Presentation on "International Taxation & Practical Aspects of Form 15CB"

Nashik Branch of

Western Indian Regional Council

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SCHEME OF TAXATION

- Section 4 – Charging Section
- Income chargeable at rates prescribed by Finance Act provided
  - It comes within Scope of Total Income U/s 5 and/ or deemed income U/s. 9
  - It is not exempt U/s 10 and
  - It is subject to the provisions of Double Tax Avoidance Agreement entered by India, in case of income arising from cross border transaction

Scope of Total Income

- Section 5(1) : The total income of a ordinarily resident individual 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 ; or
- (*c*) accrues or arises to him outside India during such year

- In case of a person not ordinarily resident in India, the income which accrues or arises to him outside India shall not be so included unless it is derived from a business controlled in or a profession set up in India.

Scope of Total Income

- Section 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.

- Explanation 2 to Sec 5

  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 **shall not again be** so **included on the basis that it is received or deemed to be received** by him in India.

Scope of Total Income

- However, with effect from 01st April, 1976, the scope of Income Tax has been widened by introducing & expanding deeming provisions to bring the non-residents' income under the Indian Tax Net – Sec 9

CERTAIN SPECIFIC INCOMES COVERED IN SEC 9(1)

- Sec 9(1)(ii) – Salary Income – If earned in India
- Sec 9(1)(iii) – Salary paid by Govt to a citizen of India for service outside India
- Sec 9(1)(iv) – Dividend paid by an Indian Company outside India
- Sec 9(1)(v) – Interest paid by Govt or a resident person including interest paid by resident branches to its head office or branches abroad
- Sec 9(1)(vi) – Royalty paid by Govt or resident and even non resident where royalty is payable in respect of any property utilised for the purpose of business or profession or making or earning any income from any source in India.
- Sec 9(1)(vii) - Fees for Technical Services paid by Govt or resident and even non resident where fees is payable in respect of any services utilised for the purpose of business or profession or making or earning any income from any source in India.

WHETHER TERRITORIAL NEXUS NECESSARY FOR INCOME TO ACCRUE IN INDIA

- Territorial nexus as such not necessary for income to accrue or arise in India
- That's what is the intention of Sec 9 which says- "income shall be deemed to accrue or arise in India"
- Even under Treaty if it falls within the scope of say, FTS article it would be taxable in the source country.
- Territorial nexus has a major relevance for "Business Income" (concept of "Business with source country" or "Business in source country")

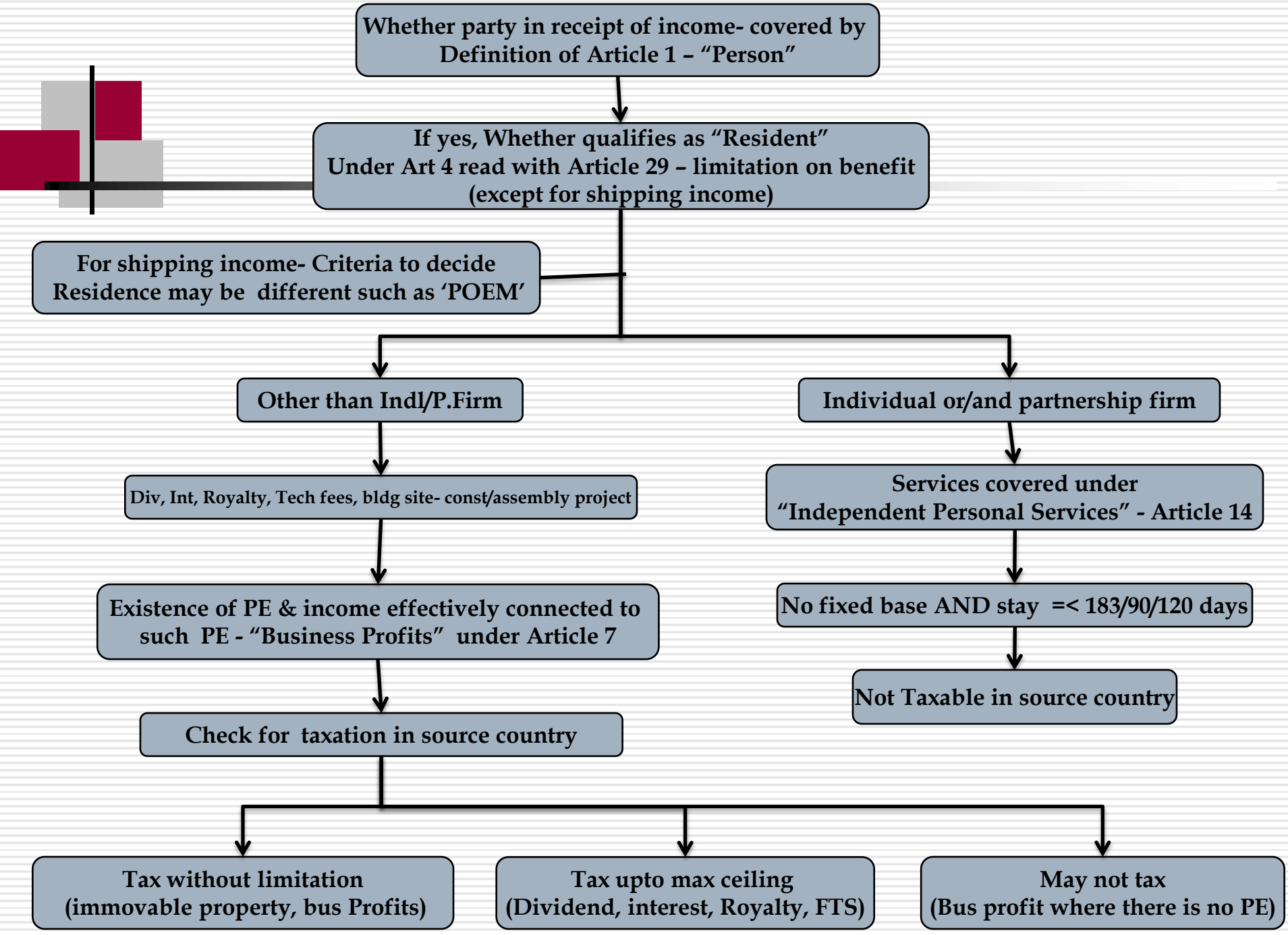
Summarizing Sec 9

Nature of Income	Taxability
Business Income Sec 9(1)(i)	Taxable if direct or indirect business connection in India or property or asset or source in India or transfer of a capital asset situated in India
Capital Gains Sec 9(1)(i)	Taxable if situs of Shares/Property in India or derives its value substantially from assets in India
Salary Income Sec 9(1)(ii)	If earned in India
Interest Income Sec 9(1)(iv)	If sourced in India (if payer is Resident)
Royalties 9(1)(vi)	If incurred for business in India irrespective of the residential status of the payer
FTS 9(1)(vii)	If incurred for business in India irrespective of the residential status of the payer

Double Taxation Avoidance Agreement

THE PROCESS OF ANALYSING TAXABILITY OF CROSS BORDER TRANSACTION

- **Step 1** : Determine characterization of Income under the Act
- **Step 2** : Check Source Rule for taxation under the Act, if found taxable under the Act, check whether DTAA exists with the contracting State
- **Step 3** : If the Treaty exists follow the process of applying the Treaty.


