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TDS on payments to non-residents

Section 195 of Income-tax Act

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Taxability of non-residents

Income-tax Act and Tax Treaty



Taxability of non-residents

Income-tax Act and Tax Treaty

- Section 90 of Income-tax Act allows a non-resident taxpayer to opt between provisions of Income-tax Act and Articles of tax treaty, whichever is beneficial to the taxpayer

Nature of income	Income-tax Act	Tax treaty
Business or profession	Section 9(1)(i)	Articles 5, 7, 14
Salary income	Section 9(1)(ii)	Article 15
Dividend income	Section 9(1)(iv) and 115A	Article 10
Interest income	Section 9(1)(v) and 115A	Article 11
Royalties	Section 9(1)(vi) / (vii) and 115A	Article 12
Capital Gains	Section 9(1)(i) and 45	Article 13

Taxability of non-residents

Income-tax Act and Tax Treaty

- Applicability of tax treaty
 - Tax resident of the country of which the tax treaty is sought to be applied – generally, it is Article 4 that deals with residential status and contains tie breaker rules
 - Taxability of non-resident as per relevant Article(s) of tax treaty that specifically deal with income of the non-resident
 - Evaluate if non-resident has a Permanent Establishment in India

Taxability of non-residents

Documents for availing tax treaty benefits

- Following list of documents a must
 - Tax Residency Certificate (TRC) issued by home country of the non-resident in terms of tax treaty with India
 - Declaration in Form 10F (if required) as prescribed by Income-tax Rules
 - Self-declaration by non-resident in relation to Permanent Establishment in India in terms of tax treaty with India

Overview

Section 195 of Income-tax Act



Overview

Scheme of section 195

Section	Brief Description
195(1)	Any person paying to non-resident required to deduct tax if such sum is chargeable tax in India
195(2)	Lower or Nil tax deduction certificate – application by payer
195(3)	Lower or Nil tax deduction certificate – application by payee
195(4)	Validity of certificate u/s 195(3)
195(5)	Power of CBDT to issue notification related to grant of certificate
195(6)	Requirement of Form 15CA / Form 15CB

Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest (not being interest referred to in section 194LB or section 194LC) or section 194LD or any other sum chargeable under the provisions of this Act (not being income chargeable under the head "Salaries") shall, 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 :

Section 195(1)

Overview of section 195(1)

Key discussion points

- Any person responsible for paying to a non-resident
 - Amended definition of residential status of non-resident company vide Finance Bill 2015 – Place of Effective Management
 - Explanation 2 to section 195 inserted by Finance Act 2012
 - Supreme Court decision in the case of Vodafone
 - Satellite Television Asian Region Ltd. (99 ITD 91) (Mum ITAT)
- Sum chargeable under the provisions of this Act
 - Taxability of non-resident as per provisions of Income-tax Act, 1961
 - Taxability of non-resident as per India's tax treaty

Overview of section 195(1)

Key discussion points

- At the time of credit of such income to the account of the payee or at the time of payment
- Deduct income-tax thereon at the rates in force
 - Royalties / Fees for Technical Services taxable at 10% as per Budget 2015
 - Business income of Permanent Establishment
 - No surcharge / cess on rate of tax prescribed under India's tax treaties (such as for royalties, fees for technical services, interest etc.)
 - DIC Asia Pacific Pte. Ltd. (52 SOT 447) (Kol ITAT);
 - M Far Hotels Ltd. (58 SOT 261) (Cochin ITAT);
 - Sunil V. Motiani (59 SOT 37) (Mum ITAT)

Section 206AA Issues



Section 206AA

Issues

- Applicability of section 206AA while deducting TDS under section 195
- The rate of 20% under section 206AA not to be increase by surcharge / cess
- If income of non-resident (who does not have PAN) is not taxable in India on the basis of applicable India's tax treaty, section 206AA would not apply
 - Serum Institute of India Ltd. (56 taxmann.com 1) (Pune ITAT)
- If payer has deducted TDS at the rate of 20% instead of lower TDS rate that is applicable to the non-resident (for failure on the part of non-resident to furnish PAN), the non-resident may claim refund of income-tax by obtaining PAN and filing a return of income
- In case of grossing up for a non-resident (who does not have PAN), the payer would be required to gross up at the income-tax rate applicable to the non-resident and then deduct TDS at 20%

Disallowance under section 40(a) Payer



Disallowance under section 40(a)

Payer

- Disallowance under section 40(a)(i) is on the same lines as section 40(a)(ia)

Particulars	Position prior to amendment	Position post amendment
Tax deducted but not deposited within due date for paying TDS but deposited before due date of filing return of income	Allowed only in the financial year in which the tax is deposited	Allowed in the financial year in which the tax is deducted
Tax not deducted in the financial year but deposited before due date of filing return of income	Allowed only in the financial year in which the tax is deposited	Allowed only in the financial year in which the tax is deposited
Tax deducted in the financial year but deposited after due date of filing return of income	Allowed only in the financial year in which the tax is deposited	Allowed only in the financial year in which the tax is deposited

TDS Compliance Payer



TDS Compliance

Overview

Select payments	Applicable withholding tax rate	Key points in relation to payments to non-residents
Royalty	<ul style="list-style-type: none">• 25% (plus surcharge and cess) as per Act;• India's tax treaties generally provide for lower tax rate of 10-15%	<ul style="list-style-type: none">• To determine whether non-resident is eligible for lower tax rate prescribed under India's tax treaties, following documentary evidence from the non-resident may be obtained:<ul style="list-style-type: none">– Tax Residency Certificate issued by home country tax authorities in terms of relevant India's tax treaty;– Declaration in Form 10F as prescribed by Income-tax Rules;– Self-declaration by the non-resident in relation to permanent establishment in India in terms of relevant India's tax treaty.• Indian tax law requires for submission of Form 15CA and Form 15CB
Fees for Technical Services	<ul style="list-style-type: none">• 25% (plus surcharge and cess) as per Act;• India's tax treaties generally provide for lower tax rate of 10-15%• If tax treaty includes 'make available' clause, tax rate may possibly be reduced to NIL	

TDS Compliance

Tax deduction on payment to non-residents

- Payer to deduct tax and to deposit it within prescribed timelines
- Due dates of depositing tax deducted

Amount paid / credited	Due dates of deposit tax deducted
In the month of March	30 April
In other months	7th day of the following month

- Consequences of non-compliance

Defaults	Consequences
Failure to withhold tax	<ul style="list-style-type: none">• Recovery of the amount of TDS• Payment will be disallowed
Delay in withholding tax	<ul style="list-style-type: none">• 1% per month from date on which tax was due to be deducted to date on the tax is deducted
Delay in depositing tax	<ul style="list-style-type: none">• 1.5% per month from date on which tax was deducted to date on the tax is deposited

