TDS ON FOREIGN REMITTANCES

A 360°perspective

By

Vikram Vijayaraghavan, Advocate

Subbaraya Aiyar, Padmanabhan & Ramamani Advocates

http://www.saprlaw.com

Agenda

1. Provisions related to Non-residents
2. International Taxation – Overview of important TDS Sections
3. Machinery & Disallowance provisions
   - S.195 – A detailed look
   - S.40(a)(i) – Disallowance sections
   - S.201(1), S.160
4. A typical TDS disallowance scenario
5. Deeming fiction (S.9) & corresponding DTAA Articles – a deep dive
   - Foreign Commission Agent
   - Capital transactions - “Vodafone” amendments
   - Royalty
   - Fees for Technical Services

Agenda

6. TDS relief - Some interesting avenues
   - Impossibility of performance
   - Non-discrimination
   - MFN (Most Favoured Nation)
7. S.9(1)(ii), (iii) & (iv) – Salaries & Employment
   - Working abroad
   - Employment/Secondment
8. Sound of one-handed clapping!
   - S.206AA
   - S.94A
   - Equalization Levy – Part I & II

Agenda

9. Recent updates
    - PILCOM ruling
    - S.6 – Residence amendments
    - S.6 - POEM (Place of Effective Management)
10. Miscellaneous topics
    - Reimbursement & TDS
    - Payment through intermdiary
    - S.9(1)(viii)
    - TDS on immovable property with NR as seller
    - S.172 – Shipping
    - Penal provisions

Non-Resident related Provisions under IT Act

Section of IT Act	What it deals with
2(30)	Non-resident definition
4	Charge of Income
5	Scope of total income
6	Residence in India
7	Income deemed to be received
9	Income deemed to accrue or arise in India
9A	Certain activities not to constitute business connection in India
10(4) / (4B)	Interest – NRE
10(6B)	Tax paid by Govt/Indian Employer
10(8A)/10(8B)/10(9)	Exemption to consultant
40(a)(i)	Disallowance for non-deduction on NR payments
172, 44BB	Shipping business

Non-Resident - Provisions under IT Act

Section of IT Act	What it deals with
44BB	Prospecting Mineral Oil
44BBA	Operation of Aircraft
44C	Head Office expenditure
44DA	Royalty – FTS when PE in India
47(viia)	GDR transfer - NR to NR
90/91/90A	DTAA etc.
92-92F	Transfer Pricing
93	Avoidance of income-tax by transactions resulting in transfer of income to NRs
115A	Tax on Dividend, Royalty, FTS and interest
115AB	Tax on Income/CG on Units purchased in Foreign Currency
115AC	Income / shares / GDR purchased in forex

Non-Resident - Provisions under IT Act

Section of IT Act	What it deals with
115AD	Tax on Income of FII from securities
115BBA	Tax on Entertainer/Sportsmen/Sports Assoc.
115BBD	Tax on dividend from foreign cos
S.115C	Definitions – convertible foreign exchange, NRI, LTCG
115D	Special provisions for computation of income
115E	Tax on Investment Income & LTCG
115G	Return of Income not to be filed in certain cases
115H	Benefit of scheme available in certain cases even after becoming resident
115-I	Non-application of scheme if NR so chooses
160-163	Agent
173	Recovery of tax from asset

Non-Resident Provisions under IT Act

Section of IT Act	What it deals with
194E	TDS – Entertainer/ Sportsmen /Sports Assoc.
194LBA/LC/LD	TDS – Interest
195	**TDS**
196A	TDS on Units
285	Statement by NRs having Liaison Office
286	Reporting of International Group
We will also talk about S.201/201(1) – assessee in default, notice sent to the payer	
S.94A, DTAA articles, MLI, OECD BEPs etc!	

International Taxation – TDS Sections An Overview

- **S.5(2)**: charging provision
  - *accrues* or arise or
  - ***deemed to accrue or arise*** (S.9) or
  - *received in India* or
  - ***deemed to be received*** *in India*
- **S.9:** deeming provisions

OR

- **Relevant DTAA**
  - Article 7 r.w. 5 Business profits r.w. Permanent Establishment
  - Article 12/13 Royalties or FTS
- **S.195**: rates in force
- **Disallowances under S.40(a)(i), S.201(1), s.163,**

S.5

S.5(2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—

(a) is received or is deemed to be received in India in such year by or on behalf of such person ; or

(b) accrues or arises or is ***deemed to accrue or arise to him*** *in India during such year.*

S.5

Explanation 1.—Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India.

Explanation 2.—For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India.

S.2(30) r.w. S.6

S.2(30) "non-resident" means *a person who is not a "resident" , and for the purposes of sections 92, 93 and 168, includes a person who is not ordinarily resident within the meaning of clause (6) of section 6 ;*

S.6 – Resident, RNOR

6. For the purposes of this Act,—

(1) An individual is said to be resident in India in any previous year, if he—

(a) is in India in that year for a period or periods amounting in all to one hundred and eighty-two days or more ; or

(c) having within the four years preceding that year been in India for a period or periods amounting in all to three hundred and sixty-five days or more, is in India for a period or periods amounting in all to sixty days or more in that year.

Explanation 1.—In the case of an individual,—

(a) being a citizen of India, who leaves India in any previous year as a member of the crew of an Indian ship as defined in clause (18) of section 3 of the Merchant Shipping Act, 1958 (44 of 1958), or for the purposes of employment outside India, the provisions of sub-clause (c) shall apply in relation to that year as if for the words "sixty days", occurring therein, the words "one hundred and eighty-two days" had been substituted ;

(b) being a citizen of India, or a person of Indian origin within the meaning of Explanation to clause (e) of section 115C, who, being outside India, comes on a visit to India in any previous year, the provisions of sub-clause (c) shall apply in relation to that year as if for the words "sixty days", occurring therein, the words "one hundred and eighty-two days" had been substituted 6[and in case of the citizen or person of Indian origin having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year, for the words "sixty days" occurring therein, the words "one hundred and twenty days" had been substituted].

Explanation 2.—For the purposes of this clause, in the case of an individual, being a citizen of India and a member of the crew of a foreign bound ship leaving India, the period or periods of stay in India shall, in respect of such voyage, be determined in the manner and subject to such conditions as may be prescribed.

Preventing Tax Abuse
Residency provisions – Finance Bill 2020

- Section 6(1) of the ITA provides that an individual qualifies as a resident in India in a previous year if he
  - (i) is in India during that year for a total of 182 days or more ("T1"); or
  - (ii) is in India during that year for 60 days or more and has been in India for a total of 365 days over the course of the 4-year period preceding that year ("T2").
- Explanation 1 further clarifies that with regard to T2, where the taxpayer is an Indian citizen or PIO who was visiting India during the previous year, requirement of having to spend 60 days or more in the previous year shall be extended to 182 days.
  - extension of time was specifically provided to Indian citizens and PIOs to allow them to visit India for a longer period of time without qualifying as residents.

Preventing Tax Abuse
Residency provisions – Finance Bill 2020

- Govt feels many Indian citizens / PIOs have taken advantage of the extension of time to carry on substantial economic activities in India without qualifying as residents, so now extension of time limited from 182 days to 120 days.
- In other words, pursuant to T2, an Indian citizen or PIO will qualify as a tax resident of India if he is in India during that year for 120 days or more and has been in India for a total of 365 days over the course of the 4-year period preceding that year.
- *Points to ponder: 120 is an arbitrary choice!*

Preventing Tax Abuse
Residency provisions – Finance Act 2020

- FA 2020 has modified this proposed provision in the FB 2020. It will now cover an Indian citizen/Person of Indian Origin, if that individual's total income, (other than 'income from foreign sources') exceeds INR 15 lakh during the previous year.
- 'Income from foreign sources' has been defined as income which accrues or arises outside India (except income derived from business controlled in or profession set up in India).

6(a) in clause (1), in Explanation 1, in clause (b), for the words "substituted" occurring at the end, the words "substituted and in case of the citizen or person of Indian origin having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year," for the words "sixty days" occurring therein, the words "one hundred and twenty days" had been substituted

Preventing Tax Abuse
S.6(1A) – Finance Bill 2020

- S.6(1A): *"Notwithstanding anything contained in clause (1), an individual, being a citizen of India, shal lbe deemed to be resident in India in any previous year, if he is not liable to tax in any other country of territory by reason of his domicile or residence or any other criteria of similar nature"*
- **New section causing much controversy**!
- Would it imply that even if a person is not subject to tax, but is still within the scope of taxation in a foreign country or jurisdiction, or if a foreign country exempts its residents from taxation, India's right under S.6(1A) would come into play?
  - Remember ***In Re: Mohsinally Alimohammed … vs Unknown (AAR)*** on 23.12.1994

Preventing Tax Abuse
S.6(1A)

- Finance Act 2020 now reads:

"(1A) Notwithstanding anything contained in clause (1), an individual, being a citizen of India, having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year shall be deemed to be resident in India in that previous year, if he is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature;

Preventing Tax Abuse

Press Release

The Finance Bill, 2020 has proposed that an Indian citizen shall be deemed to be resident in India, if he is not liable to be taxed in any country or jurisdiction. This is an anti-abuse provision since it is noticed that some Indian citizens shift their stay in low or no tax jurisdiction to avoid payment of tax in India.

The new provision is not intended to include in tax net those Indian citizens who are bonafide workers in other countries. In some section of the media the new provision is being interpreted to create an impression that those Indians who are bonafide workers in other countries, including in Middle East, and who are not liable to tax in these countries will be taxed in India on the income that they have earned there. This interpretation is not correct.

In order to avoid any misinterpretation, it is clarified that in case of an Indian citizen who becomes deemed resident of India under this proposed provision, income earned outside India by him shall not be taxed in India unless it is derived from an Indian business or profession. Necessary clarification, if required, shall be incorporated in the relevant provision of the law.

Preventing Tax Abuse
RNOR test (Finance Bill 2020)

- Resident but not Ordinarily Resident ("RNOR") test streamlined if such individual has been a non-resident in India for 7 out of the 10 years preceding the relevant previous year. The same amendment has also been proposed with respect to HUFs as well.
  - S.6(6)(a) & (b) replaced; 729 day test removed
- Simpler test and makes it easier for an individual to qualify as an RNOR.

Preventing Tax Abuse
RNOR test (Finance Act 2020)

- This proposed provision in FB 2020 has been withdrawn in FA 2020(!) so that existing dual conditions in the Act for an individual to qualify to be "Not Ordinarily Resident" (NOR), are retained. **This is reversion to the earlier thresholds.**
- Further, owing to the new provisions under FA 2020 regarding tax residency of individuals, the following individuals would now qualify to be NOR:
  - an Indian citizen or person of Indian origin with total income, other than income from foreign sources, exceeding INR 15 lakh during the previous year and who has been in India for 120 days or more but less than 182 days;
  - or Indian citizen who is deemed to be resident (i.e. Indian citizen with total income, other than income from foreign sources, exceeding INR15 lakh during the previous year) not liable to tax in any other jurisdiction (by reason of his domicile or residence).

S.9 - **Income deemed to accrue or arise in India**

- **Deeming fiction** – one of the most important provisions in the Indian Income Tax Act
- S.9 of the Act has been widely classified into three categories i.e., business income (S.9(1)(i), royalty (S.9(1)(vi)) and fee for technical services (S.9(1)(vii)) that makes it applicable on non-residents and are deemed to accrue or arise in India.
- Based on the heads of income, the tax rates tend to differ. With a PE in India
  - FTS & Royalties (S.115A and Article 12/13 of relevant DTAA) *typically* results in 10% tax on gross basis
  - If PE in India, taxed at ~40% with expenses of PE deductible

DTAA

S.90 - Agreement with foreign countries or specified territories.

S.90. (1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,—

(a) for the granting of relief in respect of—

(i) income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or

(ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, to promote mutual economic relations, trade and investment, or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, as the case may be, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory), or

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory, as the case may be, or investigation of cases of such evasion or avoidance, or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory, as the case may be, and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(2) Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, **in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.**

DTAA
S.90 - Agreement with foreign countries or specified territories.

(2A) Notwithstanding anything contained in sub-section (2), the provisions of Chapter X-A of the Act shall apply to the assessee even if such provisions are not beneficial to him.

(3) Any term used but not defined in this Act or in the agreement referred to in sub-section (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.

(4) An assessee, not being a resident, to whom an agreement referred to in sub-section (1) applies, shall not be entitled to claim any relief under such agreement unless a certificate of his being a resident in any country outside India or specified territory outside India, as the case may be, is obtained by him from the Government of that country or specified territory.

(5) The assessee referred to in sub-section (4) shall also provide such other documents and information, as may be prescribed.

DTAA
S.90 - Agreement with foreign countries or specified territories.

Explanation 1.—For the removal of doubts, it is hereby declared that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

Explanation 2.—For the purposes of this section, "specified territory" means any area outside India which may be notified as such by the Central Government.

Explanation 3.—For the removal of doubts, it is hereby declared that where any term is used in any agreement entered into under sub-section (1) and not defined under the said agreement or the Act, but is assigned a meaning to it in the notification issued under sub-section (3) and the notification issued thereunder being in force, then, the meaning assigned to such term shall be deemed to have effect from the date on which the said agreement came into force.

Explanation 4.—For the removal of doubts, it is hereby declared that where any term used in an agreement entered into under sub-section (1) is defined under the said agreement, the said term shall have the same meaning as assigned to it in the agreement; and where the term is not defined in the said agreement, but defined in the Act, it shall have the same meaning as assigned to it in the Act and explanation, if any, given to it by the Central Government.

S.91
Countries with which no DTAA exists.

S.91. (1) If any person who is resident in India in any previous year proves that, in respect of his income which accrued or arose during that previous year outside India (and which is not deemed to accrue or arise in India), he has paid in any country with which there is no agreement under section 90 for the relief or avoidance of double taxation, income-tax, by deduction or otherwise, under the law in force in that country, he shall be entitled to the deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.