Whether party in receipt of income- covered by Definition of Article 1 – "Person"
If yes, Whether qualifies as "Resident" Under Art 4 read with Article 29 – limitation on benefit (except for shipping income)
For shipping income- Criteria to decide Residence may be different such as 'POEM'
Other than Indl/P.Firm
Individual or/and partnership firm
Div, Int, Royalty, Tech fees, bldg site- const/assembly project
Services covered under "Independent Personal Services" - Article 14
Existence of PE & income effectively connected to such PE - "Business Profits" under Article 7
No fixed base AND stay =< 183/90/120 days
Not Taxable in source country
Check for taxation in source country
Tax without limitation (immovable property, bus Profits)
Tax upto max ceiling (Dividend, interest, Royalty, FTS)
May not tax (Bus profit where there is no PE)

CHARACTERIZATION OF INCOME / REMITTANCE

Nature of Income	IT Act	DTAA
Business or Profession	Sec. 9(1)(i)	Art. 5, 7 & 14
Salary	Sec. 9(1)(ii)	Art. 15
Dividend Income	Sec. 9(1)(iv) & Sec.115A	Art. 10
Interest Income	Sec. 9(1)(v) & Sec.115A	Art. 11
Royalty	Sec. 9(1)(vi) & Sec.115A	Art. 12
FTS	Sec. 9(1)(vii) & Sec.115A	Art. 12
Capital Gains	Sec. 9(1)(i) & Sec. 45	Art. 13

FEES FOR TECHNICAL SERVICES (FTS)

Definition of **Fees for Technical Services** as per the act:

- any consideration (including any lump sum consideration) 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”.

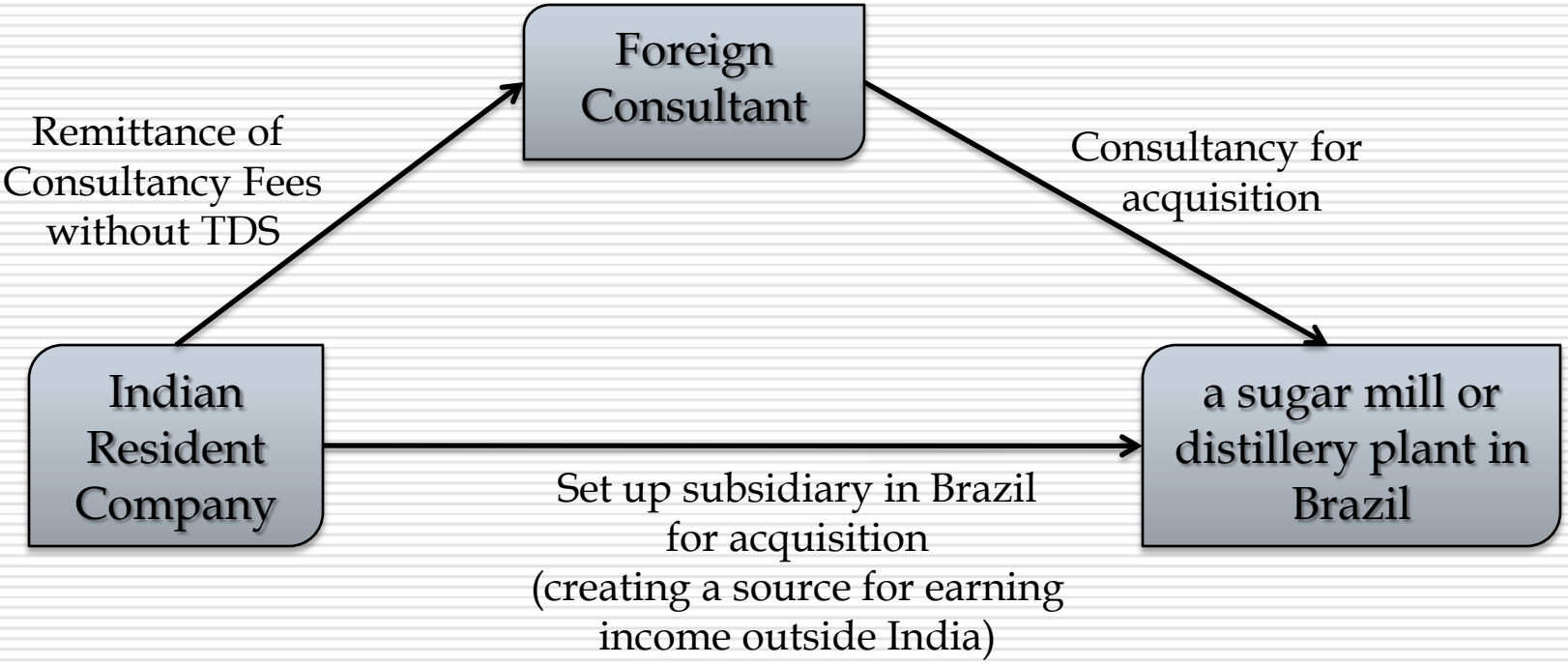
EXCEPTIONS TO SECTION 9(1)(vii)

- Source Outside India
- Business Outside India
- Presumptive Taxation
- Construction, Assembly, Mining
- Salaries

EXCEPTIONS TO SEC 9(1)(VII) CONTD..

'Source outside India'

ITO (International Taxation) vs. Bajaj Hindustan Ltd. 2011-TII-123-ITAT-MUM-INTL dated 12 August 2011



EXCEPTIONS TO SEC 9(1)(VII) CONTD..

Source Outside India

- The concept of Source Outside India is essential as this paves the way for coming out of section 9(1)(vii).
- Meaning of 'Source' need to be determined based on fact and interpretations from Judicial pronouncements as term 'Source' is not defined in the Act
- Need to distinguish between 'Source Vs. Receipt'

CASE LAW ON CONCEPT OF 'SOURCE OUTSIDE INDIA'

CIT v. Havells India Ltd. (2013) 352 ITR 376 (Delhi)(HC)

i. **Export of Goods is not Source of Income outside India:**

- Export of goods is based on contracts entered into between the parties.
- Export contracts are concluded in India. The entire manufacturing is done in India
- The source of income is that point when the export contract is concluded in India.

SOURCE OUTSIDE INDIA CONTD…

ii. **Source of Income v/s Source of monies received:**

- Commissioner Of Income Tax Vs Havells India Ltd. has marked a difference between Source of Income and source of Monies received
- In case of export sales it is concluded that it is just a source of monies received from outside India.
- This is because export contract is concluded in India. The income component of monies received from exports is situated in India.
- Thus the consideration received from exports outside India is only source of monies received and not source of Income.

EXCEPTIONS TO SEC 9(1)(vii) CONTD…

- **Business Outside India**

  If fees are payable in respect of services utilised for such business or profession carried on outside India.

  Example of Business Outside India : Overseas Branch of Indian Resident

EXCEPTIONS CONTD..

- **Presumptive Taxation**
- **ADIT vs. Valentine Maritime (Gulf) LLC (ITAT Mumbai) (I.T.A. No.700)**
  - If the contract falls u/s 44BB, incidental technical services are not assessable as "fees for technical services" u/s 9(1)(vii).
  - When a contract consists of a number of terms and conditions, each condition does not form a separate contract. The contract has to be read as a whole. The entire consideration is assessable only u/s 44BB and no part of it is assessable as fees for technical services u/s 9(1)(vii).

Construction, Mining, Assembly

- **Construction, Mining, Assembly excluded**
- The intention of the Legislature behind this exclusion is that such activities would virtually amount to carrying on business in India. Therefore, Consideration for any construction, assembly, mining or like project will therefore be chargeable to tax on net basis u/s 44D/ 44DA and not as FTS, *i.e.*, after allowing deduction in respect of costs and expenditure incurred for earning the same.
- Exclusion from FTS was denied by Delhi Court in case **Hotel Scopevista Ltd. *v.* Assistant Commissioner of Income-tax ([2007] 18 SOT 183 (DELHI))**on the basis that-

  The consideration was received for providing services in connection with construction project and not for actual construction activities.

  the services had been provided from the foreign country without actually undertaking any activities in India in relation to the construction of the hotel.

Construction, Mining, Assembly – Leading to PE

- **R & B Falcon Offshore Ltd vs. ACIT Dehradun, ITAT Delhi (2011-TII-02-ITAT-DEL-INTL)**

  An installation or a structure could become a PE only if it was actually used for exploration or exploitation of natural resources for a period of more than 120 days. The time from its positioning at the appropriate place for exploitation of mineral oil only was to be considered and not when it was under repairs or being moved to the appointed place.

  Mere office address could not be said to considered as a PE, unless it has been established that activities (other than preparatory and auxiliary activities) need to be carried out from such place for it to be considered as a PE.