TDS Compliance

TDS Returns

- Payer to file TDS return in Form 27Q
- Due dates of depositing tax deducted

Quarter ended	Due dates for filing TDS return
30 June	15 July
30 September	15 October
31 December	15 January
31 March	15 May

- Consequences of non-compliance

Defaults	Consequences
Delay in filing TDS return	Rs. 200 late filing fee per day from due date to date of furnishing TDS return (restricted to tax deductible during the quarter)

TDS Compliance

TDS Certificates

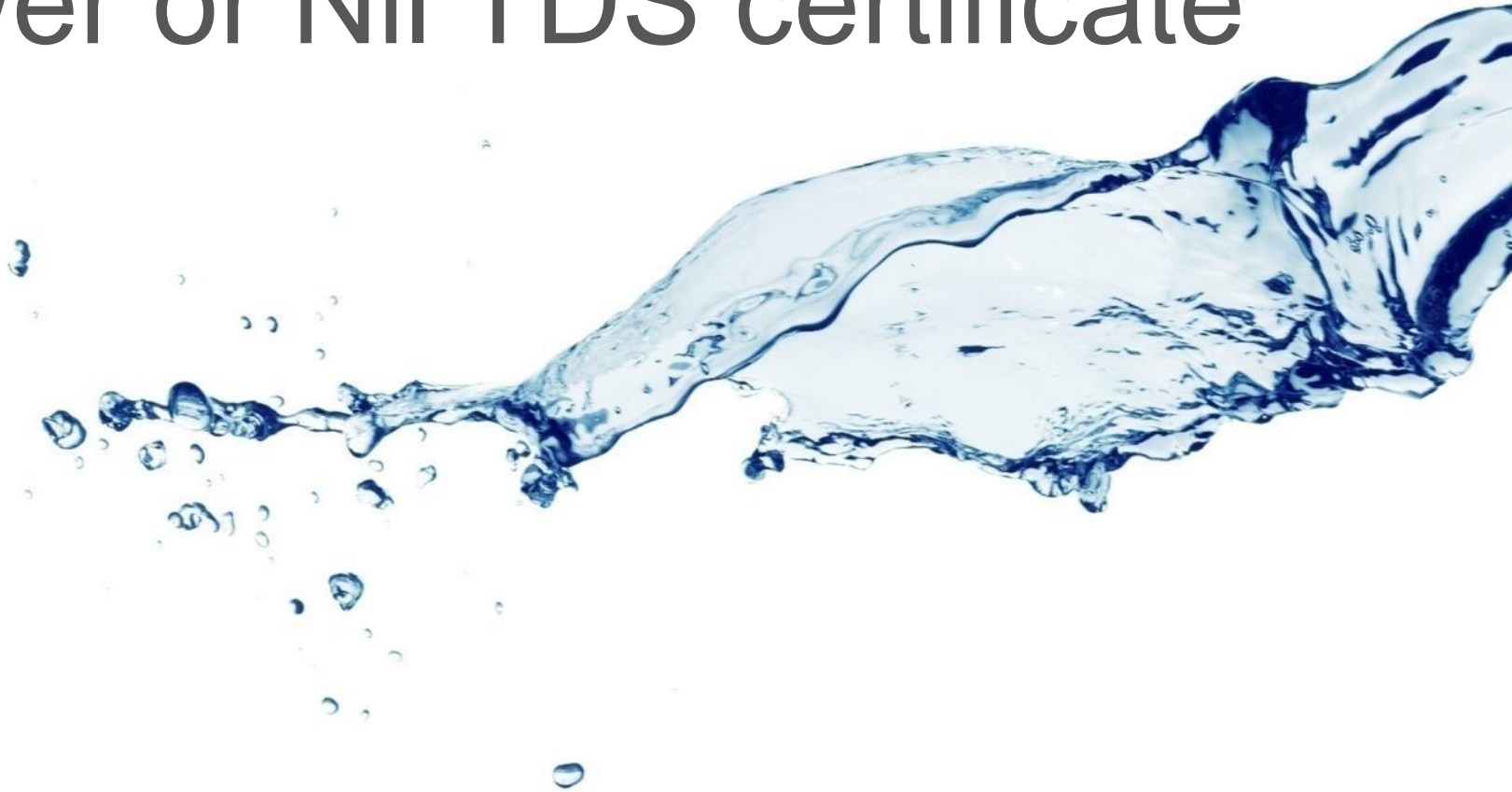
- Payer to issue TDS certificates in Form 16A
- Due dates of depositing tax deducted

Form	Due dates for issuing Form16A
Form 16A	Within 15 days from due date for furnishing quarterly TDS return

- Consequences of non-compliance

Defaults	Consequences
Delay in furnishing the WHT certificate	Penalty of INR 100 per day from due date of furnishing the withholding certificate to date of furnishing it

Remedy available to payer
Lower or Nil TDS certificate



Remedy available to payer

Lower or Nil TDS certificate u/s 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
- Decision under section 195 (2) should not be treated as a conclusion in the determination of income in the case of a foreign company
- Aditya Birla Nuvo v. DDIT (WP No. 345 of 2010) (Bom)
 - 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 AO 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 payer

CA certificate u/s 195(6)

- 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 considered
 - Evaluating if non-resident has a Permanent Establishment in India
 - Considering issues such as beneficial ownership / tax residency

Remedy available to payer

Procedure for remittance – Circular 4/2009

Remitter to obtain certificate of a Chartered Accountant in Form 15CB
(Form available at www.tin-nsdl.com)

Remitter to access the above website and electronically upload the remittance details in Form 15CA

Remitter to take a print of the filled undertaking (Form 15CA) with system generated acknowledgement number and sign it

