



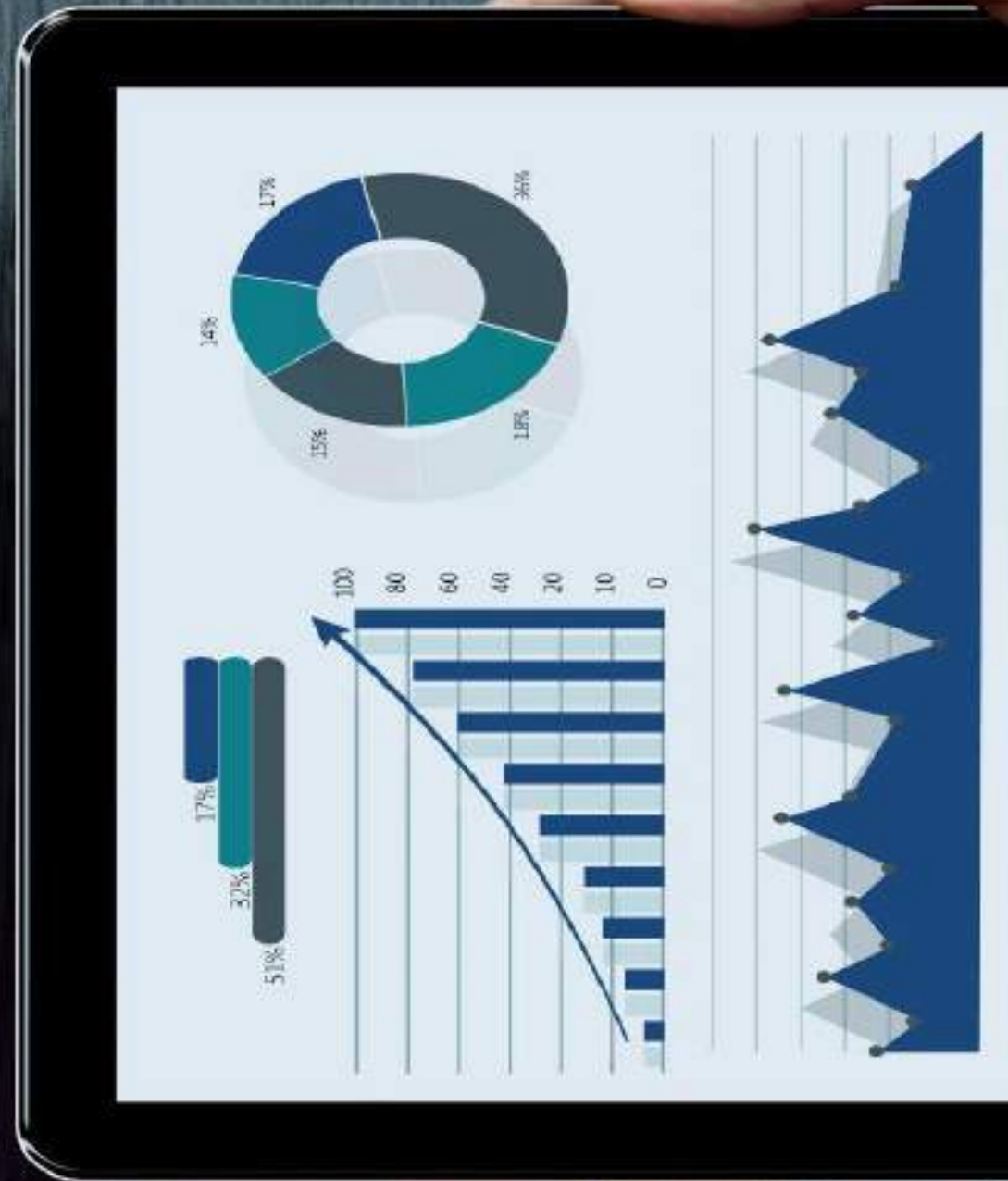
The Institute of Chartered  
Accountants of India  
(Recognized by an Act of Parliament)

Western India Regional Council  
(WIRC) of ICAI

# Taxation of Non-Residents in India

CA Vyomesh Pathak

27 August 2022



# Recent Amendments to Residential Status Provisions



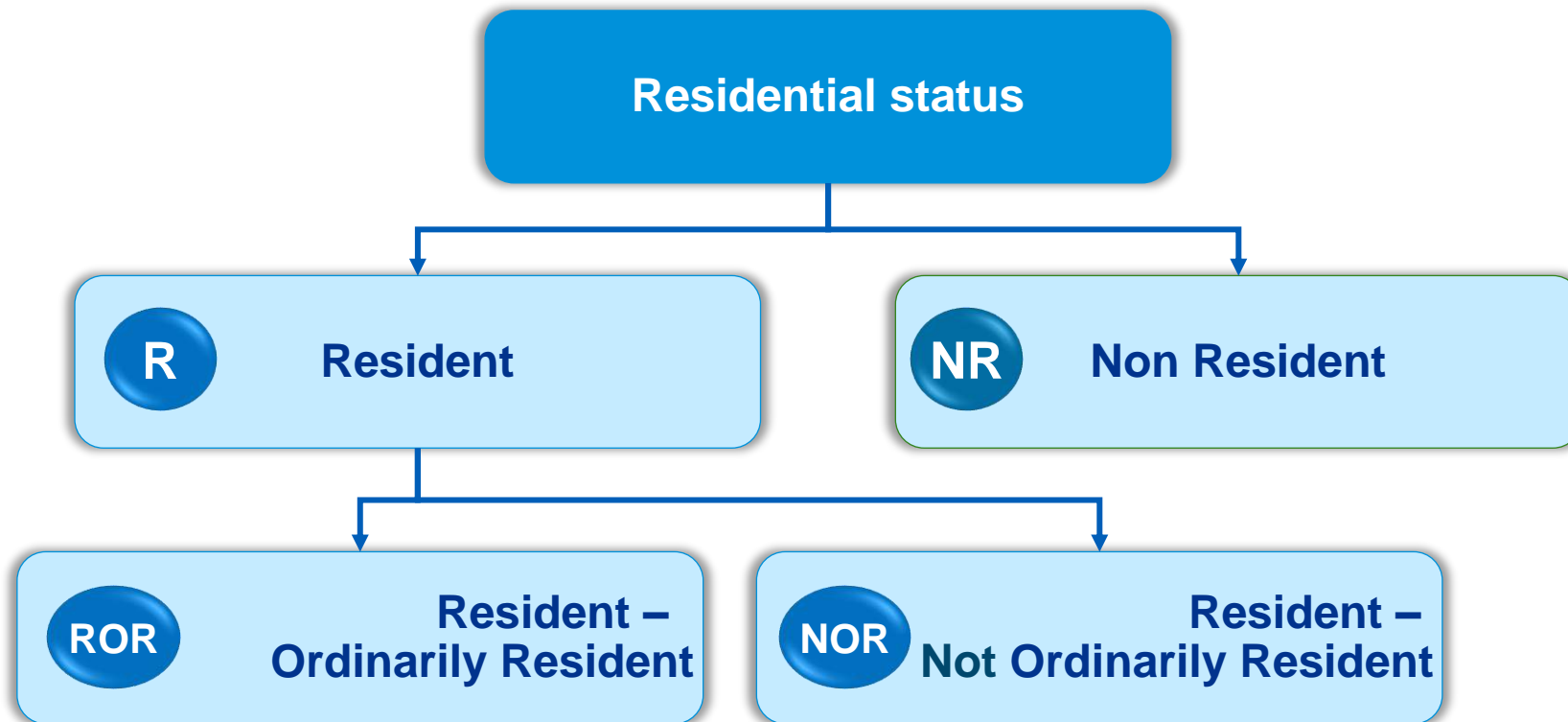
# Personal Taxes - Residential Status in India

- Residency In India determined by “Physical Number of Days of Stay in India” – Day of arrival and departure considered as stay in India

**FINANCIAL YEAR (FY)**

01 APRIL

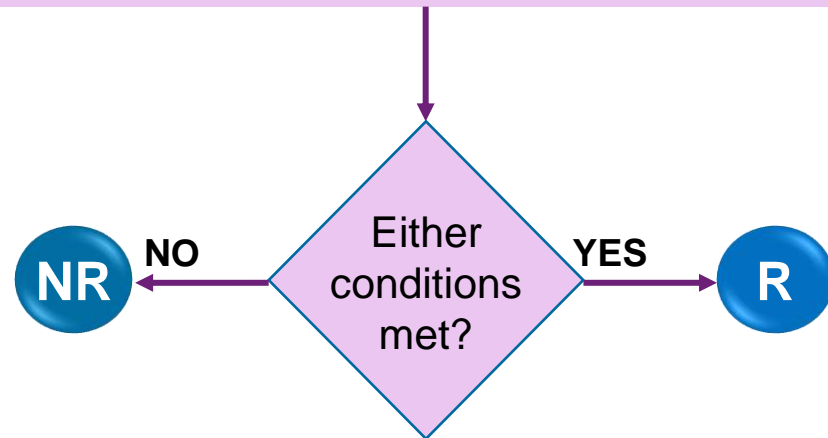
31 MARCH



# Residential Status in India- Current Provisions

## Basic Conditions

- 182 days or more in a FY
- 60 days\* or more in a FY + 365 days or more in four FY preceding the relevant FY

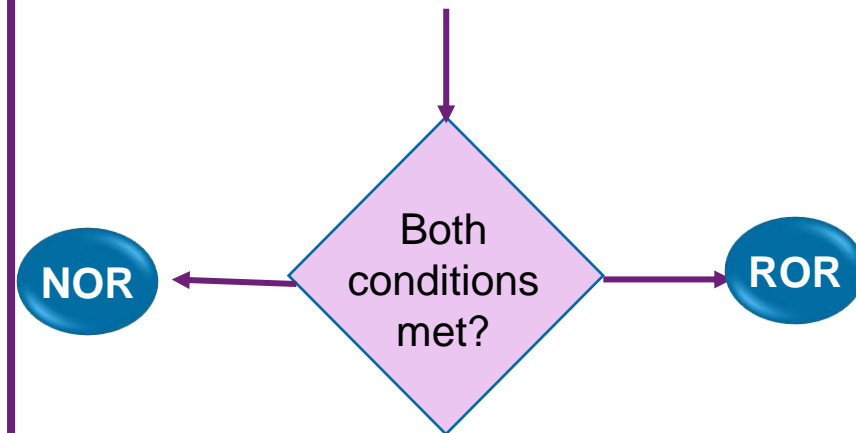


\*

- a) 60 days replaced by 182 days in year of departure for Indian citizen leaving India for employment.
- b) **60 days gets replaced by 182 days** in the year of visit to India for Citizen of India / Person of Indian Origin, while being outside India

## Additional Conditions

- "Resident" in India in **2 out of 10** FY preceding the relevant FY
- **Present in India for 730 days or more during the 7 FY preceding the relevant FY**



# Changes in Residency conditions as per Finance Act, 2020

- For Citizen of India / PIO who being outside India comes to India on **visits**, residency triggered with reduced period of 120 days (from current 182 days)
- Test for qualifying as Not Ordinarily Resident (NOR) truncated-
  - Proposed that individual qualifies as NOR if NR in at least 7 out of 10 past years
  - Test of staying 730 days in past 7 years deleted
- Citizen of India **not liable to tax in any other country by reason of his residency / domicile / similar criteria - Deemed to be resident in India**

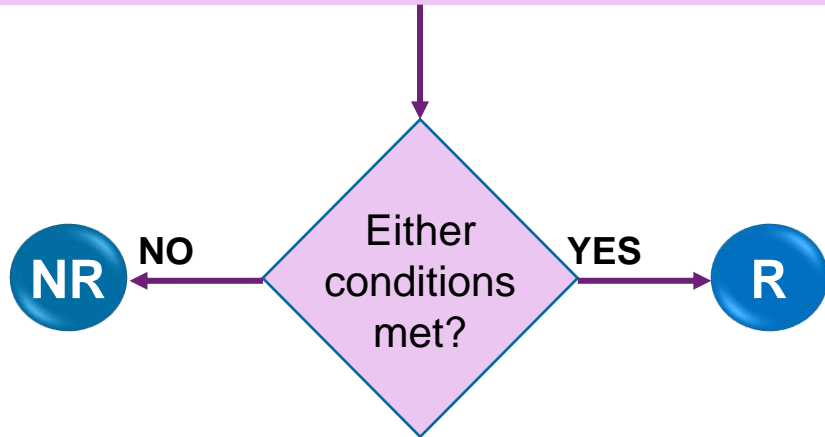
Subsequent clarifications – CBDT press release