Installation, assembly or commissioning services– Business Profits prevail over FTS

- For situations in which there are specific PE clauses for services that are de-facto in the nature of FTS or FIS, the taxability of consideration for such services is taxable as business profits.

- For Eg. Since there is a specific Installation PE, the taxability of installation, assembly or commissioning services fall under business profits although they are covered under Article 12.

Interplay between Section 44BB and Section 44DA

- **Section 44DA** provides for computing income of a non-resident, including a foreign company, by way of royalty or fee for technical services, in case the right, property or contract giving rise to such income are effectively connected with the permanent establishment of the said non-resident.

- **Section 44BB** deals with special provisions for computing profits and gains for non- residents engaged in the business of providing services or facilities in connection with exploration, etc. of mineral oils.

Interplay between Section 44BB and Section 44DA

- **Ohm Ltd. vs. DIT (2012) 28 taxmann.com 120 (Delhi)** - Revenues earned by the non-resident from rendering such specific services are covered by section 44BB whereas Section 44DA is broader and more general in nature. Thus in existence of a specific provision dealing with the income deriving from an activity in connection with prospection or extraction of mineral oils, Section 44DA cannot be invoked as specific prevails over general.

- **ADIT (International Taxation, Dehradun) vs. TDI Brooks Intl. Inc (ITA No. 749/Del/2013)** - The assessee also had PE in India and AO had already examined the effective connection of the revenue of the assessee with the PE in India. Therefore income of the assessee was assessable u/s 44BB of the Income Tax Act.

Interplay between Section 44BB and Section 44DA

- **Oil and Natural Gas Corporation Limited vs. CIT (Supreme Court) (FTS)**

  The "pith and substance" test has to be applied to determine the dominant purpose of each agreement. If the dominant purpose is mining, the income is assessable only u/s 44BB and not as "fees for technical services" u/s 9(1)(vii) & 44D

- **[2015] 59 taxmann.com 70 (Delhi - Trib.)/[2015] 37 ITR(T) 46 (Delhi - Trib.)**

  Where assessee, a tax resident of Norway, was engaged in activities relating to acquisition of 3D seismic data under contracts with 'RIL' and 'ONGC', assessee was entitled to declare its income under provision of section 44BB.

  Income arising from mobilisation and demobilisation of vessel outside india was taxable as fees from technical services under section 9(1)(vii)

Technical Services

- When special skills or knowledge related to a technical field are required for provision of such services.
- Whilst provision of engineering services would be of a technical nature, the services of psychologist would not
- Use of technology in providing services is not indicative of whether the services are of technical nature.
- Similarly delivery of services through via technological means doesn't make the services technical

Technical Services…CONTD

- Crucial to determine at what point the special skill or knowledge is used.
  - The fee for provision of service would not be technical fee, however, unless that special skill or knowledge is required when the service is provided to the customer.
  - For example, special knowledge or skill will be required to develop software and data used in computer game that would subsequently be used in carrying on the business of allowing customers to play this game on internet for a fee
  - Decision in the case of Skycell communication– use of standard facility- doesn't result into provision of technical services i.e. once the facility is created (which may be very high tech in nature), the subsequent use of such standard facility is not 'Technical in nature'.

Managerial Services

- Not much literature is available on the meaning of the term ‘managerial services’
- In the general sense, managerial services refer to the services used in the context of running and management of the business of the client. Managing a particular function of the business can be said to be rendering of managerial services. For example, a person employed to "manage" a company’s computers department would fall within the Explanation (2) of Sec 9(1)(vii) as a person rendering managerial services.

Consultancy Services

- A Consultancy service means an advisory service having element of expertise, professional knowledge and human intervention.
- However, advisory service merely involving discussion and advice of routine nature or exchange of information cannot be classified as 'consultancy services'.

- **CIT vs. Group ISM Pvt. Ltd. [2015] 57 taxmann.com 450 (Delhi)**

  Consultancy services are *something akin to advisory services provided by the non-resident, pursuant to deliberation between parties.*

Consultancy Services…contd

- Consultancy and Technical services are to some extent overlapping because a consultancy service could also be a technical service. However, the category of consultancy services also includes an advisory service, whether or not expertise in a technology is required to perform it.

COMMERCIAL SERVICES

- Fees for Commercial Service such as- Commission, Procurement Services, Liaison Services- cannot be characterized as FTS and hence not liable to tax in source country in the absence of PE or BC
- Commission- not taxable u/s. 9(1)(i)- CIT vs. Toshoku Ltd. 4 Taxmann 1 (SC- 1980), Ceat International v. CIT 237 ITR 859 & DCIT v. Divi's Laboratories Ltd [2011-TII-182-ITAT-HYD-INTL]
- **Eon Technology (P) Ltd v CIT [2011] 15 taxmann.com 391 (Delhi)**
  - income of a non-resident agent cannot be considered as (i) accruing or (ii) arising or (iii) deemed to be accruing or arising in India as the services of the non resident agents were rendered/utilized outside India and the commission was also payable/paid outside India.
  - When a non resident operates outside the country, no part of his income arises in India, and since the payment is remitted directly abroad, and merely because an entry in the books of accounts is made it does not mean that non resident has received any payment in India .

Commercial Services..Contd

- 153 ITD 176 (Mumbai – Trib.) (08.10.2014) - commission payments were made to foreign agents for securing sales orders payments will not fall in category of 'Fee for Technical Services' requiring withholding of tax
- [2015] CIT Rajasthan v. Modern Insulators Ltd.*- Commission paid for rendering services outside India is business profits and not FTS
- Welspring Universal Vs. Joint CIT –Commission paid Not FTS
- Fluidtherm Technology (P.) Ltd v. CIT, Chennai (2015) 57 taxmann.com 87 (Madras) - Sales commission not taxable in absence of PE

COMMERCIAL SERVICES CONTD…

- Payments to non-resident companies for commercial services rendered outside India are not liable to deduction of tax a source in India in absence of PE or BC
  - ACIT vs M/s Leaap International Pvt. Ltd. 2011-TII-91-ITAT-MAD-INTL (providing clearing and forwarding services at foreign ports)- CTC Journal (August 2011- page no.114)
  - G.E. India Tech (2010) 327 ITR 456 (SC) was relied upon
  - 'Canvassing services' for the business of Non Resident Principal doesn't lead to taxability in India– Star Cruise India Travel Services Pvt. Ltd. (Mum Tribunal July 2011). However one should also bear in mind 'Scope of Services in canvassing or marketing' – Refer Rolls Royce [19 SOT 42 Del]

FTS…CONTD

- FTS is not defined in the Act, OECD, US or UN model
- Fees for Technical Services under Indian Treaties
  - No separate clause for FTS – Mauritius, Indonesia, UAE, Brazil, Greece, Philippines, Syria, Thailand, Bangladesh, Libya, Myanmar, Nepal, Saudi Arabia, Sri Lanka, United Arab Republic, Tajikistan
  - In case of no separate clause- such payment is classifiable as 'Business Profits'- Tekniskil (Sendirian) Berhard V. CIT [1996] 222 ITR 551 (AAR), Siemens Aktiengesellschaft V. ITO [1987] 22 ITD 87 (Mum), GUJ Jaeger GmbH V. ITO [1991] 37 ITD 64 (Mum), Christiani & Nielsen Copenhagen V. First ITO [1991] 39 ITD 355 (Mum)
  - Differing judgment in the case of unreported AAR – Lanka Hydraulic Institution Limited- 2011- treating as 'Other Income'
  - Before concluding on taxability one should also check on existence of PE (specially, Service PE, Construction PE or Installation PE)

FTS- 'MAKE AVAILABLE'