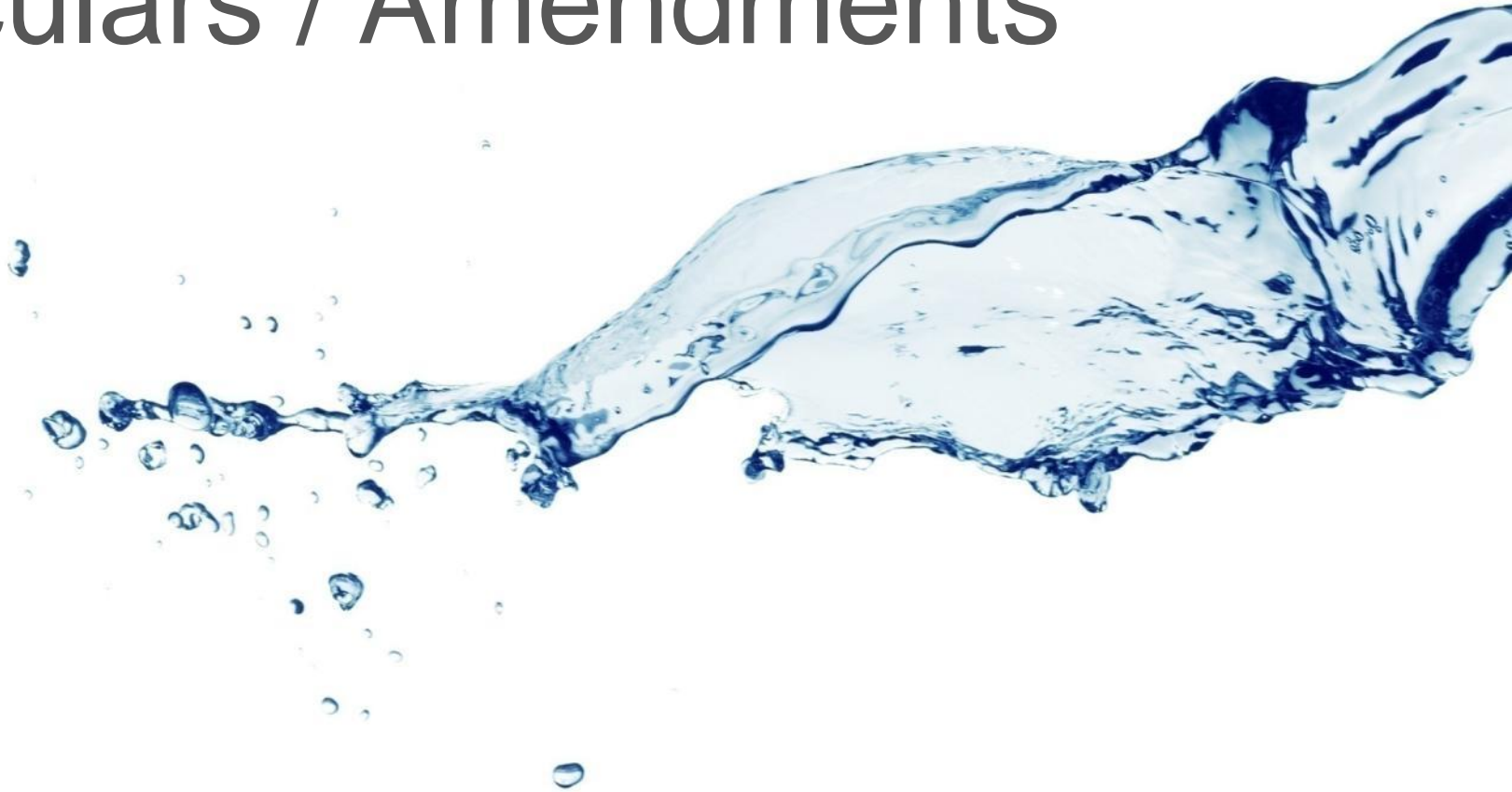
The duly signed paper Form 15CA (undertaking) and Form 15CB (certificate) is then submitted in duplicate to the RBI / authorized dealer

RBI / authorized dealer to remit the amount

A copy of Form 15CA & Form 15CB is forwarded by RBI / Authorized Dealer to the concerned Assessing Officer

Recent developments

Circulars / Amendments



Recent Developments

Circulars / Amendments

- Where there has been a failure to withhold tax as per Section 195 of the Act, disallowance under section 40(a)(i) will be restricted to appropriate proportion of the sum paid to the non-resident that is chargeable to tax under the Act
 - Circular no. 3 of 2015 dated 12 February 2015
- Dividend declared by a foreign company (shares of which derive their value substantially from assets situated in India) would not be deemed to be income accruing or arising in India as contemplated by provisions of Explanation 5 to Section 9(1)(i) of the Act and thus there would not be TDS obligation on the foreign company paying such dividend to the shareholders
 - Circular no. 4 of 2015 dated 26 March 2015

Recent Developments

Circulars / Amendments

- For the purpose of Section 194LC of the Act (which provides for a lower rate of 5% TDS on interest payments made Indian companies / business trusts on borrowings made in foreign currency), CBDT has conveyed the approval of the Central Govt. to long term infrastructure and other bonds that satisfy the below conditions:
 - Bond issue is between 1 October 2014 and 30 June 2016
 - Bond issue is in compliance of the ECD regulations of the RBI, whether under the automatic or the approval route
 - Bond issue has a loan registration number by the Reserve Bank of India
 - Bond should have an original maturity of 3 years or more
- Further, interest rate which is within the All-in-cost ceilings specified by the RBI under ECB Regulations is also approved for the purpose of Section 194LC.
 - Circular no. 15 of 2014 dated 17 October 2014

Recent Developments

Circulars / Amendments

- Tax rate on royalties / fees for technical services earned by a non-resident reduced from 25% to 10%
 - Budget 2015*
- Notified deductors to be exempt from the obligations of TAN u/s 203A. Memorandum to Finance Bill, 2015* indicated individual acquiring immovable property from non-resident will be exempt

*passed in the Lok Sabha on 30 April 2015

Recent Developments

Circulars / Amendments

- Section 9 of the Act amended vide Finance Bill 2015 to levy tax on interest that is received by a non-resident bank or any its branches outside India from its branch situated in India overriding the principle of mutuality
- Interest will be chargeable to rate tax prescribed under the Act (20% or 40%) or the applicable tax treaty and tax will have to be deducted u/s 195 of the Act accordingly
- This amendment overrules with prospective effect the decision of Sumitomo Mitsui Banking Corporation (136 ITD 66) (Mum ITAT) and other decisions following it
 - The decisions held that interest received by head office of the bank from branch in India was held not to be taxable in India since both the head office and branch were one common entity and it was not possible to make profit out of transactions with one's own self