- No intention to tax those Indian citizens who are bonafide workers in other countries, including Middle East, etc.
- Foreign income will be taxable in India only if such income is derived from a business / profession in India

# Residential Status in India- Determining R / NR

## Current Provision - Basic Conditions

- 182 days or more in a FY
- 60 days\* or more in a FY + 365 days or more in four FY preceding the relevant FY

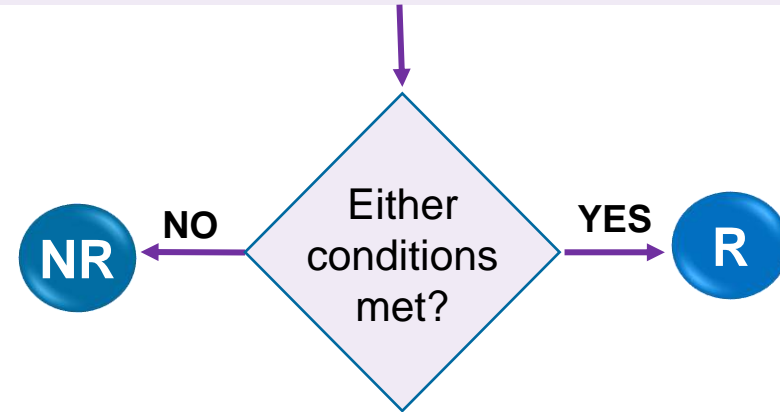


\*

- a) 60 days replaced by 182 days in year of departure for Indian citizen leaving India for employment.
- b) **60 days gets replaced by 182 days** in the year of visit to India for Citizen of India / Person of Indian Origin, while being outside India

## Proposed Provision - Basic Conditions

- No change\*



\*

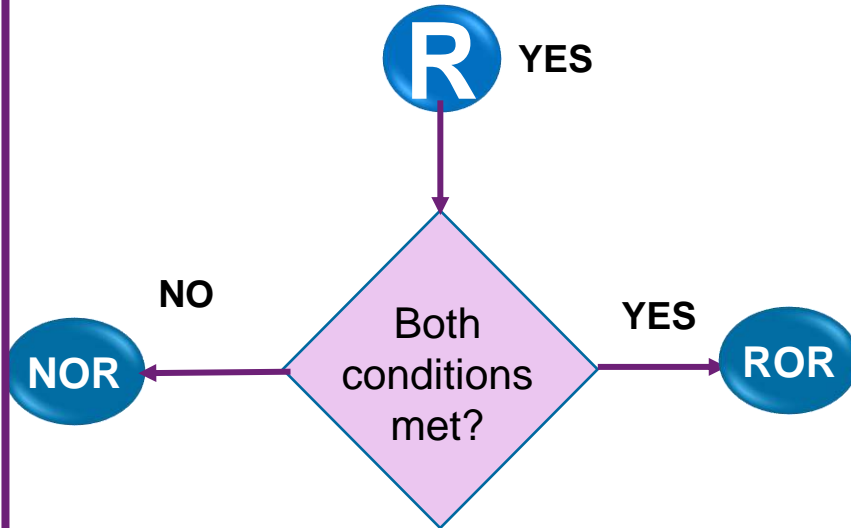
- a) No change\*
- b) **60 days gets replaced by 120 days** in the year of visit to India for Citizen of India / Person of Indian Origin, while being outside India\*

**\*Notwithstanding any of the above, Citizen of India deemed Resident in India if not liable to tax in any other country by reason of domicile/residence/similar criteria**

# Residential Status in India- ROR / RNOR

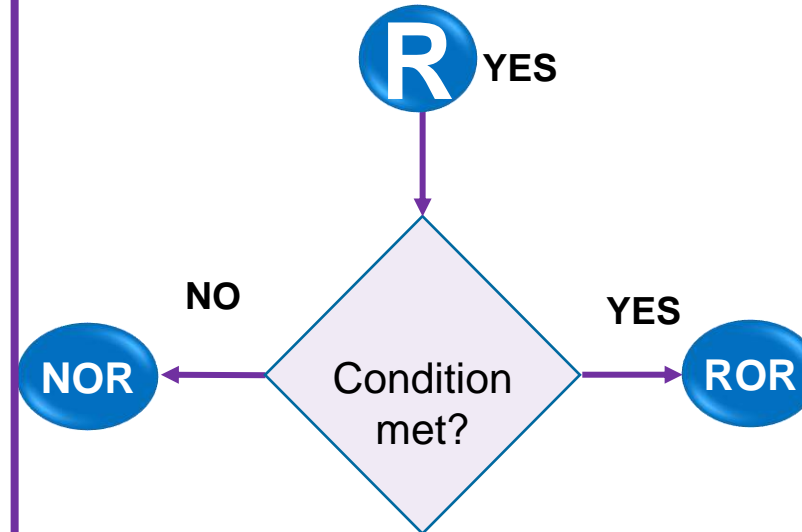
## Current Provision - Additional Conditions

- “Resident” in India in **2 out of 10** FY preceding the relevant FY
- **Present in India for 730 days or more during the 7 FY preceding the relevant FY**



## Proposed Provision - Additional Conditions

- “Resident” in India in **4 out of 10** FY preceding the relevant FY
- **Second condition deleted**



# Residency Rule for Indian Citizens/ PIO's (FY 20-21 onwards)

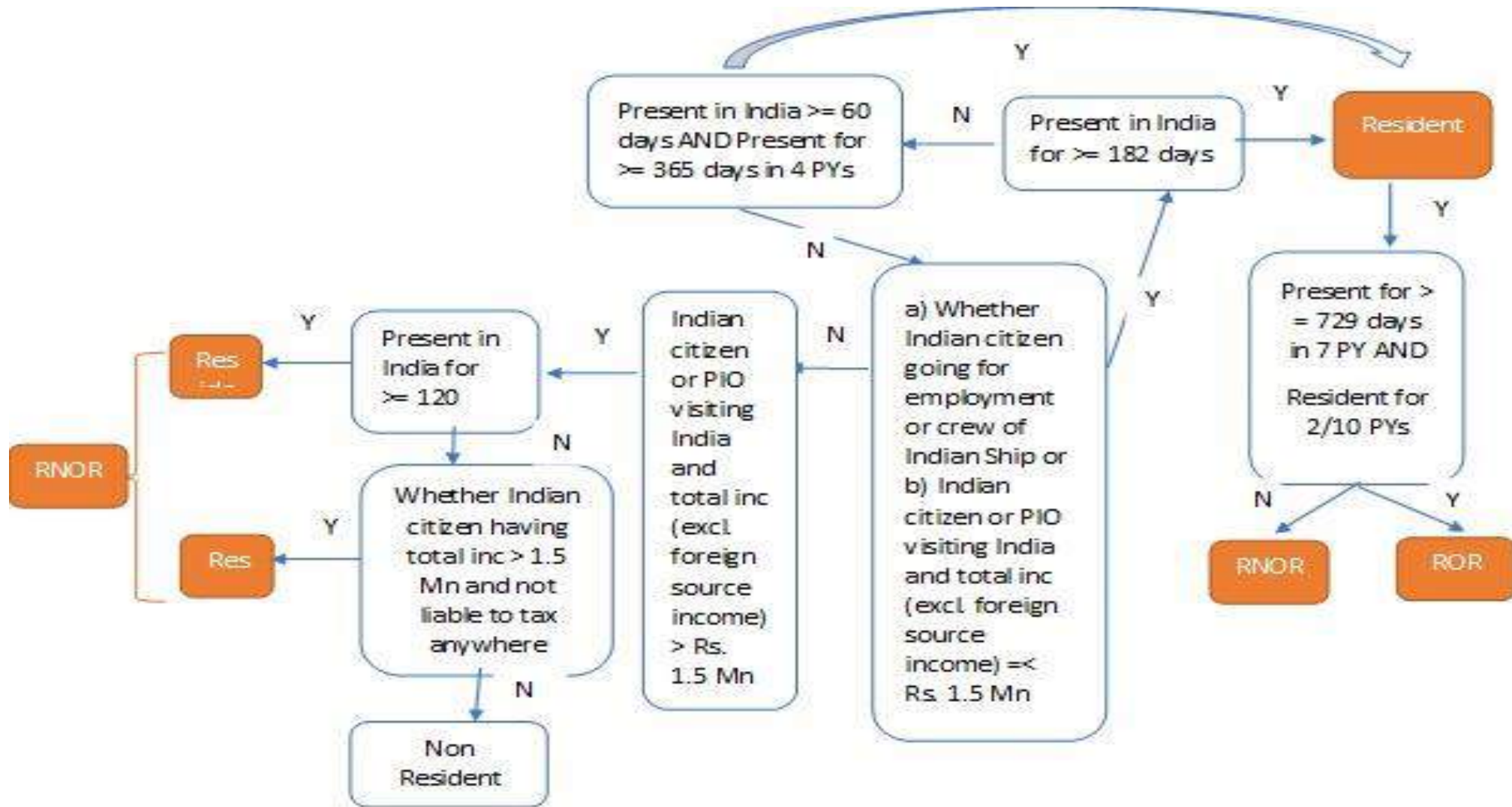
Residency/ extended residency rule	Pre- Budget	Budget	Post- Enactment
Indian citizen/ PIO coming a visit to India	<ul style="list-style-type: none"> <li>Is in India for <math>\geq 182</math> in relevant FY ; or</li> <li>Has been in India for <math>\geq 365</math> days within 4 preceding FYs and is in India for <math>\geq 182</math> days (instead of 60 days) in relevant FY</li> </ul>	<ul style="list-style-type: none"> <li>NR if <math>&lt; 120</math> days in India under second condition</li> <li>NR if <math>\geq 120</math> days but <math>&lt; 182</math> days &amp; Total Income other than foreign Income <math>\leq</math> INR 15 Lac</li> </ul>	<ul style="list-style-type: none"> <li>NR if <math>&lt; 120</math> days in India under second condition</li> <li>NR if <math>\geq 120</math> days but <math>&lt; 182</math> days &amp; Total Income other than foreign Income <math>\leq</math> INR 15 Lac</li> <li><b>NOR if <math>\geq 120</math> days but <math>&lt; 182</math> days &amp; Total Income other than Foreign source Income <math>&gt;</math> INR 15 Lac (120 Day Rule)</b></li> </ul>



# Residency Rule for Indian Citizens/ PIO's (FY 20-21 onwards)

Residency/ extended residency rule	Pre- Budget	Budget	Post- Amendment
<p>Indian citizen not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature</p>	<ul style="list-style-type: none"> <li>No deemed Residency Rule</li> </ul>	<ul style="list-style-type: none"> <li>Indian citizen “not liable to tax” in that country by reason of domicile/resident/ any other criteria, he may be deemed to be Resident in India.</li> </ul>	<ul style="list-style-type: none"> <li>Indian citizen “not liable to tax” in that country by reason of domicile/resident/ any other criteria, he may be deemed to be Resident in India.</li> <li><b>NOR if total income other than Foreign source Income &gt; INR 15 Lac (Deemed Residency Rule)</b></li> </ul>

# Residential Status in India - After Enactment



# Residential Status in India - Case Study-1

- Mr. A who is a business head for Asia Pacific region of a MNC
- He has to travel to various locations for business purposes
- He has spent 200 days travelling in FY 2020-21
- Also, he has been travelling abroad from past 2 years and has stayed out of India for 400 days in this period