Fees for included services/Make Available clause –

- What is 'make available'- The Tribunal observed that 'make available' means to provide something to one, which is capable of use by other in future. Hence, to fit into the terminology 'make available', the technical knowledge, skill, know how etc. must remain with the person receiving such services even after the particular contract comes to an end. (DDIT v. Scientific Atlanta Inc., (2009) 33 SOT 220 MUM)
- Business support, marketing information technology support services and strategy support etc., does not amount to FTS within meaning of India – Singapore Tax Treaty- AAR – Bharti Axa Gen. Ins. Co. Ltd.
- USA, UK, Australia, Canada, Cyprus, Malta, Netherlands, Portugal, & Singapore.
- Further 'Make Available' indirectly applicable due to existence of MFN clause in the protocol to the tax treaties with Belgium, France, Israel, Hungary, Kazakhstan, Spain, Switzerland and Sweden{ Sandvik AB (TS-738 ITAT 2014(PUN)}
- FTS/ FIS not include managerial services – USA, UK, Spain

SCOPE OF 'MAKE AVAILABLE' IN DIFFERENT TREATIES

Article 12 under India-**Canada** Treaty:

"*4. For the purposes of this Article, 'fees for included services' means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services :*

(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received; or

(b) make available technical knowledge, experience, skill, know-how, or processes or consist of the development and transfer of ***a technical plan or technical design****."*

SNC-Lavalin International Inc V/s Deputy Director Of Income Tax, International Taxation, [2008] 26 SOT 155 (DELHI)- Fees for Designing services held taxable

SCOPE OF 'MAKE AVAILABLE' IN DIFFERENT TREATIES ...CONTD

Article 12 under India-**Singapore** Treaty:

"4. The term "fees for technical services" as used in this Article means payments of any kind to any person in consideration for services of a managerial, technical or consultancy nature (including the provision of such services through technical or other personnel) if such services :

(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received ; or

(b) make available technical knowledge, experience, skill, know-how or processes, which enables the person acquiring the services to apply the technology contained therein ; or

(c) consist of the development and transfer of ***a technical plan or technical design, but excludes any service that does not enable the person acquiring the service to apply the technology contained therein****."*

MANAGERIAL SERVICES

In case of ***Raymond Ltd. V. Deputy Commissioner of Income Tax (2003) 86 ITD 791(MUM).*** The term "Managerial Services" was interpreted as follows

- Managerial services cover a larger field than one particular activity
- A person cannot be said to render managerial services if it is limited to a "one-off" transaction.
- It is implied in the very nature of managerial services that there would be some continuity in the sense that the rendering of the services would cover a series of transactions or a series of projects or steps undertaken by the person engaging such services.

MANAGERIAL SERVICES ...CONTD

In case of ***Kotak Securities – 206 Taxmann 86,*** it was held that -

- The transaction charges paid by the assessee were in the nature of 'fees for technical services' covered under Section 194.
- CIT(A) upheld the order of the AO stating that the stock exchange is not merely a mute spectator providing only physical infrastructure to the members but the stock exchange was a supervisor, overseer, manager controller, settlor and arbitrator over the security trading done through the stock exchange and provides managerial services. Thus, section 194J was applicable.

MANAGERIAL SERVICES ...CONTD

- In order to be characterized as "managerial services", the service should have an impact on the running of the business of the assessee and it is not sufficient [to attract section 9(1)(vii)] if the assessee ultimately gains by the result of such services.
- **J.K. (Bombay) Ltd. v. CBDT (1979)**

  Managerial service may be professional service like legal or medical service, but that would not be technical services like engineering service.

MANAGERIAL SERVICES ...CONTD

- **Oberoi Hotels India (P.) Ltd. v. CBDT [1998] 97 taxmann 453 (SC)**

  The assessee, a hotel company, having a long time experience and worldwide reputation in the hotel field entered into an agreement with a foreign hotel by which the assessee was required to provide training to the staffs and management of the foreign hotel, to advertise and worldwide promotion of the hotel, to supply consultants and specialists and to operate the hotel for a certain period of time. These services were said to be managerial services.

- ***Steria (India) Limited* (2014) AAR Nos. 1055 of 2011**

  Services like corporate communications, financing, group marketing, internal audit, human resources, communication risk control, information systems, controlling and consolidation, legal, group global operations, technology, management information services etc rendered to an Indian company are characterized as managerial services and thus fall within the scope of FTS u/s 9(1)(vii).

IPS PREVAILS OVER FTS

- Certain treaties exclude from scope of FTS income covered in IPS. (China, France, Namibia, Oman, Tanzania, Vietnam)
- But where such specific exclusion is not there, in such cases, Article 14 of IPS should prevail (235 ITR 698- AAR- Eberhard Gustav Von Der Mark V CIT) - rationale being if a case fell under more beneficial provisions of a treaty, then it would be futile to stretch the interpretation to bring it under some other provisions of the treaty.
- For example: Say, an engineer renders services for testing of a machine. In such situation, even though the services relate to technical field, the services rendered by an individual will fall under within the scope of Article 14 – "Independent Personal Services".
- Special provision would prevail over general provision. Thus, one should first apply Article on Independent Personal Services and then Article 12 on FTS (MSEB Vs DCIT 270 ITR 36).

Procurement and related Services

- Offshore Supplies - Supply of Equipments, materials etc.
- Offshore Services – Design, engineering, project management and control

→ Outside India

- Onshore Supplies – Supply of Equipments, materials etc.
- Onshore Services – civil, erection, installation, testing, commissioning, supervision work.

→ Inside India

Taxability – Offshore Supply of Equipment

- Whether such transactions fall under ambit of royalty. (See Royalty defn as per act)
- Since it is nature of outright sale and connected to the EPC contract, there is no "right to use " of equipment involved. Hence outside the purview of royalty.
- The issue now may be limited to whether non-resident supplier has a business connection or PE.
- If PE in India, then profits to the extent attributable to PE are taxable.
- If supply not connected to PE and directly to project owner, income will not be taxable subject to conditions.

Taxability - Offshore Supplies (Contd…)

- Taxability is one of the most debatable issues.
- CBDT issued circular No. 23 of 1969 with regards to the same.
- As per circular, income from offshore supplies can be claimed tax exempt provided:
  - **"Transfer of title"** (risk and ownership) in equipment passes to buyer outside India.
  - Entire **"sale consideration"** received outside India.
  - Transaction is at **"arms length"**.
  - Contract is **"executed"** outside India.
- Revenue authorities may however take contrary view.

Judicial Pronouncements - Offshore Supply of Equipment

- **Ishikawajima – Harima Heavy Industries vs. DIT [2007] 288-ITR-408 (SC) it was held that -**
  - Only such part of income as is attributable to the operations carried out in India can be taxed in India.
  - If all parts of transactions i.e. transfer of property in goods as well as payment was carried outside India, transaction cannot be taxed in India.
  - The situs of signing contract is of no material consequence if all activities connected to offshore supplie sis situated outside India.
  - If PE exists it would be a taxable entity. However, existence of PE would not constitute sufficient 'business connection'. The fiscal jurisdiction of a country would not extend to taxing the entire income attributable to PE.

Judicial Pronouncements - Offshore Supply of Equipment

- **DIT (International Taxation) vs. Ishikawajima – Harima Heavy Industries [2013] 29 taxmann.com 75 (Bombay) it was held by the ITAT that -**
  - SC in the aforesaid assessee's own case has held that apart from non-applicability of Section 9(1) of the Income tax Act, 1961, in the present case Article 7 of DTAA between India and Japan is also applicable.
  - Hence the income arising from offshore supply of equipments and services would not be taxable.
  - If the assessee is not liable to tax in view of the Article 7 of DTAA between India and Japan, then, irrespective of the amendment to section 9(1) of the Act, the assessee would not be liable to tax.
- Thus **despite retrospective amendment** to section 9(1) with effect from 1-6-1976 **assessee would not be liable to tax** in respect of such amount under explanation to the said section.

Judicial Pronouncements - Offshore Supplies (Contd…)

- **DIT vs. LG Cable Ltd. [2011-TII-02-HC-DEL-INTL]**
  - LG was awarded two contracts by Power Grid, one for onshore execution of Fibre Optic Cabling system package project involving onshore services and including erection/installation, testing and communicating etc. and other for offshore supply of equipments and offshore services.
  - LG set up project office for onshore services and treated the same as PE and offered income in terms of Article 5 and 7 of India-Korea DTAA.