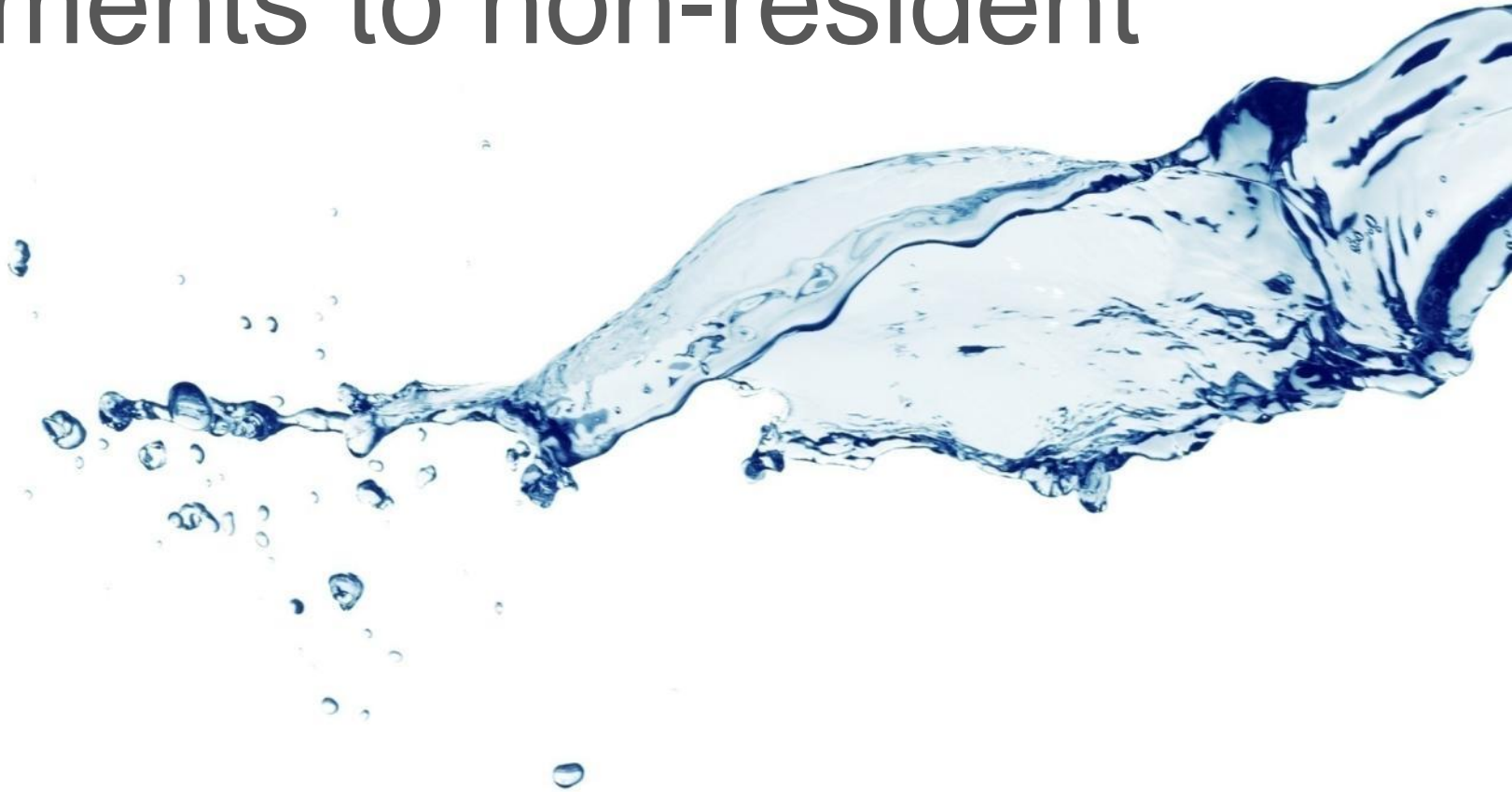
Recent Developments

Circulars / Amendments

- Section 194LD provided for concessional tax rate 5% on interest payment made to FIIs on rupee denominated bonds of Indian companies and government securities from 1 June 2013 to 1 June 2015. The benefit has been extended to interest payment up to 1 July 2017
 - Finance Bill, 2015
- Section 194LC of the Act provides for concessional rate of TDS of 5% on interest payments by Indian company to non-residents pursuant to certain moneys borrowed in foreign currency. Finance Bill, 2015 has liberalized:
 - Extending benefit to payment of interest by business trusts
 - Extending benefit to loans / issue of bonds from earlier date of 1 July 2015 to 1 July 2012
 - Extending coverage from long term infrastructure bonds to all types of long term bonds issued from 1 October 2014

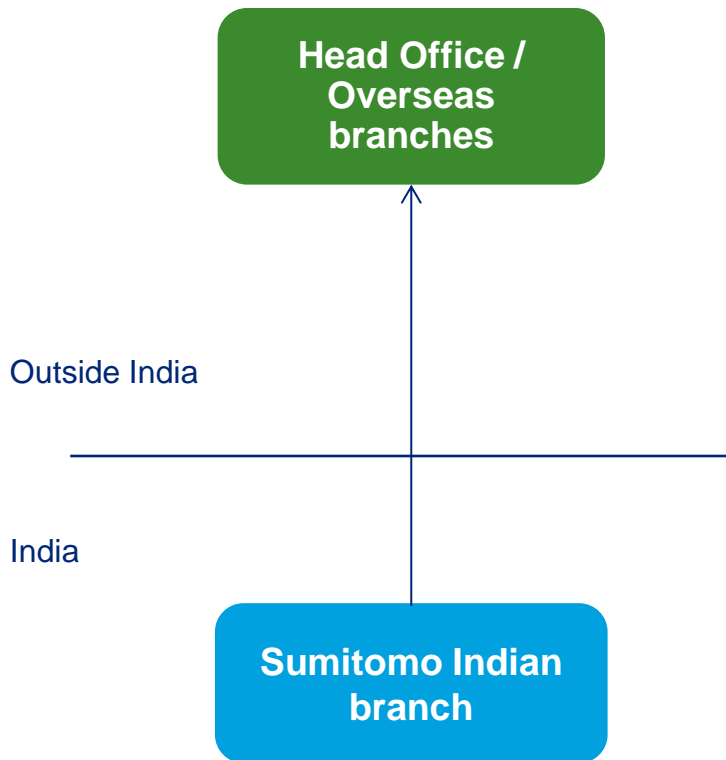
Recent Decisions

payments to non-resident



Recent Decisions

Sumitomo Mitsui Banking Corpn. (136 ITD 66) (Mumbai ITAT)