Income Tax vs. DTAA Overview

Type of income of NR	Income Tax Act	DTAA
Business Income	S.9(1)(i) – Business connection / PE	Article 7 r.w. Article 5
Royalties	S.9(1)(vi) and S.115A	Article 13
FTS	S.9(1)(vii) and S.115A	Article 13
Capital Gains	S.9(1)(i) and S.45	Article 14
Profession	S.9(1)(i) - Fixed base	Article 15 (Independent Personal Services)
Salary	S.9(1)(ii) and S.115A	Article 16 (Dependent Personal Services)
Dividend Income	S.9(1)(v) and S.115A	Article 11
Interest	S.9(1)(iv) and S.115A	Article 12

Act vs. DTAA: A constant battle

- Act provisions and DTAA articles are always to be considered
  - Throughout this lecture we will have the provisions of the Act and the corresponding DTAA Article considered
- In many cases, the relevant DTAA may have beneficial provisions which can be invoked
  - New amendments and levies challenge the power and usefulness of DTAA's
  - Over time, there is a unilateral exercise to get around the limitations of the DTAA as we shall see later in the lecture
    - Equalization Levy
    - S.94A
    - SEP (Significant Economic Presence) / Virtual PE's

S.195

Other sums.

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***

S.195 – Machinery provision

- Who
  - Any person responsible for paying to a non-resident or a foreign company
- What
  - Any interest or **any other sum chargeable to tax** under the provisions of the IT Act
- When
  - At time of credit or payment whichever earlier
- How
  - Deduct income-tax thereon at **rates in force**

S.195 – “Rates in force”

- Defined in sec.2(37A)
- Rates of income-tax specified in the Finance Act or the rates specified in the DTAA, whichever is applicable by virtue of Section 90 or Section 90A – Section 2(37A)(iii) - Circular No. 728 of 30 October 1995

S.195(1)
Explanations

Explanation 1.—For the purposes of this section, where any interest or other sum as aforesaid is credited to any account, whether called "Interest payable account" or "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.

Explanation 2.—For the removal of doubts, it is hereby clarified that the obligation to comply with sub-section (1) and to make deduction thereunder applies and shall be deemed to have always applied and extends and shall be deemed to have always extended to all persons, resident or non-resident, whether or not the non-resident person has—

(i) a residence or place of business or business connection in India; or

(ii) any other presence in any manner whatsoever in India.

S.195(2) – the *Samsung* fiasco

(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 in such form and manner to the Assessing Officer****,* ***to determine in such manner, as may be prescribed, 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.*

(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).

S.195(4)…S.194(7)

(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.

(5) The Board may, having regard to the convenience of assessees and the interests of revenue, by notification in the Official Gazette, make rules specifying the cases in which, and the circumstances under which, an application may be made for the grant of a certificate under sub-section (3) and the conditions subject to which such certificate may be granted and providing for all other matters connected therewith.

(6) The person responsible for paying to a non-resident, not being a company, or to a foreign company, any sum, whether or not chargeable under the provisions of this Act, shall furnish the information relating to payment of such sum, in such form and manner, as may be prescribed.

(7) Notwithstanding anything contained in sub-section (1) and sub-section (2), the Board may, by notification in the Official Gazette, specify a class of persons or cases, where the person responsible for paying to a non-resident, not being a company, or to a foreign company, any sum, whether or not chargeable under the provisions of this Act, shall make an application in such form and manner to the Assessing Officer, to determine in such manner, as may be prescribed, the appropriate proportion of sum chargeable, and upon such determination, tax shall be deducted under sub-section (1) on that proportion of the sum which is so chargeable.

S.195 - Overview

- Lays down responsibility of TDS on the “person responsible for paying” to non-resident
- Payer/Payee - Application to the Assessing Officer for lower/ NIL deduction of tax by payer [S.195(2)/195(3)]
- Certificate for lower/NIL deduction of tax [S.197]
- Declaration to be filed + CA certificate [S. 195(6)].
- Board can specify a class of persons or cases, where payer has to make an application. *No person or classes have been specified so far.*

S.195(2) Application – Mandatory or not An unnecessary controversy?

- **Samsung Corporation decision (185 Taxmann 313 Karnataka HC)** held it is a statutory obligation for obtaining S.195(2) certificate
- **GE Technology decision in 234 CTR 153** clarified S.195(2) certificate non-mandatory
- **CBDT Circulars since:**
  - 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)**

S.195(2) - Not mandatory
G.E.India Technology Centre vs. CIT (327 ITR 456 SC)

7. ....It may be noted that Section 195 contemplates not merely amounts, the whole of which are pure income payments, it also covers composite payments which has an element of income embedded or incorporated in them. Thus, where an amount is payable to a non-resident, the payer is under an obligation to deduct TAS in respect of such composite payments. The obligation to deduct TAS is, however, limited to the appropriate proportion of income chargeable under the Act forming part of the gross sum of money payable to the non-resident. ***This obligation being limited to the appropriate proportion of income flows from the words used in Section 195(1), namely, "chargeable under the provisions of the Act". It is for this reason that vide Circular No. 728 dated October 30, 1995 the CBDT has clarified that the tax deductor can take into consideration the effect of DTAA in respect of payment of royalties and technical fees while deducting TAS.***

S.195(2) - Not mandatory
G.E.India Technology Centre vs. CIT (327 ITR 456 SC)

*In our view, **Sections 195(2) and 195(3) are safeguards**. The said provisions are of practical importance. This reasoning of ours is based on the decision of this Court in Transmission Corporation (supra) in which this Court has observed that the provision of Section 195(2) is a safeguard. From this it follows that where a person responsible for deduction is fairly certain then he can make his own determination as to whether the tax was deductible at source and, if so, what should be the amount thereof.*

S.195(2) - Not mandatory
G.E.India Technology Centre vs. CIT (327 ITR 456 SC)

*It may also be noted that Section 195(1) is in identical terms with Section 18(3B) of the 1922 Act. In **CIT Vs. Cooper Engineering [68 ITR 457]** it was pointed out that if the payment made by the resident to the nonresident was an amount which was not chargeable to tax in India, then no tax is deductible at source even though the assessee had not made an application under Section 18(3B) (now Section 195(2) of the I.T. Act). ..... **Hence, apart from Section 9(1), Sections 4, 5, 9, 90, 91 as well as the provisions of DTAA are also relevant, while applying tax deduction at source provisions. Reference to ITO(TDS) under Section 195(2) or 195(3) either by the non-resident or by the resident payer is to avoid any future hassles for both resident as well as non-resident.***

*8. If the contention of the Department that the moment there is remittance the obligation to deduct TAS arises is to be accepted then we are obliterating the words "chargeable under the provisions of the Act" in Section 195(1). The said expression in Section 195(1) shows that the remittance has got to be of a trading receipt, the whole or part of which is liable to tax in India. The payer is bound to deduct TAS only if the tax is assessable in India. If tax is not so assessable, there is no question of TAS being deducted. [See : **Vijay Ship Breaking Corporation and Others Vs. CIT 314 ITR 309**]*

S.195(2) - Not mandatory
G.E.India Technology Centre vs. CIT (327 ITR 456 SC)

9. ....Hence, the provisions relating to TDS applies only to those sums which are chargeable to tax under the I.T. Act. If the contention of the Department that any person making payment to a non-resident is necessarily required to deduct TAS then the consequence would be that the Department would be entitled to appropriate the moneys deposited by the payer even if the sum paid is not chargeable to tax because there is no provision in the I.T. Act by which a payer can obtain refund. Section 237 read with Section 199 implies that only the recipient of the sum, i.e., the payee could seek a refund. It must therefore follow, if the Department is right, that the law requires tax to be deducted on all payments. ***The payer, therefore, has to deduct and pay tax, even if the so-called deduction comes out of his own pocket and he has no remedy whatsoever, even where the sum paid by him is not a sum chargeable under the Act. The interpretation of the Department, therefore, not only requires the words "chargeable under the provisions of the Act" to be omitted, it also leads to an absurd consequence. The interpretation placed by the Department would result in a situation where even when the income has no territorial nexus with India or is not chargeable in India, the Government would nonetheless collect tax.***

S.195(2) - Not mandatory
G.E.India Technology Centre vs. CIT (327 ITR 456 SC)

In our view, Section 195(2) provides a remedy by which a person may seek a determination of the "appropriate proportion of such sum so chargeable" where a proportion of the sum so chargeable is liable to tax. The entire basis of the Department's contention is based on administrative convenience in support of its interpretation. According to the Department huge seepage of revenue can take place if persons making payments to non-residents are free to deduct TAS or not to deduct TAS. It is the case of the Department that Section 195(2), as interpreted by the High Court, would plug the loophole as the said interpretation requires the payer to make a declaration before the ITO(TDS) of payments made to non-residents. ***In other words, according to the Department Section 195(2) is a provision by which payer is required to inform the Department of the remittances he makes to the non- residents by which the Department is able to keep track of the remittances being made to non-residents outside India. We find no merit in these contentions.***

CBDT Circular 3 of 2015
An important TDS Circular!

Subject:- Clarification regarding 'Amounts not deductible' under sub-clause (i) of clause (a) of section 40 of Income-tax Act, 1961 ('Act')-regarding

Section 40(a)(i) of the Act stipulates that in computing the income chargeable under the head "Profits or gains or profession", any interest, royalty, fees for technical services or other sum chargeable under this Act either payable in India to a non-resident (not being a company)/a foreign company or payable outside India, shall not be allowed a deduction, if there has been a failure in deduction or in payment of tax deducted in respect of such amounts under Chapter XVII-B of the Act.

2. Disallowance regarding 'other sum chargeable' under section 40(a)(i) is triggered when the deductor fails to withhold tax as per provisions of section 195 of the Act. Doubts have been raised about the interpretation of the term 'other sum chargeable' i.e. whether this term refers to the whole sum being remitted or only the portion representing the sum chargeable to income-tax under relevant provisions of the Act.

CBDT Circular 3 of 2015 (contd.)
An important TDS Circular!

3. Central Board of Direct Taxes has already issued Instruction No. 02/2014 dated 26.02.2014 (F. No. 500/33/2013-FTD-I) regarding deduction of tax at source under sub-section (1) of section 195 read with section 201 of the Act relating to payments made to on-residents ***in cases where no application is filed by the deductor for determining the sum so chargeable under sub-sec/ion (2) of section 195 of the Act. Vide this Instruction, Board has clarified that in cases where tax is not deducted at source under section 195 of the Act, the Assessing Officer shall determine the appropriate portion of the sum chargeable to tax, as mentioned in sub-section (1) of section 195 to ascertain the tax-liability on which*** *the deductor shall be deemed to be an assessee in default under section 201 of the Act. It has been further clarified that such appropriate portion of the said sum will depend on the facts and circumstances of each case taking into account the nature of remittances, income component therein or any other fact relevant to determine such appropriate proportion.*

CBDT Circular 3 of 2015 (contd.)
An important TDS Circular!

*4. **As disallowance of amount under section 40(a)(i) of the Act in case of a deductor is interlinked with the sum chargeable under the Act as mentioned in section 195 of the Act for the purposes of tax deduction at source**, the Central Board of Direct Taxes, in exercise of powers conferred under section 119 of the Act, hereby clarifies that for the purpose of making disallowance of 'other sum chargeable'· under section 40(a)(i) of the Act, **the appropriate portion of the sum which is chargeable to tax under the Act shall form the basis of such disallowance and shall be the same as determined by the Assessing Officer** having jurisdiction for the purpose of sub-section (1) o1section 195 of the Act as per Instruct on No. 2/2014 dated 26.02.2014 of CBDT. Further, where determination of 'other sum chargeable' has been made under sub-section (2), (3) or (7) of section 195 of the Act, such a determination will form the basis for disallowance, if any under section 40(a)(i) of the Act.*

Section 195(6) - CA Certificate

- Information on remittance of amount to be furnished by the payer in Form 15CA
- Certificate from Chartered Accountant may be obtained in Form 15CB
- Procedure prescribed in **Rule 37BB of the Income Tax Rules**
  - Revised Rule 37BB w.e.f 1st April 2016 (press release 17th Dec 2015 by CBDT)
- Points to be factored
  - Examination of PE and attribution of profit to PE
  - Beneficial ownership/ Tax residency, whether TRC is sufficient evidence to claim Tax Treaty Benefits.
  - Classification of Income : Royalty, FTS, etc.
  - Issuance of certificate in absence of complete information about payee

CA certificate and adjudication of taxability

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

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

S.195A – “Grossing up”
Income payable 'net of tax'.

S.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.

S.197 – Certificate for deduction at lower rate

197. 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 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 18[Assessing] Officer shall, on an application made by the assessee in this behalf, give to him such certificate as may be appropriate.

(2) Where any such certificate is given, the person responsible for paying the income shall, until such certificate is cancelled by the Assessing Officer, deduct income-tax at the rates specified in such certificate or deduct no tax, as the case may be.

(2A) The Board may, having regard to the convenience of assessees and the interests of revenue, by notification in the Official Gazette, make rules specifying the cases in which, and the circumstances under which, an application may be made for the grant of a certificate under sub-section (1) and the conditions subject to which such certificate may be granted and providing for all other matters connected therewith.

S.197 Certificate - Application

- Application in Form No.13; upon receipt of the application, the AO has to determine the existing and estimated tax liability after taking into consideration tax payable on the estimated income of the ongoing financial year, tax payable on the assessed or returned or estimated income, as the case may be, of the previous four financial years, existing liability under the Act. The assessing officer has to also consider the advance tax payment, tax deducted at source and tax collected at source for the ongoing financial year till the date of making of the application.
- The Nil or lower TDS or TCS application is valid for the period for which it is issued or until the assessing officer cancels it.
- Circular 774 of 1999 : No certificate after payment

Want to contest tax deduction?

S.248 : Pay tax and appeal

248. Appeal by person denying liability to deduct tax Any person having in accordance with the provisions of sections 195 and 200 deducted and paid tax in respect of any sum chargeable under this Act, other than interest, who denies his liability to make such deduction, may appeal to the Deputy Commissioner (Appeals) or, as the case may be, the Commissioner (Appeals) to be declared not liable to make such deduction.

S.40(a)(i) – Disallowance provision on payments to NRs without TDS

S.40. *Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession",—*

(a) in the case of any assessee—

(i) any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act, which is payable,—

(A) outside India; or

(B) in India to a non-resident, not being a company or to a foreign company,

on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139 :

S.40(a)(i) Proviso's

Provided that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date specified in sub-section (1) of section 139, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid:

Provided further that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purposes of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the payee referred to in the said proviso.

- *Ins. by the Act No. 23 of 2019, w.e.f. 1-4-2020.*

S.40(a)(i)

- *Explanation.—For the purposes of this sub-clause,—*

(A) "royalty" shall have the same meaning as in Explanation2 to clause (vi) of sub-section (1) of section 9;

(B) "fees for technical services" shall have the same meaning as in ***Explanation 2*** *to clause (vii) of sub-section (1) of section 9;*

Contrast between S.40(a)(i) and S.40(a)(ia) Payments made to NRs vs to Residents

S.40(a)(ia) ***thirty per cent of any sum payable*** *to a resident, on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139 :*

Provided that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date specified in sub-section (1) of section 139, thirty per cent of such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid :

Provided further that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purpose of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the payee referred to in the said proviso.