Judicial Pronouncements - Offshore Supplies (Contd…)

- Delhi court in case of offshore supply of equipment held that *the same cannot be taxed in India merely because it is interlinked with satisfactory performance of the onshore contract.*
- The consideration for performance of activities within India was separate from consideration for supply of equipment.
- Further the PE had no role to play in execution of offshore supply contract and was set up for sole purpose of enabling the performance of the onshore services.

Judicial Pronouncements - Offshore Supplies (Contd…)

- **Technip Italy SPA vs. ACIT [2010-TII-133-DEL-INTL] it was held that-**
  - In case of offshore supplier, since the entire transaction is completed on high seas, the profits from such sale are not taxable in India. The fact that a turnkey contract by itself, is not of much significance and for the purpose of taxability, it is not necessary that contract is to be considered as an integrated one. Hence, in above view revenue earned from offshore supply of equipment is not chargeable to tax in India.

Judicial Pronouncements - Offshore Supplies (Contd…)

- **Kolkata Tribunal in case of Dongfang Electric Corporation vs. DDIT (International Taxation) [2012] 23 taxmann.com 170 held that –**
  - Kolkata Tribunal in case of Dongfanf Electric Corporation vs. DDIT (Intl Tax) [2012] 23 taxmann.com 170 held that *transactions involved in offshore and onshore service contracts entered into with foreign entity are to be* ***looked at as a whole*** *and not on a stand alone basis.*

Judicial Pronouncements - Offshore Supplies (Contd…)

- **Some other judicial decisions wherein it was held that transaction sin nature of offshore supply of equipments were not taxable in India:**
  - LS cable Ltd [2011-TII-20-ARA-INTL]
  - AAR in case of SEPCO III Electric Power Corporation (AAR No. 1008 of 2010 dated 31st January 2012)
  - Hyosung Corporation vs. DIT (IT) 2009-TII-14-ARA-INTL
  - JCIT vs. Seimens Akteingesellschaft (2010-TII-09-ITAT-MUM-INTL)
  - Joint Stock Company Foreign Economic Association "Technopromexport" vs. DIT (IT) [2010-TII-10-ARA-INTL]

Taxability – Offshore Supply of Services

- Designs, drawings, engineering services etc. in connection with contracts likely to be taxed as Fees for Technical Services (FTS).
- If the same does not fall under FTS, the issue of taxability may be limited to whether the service has a business connection or PE.
- If it is found that services relate to business connection or PE in India, then issue as to profits that should be attributable to business connection or PE arises.
- Income shall not be taxable if services are rendered from outside India and PE or business connection has no role to play in respect of rendition of services.

Judicial Pronouncements - Offshore Supply of Services

- **Ishikawajima – Harima Heavy Industries vs. DIT [2007] 288-ITR-408 (SC) it was held that -**
  - Sufficient territorial nexus between rendition of services and territorial limits of India is necessary to make income taxable.
  - If offshore elements form integral part of the contract, entire contract would not be attributable to the operations in India even if place of execution of contract is in India.
  - Section 9(1)(vii) read with explanatory memorandum cannot be given a wide meaning so as to hold that the amendments was only to include income of non-resident tax payers received by them outside India from Indian concern s for services rendered outside India.

Judicial Pronouncements - Offshore Supply of Services

- For section 9(1) (vii) to be applicable, it is necessary that the services not only be utilized within India, but also be rendered in India or have such a "live link" with India that the entire income from fees as envisaged in Article 12 of the DTAA becomes taxable in India.
- The terms 'effectively connected' and 'attributable to' are to be construed differently even if the offshore services and PE were connected.
- Article 7 of DTAA is applicable in this case and it limits the tax on business profits to that arising from the operations of the permanent establishment.
- Applying the principle of appropriation of composite transactions (having some operations in one territory and some in others), it is essential to determine taxability of various operations.

Judicial Pronouncements - Offshore Supply of Services

- The location of source within India would not render sufficient nexus to tax the income from that source.
- If the test applied by the Authority for Advanced Ruling is to be adopted here too, then it would eliminate the difference between the connection between Indian and foreign operations, and the apportionment of income accordingly.
- The services are inextricably linked to the supply of goods, and it must be considered in the same manner.

Judicial Pronouncements - Offshore Supply of Services

- **Design, drawings, engineering services inextricably linked with equipment:**
  - Delhi High Court in case of **Linde AG, Linde Engineering Division vs. DDIT [2014] 44 taxmann.com 244 (Del)** held that in relation to taxability of offshore services (design, drawings, engineering) inextricably linked to and forming part of manufacturing and fabrication of the offshore supplies, such services would not be taxable as FTS under the provisions of the act.
  - AAR in case of Rotem Co. vs. DIT [2005] 279 ITR 165 held the same.

Judicial Pronouncements - Offshore Supply of Services (Contd…)

- Delhi ITAT in case of **Posco Engineering & Construction Co. Ltd. vs. DDIT [2014] 42 taxmann.com 500 (Del-Trib)** held that design and engineering cannot be considered as part of equipment to be supplied. In fact such design and drawings deal with every aspect of erection and commissioning of plant. All such drawings are customised. Thus, transaction of supply of design and engineering being of technical in nature, was liable to tax as FTS.

Judicial Pronouncements - Offshore Supply of Services (Contd…)

- **Technical or Consultancy services incidental to execution of project cannot be segregated and brought to tax under FTS. This was held in -**
  - Pintsch Bamag (2009-TII-23-ARA-INTL)
  - Hotel Scopevista Ltd. ACIT (2007-TII-44-ITAT-DEL-INTL)
  - CIT vs. Sundwiger EMFG & Co. (2003-TII-53-HC-AP-INTL) – payments received for services part & parcel of sale consideration could not be severed and taxed as technical services of non-resident co. for services rendered by it.
  - CIT vs. Neyveli Lignite Corp Ltd. (2003-TII-31-HC-MAD-INTL)

Taxability – Onshore Supply of Equipment & Services

- It would be taxable in normal course.
- Income from transactions of onshore supply of equipment and services will be treated as income accrued or arise in India and hence taxable in India.
- Such transactions can either fall under royalty or FTS. In this case whether treaty contains clauses on FTS/service PE/construction PE/supervisory PE needs to be examined.
- In case they fall outside the ambit of royalty or FTS, it will be treated as business income.

Judicial Pronouncements - Onshore Supply of Equipment & Services

- **AAR (Delhi) in case of Roxar Maximum Reservoir Performance WLL (AAR No. 977 of 2010) held that -**
  - The purpose of the contract is installation of gauges at site to enable ONGC to carry out its operations. The contract is clearly not for sale of equipment nor for mere erection of the same.
  - It is a composite contract for supply of equipments and erection within territory of India (i.e.onshore supply of equipment and services).
  - Even the payment is received as a performance of whole of contract in India. Thus the income is accrued in India.

Judicial Pronouncements - Onshore Supply of Equipment & Services

- It is clear that it is a contract for installation of equipment which the tenderer itself is to supply. It is an indivisible contract.
- The object in floating the tender is to get the gauges installed at sites indicated, in furtherance of oil extraction. Hence on a look at the contract in the light of the objective sought to be achieved, it cannot be accepted that the contract contains two distinct parts and they have to be separated for the purpose of taxation. Thus on a true construction of contract in question, the income there under has arisen to applicant in India.
- The contract is composite and cannot be treated independent one for onshore supply of equipment and services.