→ Payment of interest

Facts

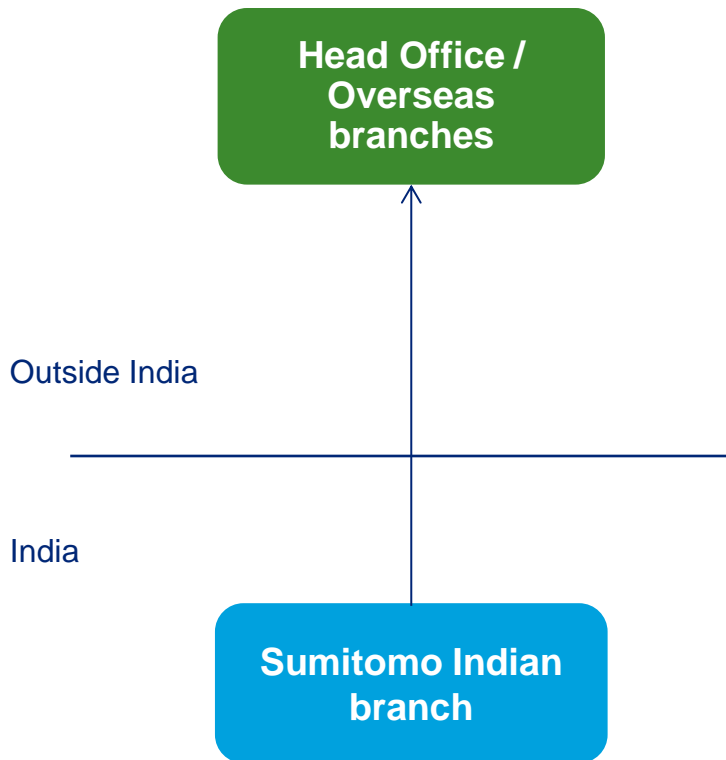
- Indian branch of foreign bank paid interest to the Head Office at Japan and other overseas branches
- Interest was claimed as deduction while computing profits attributable to Indian branches constituting PE in accordance with Article 7 of the India-Japan DTAA
- No tax was deducted at source on payment of interest to the HO at Japan and other branches

Questions before the ITAT

- Whether interest payments are allowable in the hands of branch of the bank and whether interest income is not taxable in India in the hands of Head Office of bank

Recent Decisions

Sumitomo Mitsui Banking Corpn. (136 ITD 66) (Mumbai ITAT)



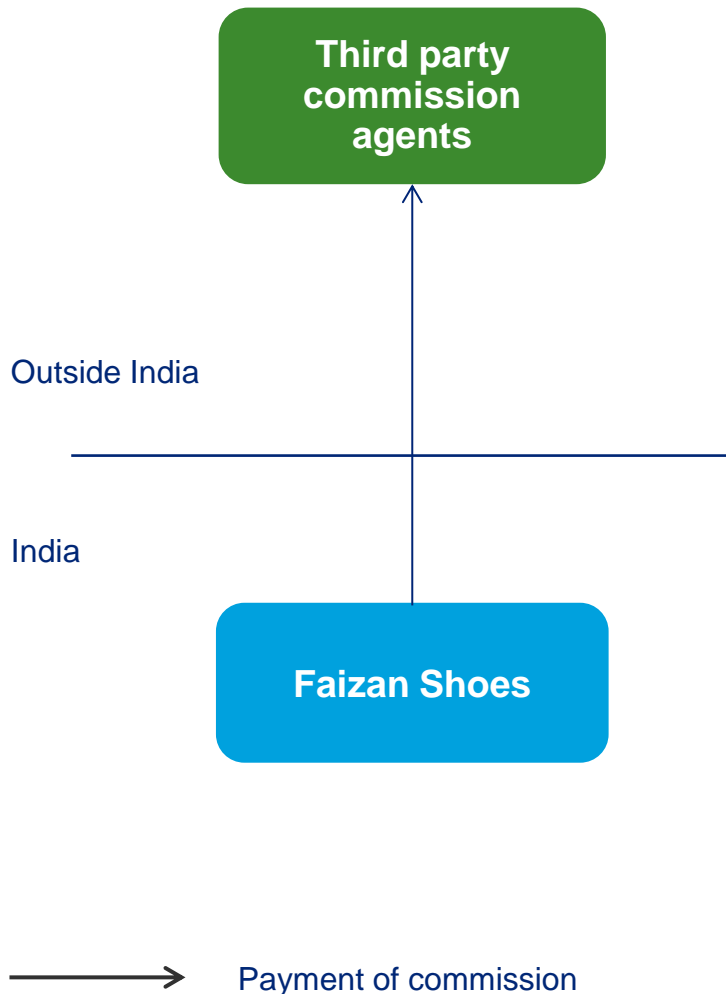
→ Payment of interest

Ruling

- As per Article 7(2) and 7(3) of India-Japan treaty and para no. 8 of the protocol, PE is to be treated as separate and distinct entity for computing profits attributable to the PE and further, in case of banking companies, interest is also to be allowed as deduction
- Even though while computing profits of PE, interest was deductible, it could not be taxed in India as income of foreign bank since being payment to self it cannot give rise to income that is taxable in India as per ITA. Further there was nothing contrary to this position in India-Japan tax treaty.
- Since interest was not chargeable to tax in India, provisions of Section 195 were not applicable and thus there can be no disallowance u/s 40(a)(i).

Recent Decisions

Faizan Shoes (P. (Ltd.) (367 ITR 155) (Mad HC)



Facts

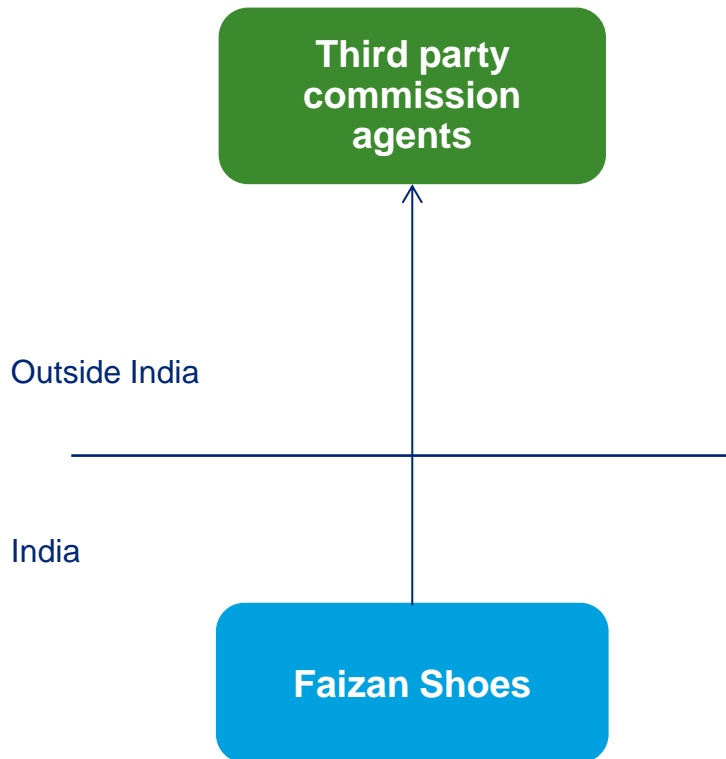
- Taxpayer entered into an agency agreement with a non-resident to secure orders from customers for export of the leather articles manufactured by the taxpayer
- Non-resident would be responsible for prompt payment in respect of the
- Taxpayer undertook to pay commission to the agent

Questions before HC

- Whether there is no disallowance u/s 40(a)(i) when as per the AO, the agent's service falls within the purview of Section 9(1)(vii) and as per explanation to Section 9, Section 9(1)(vii) applies even if non-resident does not have business connection in India or has not rendered services in India.

