable” includes amounts which are “paid” during the year also.
- ▶ With disallowance for residents u/s 40(a)(ia) restricted to 30%, the issue of non-discrimination remains.
  - ▶ Herbalife International India (P.) Ltd. [2016] 69 taxmann.com 205



## Disallowance of expenses – S.40(a)(i)

- ▶ **Virola International - 42 taxmann.com 286 Agra ITAT (Feb. 2014)**
  - ▶ **Ishikawajima (288 ITR 408)(SC)** – FTS is taxable only if non-resident renders services in India.
  - ▶ To counter this, Section 9 amended retrospectively from 1962 to clarify that rendering of services in India is not necessary. Finance Act passed on 8<sup>th</sup> May 2010.
  - ▶ However, the payer cannot know how the law will be amended. Hence even though income earner is taxable due to retrospective change in law, payer cannot be disallowed expenses (payments before 8<sup>th</sup> May 2010).

## Disallowance of salary – S. 40(a)(iii)

- ▶ If tax is not deducted on:
  - ▶ **salary paid outside India, or**
  - ▶ to a non-resident,  
salary expenditure will not be allowed.
- ▶ If tax is paid in subsequent year, expenditure will be allowed in the year of incurring the expenditure.
  - ▶ Difficulty if assessment is over.

## Disallowance of expenses against “other incomes” – S. 58

- ▶ For Interest expenditure - S. 58(1)(a)(ii):
  - ▶ If tax is not deducted on **interest paid outside India**, interest expenditure will not be allowed.
  - ▶ If tax is paid in subsequent year, interest will be allowed in the year of incurring the expenditure.
    - ▶ Difficulty if assessment is over.
- ▶ For Salary expenditure - S. 58(1)(a)(iii):
  - ▶ If tax is not deducted on **salary paid outside India**, salary expenditure will not be allowed.
  - ▶ If tax is paid in subsequent year, salary will be allowed in the year of incurring the expenditure.
    - ▶ Difficulty if assessment is over.

# Penalties & Other consequences

## ▶ **Penalties:**

- ▶ For failure to pay tax deducted – S. 221
- ▶ For failure to deduct tax – S. 271C
- ▶ For failure to file TDS return – S. 272A
- ▶ **For failure to furnish information or for furnishing inaccurate information under S. 195 – S. 271-I – Rs. 1,00,000**
- ▶ **On CA for furnishing incorrect information in certificate – S. 271J – Rs. 10,000 for each such certificate**

## ▶ **Other consequences:**

- ▶ Charge on all the assets – S. 201(2)
- ▶ Prosecution for failure to pay tax deducted – S. 276B
- ▶ Tax may be recovered from any assets which are or may at any time come within India – S. 173

# Refund of TDS

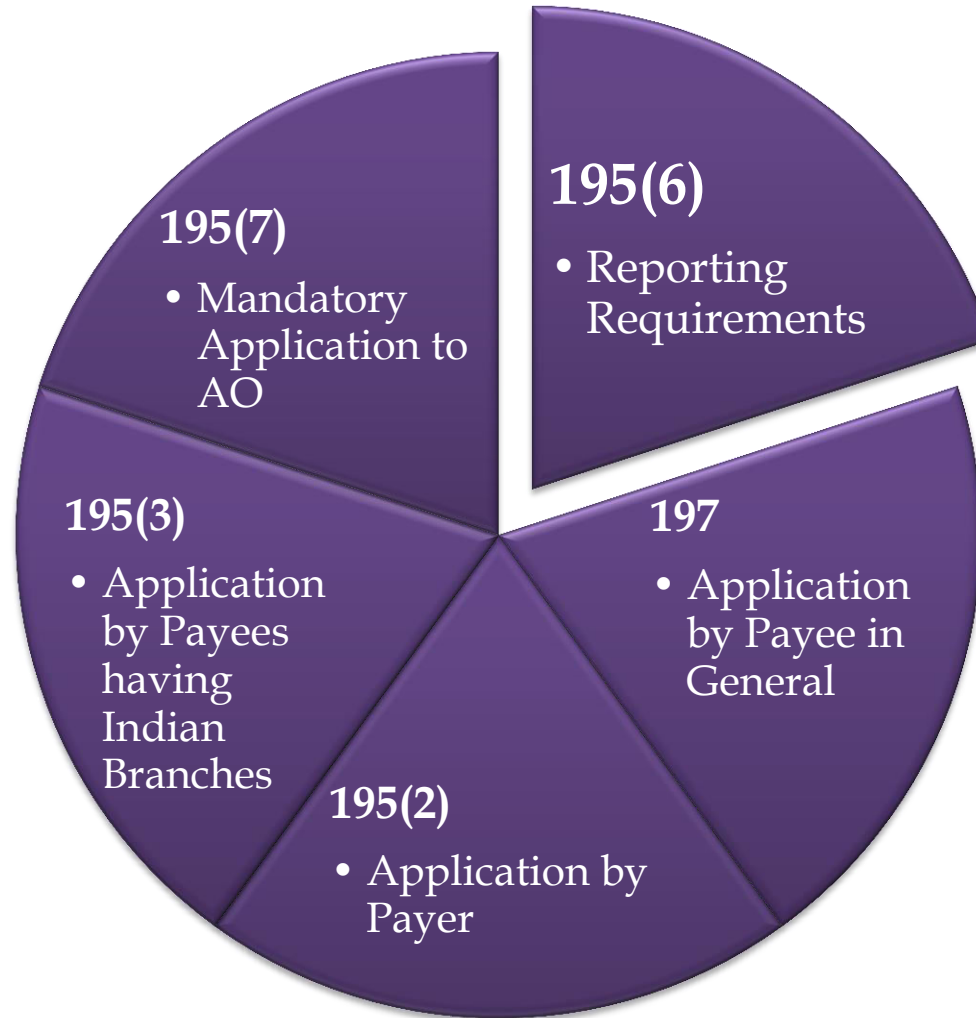
- ▶ Normally the recipient of income is required to file a return and claim refund for excess TDS.
- ▶ Circular No. 7 dated 23.10.2007 and No. 7 dated 27.9.2011 – Administrative machinery for refund for specified cases.
- ▶ Time limit – 2 years from the end of financial year in which tax is deducted.
- ▶ Applicable to cases where:
  - ▶ Contract is cancelled in whole or partially
  - ▶ Change in law, or order, reducing tax liability
  - ▶ Mistakes in deduction or payment of tax
- ▶ Rule 31A(3A) - Form 26B has been prescribed.