Basic Condition I

- Resides in India for minimum 182 days – **NOT SATISFIED**

Basic Condition II

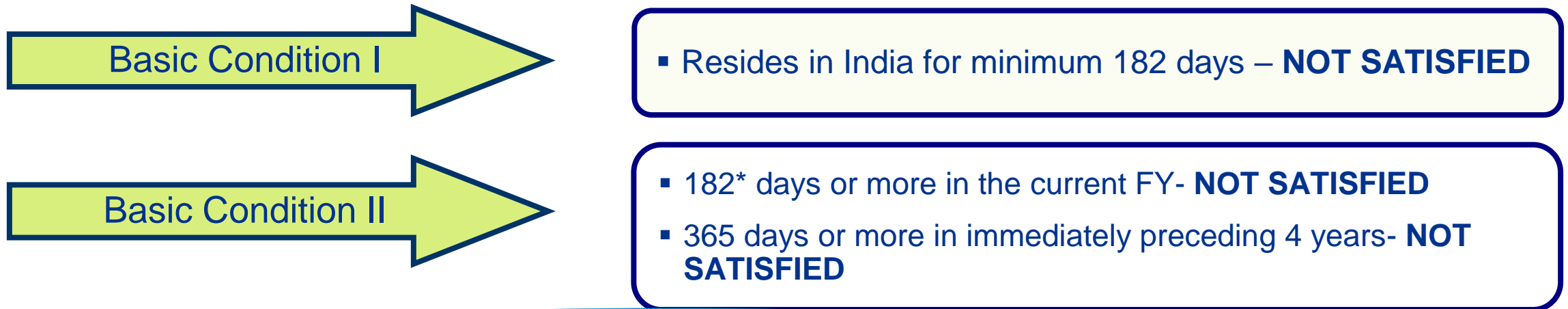
- 60 days or more in the current FY- **SATISFIED**
- 365 days or more in immediately preceding 4 years- **SATISFIED**

Additional Conditions for ROR

- Resident in 2 out of 10 immediate FY- **SATISFIED**
- 730 days or more in immediately preceding 7 years- **SATISFIED**

# Residential Status in India - Case Study-2

- Ms. Poo went to London to join a reputed university for a graduation course (three years).
- While studying there, her professor suggested her to join a post-graduate course at the same university (two years).
- She had to get an internship certificate to complete the course.
- Upon completion, the firm offered her a permanent position. She has been an employee there for the past four years.
- That is, Ms Poo has stayed out of India for nine years now.
- She receives rental income from the property that she inherited from her parents.



\*The condition of minimum 60 days stay in the current FY will get extended to 182 days since she has left India for employment

# Residential Status in India - Case Study-3

- Ms. B, a Person of Indian Origin residing in Canada and doing job there visits India regularly to meet her parents.
- During FY 2020-21, her stay in India during all her visits is 135 days
- She earns dividend income and interest income from her investments in India.
- During FY 2020-21, she has earned INR 16,50,000 (1.65 million).

Basic Condition I

- Resides in India for minimum 120\* days –**SATISFIED**

Basic Condition II

- Income from Indian source exceeds INR 1.5 million-**SATISFIED**

\*The condition of minimum 120 days stay in the current FY for PIOs visiting India will be applicable as per new amendment

# Scope of Total Income [Section 5]



# Scope of Total Income - Section 5

## Resident - Taxability

- Income received / deemed to be received in India
- Accrues / arises / deemed to accrue or arise in India
- Accrues or arises outside India



Exemption to resident but NOT ordinarily resident w.r.t income accruing outside India unless it is derived from a business controlled in or profession setup in India

## Non-Resident - Taxability

- Income received or deemed to be received in India by or on behalf of a person
- Accrues or arises or deemed to accrue or arise in India

- **Incidence of tax on income depends upon:**
  - Person's residential status
  - Place/ time of accrual of income
  - Place/ time of receipt of income
- **Residence based taxation v/s source based taxation**
- **Income once taxed on accrual/ deemed accrual basis cannot be taxed again on receipt basis.**

# Taxability of Income

## Residential Status

ROR

NOR

Non Resident

## Income liable to tax in India

- Global income liable to tax in India

- Income sourced from India
- Income received/ deemed to be received in India
- Income derived from business controlled/ Profession set-up in India

- Income sourced from India
- Income received/ deemed to be received in India

*Broadly, NOR/ NR not taxable in India on foreign sourced income unless received for working in India*



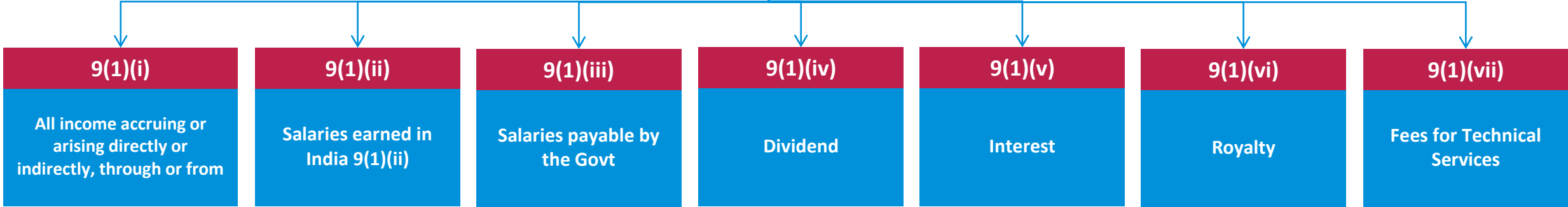


# Income deemed to accrue or arise in India [Section 9]



# Income deemed to accrue or arise in India -Section 9

## Incomes deemed to accrue or arise in India

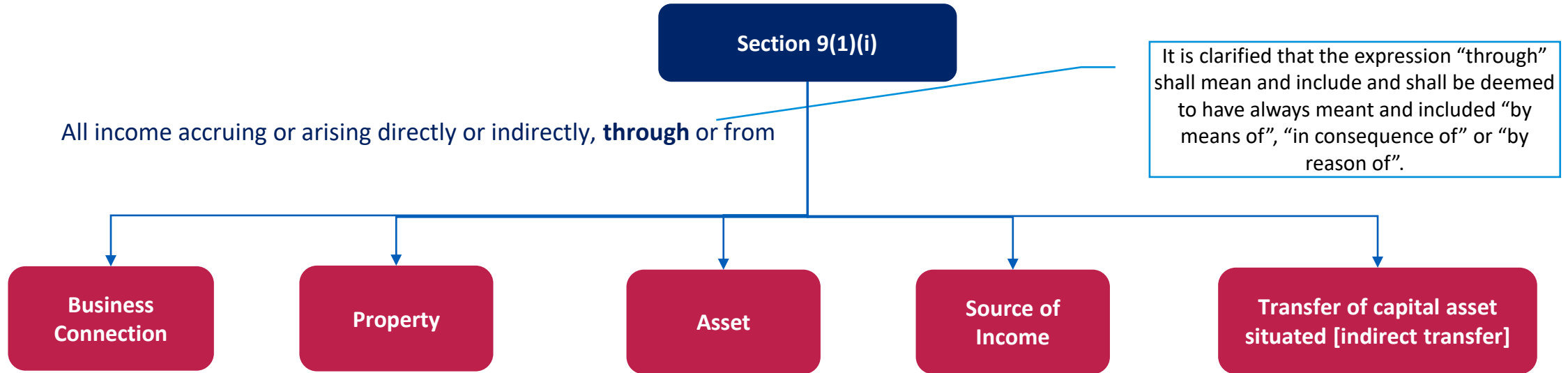


Only income attributable to India shall be deemed to accrue in India

- Business connection
- Property
- Asset
- Source of income
- Transfer of capital asset situated [indirect transfer cases]

in India

# Indirect transfer -Section 9(1)(i)



It is clarified that any asset or capital asset being any share or interest in a foreign company shall be deemed to be situated in India if such share/ interest derives, directly or indirectly, its value substantially from the assets located in India

# Business Connection -Section 9(1)(i)

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- Business connection is **an Indian equivalent of Permanent Establishment**. It has a **wider scope** and has been used extensively by revenue authorities to tax income of non-residents in India.
- The basic concept is that a non-resident person should be liable to tax for the profits earned in India if he has **real and significant or substantial economic nexus**.
- The term is significant for **international transactions**.

## Essential features



- **Real and intimate relation** must exist between the business activities by a non-resident carried on outside India and the activities within India
- The relation contributes directly or indirectly to the earning of income by non-resident in his business
- **A course of dealing and continuity of relationship** and not a mere isolated or stray nexus between the business of the non-resident outside India and the activity in India, would furnish a strong indication of business connection.

# Business Connection -Section 9(1)(i)



- **‘Business connection’ includes** any business activity carried out through a person, who habitually:
  - Exercises in India **authority to conclude contracts on behalf of non-resident or** *habitually plays the principal role leading to conclusion of contracts by that non-resident* and the contracts are—;
    - (i) *in the name of the non-resident; or*
    - (ii) *for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or*
    - (iii) *for the provision of services by the non-resident; or*
  - **Maintains in India stock of goods** from which he regularly delivers goods on behalf of non resident; **OR**
  - **Secures orders in India mainly or wholly for the non-resident/** other non-residents subject to common control as the former non-resident
  
- *Exclusion in explanation 2(a) for **activities limited to purchase of goods for non-resident** now deleted.*
  
- **Business connection does not include** any business activity carried out by a person having an **independent status acting in the ordinary course of his business**

# Business Connection - Attribution & Exceptions

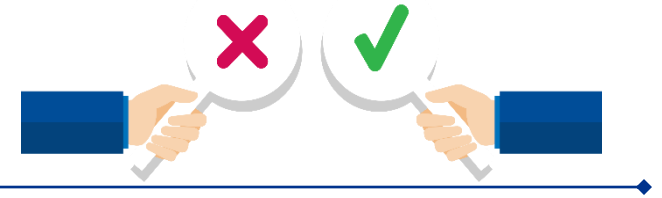
## Attribution

- In the case of business for which **all the operations are not carried out in India**:
  - Income reasonably **attributable** to operations carried out **in India** shall be chargeable to tax in India

## Exceptions- No income shall be deemed to accrue or arise in India

- In case of a non-resident, business of which operations **are confined to purchase of goods in India for export**
- Non resident running **a news agency or publishing newspapers**, activities are confined **to collection of news and views in India for transmission out of India**
- Individual/firm/company whose operations are confined **to shooting a cinematography film in India**
- Foreign company engaged in mining activities are confined **to display of uncut and unsorted diamond in any SEZ**

# Case studies



## Case study - 1

- Mr X an assessee carried on business as an importer and as a commission agent of non-resident exporters.
- For two of the non-resident exporters he canvassed orders for supply of woollen yarn and communicated the same to non-residents and received commission on the sale made by them
- Mr X had no authority to accept any orders on behalf of the non-residents. The non-resident was not obliged to accept the orders procured by Mr. X
- The orders were accepted, price received and delivery of goods was given by the non-residents outside India

**No business connection in India – CIT vs RD Aggarwal & Co (1965)(56 ITR 20) (SC)**

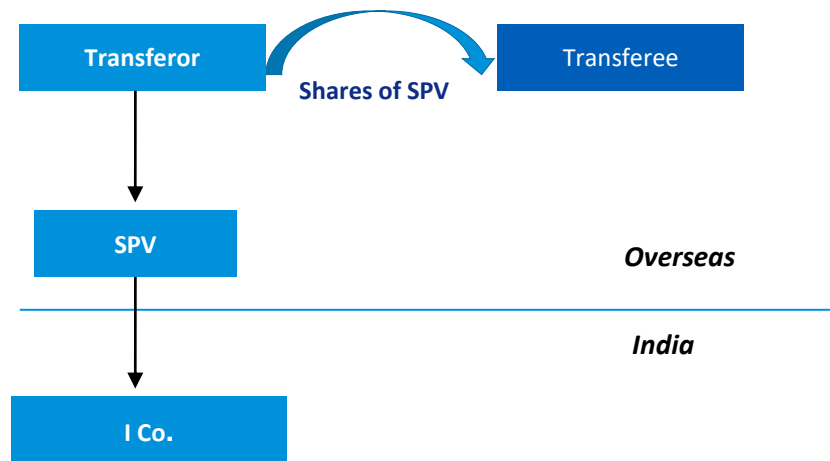
## Case Study – 2

- ABC of Netherlands used to import iron and manganese ore from India. Being dissatisfied with the activities of Indian exporters from whom it made purchases it appointed Mr. A as its representative in India.
- Mr. A was to supervise the correct execution of the contracts of ABC with Indian exporters as to the quantity, quality, time of delivery and transport until the goods reached the steamer.
- A's activity involved procurement of raw materials and ensuring regular and proper supply of raw materials
- A used to get remuneration from ABC