Recent Decisions

Faizan Shoes (P. (Ltd.) (367 ITR 155) (Mad HC)



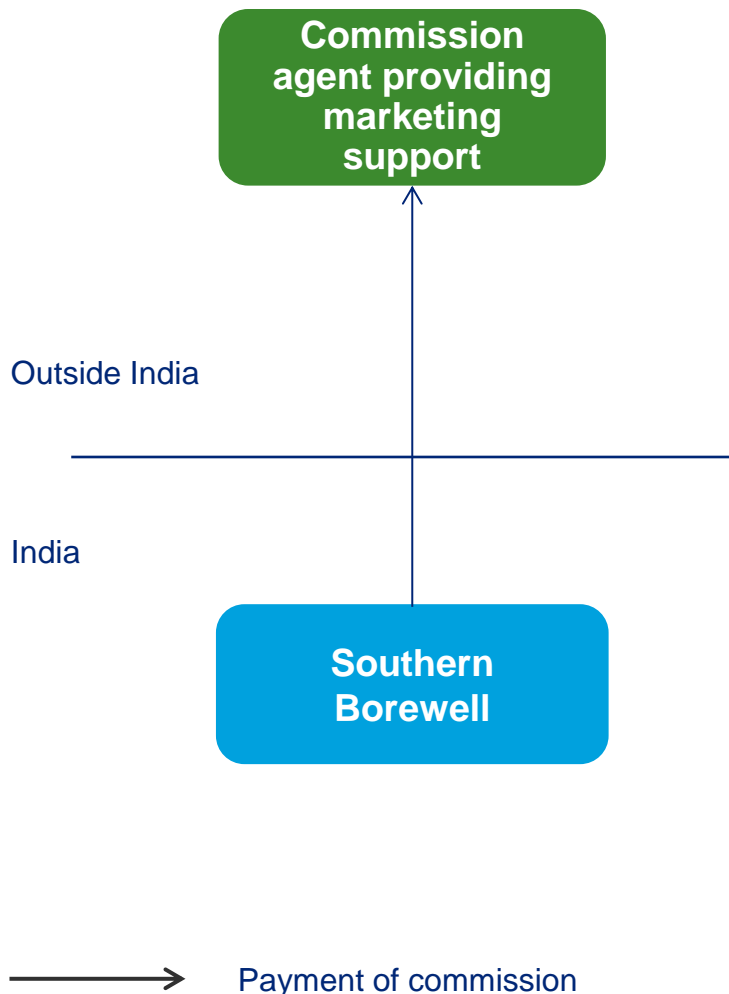
Ruling

- The High Court held that the commission agent did not provide technical services for the purposes of running the business of the assessee in India and they can at best be called as service for completion of the export commitment and hence would not be FTS
- The High Court followed the ruling of the SC in the case of Toshuku Ltd. (125 ITR 525) wherein it was held that where non-resident agents are paid commission and no business was carried out in India, no income accruing or arising abroad can be deemed to accrue or arise in India
- Therefore, the income not being chargeable to tax, Section 195 was not applicable

→ Payment of commission

Recent Decisions

Southern Borewells (43 taxmann.com 378) (Ker HC)



Facts

- Taxpayer entered into contract with a foreign company for providing marketing support to win the contract for constructing bore wells in a foreign country

Questions before HC

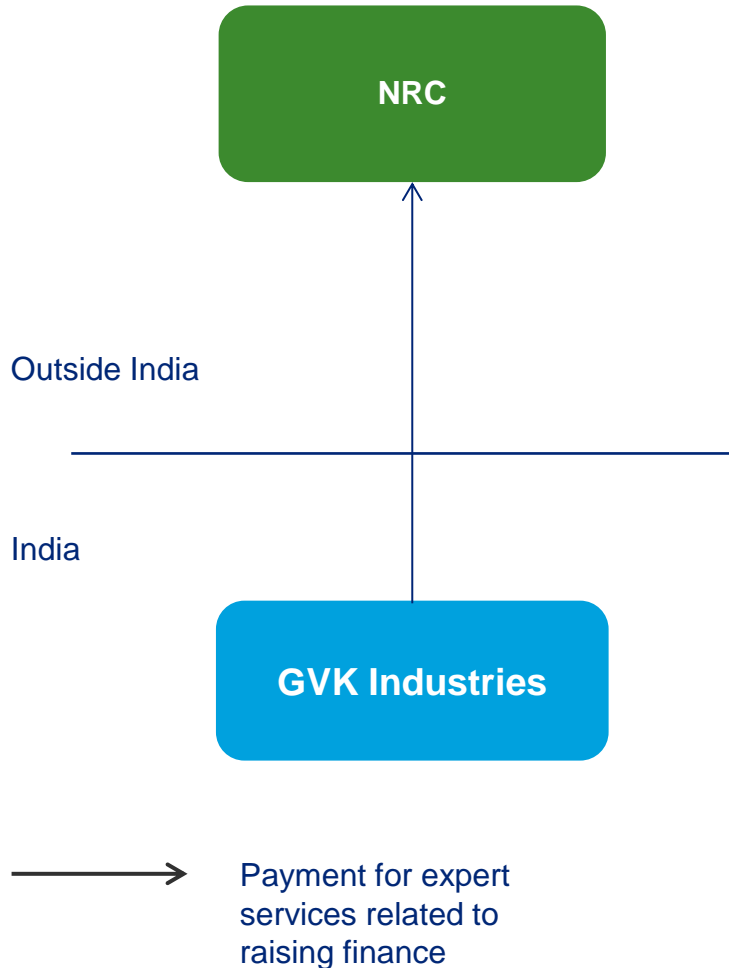
- Whether the Tribunal was right in holding that the income did not accrue in India and hence the taxpayer was not liable to deduct tax since the non-resident is not liable to tax in India

Ruling

- The HC held that no substantial question of law arose in this matter and hence the Tribunal's judgement did not warrant interference

Recent Decisions

GVK Industries Ltd. (SC)