Tax Implications

Revenue Streams	No PE in India	PE in India	Broad Taxability
Offshore Supplies	N	Y	PE – taxable @ 42.024% of profits to extent attributable to PE If supply not connected to PE and directly from HO of project owner, not taxable.
Offshore Services	Y (IF FTS as per Act as well as DTAA)	Y	No PE – taxable on gross basis as FTS @ 10.30% or DTAA (lower of two) PE – Taxable on net basis @ 42.024% if services effectively connected to PE and to extent attributable to PE. If not effectively connected, taxable @ 10.30%

Tax Implications (Contd…)

Revenue Streams	No PE in India	PE in India	Broad Taxability
Onshore Supplies	N. A.	Y	Taxable @ 42.024% on net basis
Onshore Services	N. A.	Y	Taxable @ 42.024% on net basis

Royalty under the Income-tax Act, 1961

- Consideration (incl. lumpsum consideration) for :

- **Transfer of all or any rights (including license) in:**
  - **Patent, invention, model, design, secret formula or process or trademark, etc. (IP)**
  - **copyright, literary, artistic or scientific work including films or video tapes/tapes for use in TV/radio broadcasting**

- **Imparting of any information concerning**
  - **the working of or use of IP**
  - **technical, industrial, commercial or scientific knowledge, experience or skill**

- **Use of**
  - **any IP**
  - **or right to use any industrial, commercial or scientific equipment**

- Rendering of any services in connection with above

ROYALTY…CONTD

Factors affecting characterization of Royalty Income

- Remittance towards royalty presupposes the fact that "assets are already in existence"
- It is then only, can be said that payment is towards either use or right to use, or transfer of all or any right or even imparting or information in connection with working or use
- Therefore, a contract of service or work, which leads to creation or emergence of any right, property or information, should not lead to characterization of the transaction as Royalty.
- Marriott International Licensing Co BV [TS-621-ITAT-2013(Mum)]
- Neo Sports Broadcast (P) Ltd. 15 Taxmann.com 175 (Mumbai Tribunal). It was a case of live telecast.

AMENDMENT FROM THE FINANCE ACT 2013

The definition of "Royalty" has undergone a change after the amendment made by the Finance Act 2013, by inserting Explanations 4, 5 & 6.

[Explanation 4. – transfer of all or any rights in respect computer software

Explanation 5. – royalty includes and has always included consideration in respect of any right, property or information, whether or not –

(a) the possession or control 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. – "process" includes and shall be deemed to have always included transmission by satellite.

Explanation 5 to Sec 9(1)(vi) dealing with 'Control', 'Use' & 'Location'

- The intention of the legislature is to treat payment of hire charges of equipment (right/property/information) as 'Royalty' even where control and possession is not with the payer OR

- Even where use of equipment (right/property/information) is direct or indirect by the payer OR

- Whether the location of such equipment (right/property/information) is in India or not

There were judicial pronouncements characterizing payments as in the nature of Business Profits and not as Royalty and therefore to overcome such decisions, this amendment is introduced.

Explanation 5 to Sec 9(1)(vi) dealing with 'Control', 'Use' & 'Location'

- The issue therefore is whether such meaning ascribed to the term 'control' or the scope of the word 'control' can be imported into treaty which have been executed prior to such definition
- Article 3(2) of the OECD reads as follows:
- As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, **unless the context otherwise requires**, have the meaning that it has at that time under the law of.....

Explanation 5 to Sec 9(1)(vi) dealing with 'Control', 'Use' & 'Location'

- It is quite likely that the understanding of the term 'control' would not be what Indian Income Tax Act is now trying to provide and further
- Due emphasis should be given to the phrase- ***'unless context otherwise requires'***,
- The amendment in the domestic law in this manner could entirely vitiate the understanding that two sovereign countries had while signing the treaty

Case laws on Explanation 5 to Sec 9(1)(vi)

- In favour of tax payer- holding that enlarged scope of the term 'control' would not apply to treaty:
  - B4U Entertainment Ltd. 21 Taxmann.com 529 (Mumbai Tribunal)- Hire Charges of Transponder
  - Channel Guide India Ltd. 25 Taxmann.com 25 (Mumbai Tribunal)- use of satellite. Sec 40(a)(i) cannot be applied- legal maxim- **'lex non cogit ad impossiblia'**
  - Retro tax amendments only change tax liability with retrospective effect and not tax withholding obligations- 42 taxmann.com 286 – Agra Tribunal. DCIT Vs. Virola International

Case laws on Explanation 5 to Sec 9(1)(vi)

CIT (TDS) Vs. Maharashtra State Electricity Distribution Co. Ltd. [2015] ITA No.336 of 2013

- Inherent in the meaning of 'right to use' is certain element of possessory control and therefore to fall under the character of Royalty, in terms of Sec 9(1)(vi), there has to be an element of possession with the user or payer.
- The decision also gives an interesting example of Toll Road as under-

'An example is the use of a toll road (instead of highway). If use of a toll road could be characterised as use of land, it would be an extreme view if we held that toll to be paid for use of a toll road would be subject to deduction of tax at source only because it could also be characterised as rent for use of land. Such an extreme view will not be justified under any circumstances'.

Case laws on Explanation 5 to Sec 9(1)(vi)

- Though the legislature has every right to introduce deeming fiction, however, the creation of such deeming fiction should not lead to meaning which vitiates the comprehensible understanding. Deeming fiction should not make an 'apple' to be an 'orange'.

ROYALTY…CONTD

Royalty under OECD model:

- Means payments of any kind received as a consideration for the use of, or the right to use-
- any copyright of literary, artistic or scientific work including cinematograph films,
- any patent, trade mark, design or model, plan, secret formula or process or for information concerning industrial, commercial or scientific experience

Copyright Law w.r.t. Software payments

- **Copyright – a form of intellectual property protected under the Copyright Act, 1957**
- **Refers to the exclusive right to do or authorize others to do certain acts in relation to:**

→ Literary Works	→Artistic Works
→ Dramatics Works	→Cinematograph Films
→ Musical Works	→Sound Recordings

- **'Literary work' includes computer programmes**
- **Exclusive rights include the right to:**
  - → Reproduce the work
  - → Issue copies of the work to the public, not being copies already in circulation
  - → Perform or communicate the work to the public
  - → To make translations or adaptations of the work, etc.

Copyright Law w.r.t. Software Payments…contd

- **Exclusive right are subject to 'fair use doctrine' i.e. following acts to not constitute infringement:**
  - → Private use, including research, review, criticism (of literary, dramatic, musical works, other than computer programmes)
  - → the making of copies or adaptation of a computer programme by the lawful possessor of a copy of such computer programme, from such copy:
    - (i) in order to utilize the computer programme for the purposes for which it was supplied; or
    - (ii) to make back-up copies
- **Exploitation of Copyright**
  - → Exploitation by owner
  - → "Assignment" to others for exploitation
  - → License of all or some of his rights for royalties

SOFTWARE PAYMENTS

- Can it be regarded as payment towards- Royalty?
- Scope under the Act [9(1)(vi)] & U.S. Treaty
  - *Transfer of all or any right (including the granting of a license) in respect of any copyright of literary, artistic…..*
  - *Payment of any kind recd as consideration for use of, or right to use any copyright of literary, artistic….*

  Controversy is whether there is any transfer of 'Right in Copyright'

SOFTWARE PAYMENTS ...CONTD

- **Software payment considered as Royalty:**
  - Millennium IT Software Ltd. (AAR- 28/09/2011),
  - ING Vyasa Bank Vs DDIT (ITAT B'lore-5/8/2011),
  - Gracemac Corporation, Microsoft Corporation Vs ADIT (ITAT Delhi- 26/10/2010)
  - Cosmic Circuits (P.) Ltd (2013) 58 SOT 364 (Bang.)(Trib.)- Payments made for downloading lisenced software is considered as royalty.
  - Reliance Infocom Ltd
  - Income-tax Officer (International Taxation)-II, Chennai v. F.L. Smidth Ltd. [2014] 51 taxmann.com 90 (Chennai - Trib.)

SOFTWARE PAYMENTS ...CONTD

- **Software payment not considered as Royalty but as Business income:**
  - ADIT Vs TII Team Telecom International Pvt. Ltd. (ITAT Mumbai- 26/8/2011)
  - Dassault Systems (AAR- 29/1/2010)
  - Infrasoft Ltd. v Director of Income Tax [2013] 39 taxmann.com 88 (Delhi)
  - Director of Income-tax v. Nokia Networks OY [2012] 25 taxmann.com 225 (Delhi)
  - Financial Software & Systems (P.) Ltd.
  - Infotech Enterprises Ltd.
  - Bartronics India Ltd. [2014] 43 taxmann.com 16 (Hyderabad - Trib.)