**Constitutes a business connection in India – Blue Star Engg Co (Bom) Ltd vs CIT (1969) (73 ITR 283) (Bomb HC)**

# Explanation 6 to section 9(1)(i)-Substantial value

## Illustration 1



SPV's shares deemed to be situated in India, if:

- i. Value of I Co. is more than Rs. 10 Crores; and
- ii. Value of shares in the I Co is more than 50% of the value of assets of SPV as on specified date

- Balance Sheet date prior to transfer; or
- Date of transfer, if Book Value on date of transfer more than Book Value on Balance Sheet date by 15%

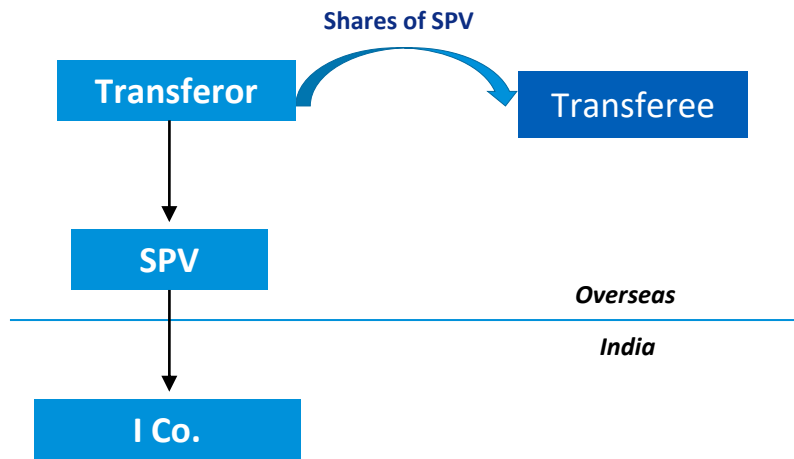
➤ Reporting obligation on I Co. (Section 285A)

➤ Penalty on failure to report – 2% of transaction value, if change in management/ control of I Co. (Section 271G)



# Explanation 7 to section 9(1)(i)-Exemption

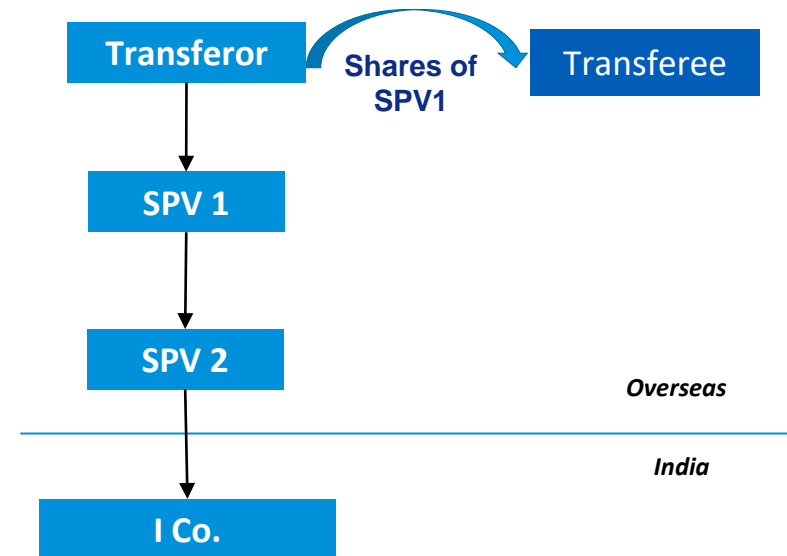
Illustration 2



No income deemed to accrue or arise in India, if transferor (at any time in the twelve months preceding the date of transfer) holds in SPV:

- i. No management or control; **and**
- ii. Voting power/ share capital/ interest  $\leq 5\%$

Illustration 3



No income deemed to accrue or arise in India, if transferor (at any time in the twelve months preceding the date of transfer) holds :

- i. No management or control in either SPV 1 **and**
- ii. No right in SPV 1 that entitles him to management and control in SPV 2; **and**
- iii. Such voting power/ share capital/ interest in SPV1 that results in holding voting power/ share capital/ interest  $< 5\%$  in SPV 2

# Agreement with foreign countries or specified territories [Section 90]



# Availing treaty benefits – Section 90

## Multilateral Instrument

- Central Government may enter into an agreement with:
  - Government of any country outside India; or
  - Specified territory outside India.
- The agreement may be entered for:
  - Granting relief in respect of **'income on which Income-tax has been paid' / 'income-tax chargeable'** in India and in country/ specified territory outside India;
  - For **avoidance of double taxation of income** in India and in country/ specified territory outside India;
  - For **exchange of information for prevention/ investigation of evasion/ avoidance of income-tax** chargeable in India or in country/ specified territory outside India; or
  - For **recovery of Income-tax** in India and in country/ specified territory outside India.
- **For taxpayer to whom such agreement applies, the beneficial provisions of the Act or such agreement (i.e. tax treaty), as the case may be, shall apply**

*“A tax treaty neither generates a tax claim that does not otherwise exist under domestic law nor expands the scope of a tax claim.....”*

# Tax Residency Certificate (TRC)

*Tax Residency Certificate mandatory condition for claiming benefits under the tax treaty*

- **To be taken from home countries' tax authorities. No specific format prescribed.**
- **Additional information** notified by CBDT to be furnished in '**Form 10F**' as follows:
  1. **Status** of non-resident (individual, company, firm etc.)
  2. **PAN** of non-resident (if any)
  3. **Nationality** (if individual)/ Country of incorporation (if firm, company etc)
  4. **Tax Identification Number** in the country of residence;
  5. **Period of validity** of TRC
  6. **Address of non-resident**
- Non-resident assessee **to keep and maintain documents** which are necessary to substantiate above information. Indian Tax authorities may demand the same at later stage

# Taxability of Capital Gains



# Taxability of Capital Gains- Period of holding- Short Term / Long Term

Capital Assets	Months to be checked for determining nature of Capital Asset
Listed Equity Shares/ Listed Preference Shares/ Listed Debentures	12 months
Unlisted shares/ Shares of a Private Company	24 months
Equity Oriented Mutual Funds	12 months
Debt Oriented Mutual Funds	36 months
Zero Coupon Bonds	12 months
Bonds ( Other than zero coupon bonds)	36 months
Unlisted Debentures	36 months
Units of UTI	12 months
Land / Building / Immovable Property	24 months

# Taxability of Capital Gains

PARTICULARS		TAXABILITY FOR NRI*
Equity Shares, Units of Equity Oriented MF, Units of UTI, Zero Coupon Bonds	Long Term	<ul style="list-style-type: none"> <li>Listed securities (other than units) – 10% without indexation benefit</li> <li>Unlisted securities or shares of closely held companies – 10% (Indexation and foreign currency benefit not available)</li> </ul>
	Short Term	<ul style="list-style-type: none"> <li>Equity Shares and Units of Equity Oriented MF / Balanced MF-15% if STT paid</li> <li>Non STT – In case of Individuals, STCG taxable at normal slab rates as may be applicable</li> </ul>
Bonds, Debentures and Government Securities/ Units of other than Equity Oriented MF	Long Term	<ul style="list-style-type: none"> <li>Unlisted - 10% (Indexn. not available)</li> <li>Listed - 10% (Indexn. And foreign currency benefit not available)</li> </ul>
	Short Term	<ul style="list-style-type: none"> <li>In case of Individuals, STCG taxable at normal slab rates as may be applicable</li> </ul>
Other Assets, viz. Residential house	Long Term*	<ul style="list-style-type: none"> <li>20% (Indexn. Benefit available)</li> </ul>
	Short Term	<ul style="list-style-type: none"> <li>In case of Individuals, STCG taxable at normal slab rates as may be applicable</li> </ul>

\* Tax rates are exclusive of surcharge and education cess

# Taxability of Capital Gains- Shares or Debentures

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## Currency fluctuation benefit – First proviso to Sec. 48

- Cost of acquisition, expenditure on transfer and full value of consideration to be converted into foreign currency in which shares or debentures were acquired
- Capital gains shall be reconverted to Indian currency
- The conversion rate shall be average of TTBR + TTSR as per Rule 115A

Cost of acquisition	Date of acquisition
Expenditure on transfer	Date of transfer
Full value of consideration	Date of transfer



# Taxability of Royalty and FTS



# Taxability of Royalty – Definition under the Act

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- Consideration (including lumpsum consideration) for:

- **Transfer of all or any rights (including license) in:**

- patent, invention, model, design, secret formula or process or trademark, etc. (IP)
- copyright, literary, artistic or scientific work including films or video tapes/tapes for use in TV/radio broadcasting

- **Imparting of any information concerning:**

- the working of or use of IP
- technical, industrial, commercial, scientific knowledge, experience or skill

- **Use of:**

- any IP
- or right to use any industrial commercial or scientific equipment

- Rendering of any services in connection with above

# Taxability of Royalty – Definition under the Act- expanded by Finance Act 2012

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- Retrospective “clarification” from 1 June 1976
  - Explanation 4 - use or right to use computer software (including granting of license)
  - Explanation 5 - Test of possession / control / use / location of right, property or information not relevant
  - Explanation 6 - “process” includes use or right to use transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fiber or by any other similar technology, irrespective of whether such process is secret
- Expanded scope to cover software payments, bandwidth charges, transponder hire charges, connectivity charges

# Taxability of Royalty – Definition under the Treaties

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- **OECD Model** – Payments of any kind received as a consideration for

- **Use of or right to use :**
  - copyright of literary, artistic or scientific work including cinematograph films
  - patent, trademark, design or model, plan, secret formula or process

- **Information concerning**
  - industrial, commercial or scientific experience

- **UN Model** – Payments of any kind received as a consideration for:

- **Use of or right to use :**
  - copyright of literary, artistic or scientific work including cinematograph films or films or tapes used for radio or television broadcasting
  - patent, trademark, design or model, plan, secret formula or process
  - **industrial, commercial or scientific equipment**