Key points from Supreme Court Ruling

- The ruling is important as it has validated the source rule contained in section 9
- It is well settled that the source based taxation is accepted and applied in the international tax laws.
- The source rule is in consonance with the nexus theory and does not fall of the said doctrine on the ground of extraterritorial operations
- The Supreme Court has explained the meaning of consultancy services

Taxability of software payments brief overview



Transfer for full ownership of rights in copyright

Capital Gains or Business Income

- Consideration received for transfer of full ownership of right in copyright is in the nature of capital gains
- Consideration cannot be said to be for the use of rights
- Form of consideration would not alter the essential character of transfer of full ownership even if consideration is in installments or related to a contingency
- Under Income-tax Act, even though full transfer of rights is included in the definition or royalty payments characterized as capital gains are excluded from the definition of royalty

Transfer of partial rights

Royalty

- Consideration for transfer of right to commercially exploit the rights in the copyright that would otherwise be the sole prerogative of the IPR owner would be royalty
- Granting of rights to use IPR in a manner that would, without a license, lead to infringement of copyright
- Royalty is essentially income from letting of IPR such as patents, copyright, similar property to commercially exploit it
- Distinction between letting out IPR and transfer of full ownership in IPR
- Under Income-tax Act, payments for right to use of computer software is royalty

Distribution of copyrighted article

Business Income

- Consideration for right to distribute copies of copyrighted article without the right to reproduce it would be characterized as business income
- No right to commercially exploit the copyright per se
- Distribution of software irrespective of whether distributed on tangible media or electronically (without right to reproduce it)

Acquisition of copyrighted article by end-user

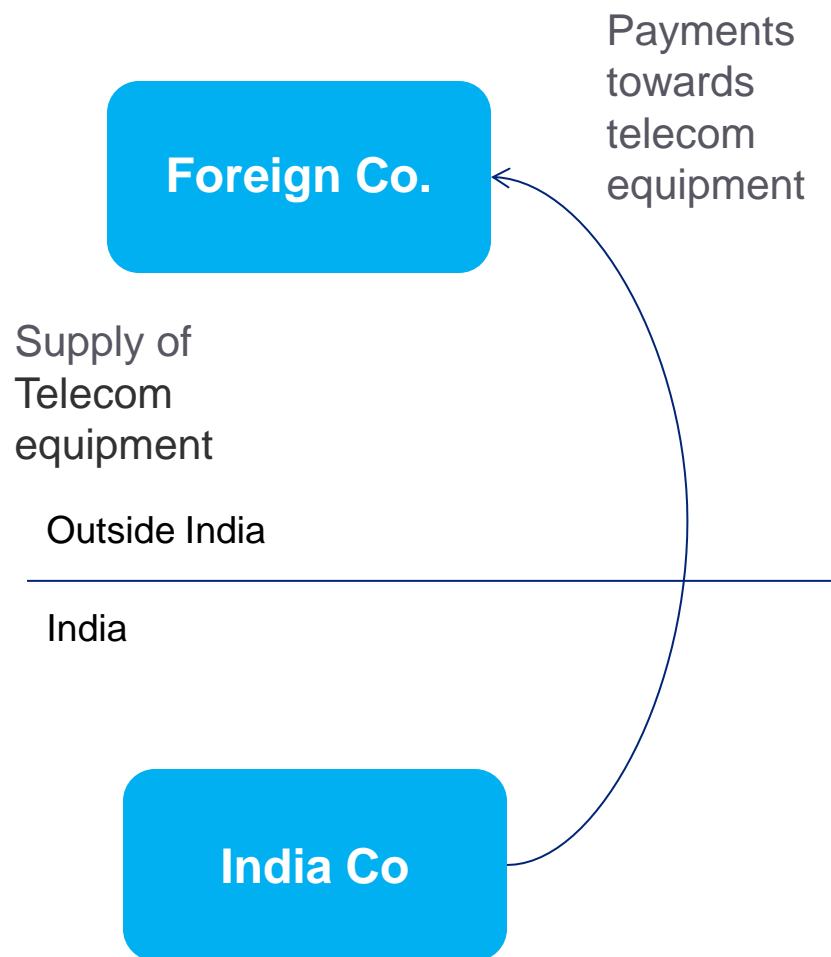
Business Income

- End-user acquiring a copyrighted article i.e. copy of software program
- Copyright v. copyrighted article i.e. author's right v. reader's right in a book
- OECD view: payment for copyright is royalty whereas payment for copyrighted article is business income
- Indian Courts divided on characterization of payments to copyrighted article as business income or royalty
 - Right to make a copy for personal consumption such as a right to make copy for back-up or right to transfer a copy on hard-drive
 - Over-emphasis on clauses of End-User Licensing Agreement (EULA) in relation to making copies

Mixed Contracts – Royalties

Bundled / Embedded Software

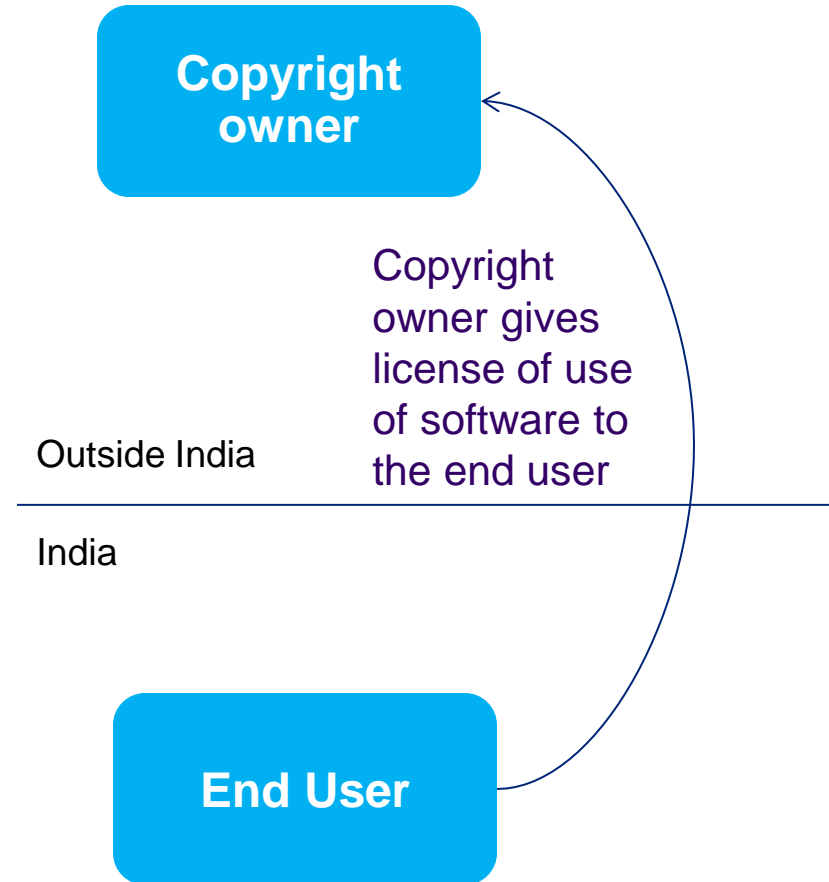
- Foreign Co. engaged in manufacturing advanced telecom systems and equipment
- Equipment manufactured outside India is sold to Indian telecom operators on a principal-to-principal basis.
- Software is loaded on the hardware and does not have any independent existence.
- Software is embodied in the system and facilitates the functioning of the equipment and is an integral part thereof.
- There could be two types of arrangement:
 - No separate payment for software
 - Separate amount provided for hardware and software