JUDICIAL PRONOUNCEMENTS ON ROYALTY TRANSACTIONS CONTD..

- **Software License :**
  Infrasoft Ltd. v Director of Income Tax [2013] 39 taxmann.com 88 (Delhi)

- The definition of the term "royalty" has undergone a change under the Income Tax Act, 1961. However it has not changed under the various treaties. Reference has been made to CIT v. Davy Ashmore India Ltd and it is once again established that In case of inconsistency between the terms of the Agreement and the taxation statute, the Agreement alone would prevail.
- Licensee has not been provided with any of the rights mentioned in clause (a) of section 14 of the Copyrights Act, 1957. Hence not in the nature of Royalty.

JUDICIAL PRONOUNCEMENTS ON ROYALTY TRANSACTIONS

- **'Use of electronic database'** treated as Royalty-Gartner V ADIT 37 Taxmann.com 16, Wipro Ltd. V ITO, 94 ITD 9 (B'lore), DCI T Vs. Infosys 263 ITR
- **Sale of 'Business Information Report'** not treated as Royalty- Dun & Bradstreet Vs. ADIT [2010-TII-59-MUM ITAT]. Here also, it was a case of access to database in central server located in the U.S.
- **Payment to non-resident for data processing -** Where the assessee transmitted raw data to SPL in Singapore which processed it with the help of application software provided by the assessee and hardware owned by SPL, then the payment made by the assessee to SPL cannot be termed as consideration for use of process so as to treat the same as royalty.-Vide Standard Chartered Bank & Anr. v. Dy. Director of IT & Anr. (2011) 39 (II) ITCL 508 (Mum 'L'-Trib) – contrary view- Cargo Community Network 289 ITR 355 (AAR)

JUDICIAL PRONOUNCEMENTS ON ROYALTY TRANSACTIONS CONTD..

Secret Process:

D.C.M. Limited vs. CIT, [1989] 29 ITD 123 (DELHI)

- Consideration paid by the assessee for transfer of drawings, designs, etc., by an English company, to the assessee, outside India, did not constitute royalty under article 13 of the DTAA.
- In the absence of having a permanent establishment in India, the business profits could also not be taxed in India

JUDICIAL PRONOUNCEMENTS ON ROYALTY TRANSACTIONS CONTD..

- **Supply of Information**

JCIT v. Telerate [2010-TII-72-ITAT-MUM-INTL]

- When the taxpayer chooses to be covered by provisions of an applicable tax treaty, the tax department cannot thrust provisions of the Act on the taxpayer. The tax treaty and the Act offer alternative but similar modes of taxation of FTS therefore, the provisions of tax treaty shall prevail if they are more beneficial to the taxpayer.
- The income from supply of information relating to various markets should be taxed as business profits under Article 7(3) of the tax treaty and accordingly, the expenses incurred for earning the income should be allowed as a deduction.

BANDWITH/ USE OF STANDARD FACILITIES

i. **Infosys Technologies Ltd [2011] 45 SOT 157 (Bang.)**

- Payments made to Service Providers for providing facilities for down linking signals in foreign country were neither in the nature of managerial, consultancy or technical services nor was it for the right to use industrial, commercial or scientific equipment.

ii. **Skycell Communications Ltd v Dy CIT [2001] (251 ITR 53), Madras**

- Payments for use of mobile phone services would not constitute royalties or fees for technical services

iii. **Wipro Ltd v ITO (2003) 80 TTJ Bang 191**

- Payment for Bandwith would constitute neither royalties nor fees for technical services either under the Act or under the agreement for Avoidance of Double Taxation with USA

BANDWITH/ USE OF STANDARD FACILITIES CONTD…

However a contrary view is established in a recent case **Verizon Communications Singapore Pte Ltd. v. ITO [2013] 39 taxmann.com 70 (Mad)** where in it was held that :

- After the amendment was introduced [in Section 9(1)(vi) of the Act in the year 2012, irrespective of possession, control with the payer or use by the payer or the location in India, the consideration would nevertheless be treated as 'royalty' and therefore, the decisions cited4 by the taxpayer cannot be relied to understand the scope of the expression 'royalty'
- Thus the consideration received by the non-resident taxpayer from the Indian customers for provision of Bandwidth/Telecom Services outside India was for the 'use of, or the right to use equipment' and therefore, royalty under Section 9(1)(vi) of the Income-tax Act, 1961 (the Act).

WHETHER AMENDMENTS TO ROYALTY PROVISIONS WILL PREVAIL OVER TREATY?

- **CIT v. Visakhapatnam Port Trust [(1983) 144 ITR 146 (AP)]-**Provisions of Sections 4 and 5 of the Income-tax Act are expressly made "subject to the provisions of the Act" which means that they are subject to the provisions of Section 90. By necessary implication, they are subject to the terms of the Double Taxation Avoidance Agreement, if any, entered into by the Government of India. Therefore, the total income specified in Sections 4 and 5 chargeable to Income-tax is also subject to the provisions of the agreement to the contrary, if any.
- **CIT v. Davy Ashmore India Ltd. [(1991) 190 ITR 626 (Cal)]-**In case of inconsistency between the terms of the Agreement and the taxation statute, the Agreement alone would prevail.
- **B4U Holdings Ltd. (21 Taxmann.com 529)-**The treaty provisions not having undergone change, the clarification of Explanation 5 should not apply to treaty

WHETHER AMENDMENTS TO ROYALTY PROVISIONS WILL PREVAIL OVER TREATY?

- **Karnataka High Court in CIT v. R.M. Muthaiah [1993] 202 ITR 508 (Kar)**

  The effect of an 'agreement' entered into by virtue of Section 90 of the Act would be:

  - if no tax liability is imposed under this Act, the question of resorting to the agreement would not arise. No provision of the agreement can possibly fasten a tax liability where the liability is not imposed by this Act;
  - if a tax liability is imposed by this Act, the agreement may be resorted to for negativing or reducing it;
  - subject to above ,in case of difference between the provisions of the Act and of the agreement, the provisions of the agreement prevail over the provisions of this Act and can be enforced by the Appellate Authorities and the court.

  DIT v. Nokia Networks OY [TS- 700- HC- 2012 (Del)]-

  Retrospective amendment in domestic law cannot be read into tax treaty

Recent Case laws on Royalty

- **[2014] 51 taxmann.com 90 (Chennai - Trib.) - Income-tax Officer (IT)-II, Chennai *v.* F.L. Smidth Ltd.**

  Payment made for acquiring readymade, non-customized 'shrink wrap software' available in market only for in-house use without any right to copy, refurnish, sale or display thereof was held to be 'Royalty'.

- **[2014] 44 Taxmann.com 1 (Mum Tribunal). Viacom 18 Media Pvt. Ltd Vs ADIT.**

  Payment of fees for use of satellite transponder service by assessee to US company taxable as 'royalty', under article 12 of India-US DTAA. Retrospective amendment introduced through Explanation 6 referred. Also refer [2014] 46 Taxmann.com 50 (Cochin Tribunal) Kerala Vision Ltd.Vs. ACIT.

OBLIGATIONS ON PAYERS TO DEDUCT TAX FROM ANY PAYMENTS TO NON RESIDENTS

- Obligation is provided in Section 195
- The objective of section 195 is to ensure tax collection at source from payments to non-residents so that the Tax Authorities are not put to the hassles of recovering it from a non-resident, whose connection with India may be transient or whose assets in India may not be sufficient enough to meet the tax liability

SECTION 195(1)

"Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest 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."*

- This was brought out in **G.E. India Tech (2010) 327 ITR 456 (SC)-**payer is bound to deduct tax only if sum is chargeable to tax in India read with Sec 4,5 & 9

SECTION 195(1) CONTD…

- **GE India Technology Centre Pvt. Ltd. v. CIT & Others:**
  - If the payment does not contain the element of income, the payer cannot be made liable
  - **Section 195(2) is based on the 'principle of proportionality'.** The said sub-section gets attracted in cases where the payment made is composite payment in which certain portion of the payment has an element of 'income' chargeable to tax in India.