S.40 miscellaneous issues
Paid vs Payable unnecessary controversy

- “payable” used in the Sections, so to amounts paid s.40 doesn’t apply; it only applies to payable amounts?!
  - **M/s Palam Gas Service Vs Commissioner of Income Tax (Supreme Court of India) (Civil Appeal No. 5512 of 2017 dated 03/05/2017)**
  - Section 40(a)(ia) covers not only those cases where the amount is payable but also when it is paid. In this behalf, one has to keep in mind the purpose with which Section 40 was enacted and that has already been noted above. We have also to keep in mind the provisions of Sections 194C and 200.
  - Judgment of the Allahabad High Court in *CIT v. Vector Shipping Services (P) Ltd.*, *(2013) 357 ITR 642* did not decide the question of law correctly.

S.40 miscellaneous issues
Short deduction

- ***CIT vs. S.K.Tekriwal (ITAT No.183 of 2012 dated 30.12.2012) Kol. HC***
- No s. 40(a)(ia) disallowance for short-deduction TDS default
  - The assessee paid machinery hire charges on which it deducted TDS at 1% u/s 194C. The AO claimed that the amount was in the nature of “rent” and TDS at 10% ought to have deducted u/s 194-I.
- S. 40(a)(ia) can be invoked only when the two conditions, namely, that tax is deductible at source and such tax has not been deducted is satisfied. Where tax is deducted by the assessee under a wrong provisions of TDS and there is a shortfall, s. 40(a)(ia) disallowance cannot be made.

S.201 – “assessee in default” Consequences of failure to deduct or pay.

201. (1) Where any person, including the principal officer of a company,—

(a) who is required to deduct any sum in accordance with the provisions of this Act; or

(b) referred to in sub-section (1A) of section 192, being an employer,

does not deduct, or does not pay, or after so deducting fails to pay, the whole or any part of the tax, as required by or under this Act**, then, such person, shall, without prejudice to any other consequences which he may incur, be **deemed to be an assessee in default in respect of such tax:

*Provided that any person, including the principal officer of a company, who fails to deduct the whole or any part of the tax in accordance with the provisions of this Chapter on the sum paid to a payee or on the sum credited to the account of a payee shall not be deemed to be an assessee in default in respect of such tax if **such payee**—*

(i) has furnished his return of income under section 139;

(ii) has taken into account such sum for computing income in such return of income; and

(iii) has paid the tax due on the income declared by him in such return of income,

and the person furnishes a certificate to this effect from an accountant in such form as may be prescribed:

S.201(1A) – Interest

Provided further that no penalty shall be charged under section 221 from such person, unless the Assessing Officer is satisfied that such person, without good and sufficient reasons, has failed to deduct and pay such tax.

(1A) Without prejudice to the provisions of sub-section (1), if any such person, principal officer or company as is referred to in that sub-section does not deduct the whole or any part of the tax or after deducting fails to pay the tax as required by or under this Act, he or it shall be liable to pay simple interest,—

(i) at one per cent for every month or part of a month on the amount of such tax from the date on which such tax was deductible to the date on which such tax is deducted; and

(ii) at one and one-half per cent for every month or part of a month on the amount of such tax from the date on which such tax was deducted to the date on which such tax is actually paid,

and such interest shall be paid before furnishing the statement in accordance with the provisions of sub-section (3) of section 200:

Provided that in case any person, including the principal officer of a company fails to deduct the whole or any part of the tax in accordance with the provisions of this Chapter on the sum paid to a payee or on the sum credited to the account of a payee but is not deemed to be an assessee in default under the first proviso to sub-section (1), the interest under clause (i) shall be payable from the date on which such tax was deductible to the date of furnishing of return of income by such payee.

S.201(1A) – *Hindustan Coca Cola* decision

- **Hindustan Coca Cola Beverages (P) Ltd., vs. CIT 293 ITR 226 (SC)**

*10. Be that as it may, the **circular No. 275/201/95- IT(B) dated 29.1.1997** issued by the Central Board of Direct Taxes, in our considered opinion, should put an end to the controversy. The circular declares "no demand visualized under Section 201 (1) of the Income- tax Act should be enforced after the tax deductor has satisfied the officer-in-charge of TDS, that taxes due have been paid by the deductee-assessee. However, this will not alter the liability to charge interest under Section 201 (1A) of the Act till the date of payment of taxes by the deductee-assessee or the liability for penalty under Section 271C of the Income-tax Act.“*

11. In the instant case, the appellant had paid the interest under Section 201 (1A) of the Act and there is no dispute that the tax due had been paid by deductee- assessee (M/s Pradeep Oil Corporation). It is not disputed before us that the circular is applicable to the facts situation on hand.

S.201(2), (3) & (4)

(2) Where the tax has not been paid as aforesaid after it is deducted, the amount of the tax together with the amount of simple interest thereon referred to in sub-section (1A) shall be a charge upon all the assets of the person, or the company, as the case may be, referred to in sub-section (1).

(3) No order shall be made under sub-section (1) deeming a person to be an assessee in default for failure to deduct the whole or any part of the tax from a person resident in India, at any time after the expiry of seven years from the end of the financial year in which payment is made or credit is given or two years from the end of the financial year in which the correction statement is delivered under the proviso to sub-section (3) of section 200, whichever is later.

(4) The provisions of sub-clause (ii) of sub-section (3) of section 153 and of Explanation 1 to section 153 shall, so far as may, apply to the time limit prescribed in sub-section (3).

Explanation.—For the purposes of this section, the expression "accountant" shall have the meaning assigned to it in the Explanation to sub-section (2) of section 288.

Order u/S.195(2) doesn’t provide immunity u/S.201(1)

Aditya Birla Nuvo v. DDIT 342 ITR 308 (Bombay)

- The order under sec. 195(2) is tentative in nature and does not have any effect beyond providing immunity under sec. 201 and does not preclude the assessing officer to either reexamine the chargeability of income in regular assessment proceedings or to recover the taxes from the payer in his representative capacity.

S.160 – Representative Assessee

160. (1) For the purposes of this Act, "representative assessee" means—

(i) ***in respect of the income of a non-resident*** *specified in sub-section (1) of section 9, the agent of the non-resident, including a person who is treated as an agent under section 163;*

S.163 - Agent

163. (1) For the purposes of this Act, "agent", in relation to a non-resident, includes any person in India—

(a) who is employed by or on behalf of the non-resident; or

*(b) **who has any business connection with the non-resident;** or*

(c) from or through whom the non-resident is in receipt of any income, whether directly or indirectly; or

(d) who is the trustee of the non-resident;

and includes also any other person who, whether a resident or non-resident, has acquired by means of a transfer, a capital asset in India :

Provided that a broker in India who, in respect of any transactions, does not deal directly with or on behalf of a non-resident principal but deals with or through a non-resident broker shall not be deemed to be an agent under this section in respect of such transactions, if the following conditions are fulfilled, namely:—

(i)the transactions are carried on in the ordinary course of business through the first-mentioned broker; and

(ii)(the non-resident broker is carrying on such transactions in the ordinary course of his business and not as a principal.

Explanation.—For the purposes of this sub-section, the expression "business connection" shall have the meaning assigned to it in Explanation 2 to clause (i) of sub-section (1) of section 9 of this Act.

(2) No person shall be treated as the agent of a non-resident unless he has had an opportunity of being heard by the Assessing Officer as to his liability to be treated as such.

A typical disallowance….u/S.40(a)(i)

- Step 1: **Classification of payments:**
  - Typically, as *not* being business profits (S.9(1)(i) or Article 7 r.w. Article 5), rather
  - Being Royalty or Fees for technical services (S.9(1)(vi)/S.9(1)(vii) or Article 12/13)
  - Lot of PE cases now (service PE, DAPE, supervisory PE etc.). PE tax on basis (i.e. income of PE – its expenses) , Royalty/FTS tax on gross basis
  - Note that S.9 is a *deeming* provision : Accruing or arising in India irrespective of place of rendering & utilization of services (at least from Finance Act 2010!)
- Step 2: Hold that, due to S.9 above, sums paid to NR were chargeable to tax and **tax should have been withhold as per S.195**
- Step 3: As tax was not withheld u/S. 195, **disallowance of expenditure made u/S. 40(a)(i) on said payments to NR**

S.9(1)(i) of the Act
Business income

Income deemed to accrue or arise in India.

S.9. *(1) The following incomes shall be deemed to accrue or arise in India :*

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

Explanation 1.—For the purposes of this clause—

(a) in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India ;

S.9(1)(i)
Explanation 1

(b) in the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export ;

(c) in the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India ;

Section 9(1)(i)
Explanation 1

(d) in the case of a non-resident, being—

(1) an individual who is not a citizen of India ; or

(2) a firm which does not have any partner who is a citizen of India or who is resident in India ; or

(3) a company which does not have any shareholder who is a citizen of India or who is resident in India,

no income shall be deemed to accrue or arise in India to such individual, firm or company through or from operations which are confined to the shooting of any cinematograph film in India;

(e) in the case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to the display of uncut and unassorted diamond in any special zone notified by the Central Government in the Official Gazette in this behalf

S.9(1)(i)
Explanation 2 – business connection

Explanation 2.—*For the removal of doubts, it is hereby declared that "business connection" shall include any business activity carried out through a person who, acting on behalf of the non-resident,—*

(a) has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident or habitually concludes contracts 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

(b) has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or

(c) habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident

Section 9(1)(i)
Proviso to Explanation 2

Provided that such business connection shall not include any business activity carried out through a broker, general commission agent or any other agent having an independent status, if such broker, general commission agent or any other agent having an independent status is acting in the ordinary course of his business :

Provided further that where such broker, general commission agent or any other agent works mainly or wholly on behalf of a non-resident (hereafter in this proviso referred to as the principal non-resident) or on behalf of such non-resident and other non-residents which are controlled by the principal non-resident or have a controlling interest in the principal non-resident or are subject to the same common control as the principal non-resident, he shall not be deemed to be a broker, general commission agent or an agent of an independent status.

DTAA (India-UK)
Article 7 r.w. Article 5

*1. For the purposes of this Convention, the term "permanent establishment" means a **fixed place of business** through which the business of an enterprise is wholly or partly carried on.*

2. The term "permanent establishment" shall include especially :

(a) a place of management;

(b) a branch;

(c) an office;

(d) a factory;

(e) a workshop;

(f) premises used as a sales outlet or for receiving or soliciting orders;

(g) a warehouse in relation to a person providing store facilities for others;

(h) a mine, an oil or gas well, quarry on other place of extraction of natural resources;

(i) an installation or structure used for the exploration or exploitation of natural resources;

(j) a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or supervisory activity continues for a period of more than six months, or where such project or supervisory activity, being incidental to the sale or machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 per cent of the sale price of the machinery and equipment;

(k) the furnishing of services including managerial services, other than those taxable under Article 13 (Royalties and fees for technical services), within a Contracting State by an enterprise through employees or other personnel, but only if:

(i) activities of that nature continue within that State for a period or periods aggregating more than 90 days within any twelve-month period;

(ii) services are performed within that State for an enterprise within the meaning of paragraph 1 of Article 10 (Associated enterprises) and continue for a period or periods aggregating more than 30 days within any twelve-month period:

Provided that for the purposes of this paragraph an enterprise shall be deemed to have a permanent establishment in a Contracting State and to carry

DTAA
Article 7 r.w. Article 5

3. The term "permanent establishment" shall not be deemed to include:

(a) the use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;

(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;

(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;

(e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information or for scientific research, being activities solely of a preparatory or auxiliary character in the trade of business of the enterprise. However, this provision shall not be applicable where the enterprise maintains any other fixed place of business in the other Contracting State for any purpose or purposes other than the purposes specified in this paragraph;

(f) the maintenance of a fixed place of businesses solely for any combination of activities mentioned in sub-paragraphs (a) to (e) of the paragraph, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

4. A person acting in a Contracting State for or on behalf of an enterprise of the other contracting State - other than an agent of an independent status to whom paragraph (5) of this Article applies, shall be deemed to be a permanent establishment of that enterprise in the first mentioned State if:

(a) he has, and habitually exercises in that State, an authority to negotiate and enter into contracts for or on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise; or

(b) he habitually maintains in the first-mentioned Contracting State a stock of goods or merchandise from which he regularly delivers goods or merchandise for or on behalf of the enterprise; or

(c) he habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise itself or for the enterprise and the enterprises controlling, controlled by, or subject to the same common control, as that enterprise.

Section 9(1)(i)
Business connection & PE
Foreign Commission Agent Payments

- CBDT had issued Circular No.7 dated 22.10.2009, by which, earlier Circulars No.23 dated 23 July 1969, Circular No.163 dated 29th May 1975 and Circular No. 786 dated 7th February 2000, which were based on Circular No.23, have been withdrawn
  - Department held that commission payments were hence taxable
- Incorrect view of Department: **Commission paid to non-resident (foreign) agents not taxable in India**
  - S.9(1)(i) r.w Explanation : no PE in India to attribute income to, payments not exigible to tax. SKF Boilers of AAR bad law *and*
  - Article 7 r.w. Article 5: no PE means business profits of foreign agent in country of residence
- **CIT vs. Toshoku Limited, 125 ITR 525 (SC)**
- **CIT vs. Faizan Shoes (P.) Ltd.[2014] 367 ITR 155 (Mad.)**
- **CIT vs. Kikani Exports (P) Ltd. (49 taxmann.com 601 Madras HC)**
- **ACIT vs. Manufax (India) (ITA Nos. 434 434/Agra/2015 dated 11.4.2018 Special Bench)**

Foreign Commission Agent Payments

- Beware though!
  - Keep wording of agreement simple
  - Mere existence of line “systematic market research” lead to disallowance u/S. 9(1)(vii)
    - **CIT vs. Evolv Clothing Company (ITA No.2100/Mds/2012 dated 11.3.2013)**
  - Remember, classification of these commission agent payments as FTS is an easy way for Department to say sum is exigible to tax and lead to S.40(a)(i) !!

What is a PE?

- **CIT v. Vishakapatnam Port Trust**, a landmark decision on the subject of Permanent Establishment, the Andhra Pradesh High Court held that *"The words Permanent Establishment postulate the existence of a substantial element of an enduring or permanent nature of a foreign enterprise in another, which can be attributed to a fixed place of business in that country. It should be of such a nature that it would amount to a* ***virtual projection*** *of the foreign enterprise of one country onto the soil of another country."*

What is a PE?