Royalties

Shrink-wrapped Software

- Copyright owner develops and markets software
- Software is provided in a packed form to the customers in India along with end user license agreement. The license agreement appears on computer screen and must be accepted by the user before the user can operate the software.
- The license can be a single user license or can be a multiple user license
- Copyright owner will retain all copyright, trade mark, trade secrets and other proprietary rights.
- The end user is not permitted to make any modification or make, works derivative of the software and user is not entitle to reverse engineer, decompile, disassemble or otherwise discover the source code of the software



Royalties

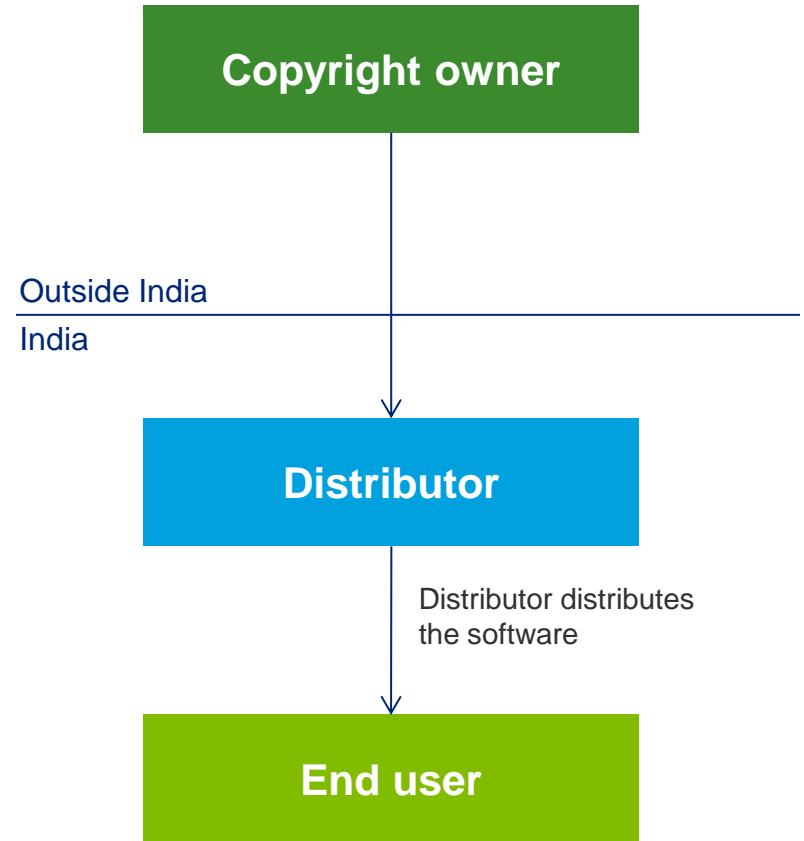
Distribution

Scenario 1

- Copyright owner appoints distributor as an approved/ exclusive distributor with no rights to copy

Scenario 2

- Standardized product sold by copyright owner through independent, third party, non-exclusive reseller network; no right to open/ use the product



Taxability of e-commerce transactions

Important decisions



Select Court Rulings

Payments for e-commerce transactions

Ruling	Brief Discussion
Thoughtbuzz (P) Ltd (346 ITR 345) (AAR)	<ul style="list-style-type: none">• Subscription paid for social media monitoring services for market intelligence• Royalty as per Explanation 2(iv) to section 9(1)(vi) of the ITA since the appellant is in the business of gathering, collating and making available/imparting information concerning industrial and commercial knowledge, experience and skill• Royalty as per Article 12(2) of India-Singapore tax treaty since it is grant of use of process, information concerning industrial, commercial and scientific experience• Taxable as royalty under section 9(1)(vi) of the Act and Article 12 of India-Singapore tax treaty
CIT v. Wipro Limited (203 Taxman 621) (Kar HC)	<ul style="list-style-type: none">• Payment to obtain license for use of database• Contention of taxpayer that payment was akin to making a subscription for journal or magazine of foreign publisher and, thus, payment fell outside scope of clause (ii) of Expln. 2 to section 9(1)(vi) and article 12 of Indo-US DTAA not accepted• Treated as royalty

Select Court Rulings

Payments for e-commerce transactions

Ruling	Brief Discussion
Yahoo India (P.) Ltd v. DCIT (46 SOT 105) (Mum ITAT)	<ul style="list-style-type: none">• Uploading and display of banner advertisement on its portal was entirely responsibility of Yahoo Holdings (Hong Kong) Ltd. (YHHL)• Taxpayer had no right to access portal of YHHL,• Payment made by taxpayer to YHHL for services rendered for uploading and display of banner advertisement of Department of Tourism of India on its portal was not in nature of royalty taxable in India and, therefore, taxpayer was not liable to deduct tax at source from such payment
Pinstorm Technologies Private Limited v. ITO (54 SOT 78) (Mum ITAT)	<ul style="list-style-type: none">• Payment for banner advertisement and hosting services was not taxable as royalty under section 9(1)(vi) of the ITA.• Payments are in the nature of business profit on which no tax was deductible at source since the same was not chargeable to tax in India in the absence of any PE of Google Ireland Ltd. in India.• Decision of Mum ITAT in the case of Yahoo India was followed

Select Court Rulings

Payments for e-commerce transactions

Ruling	Brief Discussion
People Interactive (I) P Ltd. (ITA No. 2179,2180,2181 and 2182/Mum/2009) (Mum ITAT)	<ul style="list-style-type: none"><li data-bbox="581 419 1773 519">• The assessee company could not operate or even does not have physical access to the equipments system.<li data-bbox="581 534 1773 634">• Further, it is not using equipments but only availing services provided by non-resident.<li data-bbox="581 648 1611 691">• Accordingly, payments cannot be treated as royalty

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