- **Information concerning**
  - industrial, commercial or scientific experience

# Taxability of Royalty – Under the Act

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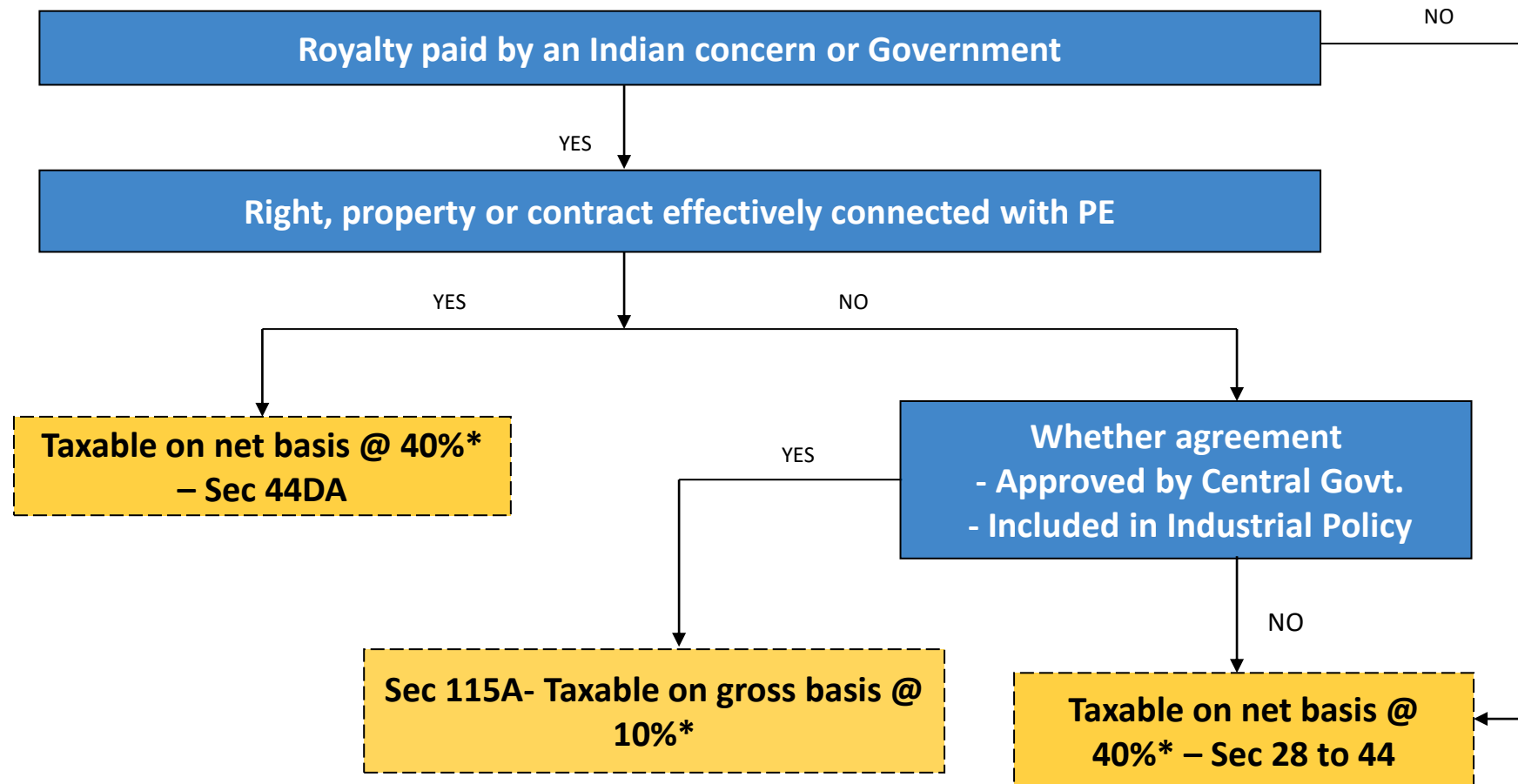
## **Section 5 – Scope of Total Income for Non Residents**

- Income received/ deemed to be received in India
- Income accruing/ arising in India or deemed to accrue or arise in India

## **Section 9 – Income deemed to accrue or arise in India**

- Royalty taxation provisions introduced w.e.f. 1 June 1976 i.e. AY 1977-78
- Royalty – Section 9(1)(vi) r.w. Explanation 2, 4, 5 & 6
- Royalty deemed to accrue or arise in India if paid by
  - Government
  - Resident – except for business/ profession/ source of income outside India
  - Non-Resident – where it relates to business/ profession/ source of income in India
- Taxable on gross basis @10%\* under Section 115A
- Taxable on net basis if effectively connected with PE/ fixed place of business of non-resident in India under Section 44DA

# Taxability of Royalty - Under the Act



\*plus applicable surcharge and cess

# Taxability of Royalty – Under the Treaty

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- Article 12(1) – Distribution of rights of the Contracting States
- Article 12(2) – Ceiling of gross taxation by the State of Source
- Article 12(3) – Meaning of the term ‘Royalty’
- Article 12(4) – Taxation of Royalty if effectively connected with PE/ Fixed Base of Non-Residents in the State of Source
  - To be taxed as per Article 7
- Article 12(5) – Arising of Royalty in the State of Source
  - Where payer is Resident; or
  - If the Payer has a PE/ Fixed Base in the State of Source and the Royalty is connected and borne by such PE/ Fixed Base
- Article 12(6) – Adjustments for related party transactions
  - Excess over Arm’s-length price to be taxable as per domestic law

# Taxability of FTS – Definition Under the Act

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## **FTS – consideration for rendering**

- Managerial, Technical or Consultancy services
  - Including provision of services of technical or other personnel
  - Does not include
    - consideration for construction, assembly, mining or like project
    - Income by way of salary



# Taxability of FTS – Definition Under the Treaties

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- Generally, same as under the Act – Restricted definition in some Treaties
  - “Make available” technical knowledge, experience, skill, know-how or process
  - Development & transfer of technical plan or design
- Under the OECD, UN and US MC
  - There is no specific article on FTS in either OECD/ UN/ USMC
  - They are on par with Business Income
    - Taxable in State of Source only if attributable to PE of Non-Resident in that State

# Taxability of FTS - Under the Treaty - Concept of “Make Available”

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- **Treaties with US, UK, Singapore, Australia, Canada, etc. have the concept of “make available” in the FTS definition**
- **“Make available” – what it means ?**
  - Mere requirement of technical input by a person providing services does not necessarily mean that technical knowledge is “made available”
  - Use of a product which embodies technology cannot be considered to make technology available
  - Transmission of technical knowledge, skill, etc. from person rendering the services to the person utilising the services
  - Technical knowledge, skill, etc. must remain with the person utilising the service even after rendering of services has come to an end
  - Person utilising the service is able to make use of technical knowledge independently, without recourse to the performer of services in future

“Make available” significantly narrows down the scope of FTS

# Taxability of FTS - Under the Treaty

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- Article 12(1) – Distribution of rights of the Contracting States
- Article 12(2) – Ceiling of gross taxation by the State of Source
- Article 12(3) – Meaning of the term FTS
- Article 12(4) – Taxation of FTS if effectively connected with PE/ Fixed Base of Non- Residents in the State of Source
- Article 12(5) – Arising of FTS in the State of Source
  - Where payer is Resident; and/or
  - If the Payer has a PE/ Fixed Base in the State of Source and the FTS is effectively connected and borne by such PE/ Fixed Base
- Article 12(6) – Adjustments for related party transactions
  - Excess over Arm's-length price to be taxable as per domestic law

# Taxability of Dividend, Interest etc.



# Special Provisions for NRIs

Nature of Income	Taxability
LTCG on shares of Indian company or debentures or deposits purchased in forex	10%
Interest Income	20%

- Option not to file ROI if tax deducted
- Exemption like Sec.54F if reinvestment made in foreign exchange asset
- No deduction under Chapter VIA Allowed
- Option to claim even after becoming resident

\* Tax rates are exclusive of surcharge and education cess



# Special Provisions for Non Residents

Nature of Income	Taxability under the Act
Dividends	20%
Interest on infrastructure bonds	5%
Interest on rupee denominated bonds	5%
Interest on loan raised in foreign exchange	20%
Royalties or Fees technical services	10%

\* Tax rates are exclusive of surcharge and education cess



# Exemptions available to Non Residents

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- Exemption for interest on NRE Account u/s 10(4)(ii)
- Transfer by non-resident to another non-resident of bonds or global depository receipt of Indian company u/s 47(viia)
- Transfer by non-resident to another non-resident of Rupee denominated bonds u/s 47(viiaa)
- Transfer by non-resident of bond or rupee denominated bond or derivative on IFSC u/s 47(viiab)
- Transfer by non-resident to another non-resident of government security carrying periodic interest payments u/s 47(viib)

# Most Favoured Nation (MFN) Clause





# Most Favoured Nation (MFN) Clause

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- Normally benefit under this clause is restricted to a specific group like OECD countries or developing countries
- Benefit provided is normally with respect to following:
  - Rates of taxes
  - Liability to tax
  - Deductions permissible
- Attempts to avoid discrimination between residents of different countries
- MFN clause usually found in Protocols and Exchange of notes
- Ensures equal treatment between a subset of countries
- Extends similar benefits to one country as extended to certain other countries

# Most Favoured Nation (MFN) Clause

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- MFN CLAUSE IN THE PROTOCOL:

“In respect of Dividends, Interest, Royalties, FTS and payment for use of equipments, if under the Convention, Agreement or Protocol signed after 1st Sept 1989 between India and a third State which is a member of the OECD, India limits its taxation at source 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 on the said items of income shall also apply under this Convention ...”

# Most Favoured Nation (MFN) Clause

- Applying the MFN Clause

Example: In a MFN situation, generally, one of the contracting states (say India) to the Double Tax Avoidance Agreement (“Tax Treaty”) grants the residents of the other contracting state (say Netherlands), the same beneficial treatment made available by it (that is, by India) to the resident of a third country (say Sweden) with whom it has entered into a Tax Treaty

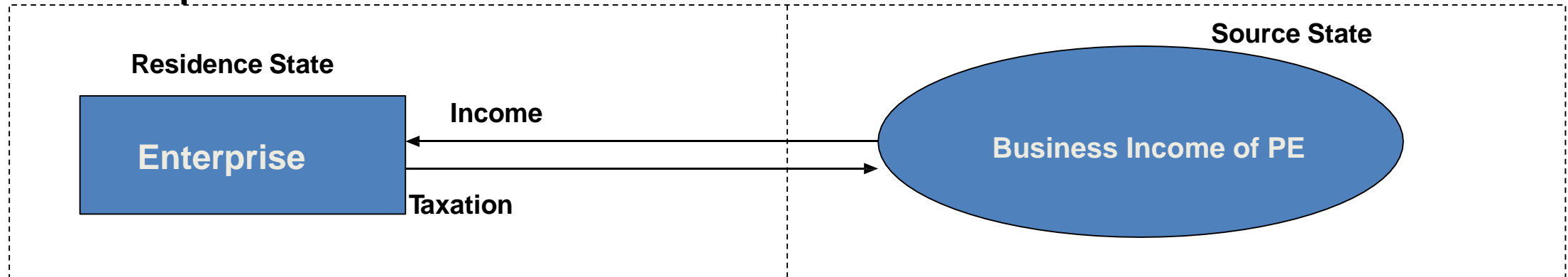


# Concept of Permanent Establishment (PE)



# Permanent Establishment (PE)

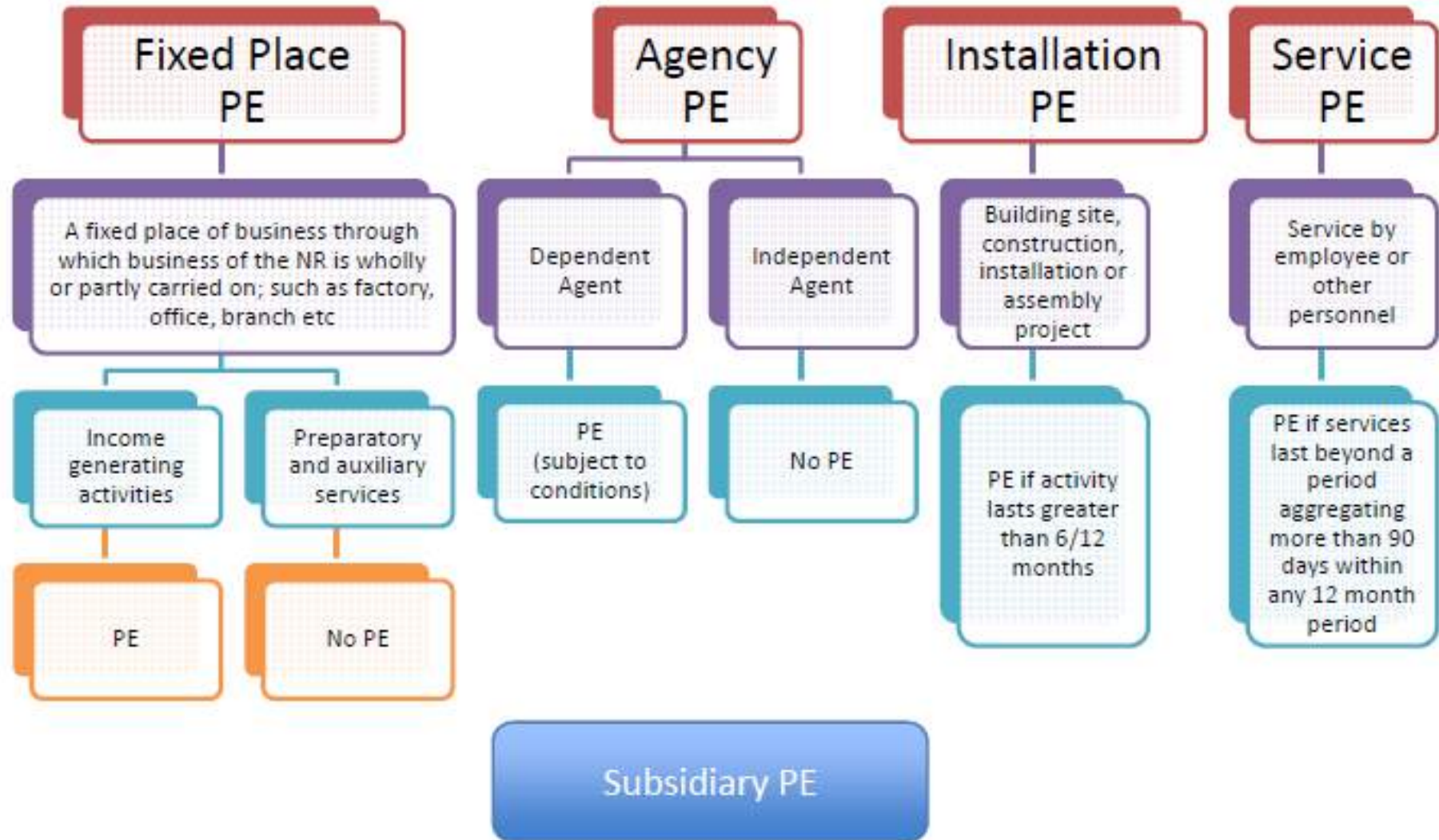
## Concept of PE



**Business income of a non-resident is not taxable in India unless such it has a taxable presence in form of a PE in India and such income is attributable to the PE**

- Definition of PE was inserted in the Act vide Finance Act, 2002. Section 92F(iia) states that the PE includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.
- Morgan Stanley [2007] 292 ITR 416 (SC) – Supreme Court observed that the PE
  - is an inclusive definition
  - covers service PE, agency PE, construction PE, etc.