- DIT vs. Samsung Heavy Industries Co. Ltd. (Civil Appeal No. 12183 of 2016 dated 22nd July, 2020)
  - Project office used for preparatory & auxiliary activities is not a PE
- UoI vs. U.A.E Exchange Centre
  - Taxability of Liaison Offices under DTAAs: The activities carried on by the liaison office of the non-resident in India as permitted by the RBI, demonstrate that the liaison office must steer away from engaging in any primary business activity and in establishing business connection as such. It can carry on activities of preparatory or auxiliary nature only.
  - A liaison office which is only carrying on such activity of a "preparatory or auxiliary" character is not a PE in terms of Article 5 of the DTAA. **The deeming provisions in Sections 5 and 9 of the 1961 Act can have no bearing whatsoever.**
- Formula One World Championships Ltd. Vs. CIT (CA 3849 of 2017 dated 24.4.2017)
  - Fixed place of business (race track) at the disposal of the foreign entity

S.9(1)(i)
Explanation 2A – Virtual PE's!

Explanation 2A.—For the removal of doubts, it is hereby declared that the significant economic presence of a non-resident in India shall constitute "business connection" in India and "significant economic presence" for this purpose, shall mean—

(a) transaction in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or

(b) systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India, as may be prescribed:

Provided that the transactions or activities shall constitute significant economic presence in India, whether or not—

(i) the agreement for such transactions or activities is entered in India; or

(ii) the non-resident has a residence or place of business in India; or

(iii) the non-resident renders services in India:

Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India. (wef 1-4-2022)

Some background to Explanation 2A

- Finance Act, 2018 enlarged the scope of the term "Business Connection" to include a new nexus to tax benefit profits of non-residents having Significant Economic Presence (SEP) in India
- SEP concept was raised by the Organisation for Economic Co-operation and Development (OECD) as part of their report on Base Erosion and Profit Shifting (BEPS) Action Plan 1.
- There were three options discussed in the BEPS Report on Action 1:
  - **Articulation of a new nexus in the form of significant economic presence;**
  - A withholding tax on certain types of digital transactions; and
  - **Imposition of an equalization levy.** (Later in this lecture!)

S.9(1)(i)
Explanation 3 & 3A – Look into the future!

Explanation 3.—Where a business is carried on in India through a person referred to in clause (a) or clause (b) or clause (c) of Explanation 2, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India.

Explanation 3A.—For the removal of doubts, it is hereby declared that the income attributable to the operations carried out in India, as referred to in Explanation 1, shall include income from—

(i) such advertisement which targets a customer who resides in India or a customer who accesses the advertisement through internet protocol address located in India;

(ii) sale of data collected from a person who resides in India or from a person who uses internet protocol address located in India; and

(iii) sale of goods or services using data collected from a person who resides in India or from a person who uses internet protocol address located in India.

Provided that the provisions contained in this Explanation shall also apply to the income attributable to the transactions or activities referred to in Explanation 2A. (wef 1-4-2022)

S.9(1)(i) : *Vodafone* Explanations
Explanations 4, 5, 6 & 7
Vodafone case quick recap

- Hutchinson Essar Limited, Indian Co, shareholding by CGP investments Ltd Mauritius. CGP is a 100% WoS of Hutchinson Telecommunication International Ltd (HTIL) Hong Kong.
- Vodafone International BV Netherlands purchases 100% of CGP shares from HTIL Hong Kong outside India
- Q1: Whether HTIL had earned income liable for capital gains tax in India as this was mainly consideration towards sale of assets in India
- Q2: Whether on payment to HTIL Vodafone was liable to deduct tax u/S.195 from sale consideration paid.
  - IT Dept issued show cause notice u/S. 201 to Vodafone as “assessee in default” for not withholding tax u/S. 195
- SLP No. 26529 of 2010 dated 20th January 2012

S.9(1)(i) – Explanation 4 & 5: *Vodafone* Explanations! Finance Act 2012 w.r.e.f 1-4-1962

- *Explanation 4.—For the removal of doubts, it is hereby clarified that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".*
- *Explanation 5.—For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India* ***shall be deemed to be and shall always be deemed to have been situated in India****, if the share or interest derives, directly or indirectly,* ***its value substantially from the assets located in India:***
- *Provided that nothing contained in this Explanation shall apply to an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in a Foreign Institutional Investor as referred to in clause (a) of the Explanation to section 115AD for an assessment year commencing on or after the 1st day of April, 2012 but before the 1st day of April, 2015:*
- *Provided further that nothing contained in this Explanation shall apply to an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I or Category-II foreign portfolio investor under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014 10[prior to their repeal], made under the Securities and Exchange Board of India Act, 1992 (15 of 1992):*
- *Provided also that nothing contained in this Explanation shall apply to an asset or a capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I foreign portfolio investor under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2019, made under the Securities and Exchange Board of India Act, 1992 (15 of 1992)*

S.9(1)(i) – Explanation 6: “substantially”
Finance Act 2015 w.e.f 1-4-2016

Explanation 6.—For the purposes of this clause, it is hereby declared that—

(a) the share or interest, referred to in Explanation 5, shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if, on the specified date, the value of such assets—

(i) exceeds the amount of ten crore rupees; and

(ii) represents at least fifty per cent of the value of all the assets owned by the company or entity, as the case may be;

(b) the value of an asset shall be the fair market value as on the specified date, of such asset without reduction of liabilities, if any, in respect of the asset, determined in such manner as may be prescribed;

S.9(1)(i) – Explanation 6: “substantially”
Finance Act 2015 w.e.f 1-4-2016

c) "accounting period" means each period of twelve months ending with the 31st day of March:

Provided that where a company or an entity, referred to in Explanation 5, regularly adopts a period of twelve months ending on a day other than the 31st day of March for the purpose of—

(i) complying with the provisions of the tax laws of the territory, of which it is a resident, for tax purposes; or

(ii) reporting to persons holding the share or interest,

then, the period of twelve months ending with the other day shall be the accounting period of the company or, as the case may be, the entity:

Provided further that the first accounting period of the company or, as the case may be, the entity shall begin from the date of its registration or incorporation and end with the 31st day of March or such other day, as the case may be, following the date of such registration or incorporation, and the later accounting period shall be the successive periods of twelve months:

Provided also that if the company or the entity ceases to exist before the end of accounting period, as aforesaid, then, the accounting period shall end immediately before the company or, as the case may be, the entity, ceases to exist;

(d) "specified date" means the—

(i) date on which the accounting period of the company or, as the case may be, the entity ends preceding the date of transfer of a share or an interest; or

(ii) date of transfer, if the book value of the assets of the company or, as the case may be, the entity on the date of transfer exceeds the book value of the assets as on the date referred to in sub-clause (i), by fifteen per cent.

Explanation 7.— For the purposes of this clause,—

(a) no income shall be deemed to accrue or arise to a non-resident from transfer, outside India, of any share of, or interest in, a company or an entity, registered or incorporated outside India, referred to in the Explanation 5,—

(i) if such company or entity directly owns the assets situated in India and the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer, neither holds the right of management or control in relation to such company or entity, nor holds voting power or share capital or interest exceeding five per cent of the total voting power or total share capital or total interest, as the case may be, of such company or entity; or

(ii) if such company or entity indirectly owns the assets situated in India and the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer, neither holds the right of management or control in relation to such company or entity, nor holds any right in, or in relation to, such company or entity which would entitle him to the right of management or control in the company or entity that directly owns the assets situated in India, nor holds such percentage of voting power or share capital or interest in such company or entity which results in holding of (either individually or along with associated enterprises) a voting power or share capital or interest exceeding five per cent of the total voting power or total share capital or total interest, as the case may be, of the company or entity that directly owns the assets situated in India;

(b) in a case where all the assets owned, directly or indirectly, by a company or, as the case may be, an entity referred to in the Explanation 5, are not located in India, the income of the non-resident transferor, from transfer outside India of a share of, or interest in, such company or entity, deemed to accrue or arise in India under this clause, shall be only such part of the income as is reasonably attributable to assets located in India and determined in such manner as may be prescribed;

(c) "associated enterprise" shall have the meaning assigned to it in section 92A;

S.9(1)(vi) - Royalty

S.9(1)(vi) income by way of royalty payable by—

(a) the Government ; or

(b) a person who is a resident, except where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(c) a person who is a non-resident, where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India :

S.9(1)(vi) - Royalty

Provided *that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property, if such income is payable in pursuance of an agreement made before the 1st day of April, 1976, and the agreement is approved by the Central Government :*

Provided further *that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum payment made by a person, who is a resident, for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non-resident manufacturer along with a computer or computer-based equipment under any scheme approved under the Policy on Computer Software Export, Software Development and Training, 1986 of the Government of India.*

Explanation 1.—For the purposes of the first proviso, an agreement made on or after the 1st day of April, 1976, shall be deemed to have been made before that date if the agreement is made in accordance with proposals approved by the Central Government before that date; so, however, that, where the recipient of the income by way of royalty is a foreign company, the agreement shall not be deemed to have been made before that date unless, before the expiry of the time allowed under sub-section (1) or sub-section (2) of section 139 (whether fixed originally or on extension) for furnishing the return of income for the assessment year commencing on the 1st day of April, 1977, or the assessment year in respect of which such income first becomes chargeable to tax under this Act, whichever assessment year is later, the company exercises an option by furnishing a declaration in writing to the Assessing Officer (such option being final for that assessment year and for every subsequent assessment year) that the agreement may be regarded as an agreement made before the 1st day of April, 1976.

3. Royalty

Explanation 2.—For the purposes of this clause, **"royalty" means consideration** (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for—

(*i*) the **transfer of all or any rights** (including the granting of a licence) **in respect of a patent, invention, model, design, secret formula or process** or trade mark or similar property ;

(*ii*) the **imparting of any information** concerning the working of, or the **use of, a patent, invention, model, design, secret formula or process or trade mark** or similar property ;

(*iii*) **the use of any patent, invention, model, design, secret formula or process or trade mark** or similar property ;

(*iv*) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill ;

(*iva*) the use or **right to use any industrial, commercial or scientific equipment** but not including the amounts referred to in section 44BB;

(*v*) the **transfer of all or any rights (including the granting of a licence) in respect of any copyright,** literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films ; or

(*vi*) the rendering of any services in connection with the activities referred to in sub-clauses (*i*) to (*iv*), (*iva*) and (*v*)

S.9(1)(vi) Royalty
Explanation 3 (Finance Act 2012 w.r.e.f 1-4-1976)

Explanation 3.—For the purposes of this clause, "computer software" means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data.

Explanation 4.—For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Explanation 5.—For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—

(*a*) the possession or control of such right, property or information is with the payer;

(*b*) such right, property or information is used directly by the payer;

(*c*) the location of such right, property or information is in India.

Explanation 6.—For the removal of doubts, it is hereby clarified that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret;

Royalty under DTAA
India-UK Article 13 (for example)

ARTICLE 13 ROYALTIES AND FEES FOR TECHNICAL SERVICES

1. Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the law of that State; but if the beneficial owner of the royalties or fees for technical services is a resident of the other Contracting State, the tax so charged shall not exceed :

(a) in the case of royalties within paragraph 3(a) of this Articles, and fees for technical services within paragraphs 4(a) and (c) of this Article,—

(i) during the first five years for which this Convention has effect ;

(aa) 15 per cent of the gross amount of such royalties or fees for technical services when the payer of the royalties or fees for technical services is the Government of the first-mentioned Contracting State or a political sub-division of that State, and

(bb) 20 per cent of the gross amount of such royalties or fees for technical services in all other cases; and

(ii) during subsequent years, 15 per cent of the gross amount of such royalties or fees for technical services; and

(b) in the case of royalties within paragraph 3(b) of this Article and fees for technical services defined in paragraph 4(b) of this Article, 10 per cent of the gross amount of such royalties and fees for technical services.

Royalty under DTAA
India-UK Article 13 (for example)

3. For the purposes of this Article, the term "royalties" means :

(a) payments of any kind received as a ***consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work, including cinematography films or work on films, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; and***

(b) payments of any kind received as ***consideration for the use of, or the right to use, any industrial, commercial or scientific equipment, other than income derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic.***

Royalty payments TDS – a chequered history

- Satellite Transponders
- Software
- Leased line/Bandwidth charges
- Shipping of coal
- Online Advertisement (Google Case)
- Website registration (Godaddy case)

Royalty – Explanation 2 Interpretation by Judiciary

- **Satellite transponder lease: Asia Satellite Telecommn. Co Ltd. vs DIT (332 ITR 340 Del. HC)**
  - No income is deemed to accrue in India from use of satellite outside India to beam TV signals into India even if bulk of revenue arises due to viewers in India **(not "use of equipment", not use of "process")**
- **Software license:** Not transfer of "copyright" but transfer of "copyrighted article"
  - Motorola 95 ITD 269 (SB)
  - TII Team Telecom 140 TTJ (Mum) 649
  - Ericsson AB 204 TM 192
  - (Dissenting voices in *Microsoft Delhi Tribunal*, *Karnataka High Court in Samsung 203 TM 477*)
- OECD Tag Report on In
- **Bottomline:** A very wide interpretation of the English used in Explanation 2 by Dept. typically read down by the Courts

Royalty –overturning judicial decisions Finance Act 2012!

Explanation 3.—For the purposes of this clause, "computer software" means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data.

Explanation 4.—For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Explanation 5.—For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—

(*a*) the possession or control of such right, property or information is with the payer;

(*b*) such right, property or information is used directly by the payer;

(*c*) the location of such right, property or information is in India.

Explanation 6.—For the removal of doubts, it is hereby clarified that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret;

Royalty - Finance Act 2012 Amendments rendered useless?!

- **DIT vs. New Skies Satellite BV (Delhi HC)** 9(1)(vi) vs. Article 12 of DTAA: The retrospective amendment to s. 9(1)(vi) so as to supersede the law laid down in **Asia Satellite 332 ITR 340 (Del)** and assess transmission fees as "royalty" has no impact on assessees covered by DTAA because a corresponding amendment has not been made to the definition of "royalty" therein. Amendments to domestic law do not affect the DTAA
- **WNS North America Inc. vs. ADIT (152 TTJ 145) Mumbai Trib** and **DIT v. Nokia Networks OY (212 Taxman 68) Delhi HC, B4U International Holdings Limited [18 ITR(Trib.) 62] (Mum.)**
  - Amendment in Act does not have the effect of automatically altering the analogous provisions of the Double Taxation Avoidance Agreements

Royalty - Finance Act 2012 Amendments ….successful in Madras?!