# Certificates & Procedures

# Certificates & Procedures

- ▶ Snapshot of Certification Provisions
- ▶ Reporting u/s. 195(6)
- ▶ Remittance Procedures
- ▶ Form 15CA
- ▶ Form 15CB - Analysis
- ▶ Sec. 195(2) vs. Sec. 197
- ▶ Sec. 197 - Rules & Form
- ▶ Application by the Payee - Sec. 195(3)
- ▶ Mandatory application - Sec. 195(7)

# Snapshot of Certification Provisions





## Declaration and CA certificate

- ▶ Under section 195(6) declaration has to be filed **whether the payment is chargeable to tax or not.**
- ▶ Rule 37BB has been amended with effect from 1.4.2016. Declaration by the payer in Form 15CA has to be filed online.
- ▶ Between 1.6.2015 and 31.3.2016, old rule 37BB and Forms apply.

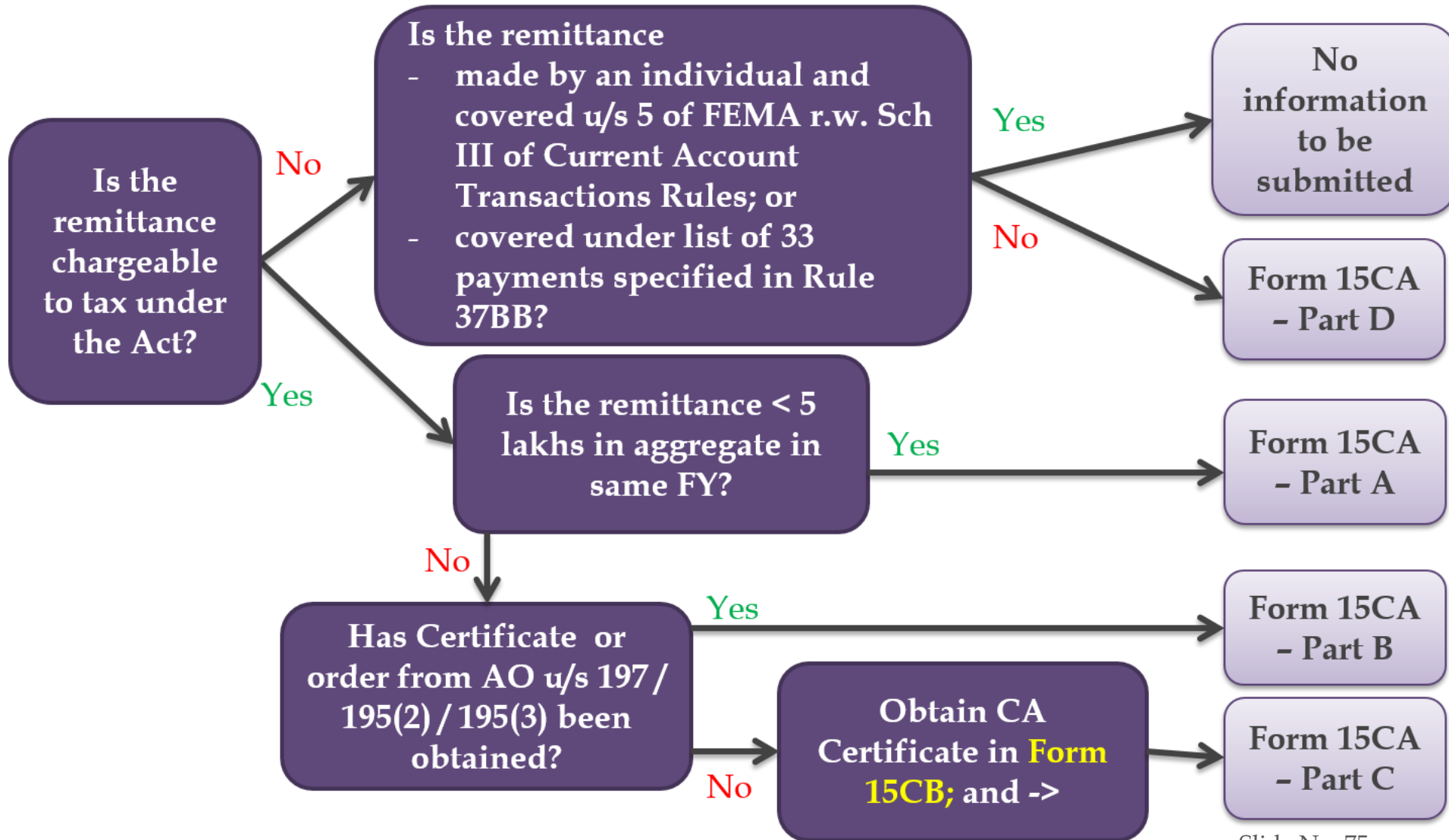
## Declaration and CA certificate

- ▶ No facility of correction. If there is an error, withdraw the form and file a fresh form.
- ▶ Very little space to give reasons for lower / NIL TDS.
- ▶ CA certificate / AO order for TDS to be given to the bank with the declaration for payment.
- ▶ Who will sign 15CB?
  - ▶ Relative cannot sign – S. 288, expln. (g)

## Form 15 CA - Information

- ▶ **Preliminaries:**
- ▶ Form to be submitted prior to remittance.
- ▶ Form can be withdrawn only within 7 days.
  
- ▶ Online submission necessary for 15CA and 15CB. Print to be submitted to bank.
  