# Permanent Establishment (PE)



# Law and Procedure for Foreign Remittances



# Overview of Section 195

Section	Provision
195(1)	Scope and conditions for applicability
195(2)	Application by the Payer to the Tax Authorities for determining the appropriate proportion of sum chargeable to tax
195(3)	Application by the Payee to the Tax Authorities for certificate for no deduction of tax
195(4)	Validity of certificate issued by the Tax Authorities
195(5)	Powers of the CBDT to issue Notifications
195(6)	Furnishing of information relating to payments
195(7)	Authority of CBDT to specify class of person or cases who shall make application under Section 195(2)
195A	Grossing up of tax



# Section 195(1)

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- **Section 195(1)** – *“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 ....”*
- 1<sup>st</sup> proviso – TDS on interest payable by Government/ PSB/ PFI only upon payment
- 2<sup>nd</sup> proviso – No TDS in respect of dividend referred to in Section 115-O
- Explanation 1 – Credit of sum not to the account of the payee, shall be deemed to be credit of such sum to the account of the payee
- Explanation 2 – Section 195(1) applies to NR also, whether or not it has residence/ place of business/ business connection/ any other presence in India

# Analysis of Section 195(1)

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## Who is responsible to deduct ?

- Any person, including individuals, HUFs, partnership firms, companies, whether resident or non-resident

## Payment to whom ?



- Non-residents and foreign companies
- It does not include RNOR
  - NR includes NOR for Sections 92, 93 and 168, but not for Section 195

## Nature of payment ?


- Interest (excluding interest under Sections 194LB, 194LC and 194LD) or any other sum chargeable to tax
- Salaries and exempt dividends are excluded

# Analysis of Section 195(1)

## When to deduct ?

- **The Act:** At the time of payment or credit of income to the account of the payee, whichever is earlier 
  - Exception to Government, public sector banks and public financial institution – only on payment
- **Tax Treaty:**
  - Royalty or FTS arising in a Contracting State and paid to a resident of the Other Contracting State may be taxed in that Other State
  - However, such Royalty or FTS may also be taxed in the State in which they arise and according to the laws of that State 

## What rate to apply ?

- Deduct tax at the rates in force (as defined under Section 2(37A)(iii))
- Rates of income-tax specified in the Finance Act or the rates specified in the DTAA, by virtue of Section 90 or Section 90A 

TDS liability triggers where sum chargeable to tax under the Act

# Payment or Credit whichever is earlier

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## Favorable

- Ramesh R. Saraiya [1965] 55 ITR 699 (SC)
- Motor Industries Co v. [2001] 249 ITR 141 (Kar.)

## Unfavourable

- United Breweries [1995] 211 ITR 256 (Kar.)
- Redington (India) Ltd. [2013] 59 SOT 152 (Chennai)
- Broadcom India Research (P.) Ltd. [2015] 68 SOT 138 (Bang.)
- Honda Motorcycle & Scooters India (P.) Ltd. [2015] 56 taxmann.com 238 (Delhi)

# Paid vs Accrual under the Treaty

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## **Royalty/ FTS held to be taxable only when 'paid' to Non-Residents**

- Siemens Aktiengesellschaft [ITA No. 124 of 2010] (Dated 22 October 2012) (Bom.)
- Johnson & Johnson [2013] 60 SOT 109 (Mum.)
- Booz. Allen & Hamilton (India) Ltd. & Co. Kg. [2013] 56 SOT 96 (Mum.)
- Pizza Hut International LLC [2012] 54 SOT 425 (Del.)
- CSC Technology Singapore Pte Ltd [2012] 50 SOT 399 (Del.)
- National Organic Chemical Industries Ltd [2006] 5 SOT 317 (Mum.)
- Uhde Gmbh [1996] 54 TTJ 355 (Mum.)

## **TDS on accrual basis**

- Flakt (India) Limited [2004] 267 ITR 727 (AAR)

# Analysis of Section 195(1)

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## **Transmission Corporation of A. P. Ltd. [1999] 239 ITR 587 (SC)**

- Payment to NR towards purchase of machinery and erection & commissioning thereof
- Assessee's contention – Section 195 applies only in respect of sums comprising of pure income or profit
- Held that:
  - TDS applicable not only to amount which wholly bears income character but also to sums partially comprising of income
  - Obligation to deduct tax limited to portion of the income chargeable to tax
  - Section 195 is for tentative deduction of tax and by deducting tax, rights of the parties are not adversely affected
  - Rights of parties safeguarded by Sections 195(2), 195(3) and 197
    - File application to AO – If no application filed, tax to be deducted

Is it mandatory to file application to AO if income is not taxable at all?

# Analysis of Section 195(1)

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## **GE India Technology Centre (P.) Ltd. 327 ITR 456 (SC)**

- Payer not liable to deduct tax if amount not chargeable to tax
- Section 195(2) applies where the payer is in no doubt that tax is payable in respect of some part of the amount
  - It applies only in cases of composite payment, in which certain portion has an income element
- If payer is fairly certain, then he can make his own determination of TDS without approaching AO

# Analysis of Section 195(1)

## Sum chargeable to tax – withholding guidelines

Situation	Consequences
Entire payment not chargeable to tax	Not required to withhold tax
Entire payment subject to tax	Tax should be withheld
Part of payment subject to tax	Tax should be withheld on the appropriate proportion of sum chargeable to tax*
Part of payment subject to tax in India – Payer unable to determine appropriate portion of the sum chargeable to tax	Apply to AO for determination of TDS
Payer believes that tax should be withheld but payee does not agree	Approach the AO for determination of TDS

\* CBDT Instruction No. 2/2014 dated 26 February 2014



# Provisions for taxing Non-Resident's Income in India

## Chargeability to tax governed by the provisions of Act / DTAA

Nature of income	Act*	Treaty
Business/ Profession	Taxable if business connection in India [Section 9(1)(i)]	Taxable if income is attributable to a Permanent Establishment in India [Articles 5, 7 & 14]
Salary Income	Taxable if services are rendered in India [Section 9(1)(ii)]	Taxable if the employment is exercised in India (subject to short stay exemption) [Article 15]

\* Apart from Section 5, wherever applicable

Act/ DTAA, whichever is beneficial prevails

# Provisions for taxing Non-Resident's Income in India

## Chargeability to tax governed by the provisions of Act / DTAA

Nature of income	Act*	Treaty
Dividend Income	Taxable if paid by an Indian Company [Section 9(1)(iv)] – (Exempt till AY 2020-21)	Taxable if paid by an Indian Company [Article 10]
Interest Income	Taxable if deemed to arise in India [Sections 9(1)(v), 115A]	Taxable if interest income arises in India [Article 11]
Royalties/ FTS	Taxable if deemed to arise in India [Sections 9(1)(vi)/(vii), 115A]	Taxable if royalty/ FTS arises in India [Article 12]
Capital Gains	Taxable if situs of shares / property in India [Sections 9(1)(i), 45]	Generally taxable if the situs of shares/ property in India [Article 13]

\* Apart from Section 5, wherever applicable

Act/ DTAA, whichever is beneficial prevails

# Analysis of Section 195(1)

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- Are rates prescribed under DTAA to be increased by surcharge and Education Cess?
  - DIC Asia Pacific Pte. Ltd. [2012] 52 SOT 447 (Kol.)
  - Sunil V. Motiani [2013] 59 SOT 37 (Mum.)
  - M Far Hotels Ltd. [2013] 50 SOT 261 (Cochin)
- Payment of royalty/ FTS effectively connected with recipient's PE in India
  - TDS @40%\* on net basis or 10%\* on gross basis?
- Applicability of Section 195 to presumptive tax
  - V.S. Dempo & Co. (P) Ltd. [2016] 381 ITR 303 (Bom.)
  - Frontier Offshore Exploration (India) Ltd [2011] 10 taxmann.com 250 (Chennai)
- Whether TDS applicable on the GST component?
  - CBDT Circular No 1/2014 dated 15 January 2014

\* Excluding surcharge and cess

# Exception to Section 195(1)

- Income not taxable in India
- Specifically covered by other Sections

Section	Particulars	Rate*
192	Salary	Average rate
194LB	Interest from infrastructure debt fund	5%
194LC	Interest from Indian company	5%
194LD	Interest on certain bonds and Government securities	5%
196B	Units of a MF specified in Sec.10(23D) purchased in foreign currency	10%
196C	Income from FCCBs or GDRs	10%
196D	Income of FIIs (except Capital Gains)	20%

\* Excluding surcharge and cess

# Grossing-up of tax (Section 195-A)

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- **Section 195A** – *“In a case other than that referred to in sub-section (1A) of section 192, where under an agreement or other arrangement, the tax chargeable on any income referred to in the foregoing provisions of this Chapter is to be borne by the person by whom the income is payable, then, for the purposes of deduction of tax under those provisions such income shall be increased to such amount as would, after deduction of tax thereon at the rates in force for the financial year in which such income is payable, be equal to the net amount payable under such agreement or arrangement.”*
- Section 195 envisages multiple grossing-up
  - For eg. amount payable to non-resident is 100 and TDS rate is 10%; Gross amount for TDS purpose would be 111.11 (100\*100/90)
- No multiple grossing-up in case of presumptive tax – ONGC [2003] 264 ITR 340 (Uttaranchal)
  - Section 195A not applicable to Section 44BB
- Exemption from grossing-up under Section 10(6BB) – Aircraft and aircraft engine lease rentals
- Section 192(1A) – Tax on non-monetary perquisite – Not covered by Section 195A
- In respect of payment made ‘net of tax’ also, the payer is under legal obligation to furnish TDS certificate to the payee [Circular no. 785 dated 24 November 1999]

# Section 195(2)- Application by the Payer

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- **Section 195(2)** – *“Where the person responsible for paying any such sum chargeable under this Act (other than salary) to a non-resident considers that the whole of such sum would not be income chargeable in the case of the recipient, he may make an application to the Assessing Officer to determine, by general or special order, the appropriate proportion of such sum so chargeable, and upon such determination, tax shall be deducted under sub-section (1) only on that proportion of the sum which is so chargeable.”*
- Can application under Section 195(2) be made for NIL withholding order?
  - Favourable
    - Van Oord ACZ India (P.) Ltd.[2010] 323 ITR 130 (Del.)
    - Mangalore Refinery and Petrochemicals Ltd. [2008] 113 ITD 85 (Mum.)
  - Unfavourable
    - GE India Technology Centre (P.) Ltd. [2010] 327 ITR 456 (SC)
    - Czechoslovak Ocean Shipping International Joint Stock Company [1971] 81 ITR 162 (Cal.)
    - Graphite Vicarb India Ltd. [1986] 18 ITD 58 (Cal.)