- **Verizon Communications Singapore Pte Ltd. Vs. ITO (361 ITR 475 Madras HC)**
  - Provision of bandwidth / telecom services is Royalty for the **'use, or the right to use equipment'** under S.9(1)(vi) and under Article 12(3)(b) of the India-Singapore DTAA
  - It is also **“use of process”** u/S.9(1)(vi) and Article 12(3) of the DTAA
  - It is FTS u/S.12(4) of the DTAA!!
  - Earlier Decisions disregarded due to Finance Act 2012 amendments
  - Amendments in 2012 were clarificatory
  - **Distinguishes Asia Satellite** saying it related to clauses (I), (vi) and (vii) and it refers to decisions
  - Amendment in Explanation 5 gives very expansive meaning to word Royalty
  - DTAA “pari materia” to Act; to be assessed as Royalty under even the DTAA

Royalty - Software

- Checkered history for taxation of Royalty as software! Initially the tide was tilted towards the assessee:
- Distinction between 'copyrighted articles' and 'copyright' is relevant. Payment for ‘copyrighted article’ is not in the nature of royalty. [**DIT v. Ericsson A.B. [2012] 204 Taxman 192 (Del HC)**].
- Software copyright supplied along with hardware as its integrated part is not Royalty. [**Lucent Technologies Hindustan Ltd (92 ITD 366)(Bang) & Motorola Inc. etc. 95 ITD 269 (Del.) (SB)**],
  - Followed by **Infrasoft Ltd v. ADIT 125 TTJ 53 (Del)**
- Sale of a standardized but special purpose software and not customized software is not Royalty under Art12 of India-Japan DTAA. **(Dassault Systems K.K. (322 ITR 125)(AAR))**

Royalty – Software
Samsung (Kar. HC) upsets the applecart!

- **Samsung Electronics Co Ltd (345 ITR 494) (Kar.)** Transfer of copyright including right to make copy of software for internal business and payment made in that regard would constitute ‘royalty’, both under ITA and respective DTAAs
- **Synopsis International Old Limited [2012] (212 Taxman 454) (Kar.)** Consideration paid is for rights in respect of copyright and for use of information embedded in software – falls within mischief of definition of ‘royalty’ under the ITA and under the DTAA

Royalty – Software
Post amendment blues

- Karanataka HC following Samsung decisions path!
  - **CIT, International Taxation v. P.S.I Data System Ltd. [2012] (208 Taxman 452)**
  - **CIT, International Taxation v. Customer Asset India (P.) Ltd. (42 taxmann.com338)**
- Post-amendment also no change and Software not taxable as Royalty under DTAA
  - **DIT v. Nokia Networks OY [2012] (253 CTR 417) Delhi High Court**
  - **Novel Inc. v. DDIT(Intl. Tax) [2014] (49 SOT 45)**

Royalty – Software
Vinzas: Madras HC gets it right?!

- **CIT vs. Vinzas Solutions Pvt. Ltd. (TCA 861/2016 dated 04.1.2017 Madras HC)**
- There is a difference between sale of a 'copyrighted article' and the 'copyright' itself. S. 9(1)(vi) applies only to the latter and not the former.
- Explanation 4 inserted by FA 2012 w.r.e.f. 01.06.1976 has to be read and understood only in that context and cannot be expanded to bring within its fold transactions beyond the realm of the proviso
- **Bottomline: Huge relief for assessee's by Jurisdictional HC in following the rationale adopted by various other Courts**

Royalty – Database access/subscription

- Karnataka High Court in the case of **ITO vs. Wipro Ltd. (TS-701-HC-2011 Kar.) and CIT vs. Infosys Technologies (17 Taxmann 115 Kar.)** held that annual subscription paid to US company for accessing its database is Royalty
  - (Incorrectly!) following **CIT vs. Samsung Electronics Co. (345 ITR 494 Kar. HC)**
- Mumbai Tribunal in the case of **Gartner Ireland Limited (60 SOT 403 Mumbai ITAT)** followed Wipro (supra) decision as it was the same payments held as Royalty
- **ONGC Videsh Ltd. vs. ITO (155 TTJ 114 Del.)** : Fee paid by ONGC to procure information in respect of exploration of oil & gas is Royalty

Royalty – Database access/subscription

- Madhya Pradesh HC in **CIT v. HEG Ltd. [2003] 263 ITR 230** had held that access to confidential data is not Royalty
- Another decision is **Factset Research Systems Inc., In re [2009] 182 Taxman 268 (AAR – New Delhi)**
- **DIT vs Dun and Bradstreet Information Services India Pvt ltd [(2011) 318 ITR 95 (Bombay High Court)] also has held in favour of assessee that payments to access reports/database is not Royalty.**
  - Indian assessee had **imported business information reports** from Dun and Bradstreet, USA, and made remittances against the same not withholding tax.
  - Following decision of AAR on identical facts in the case of Dun and Bradstreet Espana S.A. (AAR), Tribunal said payments did not attract the provisions of section 195. Upheld by Mumbai HC
- **Author's opinion: Reliance on Samsung (Karnataka HC) is incorrect; mere database access ought not be Royalty**

Royalty – Shipping
Poompuhar case - Madras HC again!

- Madras HC in Poompuhar Shipping Corp Ltd. Vs. ITO (360 ITR 257 Madras HC) held that
  - Equipment rental is Royalty even if payer does not have control (!!)
- Retrospective amendment in Explanation 5 is purely clarificatory
- Irrespective of transfer, consideration paid for use or right to use simpilciter is sufficient for it to fall under Royalty (!!)
- Ship is an “equipment” based on S.43(3) of Act
- Ship plying between coastal lines on Indian shores cannot fall under “international traffic” as per DTAA
- Foreign ship has PE in India when its ships are in India and berths reserved for it
- Proceedings under both S.201 and S.163 upheld

Royalty – Shipping

- **CIT vs. Van Oord ACZ Equipment BV [TS-695-HC-2014(Madras)]**
  - Distinguishes Poompuhar judgment
- Van Oord ACZ Equipment BV (the taxpayer) , incorporated in Netherlands, had let out dredging equipment to an Indian company, Van Oord ACZ India Private Limited. The equipment was let out on a **bareboat charter** basis, i.e., without the Master or the Crew.
- HC held that the **taxpayer was not liable to tax in India in respect of income earned from hiring of dredger on bareboat charter basis**
  - Based on amended DTAA of India-Netherlands
  - Poompuhar was time-charter; this case is bareboat charter
  - No PE as entire control of equipment not with taxpayer
- Useful for amended DTAA's like Belgium, France, Israel, Kazhakstan, Greece, Netherlands, Spain, Greece and Sweden)

Royalty – Adwords program:
Google ITAT Bengaluru – Facts of the case

- **Google India Pvt. Ltd. vs. ACIT (IT (TP)A 1511 to 1518/Bang/2013 dated 23th Oct. 217)**
- The assessee is a wholly owned subsidiary of Google International LLC, U.S.
- The assessee is appointed as a non-exclusive authorized distributor of Adword programs to the advertisers in India by Google Ireland Ltd (GIL) Google is specialized in internet search engines and related advertising services.
- The assessee entered into a **Google Adword Program Distribution** agreement (the agreement) on 12 December 2005 with GIL for resale of online advertising space under advertisers program to advertisers in India
- The assessee held that it was a reseller of the ad space and nothing more; it was akin to placing an ad in a newspaper/billboard etc.

Royalty – Adwords program:
Google ITAT Bengaluru – Facts of the cae

- Prior to said agreement, the ITES agreement dated 01.04.2004, provided limited rights to use intellectual property of GIL
  - Assesee pointed out that ITES was mainly for checking the ad content of users across the world
- Main agreement of assessee was related to marketing and distribution rights of "Adword" program to the advertisers in India
  - Included assistance & training to Indian advertisers to understand the features of the "Adword" product
- During AYs 2008-09 to 2011-12, the assessee had paid Rs. 119 crores to GIL without TDS on premise that:
  - **No rights in Google's IP were transferred to taxpayer from GIL**

Royalty – Adwords program Google Bengaluru case

- The assessee is mere reseller of advertising space made available under the Adword distribution program.
- The assessee being a distributor of ad space **does not have control over the process involved in picking ads for display (or) control of the servers, which are outside India.**
- However, the AO disagreed with asessee's contention and treated the assessee as an assessee in default (S.201) for not withholding tax at source on payments made to GIL
- **The CIT(A) upheld the order of the AO**

Royalty – Adwords program Google ITAT Bengaluru ruling

- The agreement between the assessee and GIL was **NOT in the nature of providing space for ad and display of ad** to the consumers.
  - Reference to “Adword” program in the agreement, it can be observed that it is an agreement for facilitating the display and publishing of an advertisement to the targeted customer.
- The advertiser selects some key words and on the basis of key words, the advertisement is displayed on the website or along with the search result as and when the customer selects the key words relatable to the advertisement
- Module does not merely work by providing the space in Google search engine, but it works only with the help of various patented tools and software

Royalty – Adwords program Google ITAT Bengaluru ruling (contd.)

- Google is able to target consumers/users as per the requirement of the advertiser by using the search tool/software
  - ITAT observed If only service rendered by the taxpayer was for providing the space then there was no need of directing the targeted consumers to the advertisement of the advertiser
- Truncated search results are displayed keeping in mind the commercial needs of the advertisers.
- The assessee has access to various data with respect to the age, gender, region, language, taste habits, food habits, cloth preference, the behavior on the website, etc.

Royalty – Adwords program Google ITAT Bengaluru ruling (contd.)

- Assessee uses this information for maximising impression and conversion of the customers to the ads of advertisers.
  - Hence activities of the assessee are not merely restricting to display of advertisement
- By using patented algorithm, assessee decides which advertisement is to be shown to which consumer visiting millions of website/search engine.
- Therefore it is not advertisement of the space; it is focused targeted marketing by assessee/Google with the help of technology

Royalty – Adwords program Google ITAT Bengaluru ruling (contd.)

- Assessee providing before/after sale services, after having access to user data, IPRs, secret formula, process, software and confidential information of GIL, in its own capacity under the agreement
- The assessee has not sold the storage space on the server outside India nor has it sold the identified/demarcated ad on the web site/search engine
- It is a continuous targeted advertisement campaign to the focused consumer

Royalty – Adwords program
Google ITAT Bengaluru ruling (contd.)
Whether there is use of patent of trademark?

- The Tribunal distinguished the decisions of *Sheraton International Inc v. DDIT [2009] 313 ITR 267 (Del)*, *Formula One World Championship Ltd. v. CIT [2016] 76 taxmann.com 6 (Del)* by holding that
  - Use of trademark for advertising marketing and booking in the cases were incidental activities of the taxpayer
- Therefore, payments made by the assessee was not only for marketing and promoting Adword programmes **but was also for the use of Google brand features and trademarks (!!)**

Royalty – Adwords program
Google ITAT Bengaluru **ruling (contd.)**
Whether adwords program is a secret process?

- The Tribunal held that though Adwords programme along with associated videos are available in public domain but how this programme functions for focused marketing campaign, promoting advertisements are only possible with the use of secret formula, confidential customer data only
- Since this secret process of targeting the customers, is not in public domain, **assessee was using secret process for marketing /promoting displaying of the advertisement** (!!)

Royalty – Adwords program
Google ITAT Bengaluru **ruling (contd.)**
Distinguishing precedents

- The Tribunal distinguished the decisions in the case of **Pinstorm Technologies (P.) Ltd v. ITO [2013] 154 TTJ 173 (Mum)** and **Yahoo India (P.) Ltd. v. CIT [2011] 46 SOT 105 (Mum), ITO v. Right Florists (P.) Ltd [2013] 143 ITD 445 (Kol) :**
  - Payments have been made for use of patented technology, secret process and use of trade mark. The assessee's case is not merely a case of displaying or exhibiting of advertisement by the advertiser on the website.
  - In those cases, payments were made directly by user to foreign advertising platform
- **Accordingly, since the payments made by the assessee to GIL falls within the ambit of royalty, the assessee was required to withhold tax at source on such payments (!!)**

Royalty – Website Registration

- **Godaddy.com LLC vs. ACIT (ITA No.1878/Del/2017, AY 2013-14 dated 3.4.2018)**
- Domain name is an intangible asset which is similar to trademark. Consequently, income from services rendered in connection with such domain name registration is assessable as "royalty" u/s 9(1)(vi) of the Income-tax Act
- Relied on Hon'ble Apex Court in the case of **Satyam Infoway Ltd. Vs. Siffynet Solutions Pvt.Ltd. – [2004] Supp (2) SCR 465 (SC)** stating that in that case SC held that the **domain name is a valuable commercial right and it has all the characteristics of a trademark** and accordingly, it was held that the domain names are subject to legal norms applicable to trademark.

Royalty – Website Registration

- Relied on Hon'ble Bombay High Court in the case of **Rediff Communications Ltd. Vs. Cybertooth AIR 2000 Bombay 27** which held that domain names are of importance and can be a valuable corporate asset and such domain name is more than an internet address and is entitled to protection equal to a trademark.
- Relied on Hon'ble Jurisdictional High Court in the case of **Tata Sons Ltd. v. Manu Kosuri, (2001) PTC 432 (Del.),** which held that domain names are entitled to protection as a trademark because they are more than an address.
- **Distinguished Asia Satellite Delhi HC** case on grounds it had no relevance to present facts of the case
- ITAT Delhi thus concluded that , the charges received by the assessee for services rendered in respect of domain name is royalty within the meaning of **Clause (vi) read with Clause (iii) of Explanation 2 to Section 9(1) of Income-tax Act.**
- **Note:** Completely different from payment for website hosting which was held to be not royalty in **People Interactive India Pvt. Ltd. (TS-129-ITAT-2012(Mum.))**

S.9(1)(vii) - Fees for Technical Services

S.9(1)(vii) income by way of fees for technical services payable by—

(a) the Government ; or

(b) a person who is a resident, except where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(c) a person who is a non-resident, where the fees are payable in respect of services utilised in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India :

S.9(1)(vii)
Definition of FTS

Provided that nothing contained in this clause shall apply in relation to any income by way of fees for technical services payable in pursuance of an agreement made before the 1st day of April, 1976, and approved by the Central Government.