- ▶ Remittance can be made to a country different from residence of payee.

# Form 15CA – Which part applies?



## Forms 15 CA - Information

- ▶ Even if remittance is not chargeable to tax, **following remittances do not require the form:**
- ▶ by individual under Schedule III of Current Account Regulations under FEMA.
- ▶ Payment for 33 listed items which include:
- ▶ Business payments – import of goods, airlines passages.
  - ▶ Investment abroad.
  - ▶ Personal payments – medical, education.
  - ▶ Gifts and donations.

## Form 15 CA - Information

- ▶ If income is taxable under the ITA but exempt under DTA, is form is required? (E.g. Capital gain on shares earned by Singapore resident is not taxable due to DTA). Better to submit.
- ▶ Part C or Part D? Purpose is to provide logical information to Government. Part C should be filled up. (Part D applies if sum is not chargeable to tax under ITA.)

## Form 15 CA - Information

- ▶ Parts B/C require PAN or TAN of deductor – even if the deductor may not need a PAN (e.g. agriculturist). Or there may be no TDS.
- ▶ Parts A / D do not require PAN or TAN.
- ▶ However utility asks for any one of PAN or TAN for any Part.
- ▶ Form 15CA requires online filing for which PAN is required. Thus PAN is indirectly mandatory.
- ▶ For deductee, PAN is optional.