# Section 195(3) / 197- Application by the Payee

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- **Section 195(3)** – *“Subject to rules made under sub-section (5), any person entitled to receive any interest or other sum on which income-tax has to be deducted under sub-section (1) may make an application in the prescribed form to the Assessing Officer for the grant of a certificate authorising him to receive such interest or other sum without deduction of tax under that sub-section, and where any such certificate is granted, every person responsible for paying such interest or other sum to the person to whom such certificate is granted shall, so long as the certificate is in force, make payment of such interest or other sum without deducting tax thereon under sub-section (1).”*
- **Section 195(4)** – *“A certificate granted under sub-section (3) shall remain in force till the expiry of the period specified therein or, if it is cancelled by the Assessing Officer before the expiry of such period, till such cancellation.”*

# Section 195(3) / 197- Application by the Payee

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- **Section 197(1)** – *“Subject to rules made under sub-section (2A), where, in the case of any income of any person or sum payable to any person, income-tax is required to be deducted at the time of credit or, as the case may be, at the time of payment at the rates in force under the provisions of sections 192, 193, 194, 194A, 194C, 194D, 194G, 194H, 194-I, 194J, 194K, 194LA, 194LBB, 194LBC and 195, the Assessing Officer is satisfied that the total income of the recipient justifies the deduction of income-tax at any lower rates or no deduction of income tax, as the case may be, the Assessing Officer shall, on an application made by the assessee in this behalf, give to him such certificate as may be appropriate.”*



# Section 195(3) / 197- Application by the Payee

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- **Section 195(3) - Payee satisfying certain conditions can make an application (Form 15C for banking companies or Form 15D for non-banking companies)**
- Prescribed conditions (Rule 29B):
  - Has been regularly filing tax returns and assessed to Income-tax
  - Not in default in respect of tax, interest, penalty, etc.
  - Additional conditions for non-banking companies:
    - Has been carrying on business or profession in India through a branch for at least 5 years
    - Value of Fixed Assets in India exceeds INR 50 Lakhs
- Certificate issued by the AO valid for the Financial Year mentioned therein

# Section 195(3) / 197- Application by the Payee

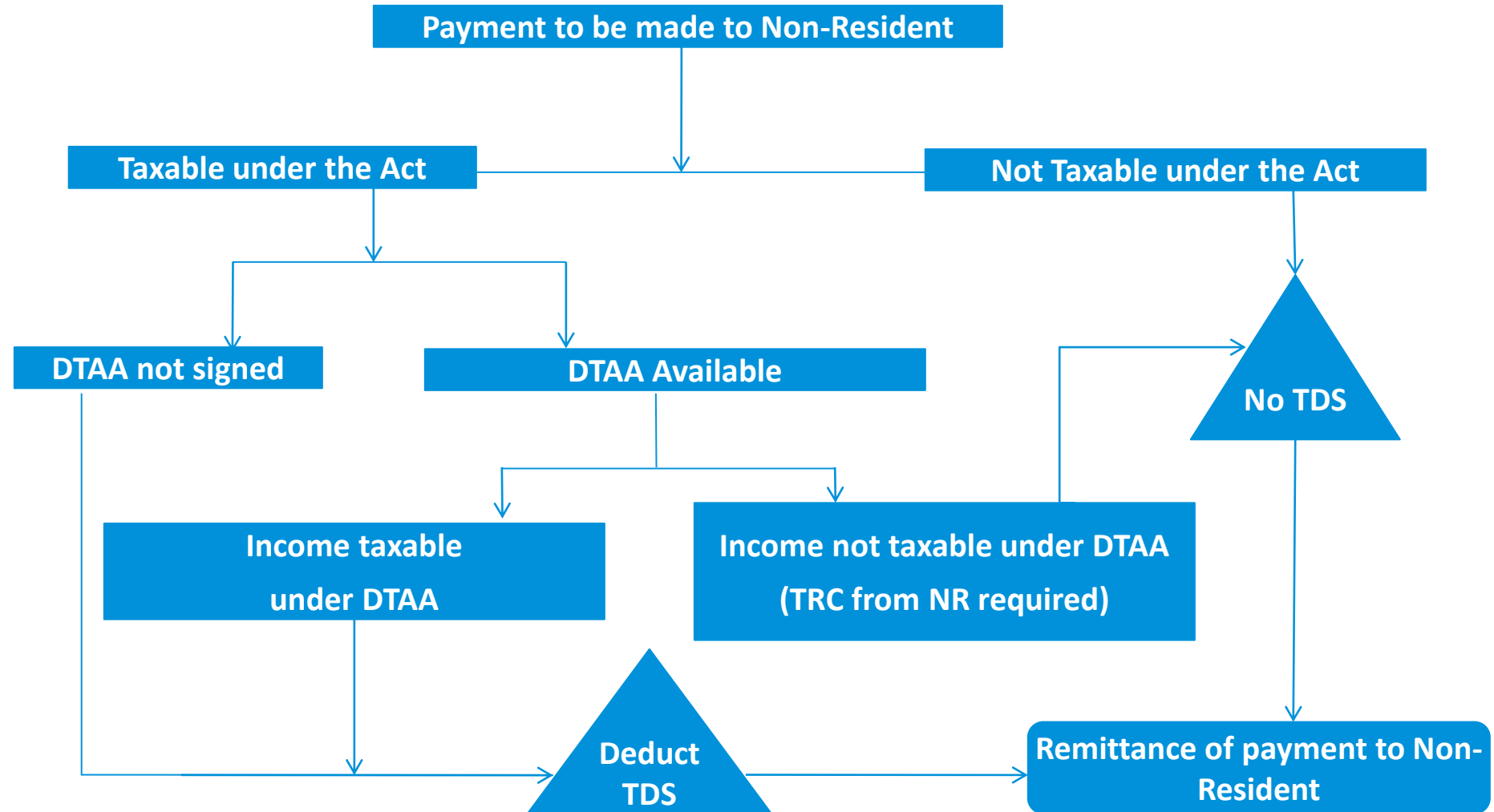
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- **Section 197 – Any payee can apply for no deduction or lower rate of deduction**
- Certificate issued by AO can be prospective only
  - Payment/ credit made prior to the date of the certificate not covered
  - Circular No. 774 dated 17 March 1999

# Lower Withholding- A Snapshot

Particulars	Section 195(2)	Section 195(3)	Section 197
<b>Overview</b>	Payer having a belief that portion (not the whole amount) of any sums payable by him to non-resident is not liable to tax in India, may make an application to <u>AO to determine taxable portion</u>	Payee may make an application to AO for granting him a <u>certificate to receive income without TDS</u>	Payee may make an application to AO for granting him <u>certificate of 'Nil' or 'lower' withholding</u>
<b>Application by</b>	Payer	Non-resident Payee	Payee
<b>Purpose</b>	Determination of portion of such sum chargeable to tax	No withholding	Lower / Nil withholding
<b>Form</b>	No specific format	Rule 29B – Form 15C and 15D	Rule 28 - Form 13
<b>Outcome</b>	AO to determine the <u>appropriate proportion</u> chargeable to tax and issue order accordingly	Certificate issued by the AO subject to conditions specified in Rule 29B	Certificate to be issued by AO subject to conditions specified in Rule 28AA
<b>Remedy</b>	Order can be appealed under Section 248	<ul style="list-style-type: none"> <li>There is no provision under Chapter XX of the Act, to appeal against the certificate issued</li> <li>Possible to pursue application under Section 264</li> <li>Possible to explore writ jurisdiction – Diamond Services International (P.) Ltd. [2008] 169 Taxman 201 (Bom)</li> </ul>	

# Withholding liability under section 195 - Summary



# Section 206AA



# Section 206AA of the Act

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- **Section 206AA(1)** – Notwithstanding anything contained in any other provisions of this Act, any person entitled to receive any sum or income or amount, on which tax is deductible under Chapter XVIIIB (hereafter referred to as deductee) shall furnish his Permanent Account Number to the person responsible for deducting such tax (hereafter referred to as deductor), failing which tax shall be deducted at the higher of the following rates, namely:—
  - (i) at the rate specified in the relevant provision of this Act; or
  - (ii) at the rate or rates in force; or
  - (iii) at the rate of twenty per cent.

# Section 206AA of the Act- An Analysis

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- Requirement to withhold tax at the higher of the following rates if deductee fails to provide its PAN to the deductor:
  - Rate specified in the relevant provision of the Act (i.e. specified rates in Chp XVII-B); or
  - Rates in force; or
  - Rate of 20%
- TDS as per the rates specified in DTAA
  - Serum Institute of India Ltd. [2015] 68 SOT 254 (Pune.)
  - Infosys BPO Ltd. [2015] 154 ITD 816 (Bang.)
  - Pricol Ltd. [ITA. No.880 & 1141/Mds./2014] [Date of Order: 9.12.2015] (Chennai.)
    - Section 206AA does not override Section 90(2) of the Act; held that lower TDS as per favourable DTAA provisions applicable and not higher rate under Section 206AA

# Section 206AA of the Act- An Analysis

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- Surcharge or education cess on maximum rate of 20% as per Section 206AA?
  - Finance Act does not include Section 206AA in its ambit for the purpose of levy of surcharge or education cess
  - No surcharge and education cess would be leviable; provided maximum rate of 20% is applied
- Section 195A vis-à-vis Section 206AA
- Need for grossing up
  - View 1 – no grossing up required
    - Neither Section 195A makes reference to Section 206AA, nor Section 206AA provides for grossing up
  - View 2 – grossing up required only vis-à-vis clause (ii) of Section 206AA(1)
    - As per Section 195A, grossing up where TDS at the rates in force
  - View 3 – grossing up in all three cases
- Manner of grossing up
  - In cases where rate in force is 10% as per DTAA – Whether grossing up should be on 10%, being rate in force or on 20%?



# Section 206AA of the Act- An Analysis

Particulars	Option 1	Option 2	Option 3	Option 4
Net of Tax Payment to non-resident	100	100	100	100
(+) Grossing up	11.11	11.11	21.11	25
Total	111.11	111.11	121.11	125
(-) TDS	11.11	22.22	21.11	25
Payment to be made to the non-resident	100	88.89	100	100

- Bosch Ltd. [2013] 141 ITD 38 (Bang.) – for grossing up, 10% rate should be considered

# Section 206AA of the Act- An Analysis

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- As per Section 206AA(7), the section shall not apply to a non-resident/foreign company, in respect of:
  - payment of interest on long-term bonds referred to in Section 194LC
  - any other payment subject to such conditions as may be prescribed

**Rule 37BC\* providing for details and documents to be furnished by the non-resident to avail relaxation under Section 206AA(7)**