Explanation 1.—For the purposes of the foregoing proviso, an agreement made on or after the 1st day of April, 1976, shall be deemed to have been made before that date if the agreement is made in accordance with proposals approved by the Central Government before that date.

Explanation 2.—For the purposes of this clause, "fees for technical services" means any consideration (including any lump sum consi-deration) for the ***rendering of any managerial, technical or consultancy services*** *(including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries";*

FTS
Ishikawajima-Harima's twin test

- ***Ishikawajima-Harima Heavy Industries Ltd. Vs. DIT [2007] 288 ITR 408 (S.C.): 207 CTR 361(S.C.)***
  - Business connection vs PE
  - Offshore vs Onshore contracts
  - **Twin test of rendering & utilization in India :** *"In view of the aforesaid reasons, no ambiguity has been left by the Apex Court in holding that if the technical or consultancy services, though utilized in India, are rendered outside India, the fees for the same will not be liable to tax in India within the provisions of section 9(1)(vii) of the Act."*
  - Was this a right decision?
    - ***Read Worley Parsons Service Pty Ltd. (In Re AAR 747 of 2007)***

Finance Act 2007
The failed amendment

"Explanation.—For the removal of doubts, it is hereby declared that for the purposes of this section, where income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of sub-section (1), such income shall be included in the total income of the non-resident, whether or not the non-resident has a residence or place of business or business connection in India.".

- This does not address the twin criteria laid out by Ishikawajima-Harima?!

Jindal Thermal, Clifford chance

- Karnataka High Court in Jindal Thermal Power Company vs. DCIT (**225 CTR 220 Kar.)**
- Bombay High Court in Clifford Chance **318 ITR 237 (Bom.)**
- Finance Bill 2010:

  "Held that the Explanation, in its present form, does not do away with the requirement of rendering of services in India for any income to be deemed to accrue or arise to a non-resident under section 9. It has been held that on a plain reading of the Explanation, the criteria of rendering services in India and the utilization of the service in India laid down by the Supreme Court in its judgement in the case of Ishikawajima-Harima Heavy Industries Ltd. (supra) remains untouched and unaffected by the Explanation."

S.9(1)(vii) - FTS
Finance Act 2010 amendment
Second time lucky!

Explanation.—For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of sub-section (1) and shall be included in the total income of the non-resident, whether or not,—

(i) the non-resident has a residence or place of business or business connection in India; or

(ii) the non-resident has rendered services in India.

Classification of payments to NR's

- Classification as FTS remains one of the most popular disallowances
  - Wide scope : "managerial", "technical", "consultancy"
  - No need for business connection
  - Place of rendering & utilization confusion has been sorted out
  - FTS and Royalty deeming fiction are powerful and easy to use tools for disallowances. Thus any payments to NR's will be tried to be put under the lens of FTS or Royalty remember!
- What are some of the possible defences if classified as FTS or Royalty?

FTS – Make available clause

- After Finance Act 2010 amendment, refuge seems to be mainly in the "make available" clause in Article 12 of the DTAA's
- Service recipient to thenceforth be able to perform service
  - Logic: Teach a person to fish instead of giving them a fish
- Main decisions are:
  - **Hon'ble Delhi High Court in the case of DIT Vs Guy Carpenter & Co Ltd [(2012) 346 ITR 504 (Del)]** and
  - **Hon'ble Karnataka High Court in the case of CIT Vs De Beers India Pvt. Ltd [(2012) 346 ITR 467 (Kar)]**

FTS – Make available
Chennai takes unique stand….again!

- **Foster Wheeler France S.A. (taxpayer) vs Deputy Director of Income Tax (DDIT),** Chennai ITAT held that payments made by a non-resident to another non-resident for providing engineering specifications are taxable as 'fees for technical services' (FTS) under the Indian Income Tax Act, 1961 as well as Article 12(4)(b) of the India-USA DTAA
  - ITAT rejected commonly used argument of 'make available' clause present in the treaty on the basis that the taxpayer was not a layman and was capable of observing the opinion/advice given by the associate company and could implement the same in future projects (!!)
- **Brakes India Chennai ITAT** on testing flywheel…..

FTS – Standard (common) service

- **CIT vs. Kotak Securities (Civil Appeal 3141 of 2016 dated 29th March 2016)**

"The service provided by the Stock Exchange for which transaction charges are paid fails to satisfy the ***aforesaid test of specialized, exclusive and individual requirement of the user or consumer who may approach the service provider for such assistance/service****. It is only service of the above kind that, according to us, should come within the ambit of the expression "technical services" appearing in Explanation 2 of Section 9(1)(vii) of the Act. In the absence of the above distinguishing feature, service, though rendered, would be mere in the nature of a facility offered or available which would not be covered by the aforesaid provision of the Act."*

CIT vs. Bharti Cellular Ltd. 330 ITR 239 SC : "element of human intervention" required for even technical service (*noscitur a sociis*) – S.194J context

- **Skycell Communications Ltd. & Anr. v. Deputy Commissioner of Income Tax & Ors (2001) 251 ITR 53**

FTS – Standard (common) technical service

- **DIT vs. A.P.Moller Maersk A S (Civil Appeal No 8040 of 2015 dated 17th February, 2017)**
  - In order to constitute "technical services", services catering to the special needs of the person using them must be rendered.
  - **The provision of a common facility is not "technical services".**
  - Amount paid towards reimbursement of a common technical computer facility is not "fees for technical services".
  - Amount received by way of reimbursement of expenses does not have the character of income
- FTS definition discussed in detail by multiple SC judgments:
  - **DIT v. Panalfa Autoelektrik Ltd., (272 CTR 117)**
  - **GVK Industries vs. ITO (371 ITR 453)**

Absence of FTS clause in DTAA

- **Tekniskil (Sendirian) Berhard v. CIT (22 ITR 551 (AAR))** , AAR had the opportunity to evaluate the old Malaysia treaty, which did not have FTS clause. The AAR ruled that there is no incompatibility between recognizing the receipts as 'FTS' and also looking upon them as the profits of a business. In light of this observation, the AAR held that **the transaction would be governed by the 'Business Profits' Article and would be taxable in India only if the tax payer had a PE in India**.
- Madras High Court in the case of **Bangkok Glass Industry Co. Ltd. v.ACIT** (34 taxmann.com 77) affirmed this principle
- Mumbai Tribunal in the case of **McKinsey & Co. (Thailand) Co. Ltd. v. DDIT (**36 taxmann.com 375 (Mum.)), **Channel Guide India Ltd v. ACIT (139 ITD 49)** and **ACIT v. Viceroy Hotels Ltd. (11 taxmann.com 216 Hyd)., Spice Telecom vs. ITO (113 TTJ 502 Bang.)**
- **DCIT vs. TVS Electronics Ltd. (TS-421-ITAT-2012(Chny)) took a different view (!!)**…. remanded back the matter with certain observations

TDS relief: Some interesting avenues. Impossibility of performance

- Verizon Communications Pte Chennai is on the taxability of the non-resident; **can the payer predict the amendments or this judgment?**
  - Impossibility of performance important in context of Finance Act 2010 to S.9 and Finance Act 2012 amendments to Royalty
- In context of Finance Act 2010 amendment:
  - **Metro & Metro vs. ACIT (ITA No.393/Agra/2012 dated 1st Nov., 2013)**
  - **Channel Guide vs. ACIT (139 ITD 49)**
  - **Sterling Abrasives vs. ITO (ITA No.2234 and 2244/Ahd/2008)**

Impossibility of Performance
An interesting angle to Royalty

- **CIT vs. NGC Networks (India) Pvt. Ltd. (ITA No.397 of 2015 dated 29th January 2018)**
- Relies on **CIT vs. Cello Plast (209 Taxmann 617 Mum. HC)**
  - **lex non cogit ad impossibilia** (law does not compel a man to do what he cannot possibly perform)
- S. 40(a)(i) TDS disallowance: A party cannot be called upon to perform an impossible Act i.e. to comply with a provision not in force at the relevant time but introduced later by retrospective amendment.
- **Interestingly: S. 40(a)(i) disallowance can be made only if the royalty falls under Explanation 2 to s. 9(1)(vi) but not if it falls under Explanation 6 to s. 9(1)(vi)**

Non-discrimination clause in DTAA's

- **Central Bank of India v/s. DCIT (42 SOT 450)** held that under Art 26(3) of India-USA DTAA payments to Non-Residents are equated with payments to Residents & so s. 40(a)(i) disallowance is not valid
  - This was upheld in **Mumbai HC in DIT vs. Citibank N.A. (ITA No.330 of 2013 dated 11th March 2015)**
- **CIT v. Herbalife International India (P.) Ltd. (ITA No.7/2007 dated 13th May, 2016) :**
  - The Delhi High court in this decision held that S.40(a)(i), before insertion of subclause (ia) in section 40(a) by the Finance (No.2) Act, 2004, were discriminatory in nature, as it provided for disallowance of payments made to nonresidents where tax was not deducted at source, whereas similar payments to residents did not result in any such disallowance.
- Useful in context of introduction of Royalty only from June 2006 and FTS from April 2005 u/s 40(a)(ia)
- Note that all non-discrimination clauses aren't the same across Treaties

Non-discrimination clause in DTAA's

- **Mitsubishi Corporation India Pvt. Ltd vs. DCIT (ITAT Delhi)**
  - In case of non-resident PE, to avoid discrimination under Article 24(3) of the India-Japan DTAA, the benefit of no disallowance u/s 40(a)(ia) for want of TDS if the recipient has paid the tax to be extended to non-residents u/s 40(a)(i)
  - Further, Tribunal observed that different tax treatment to the foreign enterprise per se is enough to invoke nondiscrimination clause in DTAA.
- Very useful in context of watering down of provisions in S.40(a)(ia)?
  - **CIT vs. Ansal Land Mark Township (ITA 160 & 161/2015 dated 26.8.2015, Delhi HC)** and 30% restriction of disallowance can now apply

Non-discrimination
S.40(a)(ia) changes

S.40(a)(ia) ***thirty per cent of any sum*** *payable to a resident, on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139 :*

....

Provided further *that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purpose of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the resident payee referred to in the said proviso.*

MFN clause

- State A binds itself to State B with respect to favourable treatment afforded by it in future to State C
- India has MFN clause with following countries –Sweden, Swiss Confederation, France, Israel, Philippines, Belgium, Netherlands, Kazakhstan, Hungary, Spain
- India-France example: *If under any Convention, Agreement or Protocol signed after September 1, 1989, between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interests, royalties, fees for technical services or payments for the use of equipment to a* ***rate lower or a scope more restricted than the rate of scope provided for in this Convention*** *on the said items of income, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply under this Convention*.

MFN Clause : Steria ruling

- The Court ruling in favour of the Taxpayer held that the **Protocol becomes automatically applicable and there is no need for a separate notification incorporating the beneficial provisions of the India – UK DTAA into the India – France DTAA**.
- The Court also dismissed the contention of the Revenue that when reference is made to one convention signed between India and another OECD member state for the purposes of ascertaining if it had a more restrictive scope or a lower rate of tax, then only that convention has to be used for both the purposes
- The Court also upheld the judgment of the Kolkata Tribunal in the case of ***DCIT vs. ITC Ltd. (82 ITD 239 Kol.)*** wherein also it was held that benefit of a lower rate or restricted scope of FTS under the India - French DTAA was not dependent on any further action by governments.
- **Court concluded that the FTS provision of the India- UK DTAA should be read into the India-France DTAA** and hence Managerial Services provided by Steria France did not constitute FTS

MFN Clause: Shell ruling

(ITA No. 1283/Ahd/2010 dated 10/11/2015)

- Shell Global Solutions International BV ("the Taxpayer") is a Dutch Company which rendered services to an Indian company. One part of the service was Non-technical services such as customer relations, quality control, review of processes, site checks/ inspections etc. ("Commercial Services").
- The Taxpayer contended that such Commercial Services did not qualify the "make available" requirement for FTS under the Dutch Treaty read with the US Treaty. At the lower levels, it was held that the entire receipts are taxable as FTS.
- The fundamental issue before the Tribunal was whether the fees for Commercial Services were taxable as FTS under Article 12 of the Dutch Treaty.
- The Tribunal reversed the decision of the CIT(A) and held that the payments for Commercial Services are not in the nature of FTS under the Dutch Treaty. The Tribunal held that the "make available" requirement imported into the Dutch Treaty from the US Treaty was not met in respect of the Commercial Services. This was by virtue of the MFN clause in the Protocol of the Dutch Treaty ("Protocol").
- Article 12 of the Dutch Treaty contains a broad definition of FTS – payments in consideration for services of a "managerial technical or consultancy nature". However, the Protocol to the Dutch Treaty which was signed on an even date, included an MFN clause. It provides that any relief (directly or indirectly reducing the rate or scope of Indian tax) extended to other OECD countries (in this case, US) shall apply to the Dutch Treaty as well. The Tribunal also noted that unlike other tax treaties, such as Philippines, Switzerland, the Dutch Treaty does not require that the governments of both countries should mutually decide on such incorporation of the relevant provision within the treaty.

MFN Clause: Interesting rulings & Govt. response

- ***DCIT vs. Sun Pharmaceutical Labs (ITA No.1345, 1346 and 1347/Ahd/2016 dated 11 July 2018)*** applied MFN clause of India-Portuguese treaty to India-Israel transactions and held that as per India-Israel MFN clause is automatic
  - India-Portugal has "make available" clause and FTS is only "technical, consultancy" services
- Government's (valentine day!) response
  - Notification 10/2017 dated 14.2.217 MFN clause omitted w.e.f 1-4-2017 in the Protocol of the India-Israel Treaty
- Interestingly, in ***ITO vs. Torrent Pharmaceuticals Ltd (76 taxmann.com 351 Ahd)*** held that India-Portuguese can't be imported India-Switzerland Treaty as that India-Switzerland DTAA has specific requirement of re-negotiation of the two Countries and review by parties
  - India-Philippines has review provisions too

S.9(1)(ii), (iii) & (iv)
Salaries, Dividend paid outside India

(ii) income which falls under the head "Salaries", if it is earned in India.