# Section 195(2) vs. Section 197

Section 195(2)	Section 197
Application by Payer - mandatory?	Application by assessee (Payee)
Application for appropriate proportion of the sum chargeable to tax – generally rate is prescribed.	Application for lower rate or nil rate for deduction of tax at source
Application to be made for each payment. Binding only for particular transaction.	Application can be for a particular period.  Applicable to period for which issued.
Appealable u/s. 248	Not appealable – only writ petition
Doubts on grant of total exemption	Can provide certificate for deduction at nil rate of tax
Application to be made on plain paper	Application in Form 13



## Section 197 – Rules and Form

- ▶ Rule 28A
  - ▶ Form 13
- ▶ Rule 28AA – Conditions applicable
  - ▶ Determination of existing and estimated tax liability based on
    - ▶ Tax payable on estimated income of previous year
    - ▶ Tax payable on assessed/returned income of past 3 years
    - ▶ Existing tax liability
    - ▶ Advance tax payment & Tax deducted at source
  - ▶ Certificate valid for such period of the previous year as specified
  - ▶ Will be issued direct to the person responsible for deduction of tax at source

## Application by Payee -195(3)

- ▶ Payee eligible as per Rule 29B can only apply
  - ▶ Foreign Bank having Indian Branch
    - ▶ For interest or any other sum not being dividends
  - ▶ Foreign Company having Indian Branch
    - ▶ For any sum not being interest or dividends
- ▶ Conditions
  - ▶ Income receivable on its own account
  - ▶ Regularly assessed to tax
  - ▶ Not in default of any tax, interest, penalty or fine
  - ▶ Available for a non-banking company
    - ▶ Carrying on business since last five years
    - ▶ Value of fixed assets exceeds Rs. Fifty Lakhs
- ▶ Application in Form 15C for Banks & Form 15D for others
- ▶ No prescribed format for issue of certificate, valid for that FY
- ▶ Certificate not appealable

## Mandatory application - Section 195(7)

- ▶ Mandatory application to AO for determination of sum chargeable to tax
- ▶ Even if sum is not chargeable to tax as per provisions of the Act
- ▶ Specify a class of persons or cases by notification
  - ▶ No notification yet
- ▶ General or special order of the AO
- ▶ Once order provided, deduction of tax from such sum
- ▶ No provision for appeal?

# Approach & Safeguards

# Approach & Safeguards

- ▶ Objectives
- ▶ Checklist - Facts
- ▶ Checklist - Tax Treaty
- ▶ Some Practical Aspects

# Objectives

- ▶ To determine taxability in India
- ▶ To know the actual overall tax cost
  - ▶ How would it be treated in the residence country
- ▶ To provide a complete and practical solution
- ▶ Am I safeguarding myself properly?

## Checklist - Facts

- ▶ Clearly examine facts. Conduct due diligence.
- ▶ Details about the transaction
- ▶ Residential status of the assessee
  - ▶ Tax Residency Certificate & Form 10F
  - ▶ PE?
- ▶ Identify the legal status of the tax payer
  - ▶ Obtain KYC - incorporation documents / passport copy.
- ▶ Ascertaining the nature of income and its characterisation
- ▶ Obtain a declaration of facts from the recipient:
  - whether business is done outside India.
  - whether there is an office in India.
  - whether there is a PE / BC in India.
- ▶ For complex issues, or business payments, obtain tax department's certificate.

# Checklist - Tax treaty

- ▶ Determining the Country of Residence of tax payer (CoR)
- ▶ Determining the Country of Source of income (CoS)
- ▶ Applicability of treaty
  - ▶ Residential status
  - ▶ Taxes covered
  - ▶ Persons covered
- ▶ Must check
  - ▶ Technical Explanation (US)
  - ▶ Protocols and Memorandum of Understandings
  - ▶ MFN clause
  - ▶ LOB clause
- ▶ References
  - ▶ OECD and UN Model Convention Commentary
  - ▶ Commentaries by learned authors
    - ▶ Klaus Vogel
    - ▶ Arvid Skaar



## Some practical aspects

- ▶ Cost benefit analysis
  - ▶ Credit in the home country against tax paid in India
- ▶ Tax return has to be filed
  - ▶ Final Assessment only on filing of tax return
- ▶ Complex legal structures & Unresolved issues
  - ▶ LLPs / Partnerships
  - ▶ Triangular treaty situation
- ▶ Law is always trying to catch up to business
  - ▶ Eg - E-commerce

## Some practical aspects...contd.

- ▶ Deemed anti-avoidance provisions
  - ▶ TP adjustments
  
- ▶ Consider for cross-checking
  - ▶ Equalisation Levy
  - ▶ FEMA
  - ▶ Customs
  - ▶ GST / Service tax
  - ▶ R & D cess

# Thank you

- ▶ Questions and comments are welcome.

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## Clause-wise break up - Section 195(1)

- ▶ Any person responsible for paying
- ▶ To a non-resident
- ▶ Or a Foreign Company
- ▶ Any interest or any other sum
- ▶ **Chargeable to tax** under the provisions of this Act
- ▶ At the time of credit of such income to the account of the payee or
- ▶ At the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode,
- ▶ Whichever is earlier,
- ▶ Deduct income-tax thereon
- ▶ At the rates in force

# Residential Status – Flow Chart