\* CBDT Notification 53/2016/F. No. 370142/16/2016-TPL dated 24 June 2016

# Rule 37BC

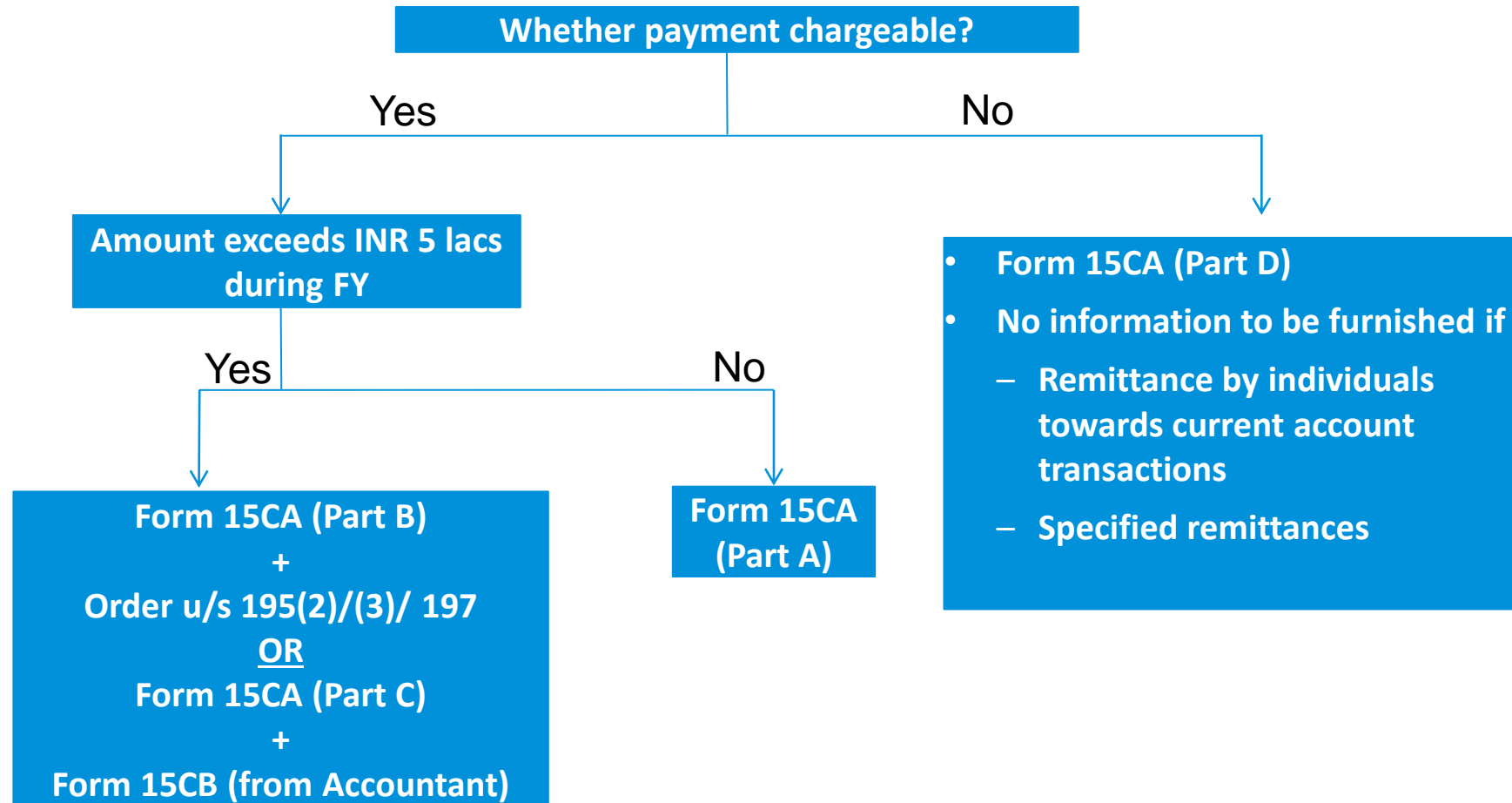
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- Section 206AA shall not apply on the following payments to non-resident deductees who do not have PAN in India, subject to deductee furnishing the specified details and documents to the deductor:
  - Interest;
  - Royalty;
  - Fees for Technical Services; and
  - Payment on transfer of any capital asset
- In respect of the above, the deductee shall be required to furnish the following to the deductor:
  - name, e-mail id, contact number
  - address in the country outside India of which the deductee is a resident
  - a certificate of his being resident from the Government of that country if the law provides for issuance of such certificate
  - Tax Identification Number of the deductee/ a unique number on the basis of which the deductee is identified by the Government

# Key Aspects for Form No 15CA / 15CB



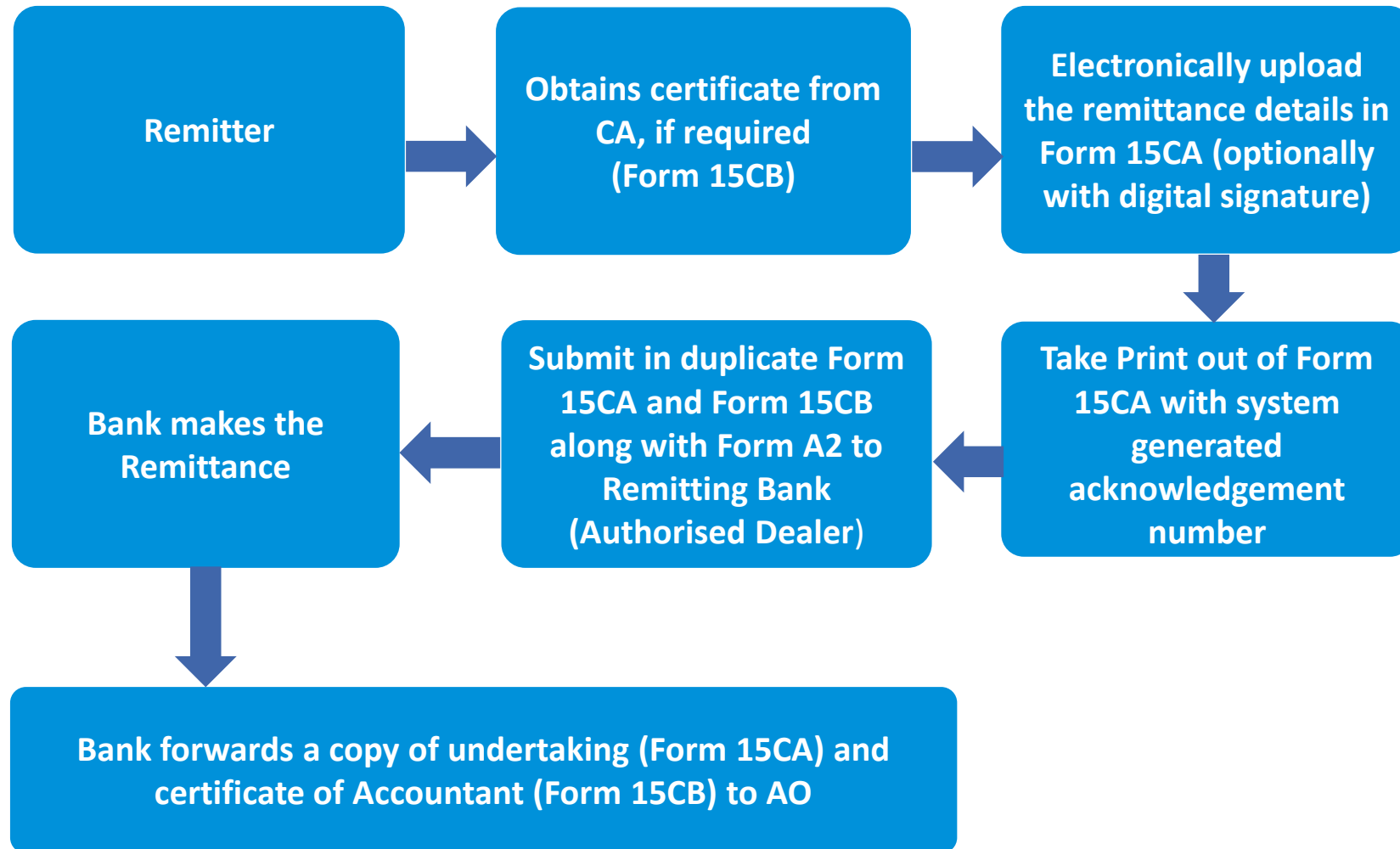
# Key Aspects for Form No 15CA / 15CB



## Note

- 1) Form 15CA to be furnished electronically and thereafter printout to be submitted to AD
- 2) Form 15CB to be furnished electronically

# Key Aspects for Form No 15CA / 15CB



# Key Documents to be maintained

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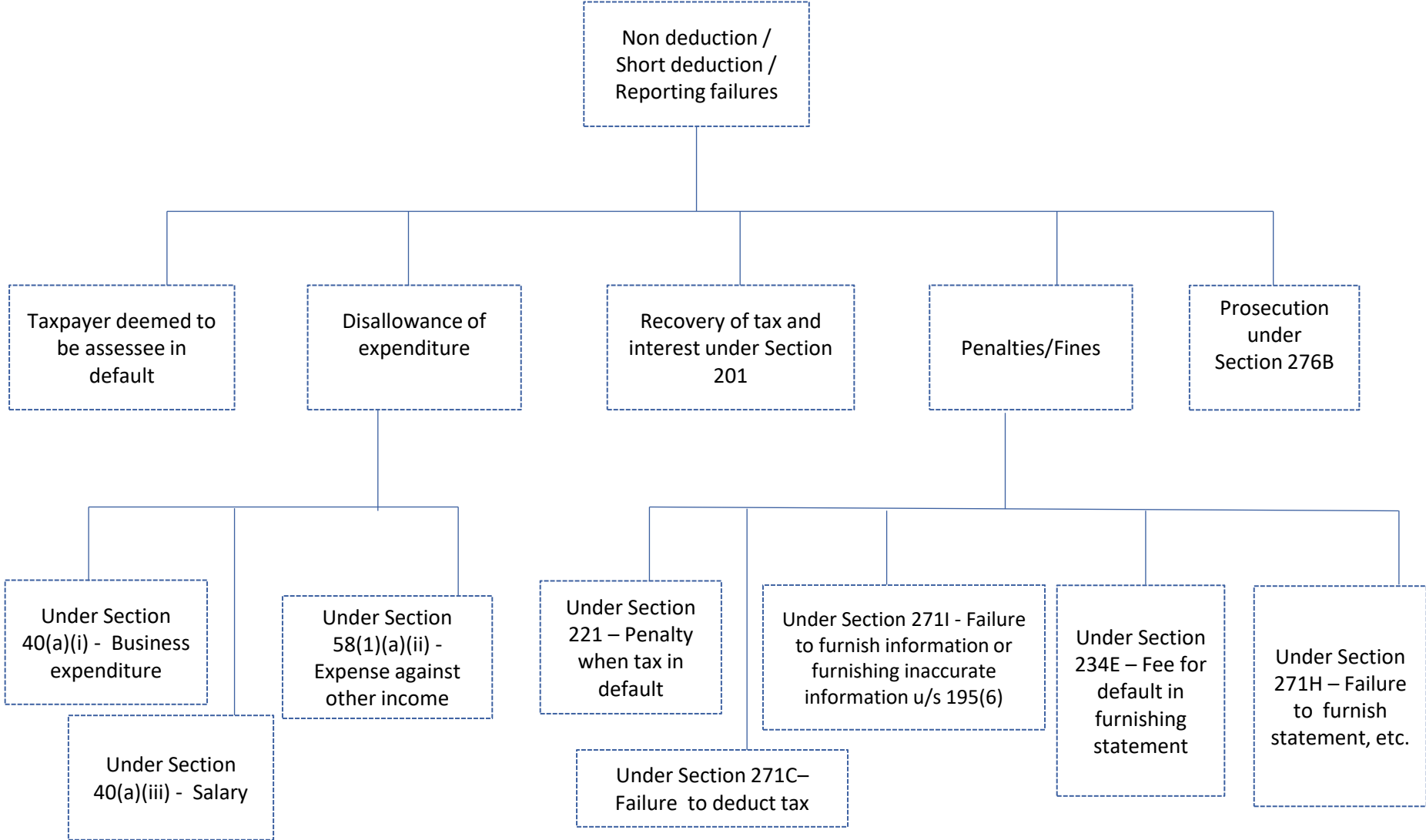
- **Suggested list – not exhaustive**
  - Agreement between parties evidencing nature of payment, consideration, withholding tax borne by whom, etc.
  - Invoice
  - No PE declaration by non-resident
  - TRC in order to claim Treaty benefits
  - Declaration about the beneficial owner of royalty/ FTS
  - Opinion/ advice obtained from consultants while taking position on withholding tax implications on given transactions
  - Exchange rate letter
  - CA certificate in Form No. 15CB

# Consequences of non-compliance





# Consequences of non/ short deduction/ reporting failures



# Key Takeaways



# Key Takeaways



**Need to be mindful while dealing with NRIs- they may not be aware of the Indian Laws**



**Check Residential status as per Income-tax and FEMA**



**Check Taxability of various income streams under the Act as well as under the respective Treaty – Dividends, Interest, Rentals, Capital Gains, Royalty / FTS etc**



**Payments can be remitted under alternative mechanism (CA certificate route) if assessee is fairly certain about TDS obligation**



**In case of a doubt or a substantial amount, it is advisable to obtain tax withholding order**



**Mitigate against severe consequences of non-compliance of Section 195**



**Tax withholding from cross-border transactions is critical!!**



**Consult an expert if required in tricky cases where amount involved is substantial**

Q & A



# Thank You



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