Explanation.—For the removal of doubts, it is hereby declared that the income of the nature referred to in this clause payable for—

(a) service rendered in India; and

(b) the rest period or leave period which is preceded and succeeded by services rendered in India and forms part of the service contract of employment,

shall be regarded as income earned in India ;

(iii) income chargeable under the head "Salaries" payable by the Government to a citizen of India for service outside India ;

(iv) a dividend paid by an Indian company outside India ;

Working abroad

- **Utanka Roy vs. DIT** (W.P.No 369 of 2014 dated 15th Dec., 2016) Held salary received by non-resident for services rendered abroad accrues outside India and not chargeable to tax in India
  - Source of receipt NOT relevant
- **Tapas Kr. Bandopadhyay vs. DDIT (ITA No.70/Kol/2016 dated 1.6.2016)** examined S.5(2)(a) of Act and held salary received by non-resident in India is taxable in India on receipt basis
  - Relied on Captain A. L. Fernandez Vs. ITO reported in 81 ITD 203 (TM)
  - Distinguished DIT vs. Prahlad Vijendra Rao (198 taxman 551 Kar.)
  - CIT vs. Avtar Singh Wadhman (115 Taxman 536 Bom.)
  - Arvind Singh Chauhan (42 Taxman.com 285 Agra)

Working abroad
Chennai blazes its own (incorrect?) path….

- **Swaminathan Ravichandran vs. ITO (ITA No.299/Mds/2016)**
- Salary received in India by a non-resident for services rendered outside India not eligible to exemption under DTAA
- Among various other observations, the Tribunal held that:
  - As Article 23 of India-China Treaty applies only to residents of India, the taxpayer by virtue of being a non-resident wrt India, was not eligible to claim exemption under Article 15(1) of the treaty (!!)
  - Did not follow judicial precedents and upheld the CIT(A) order
- **Appeal pending before Madras HC**

Employment related TDS issues Secondment

- **Centrica India Offshore Pvt Ltd v. CIT & Ors. [TS-237-HC-2014(DEL)]**
  - Held that services rendered by deputed employees “makes available” technical knowledge to the Indian entity and hence payment for those services was taxable as FTS as per DTAA (!!)
  - Also, reimbursement of salary and other associated costs by the Indian Company without an element of income could not be construed as diversion of income by overriding title.
- Secondees functioned exclusively for Centrica India under its control, supervision
- Salary was paid directly by the overseas entities into their overseas bank account and claimed as reimbursement from Centrica India.
- Such salaries were offered to tax in India by the secondees after withholding tax obligations for employee taxes.

Secondment - *Centrica* decision

- Whether the reimbursement of salary costs of secondees by Centrica India to overseas entities under the terms of the secondment agreement was in the nature of income accruing to the overseas entities?
- If so, whether Centrica India was liable to be withhold tax under section 195 of the Act?
- Ruling:
  - FTS applicable with secondees making available their technical expertise
  - Service PE – applicable
  - Payment is not reimbursement, rather payment for services
  - Payment is not diversion of income by overriding title

Secondment
Morgan Stanley – distinguishing Centrica

- ITAT Mumbai in *Morgan Stanley [TS-775-ITAT-2014(Mum)]* rules Service PE created by activities of employees seconded to India
- Not taxable as FIS
- Once a Service PE is created, the provisions of FIS article under the IndiaUS DTAA will not apply.
  - This is clear from the express terms of the FIS provision which excludes profits in connection with PE from its ambit.
  - **To this extent, the Delhi HC decision in the case of Centrica (supra) cannot be applied** as the Delhi HC did not consider the specific exclusion of PE profits from FIS article under the relevant DTAA.
- On computation of income from Service PE, payments received from Indian company would be treated as a revenue receipt and salary costs of the deputed employees would be allowed as deduction.
- **Bottomline: Way out from Centrica ruling!**

Sound of one-handed clapping

- **Changes being done unilaterally to the Act to override DTAA:**
  - Either by directly adding Sections to Act with non-obstante clause such as **S.206AA** (or)
  - Unilateral actions delegated to the CBDT such as **S.94B**
  - Introducing new kinds of tax: “a rose by another name would smell as sweet” (or have the same thorns!) such as **Equalization Levy**

Sound of one-handed clapping S.206AA

- S.206AA prescribed flat rate (20% in case of no-PAN NR's)
  - DTAA rate might be lesser!
  - Watered down by Rule 37BC of IT Rules w.e.f 1.6.2016 ; shall not apply to interest, royalty , FTS and payments on transfer of capital asset
  - *Dy. DIT (International Taxation) v. Serum Institute Of India Ltd. [2015] 56 taxmann.com 1/68 SOT 254 (Pune-Trib.)*
  - **Nagarjuna Fertilizers and Chemicals Ltd. vs. ACIT (ITA 1187/H/2014 dated Feb 13, 2017 SB)**
- **Bottomline: Goes against the principle of Bilateral Treaties to make unilateral changes**

Sound of one-handed clapping
S.206AA

Requirement to furnish Permanent Account Number.

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 XVIIB (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:

Provided that where the tax is required to be deducted under section 194-O, the provisions of clause (iii) shall apply as if for the words "twenty per cent", the words "five per cent" had been substituted.

Sound of one-handed clapping
S.206AA

(2) No declaration under sub-section (1) or sub-section (1A) or sub-section (1C) of section 197A shall be valid unless the person furnishes his Permanent Account Number in such declaration.

(3) In case any declaration becomes invalid under sub-section (2), the deductor shall deduct the tax at source in accordance with the provisions of sub-section (1).

(4) No certificate under section 197 shall be granted unless the application made under that section contains the Permanent Account Number of the applicant.

(5) The deductee shall furnish his Permanent Account Number to the deductor and both shall indicate the same in all the correspondence, bills, vouchers and other documents which are sent to each other.

Sound of one-handed clapping
S.206AA

(6) Where the Permanent Account Number provided to the deductor is invalid or does not belong to the deductee, it shall be deemed that the deductee has not furnished his Permanent Account Number to the deductor and the provisions of sub-section (1) shall apply accordingly.

(7) The provisions of this section shall not apply to a non-resident, not being a company, or to a foreign company, in respect of—

(i) payment of interest on long-term bonds as referred to in section 194LC; and

(ii) any other payment subject to such conditions as may be prescribed.

Sound of one-handed clapping
S.206AA r.w. Rule 37BC of IT Rules

Rule 37BC. (1) In the case of a **non-resident**, not being a company, or a foreign company (hereafter referred to as 'deductee') and **not having permanent account number** the provisions of section 206AA shall not apply in respect of payments in the nature of **interest, royalty, fees for technical services and payments on transfer of any capital asset, if the deductee furnishes the details and the documents specified in sub-rule (2) to the deductor**.

(2) The deductee referred to in sub-rule (1), shall in respect of payments specified therein, furnish the following details and documents to the deductor, namely:—

(i) name, e-mail id, contact number;

(ii) address in the country or specified territory outside India of which the deductee is a resident;

(iii) a certificate of his being resident in any country or specified territory outside India from the Government of that country or specified territory if the law of that country or specified territory provides for issuance of such certificate;

(iv) Tax Identification Number of the deductee in the country or specified territory of his residence and in case no such number is available, then a unique number on the basis of which the deductee is identified by the Government of that country or the specified territory of which he claims to be a resident.

Sound of one-handed clapping
S.94A

- S.94A is another example: Cyprus notified as notified jurisdictional area by CBDT on 1st Nov 2013, rescinded retrospectively from 14th Dec. 2016
  - Madras HC upheld S.94A as constitutional in **T.Rajkumar vs UOI (Appeal Number : Writ Petition Nos.- 17241 to 17243 & 17407 to 17412 of 2015 dated 12/4/2016)**

Sound of one-handed clapping

S.94A: Special measures in respect of transactions with persons located in notified jurisdictional area.

94A. (1) The Central Government may, having regard to the lack of effective exchange of information with any country or territory outside India, specify by notification in the Official Gazette such country or territory as a notified jurisdictional area in relation to transactions entered into by any assessee.

(2) Notwithstanding anything to the contrary contained in this Act, if an assessee enters into a transaction where one of the parties to the transaction is a person located in a notified jurisdictional area, then—

(i) all the parties to the transaction shall be deemed to be associated enterprises within the meaning of section 92A;

(ii) any transaction in the nature of purchase, sale or lease of tangible or intangible property or provision of service or lending or borrowing money or any other transaction having a bearing on the profits, income, losses or assets of the assessee including a mutual agreement or arrangement for allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided by or to the assessee shall be deemed to be an international transaction within the meaning of section 92B, and the provisions of sections 92, 92A, 92B, 92C [except the second proviso to sub-section (2)], 92CA, 92CB, 92D, 92E and 92F shall apply accordingly.

Sound of one-handed clapping
S.94A

(3) Notwithstanding anything to the contrary contained in this Act, no deduction,—

(a) in respect of any payment made to any financial institution located in a notified jurisdictional area shall be allowed under this Act, unless the assessee furnishes an authorisation in the prescribed form authorising the Board or any other income-tax authority acting on its behalf to seek relevant information from the said financial institution on behalf of such assessee; and

(b) in respect of any other expenditure or allowance (including depreciation) arising from the transaction with a person located in a notified jurisdictional area shall be allowed under any other provision of this Act, unless the assessee maintains such other documents and furnishes such information as may be prescribed, in this behalf.

(4) Notwithstanding anything to the contrary contained in this Act, where, in any previous year, the assessee has received or credited any sum from any person located in a notified jurisdictional area and the assessee does not offer any explanation about the source of the said sum in the hands of such person or in the hands of the beneficial owner (if such person is not the beneficial owner of the said sum) or the explanation offered by the assessee, in the opinion of the Assessing Officer, is not satisfactory, then, such sum shall be deemed to be the income of the assessee for that previous year.

Sound of one-handed clapping
S.94A

(5) Notwithstanding anything contained in any other provisions of this Act, where any person located in a notified jurisdictional area is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVII-B, ***the tax shall be deducted at the highest of the following rates****, namely:—*

(a) at the rate or rates in force;

(b) at the rate specified in the relevant provisions of this Act;

(c) ***at the rate of thirty per cent****.*

(6) In this section,—

(i) "person located in a notified jurisdictional area" shall include,—

(a) a person who is resident of the notified jurisdictional area;

(b) a person, not being an individual, which is established in the notified jurisdictional area; or

(c) a permanent establishment of a person not falling in sub-clause (a) or sub-clause (b), in the notified jurisdictional area;

(ii) "permanent establishment" shall have the same meaning as defined in clause (iiia) of section 92F;

(iii) "transaction" shall have the same meaning as defined in clause (v) of section 92F.

Sound of one-handed clapping
India’s Equalization Levy – Part I - Finance Act 2016

- E-commerce companies are the new generation of business leaders and online advertisement revenue is the key growth engine of this sector
- Case in point are Facebook and Google which are growing very fast earning substantial revenues through advertisements in the digital medium:
- Google reported ~US$70 billion and Facebook ~US$20 billion ad revenue in 2015 alone!

Sound of one-handed clapping
India’s Equalization Levy – Part I - Finance Act 2016

- Under OECD’s original draft BEPS Action Plan 1, the OECD had considered, a digital withholding tax or an equalisation levy as one option to tax digital transactions.
- However, the final Action Plan 1 report released in October 2015, did not recommend introducing such a levy as an internationally agreed standard at this stage, nonetheless it did state that countries could introduce one in their domestic laws as an additional safeguard against BEPS, provided they respect existing treaty obligations, or include them in their bilateral tax treaties.

Sound of one-handed clapping
India’s Equalization Levy – Part I - Finance Act 2016

- The Indian Govt. through the Central Board of Direct Taxes (CBDT) constituted a “Committee on Taxation of E-Commerce” which recommended in March 2016 the BEPS Action Plan proposal of an Equalization Levy
- Though the Indian Income Tax Act provisions do not mention the OECD and the Indian taxation regime is not bound by nor does it follow fully the OECD Guidelines, the Indian Govt accepted the Committee's recommendations with startling alacrity and introduced detailed “Equalization Levy” legislation in 2016 itself!

India’s Equalization Levy – Part I - Finance Act 2016

- Finance Act, 2016 introduced a new tax in India called the ‘Equalisation Levy‘ at 6%. This tax will be levied on:
  - Payments for online advertisements, provision of digital advertising space or any other facility or service for the purpose of online advertisements
  - Received or receivable by a non-resident not having PE in India
  - From a resident in India who carries out business or profession, or from a non-resident having PE in India.
- The tax will have to be collected by the payer and deposited with the government.

India’s Equalization Levy – Part I - Finance Act 2016

- The equalization levy has been defined as “tax leviable on consideration received or receivable for **any specified service** under the provisions of this chapter.”
- The levy would fall under a **separate, self-contained code and would not be part of the Income Tax Act, 1961** as it has been introduced through Chapter VIII of the Finance Act, 2016 **which does not become part of the income tax law**. Like STT, it will remain a separate tax. Hence, Double tax avoidance agreements are not applicable to EL.

  “A rose by any other name would smell as sweet!” - EL is a tax levied without having to worry about the existing tax provisions or treaties!

- The equalization levy would apply at a rate of **6%** on the gross consideration payable for a “specified service.”

India’s Equalization Levy – Part I - Finance Act 2016

- Though only 2 types of services are specified by Finance Act 201 under EL, the list of services recommended by the Committee of Taxation on E-commerce to be brought under EL **was much wider** in scope including:

  online advertising or any services, rights or use of software for on line advertising, including advertising on radio & television;

  digital advertising space;

  designing, creating, hosting or maintenance of website;

  digital space for website, advertising, e-mails, on line computing, blogs, on line content, online data or any other online facility;

  any provision, facility or service for uploading, storing or distribution of digital content;

  online collection or processing of data related to online users in India;

  any facility or service for online sale of goods or services or collecting online payments;

India’s Equalization Levy – Part I - Finance Act 2016

development or maintenance of participative online networks;

use or right to use or down load on line music, online movies, online games, online books or online software, without a right to make and distribute any copies thereof;

online news, online search, online maps or global positioning system applications;

online software applications accessed or downloaded through internet or telecommunication networks;

online software computing facility of any kind for any purpose; and

reimbursement of expenses of a nature those are included in any of the above.

India’s Equalization Levy – Part I - Finance Act 2016

- EL is so designed that there is no FTS/Royalty characterisation issue.
  - One does not have to determine whether it is a business income, royalty or FTS or any other category of income.
- Simply because a non-resident earns revenue in India, it will be liable to EL

Issues around EL

- **No double taxation:** To avoid double taxation of income which has been subject to an equalization levy, such income will be exempt in the hands of the non-resident under section 10(50) of the Income Tax Act, 1961. Thus there will be no double taxation of the same income within India.
- **No tax credit??** However, one would need to evaluate the possibility of claiming a tax credit for such levy in the home country of the non-resident service provider. But they can claim the EL as an expenditure suffered by them but not the relief of full tax adjustment.
- **To be paid, whether deducted or not:** Further section 166 of chapter VIII provides that even if Indian resident payer does not deduct EL, he has to make payment of EL to Government of India. For e.g. consider that Indian resident has made payment of Rs.100 to the non-resident and he has not deducted any tax at source. Then he will simply have to pay Rs. 6 to Government of India and close the matter.

India’s Equalization Levy – Part I - Finance Act 2016

Section 165 - Charge of equalisation levy.

(1) On and from the date of commencement of this Chapter, there shall be charged an equalisation levy ***at the rate of six per cent*** *of the amount of consideration for any specified service received or receivable by a person, being a non-resident from –*

i) a person resident in India and carrying on business or profession; or

ii) a non-resident having a permanent establishment in India.

(2) The equalisation levy under sub-section (1) shall not be charged, where –

a) the non-resident providing the specified service has a permanent establishment in India and the specified service is effectively connected with such permanent establishment;

b) the aggregate amount of consideration for specified service received or receivable in a previous year by the non-resident ***from a person*** *resident in India and carrying on business or profession, or* ***from a non-resident*** *having a permanent establishment in India,* ***does not exceed one lakh rupees****; or*

c) where the payment for the specified service by the person resident in India, or the permanent establishment in India is not for the purposes of carrying out business or profession.

India’s Equalization Levy – Part I - Finance Act 2016

- **Section 166 - Collection and recovery of equalisation levy**

1) **Every person**, ***being a resident and carrying on business or profession*** or a non-resident having a permanent establishment in India (here in this Chapter referred to as assessee) ***shall deduct the equalisation levy*** from the amount paid or payable to a non-resident in respect of the specified service at the rate specified in section 165, if the aggregate amount of consideration for specified service in a previous year exceeds one lakh rupees.

2) The ***equalisation levy so deducted during any calendar month*** in accordance with the provisions of sub-section (1) shall be paid by every assessee to the credit of the Central Government ***by the seventh day of the month immediately following the said calendar month***.

3) Any assessee ***who fails to deduct the levy*** in accordance with the provisions of sub-section (1) shall, notwithstanding such failure, **be liable to pay the levy to the credit of the Central Government in accordance with the provisions of sub-section (2)**.

India’s Equalization Levy – Part I - Finance Act 2016

- **Amendment of section 40**
- 22. In section 40 of the Income-tax Act, in clause (a), after sub-clause (ia), the following sub-clause shall be inserted with effect from the 1st day of June, 2016, namely:-

- "(ib) any consideration paid or payable to a non-resident for a specified service on which equalisation levy is deductible under the provisions of Chapter VIII of the Finance Act, 2016, and such levy has not been deducted or after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139:

- Provided that where in respect of any such consideration, the equalisation levy has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified in sub-section (1) of section 139, such sum shall be allowed as a deduction in computing the income of the previous year in which such levy has been paid;".

India’s Equalization Levy – Part I - Finance Act 2016

Amendment of section 10.

- **7.** In section 10 of the Income-tax Act,—

E)after clause (49), the following clause shall be inserted with effect from the 1st day of June, 2016, namely:

50) any income arising from any specified service provided on or after the date on which the provisions of Chapter VIII of the Finance Act, 2016 comes into force and chargeable to equalisation levy under that Chapter.

- Explanation.—For the purposes of this clause, "specified service" shall have the meaning assigned to it in clause (i) of section 161 of Chapter VIII of the Finance Act, 2016.'..

Problems with EL

- **No Advance Ruling** – Though administration of levy falls under Income Tax Act, there is no provision for seeking advance ruling regarding EL
- **Existing contracts may have to be redone –** From business standpoint, the non-resident might not accept this withholding. This might require re-negotiation for business of contracts existing in place
- **Deduction in case of credit card payments** – How will the payer deduct this levy in case of online credit card payments which is the common mode of payment for such transactions?
- **Worrisome methodology:** EL escapes the clutch of negotiated Tax Treaties and Indian Income Tax Act provisions - this method can be used to introduce new levies if the EL experiment succeeds

Sound of one-handed clapping
India’s Equalization Levy – Part II - Finance Act 2020

- FA 2020 has now introduced a new provision (Section 165A in FA 2016) to enhance the scope of the **Equalization Levy.**
- Equalization Levy will **now be extended to an e-commerce operator on ‘ecommerce supply and services’ undertaken on or after 1 April, 2020.**
- An “e-commerce operator” has been defined to **mean a nonresident who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both.**
- “e-commerce supply and services” has been defined to mean:

(i) online sale of goods owned by the e-commerce operator; or

(ii) online provision of services provided by the e-commerce operator; or

(iii) online sale of goods or provision of services or both, facilitated by the e-commerce operator; or

(iv) any combination of the above activities

India’s Equalization Levy – Part II - Finance Act 2020

- With regard to the above, the Equalization Levy shall not be levied

(i) where the e-commerce operator has a Permanent Establishment (PE) in India and the e-commerce supply or service is effectively connected to its PE.

(ii) where Equalization Levy is already levied on online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement.

(iii) where sales, turnover or gross receipts of the e-commerce operator from the e-commerce supply and services is less than INR 2 crore during the previous year.

India’s Equalization Levy – Part II - Finance Act 2020

- This Equalisation Levy will be at the rate of 2% on the amount of consideration from e-commerce supply and services made or provided or facilitated by an e-commerce operator to:
- (i) a person resident in India
- (ii) a non-resident in the following specified circumstances:

(a) Sale of advertisement, which targets a customer, who is resident in India or a customer who accesses the advertisement through internet protocol address located in India.

(b) Sale of data, collected from a person who is resident in India or uses internet protocol address located in India.

- (iii) To a person who buys such goods or services or both using internet protocol address located in India.

India’s Equalization Levy – Part II - Finance Act 2020

- Consequent to this new Equalisation Levy, an amendment has been made to section 10(50) of the Act. Income arising from ecommerce supply or services which will be covered by the Equalisation Levy will now be exempt from tax under section 10(50).

Recent ruling on TDS
PILCOM judgment

Facts: A Committee was formed by the three host members of 1996 Cricket World Cup – India Pak and Sri Lanka - under the name of PILCOM (the assessee) and the assessee opened two bank accounts in London to be operated jointly by the representatives of the Indian and the Pakistan Cricket Boards, to which the receipts from sponsorship, T.V. rights, etc., were deposited and from which expenses were met. Assessee made following payments:

(i) Guarantee money paid to 17 countries which did not participate in the World Cup matches

(ii) Amounts transferred from London to Pakistan and Sri Lanka for disbursement of prize money in those countries for matches played there

(iii) Payment to ICC as per Resolution dated Feb. 2, 1993

(iv) Payment for ICC Trophy for qualifying matches between ICC Associate members held outside India

(v) Guarantee money paid to South Africa and United Arab Emirates both of which did not play any match in India

(vi) Guarantee money paid to Australia, England, New Zealand, Sri Lanka and Kenya with whom double taxation avoidance agreements exist and

(vii) Guarantee money paid to Pakistan, West Indies, Zimbabwe and Holland.

PILCOM HC ruling
S.158BBA subject to S.9 or not?

ITAT: *The expression "in relation thereto" as appearing in section 115BBA (1) of the Act and having a wider connotation should satisfy the conditions as stipulated in section 9(1)(i) of the Act in order to be taxable in India. The Tribunal thus noted that " In that way, section 115BBA is merely subservient to section 9(1)(i) of the Act which dealing with deeming provisions which states that all income accruing or arising whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India, shall be deemed to accrue or arise in India.“* ***(PILCOM v. ITO [2001] 77 ITD 218 (Cal.))***

HC: *"The contention that section 158BBA of the Act has to be read subject to section 5(2), read with section 9 of the Act, could not be accepted, as sub-section (2) of section 5 of the Act has clearly mentioned that the same is subject to the other provisions of the Act. Section 9 of the Act provides that when income is deemed to accrue or arise in India, but this section has got no bearing nor any relevancy with the section 115BBA of the Act. Section 115BBA of the Act is completely independent from other sections and it has got nothing to do with the accrual or assessment of income in India as mentioned in section 9 of the Act.*

Once it is established that the aforesaid income of a non-resident assessee has accrued and conditions as mentioned in section 115BBA of the Act are fulfilled, then the statutory obligation of the payer under section 194E of the Act comes into play.“ ***(PILCOM v. CIT [2011] 198 Taxman 555 (Cal.))***

PILCOM SC
S.115BBA “in relation to”

"14. The mandate under Section 115 BBA (1)(b) is also clear in that if the total income of a Non-resident Sports Association includes the amount guaranteed to be paid or payable to it in relation to any game or sports played in India, the amount of income tax calculated in terms of said Section shall become payable. The expression 'in relation to' emphasises the connection between the game or sport played in India on one hand and the Guarantee Money paid or payable to the Non-resident Sports Association on the other. Once the connection is established, the liability under the provision must arise.

19. In the premises, it must be held that the payments made to the Non-Resident Sports Associations in the present case represented their income which accrued or arose or was deemed to have accrued or arisen in India. Consequently, the Appellant was liable to deduct Tax at Source in terms of Section 194E of the Act.“

[2020] 116 taxmann.com 850 SC (April 2020)

PILCOM SC “obiter dicta”
Ripe for misinterpretation

"31. Although it is not argued but we feel that obligation to deduction under section 194E is not affected by the DTAA since such a deduction is not the final payment of tax nor can be said to be an assessment of tax. The deduction has to be made and after it is done the assessee concerned gets the credit of the same and once it is found later on that income from which the deduction is made is not exigible to tax then on application being made refund with interest is always allowed. Fundamental distinction between the deduction at source by the payer is one thing and obligation to pay tax is another thing.

Advantage of the DTAA can be pleaded and taken by the real assessee on whose account the deduction is made and not by the payer.

We are of the view irrespective of the existence of DTAA the obligation under section 195E has to be discharged once the income accrues under section 115BBA".

PILCOM: S.115BBA r.w. S.194E vs DTAA
How to interpret PILCOM

- Court was examining the question of applicability of the provisions of section 115BBA of the ITA on the payments being made from India and consequently the obligation to withhold taxes under section 194E of the ITA.
- *At best*, observations of the SC in the PILCOM Ruling are to be interpreted in context of facts and strictly in the context of S.115BBA r.w. 194E of the Act with S.194E only being a mechanism for the deduction of tax owing to the income being covered under section 115BBA.
- **Has no bearing on how S.195 is to be applied!**

Miscellaneous issues

- Reimbursement is not subject to TDS
- Payments through intermediary
- Re-insurance
- TDS on immovable property (NR seller)
- S.9(1)(viii) – plugging loopholes on gifts to non-residents
- Shipping – S.172 – a code by itself!

Reimbursement : No TDS

- Amount received by way of reimbursement of expenses does not have the character of income.
  - ***DIT vs. A.P.Moller Maersk A S (Civil Appeal 8040 of 2015 dated 17.2.2017)***
  - ***Pr. CIT Vs Goldman Sachs (India) Finance Pvt Ltd. (Bombay High Court) ITA 652 of 2017 dated 6.6.2019***
- Devil is in the details! Provide enough documentation and substantiate reimbursed expenses
  - Cannot get away with “reimbursement” of technical services!

Payments through Intermediary

- ***Commissioner of Income-tax v. Hardarshan Singh 350 ITR 427 (Delhi HC)***
  - Assessee carried on business of commission agent by arranging for transportation of goods through other transporters •
  - As contract was between clients and lorry owners/transporters assessee did not deduct tax at source while making payments to transporters
  - Tribunal set aside orders holding that assessee acted only as a facilitator or intermediary and there was no privity of contract between assessee and client for carriage of goods
  - Accordingly, Tribunal concluded that assessee was not liable to deduct tax at source

TDS on Indian immovable property sale by non-resident seller

- Prima facie:
  - Long Term Capital Gain Tax – 20%
  - Short Term Capital Gain Tax – as per the income tax slab of the seller (total taxable income of seller in India)
- Seller (i.e. NRI) can apply for a lower TDS deduction from the Jurisdictional Assessing Officer of Income Tax.
  - The Assessing Officer shall issue a certificate of lower TDS deduction within a period of 30 days.
  - Based on the certificate of lower TDS deduction, the buyer of the property is required to deduct such TDS as mentioned in the certificate.
- It is mandatory for the buyer of the property (only when the seller is a non-resident) to obtain Tax Deduction and Collection Account Number (i.e. TAN).
- The exemption benefits available on Long Term Capital Gain under section 54 and section 54EC is also available to the seller (i.e. NRI).
- S.271C (penalty for non-deduction and non-payment of TDS amounting to sum equal to TDS), S.234E (late fee for non-filing TDS return)

Payments made to POA holder of Non-resident

- ***Rakesh Chauhan vs DDIT (International Taxation) [2010] 128 TTJ 116 (CHD.)***
  - Where payment is made by assessee to an individual Resident say (P) in India in respect of purchase of land which belonged to non-residents **but rights therein were assigned unequivocally to said resident as power-of-attorney** holder, such payment could not be regarded as payment to non-resident so as to require deduction of tax at source under section 195.
  - When non-resident himself nominates a particular agent to whom payment should be made and pursuant to that direction, the assessee pays the sum to the agent so nominated, the provisions of section 195 of the Act will apply.

S.9(1)(viii)

S.9(1)(viii) income arising outside India, being any sum of money referred to in sub-clause (xviia) of clause (24) of section 2, paid on or after the 5th day of July, 2019 by a person resident in India to a non-resident, not being a company, or to a foreign company

- *S.2(24)(xviia) any sum of money or value of property referred to in clause (x) of sub-section (2) of section 56;*

S.172
Shipping business of non-residents

S.172. (1) The provisions of this section shall, ***notwithstanding anything contained in the other provisions of this Act****, apply for the purpose of the levy and recovery of tax in the case of any ship, belonging to or chartered by a non-resident, which carries passengers, livestock, mail or goods shipped at a port in India.*

S.172 is a code by itself

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

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

Tribunal held:

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

Penal provisions

- We have already seen:
  - Disallowance of the particular expenses u/s.40(a)(i) if the TDS not at all deducted
  - If the TDS is deducted but not paid within time lime then interest @ 1.50 per month or part of the month from the date of deduction to date of deposit (Sec.201 (1A))
- Penal provision:
  - S.221: Tax withheld not paid
  - S.271C : Tax not withheld or short withholding
  - Penalty, not exceeding the amount of tax not withheld

Thanks!

V.Vikram

vvikram@gmail.com

vvikam@saprlaw.com