ANALYSIS OF SEC. 195 (1)

- All payments to non-resident, other than salaries, which are chargeable to tax under the Act, are covered
- There is no threshold limit
- Deduction at the time of credit or payment, whichever is earlier
- Deduction at the rates in force – As per Income Tax Act or DTAA, whichever is more beneficial
- If tax is deducted at a rate specified in DTAA, then no Surcharge or Education Cess should be levied thereon. **DIC Asia Pacific Pte. Ltd v. ADIT [2012] 22 taxmann.com 310 (Kol.)**
- Resident making payment even in INR has to consider Sec. 195

ANALYSIS OF SEC. 195 (1) ...CONTD

- Any person making payment to non-resident, including individual and HUF not liable for audit are covered
- Non-resident making payment to another non-resident is also covered, if payment is chargeable to tax in India – ABC, 228 ITR 487 (AAR)
- Sec.195 doesn't cover within its ambit RbNOR because of Sec 2(30) definition of NR includes RbNOR only for Sec 92, 93 & 168 and not for Sec.195

SECTION 195(2)

"Where the person responsible for paying any such sum chargeable under this Act (other than salary) to a non-resident considers that the whole of such sum would not be income chargeable in the case of the recipient, he may make an application to the Assessing Officer to determine, by general or special order, the appropriate proportion of such sum so chargeable, and upon such determination, tax shall be deducted under sub-section (1) only on that proportion of the sum which is so chargeable"

ANALYSIS OF SEC. 195 (2)

- AO has authority to issue special or general order determining the appropriate proportion of the sum chargeable out of the total payment to be made to the non-resident.
- Application to A.O. is to be made by the **payer (deductor).** Though not explicitly meant for lower deduction, practically, it is being used applying for lower deduction of tax
- No form prescribed for application u/s 195(2)
- Order passed by AO u/s 195 (2) is appealable

SECTION 195(3), (4), (5), (6) & 197

- Section 195 (3) & (4) : **Non-resident beneficiary** may apply to the A.O. for a certificate for NIL deduction of tax. Such certificate granted shall remain in force till the expiry of the period specified therein or till its cancellation by A.O.
- Rule 29B - Forms 15C and 15D
- Section 195 (5): For convenience of assesses and the interest of revenue, CBDT has been given power to issue notification to specify circumstances and conditions for the grant of such certificate u/s 195(3)
- Section 195 (6): Any person responsible for making payments to a Non-Resident *'whether chargeable to tax or not'* are to furnish information in report (Rule 37BB- Form 15CA & CB)
- Section 197: A.O. gives a certificate of deduction at lower rate or NIL rate of tax. Application can be made both by **payer or payee** in Form 13.

Implications of Amendment in Sec 195(6)

- Section 195(6) before its amendment by the Finance Act 2015 specifically mentioned '**person referred to in sub-section (1)'** and which sub-section in turn referred to 'any person responsible for paying for paying to a non-resident …… any other sum chargeable under the provisions of this Act".
- Therefore, the interpretation was that information required to be provided for under Section 195(6) was only in relation to remittance of a sum, which was chargeable to tax under the provisions of the Act, though out of abundant caution, information was being furnished even in respect of sums in respect of which there could be some debate particularly under the head fees for technical services.
- As a result of the amendment made by the Finance Act, 2015 whereby as per Section 195(6), a person responsible for paying any sum to a non-resident, **whether chargeable to tax or not**, shall be required to furnish the information of the prescribed sum in such form and manner as may be prescribed.

Sec 271-I. Penalty for failure to furnish information or furnishing inaccurate information under section 195

- If a person, who is required to furnish information in Forms 15CA and 15CB, fails to furnish such information; or furnishes inaccurate information, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of **one lakh rupees**."

Tabulating 195 (2) (3) & 197

	195(2)	195(3)	197
Application by	Payer	Payee –Rule 29B	Payee-Rule 28 Form 13
Scope	Whole of such sum not chargeable to tax	No deduction of tax	No deduction/Deduction at lower rate
Appealable	Order can be appealed under Sec 248, provided the payer is liable to bear the taxes and has paid such taxes	No Appeal Sec 260A	No Appeal Sec 260A

GROSSING UP OF TAX – 195A

- Applicable to all agreements entered into with non-resident from June 2002
- For the purpose of deduction of tax, income to be grossed-up, when tax chargeable on that particular income is to be borne by the payer of the income
- In case payment to non-resident is on "net of tax" basis in terms of agreement or arrangement such amount need to be appropriately grossed up at appropriate tax rates considering that the amount paid is net of tax amount
- Grossing up not to be done in case of presumptive tax
  - ONGC's case - 264 ITR 340 (Uttranchal)

REFERENCE TO OTHER PROVISIONS OF THE ACT HAVING RELEVANCE TO SEC 195

- Sec 2(37A)(iii)- definition of Rates in Force for the purpose of Sec 195- Rates prescribed in Finance Act or DTAA
- Sec 90(2) of the Act provides for option to be governed by the provisions of DTAA
- Tax should be deducted either at the rate provided in the Finance Act or at the rate provided in DTAA whichever is more beneficial to the assessee (Circular no. 333 & 728)
- Deductor can claim refund of tax if the contract is cancelled & no remittance is made/remittance made is refunded back (Circular No.790)

REFERENCE TO OTHER PROVISIONS OF THE ACT HAVING RELEVANCE TO SEC 195

Disallowance u/s 40(a)(i):

- Section 40 (a)(i) is applicable in case of non-deduction of TDS or non-payment TDS after deduction.
- It is not applicable to short deduction of TDS.
- Therefore, there is no disallowance in case of difference in TDS at the 'time of credit' and TDS at the 'time of remittance' due to exchange rate fluctuation.
- Pune Tribunal in case **Sandvik Asia Ltd v. JCIT [TS-712-ITAT-2011(PUN)]** held that taxpayer (deductor) is not required to again deduct tax u/s 195 at the 'time of remittance' due to exchange rate fluctuations, when tax was duly deducted at the 'time of credit' in books of accounts.

PROVISIONS OF MANDATORY REQUIREMENT OF PAN AS PER SECTION 206AA

- The payee should furnish its PAN to the payer, failing which the payer would be liable to withhold tax at the higher of following rates –
  - at the rate specified in the relevant provision of this Act; or
  - at the rate or rates in force; or
  - at the rate of 20%.
- The Revenue Officers are prohibited from issuing any certificate for NIL withholding or lower withholding of taxes if the application filed u/s 197 for this purpose does not contain the PAN of the payee.

PROVISIONS OF MANDATORY REQUIREMENT OF PAN AS PER SECTION 206AA

- The PAN of the payee must be referred in all correspondence, bills, vouchers and other documents exchanged between the parties.
- The Central Board of Direct Taxes ("CBDT") has issued a Press Release on January 20, 2010 advising payers to intimate payees to obtain and furnish their PAN in order to avoid tax withholding at a higher rate.
- Validity of Sec 206AA when basic rate of taxation is lower than 20%
  - Bhavani Cotton Mills (20 STC 290 SC)
  - Eli Lilly (312 ITR 225 SC)

Section 206AA… Contd

- **DDIT vs. Serum Institute of India Limited (ITAT Pune)-**
- Section 90(2) of the Act provides that tax treaties override domestic law in cases where the provisions of tax treaties are more beneficial to the taxpayer. Therefore, where the tax has been deducted on the basis of the beneficial provisions of the tax treaties, the provisions of Section 206AA of the Act cannot be invoked by the AO to insist on the tax deduction at 20 per cent, having regard to the overriding nature of the provisions of Section 90(2) of the Act.
- It would be incorrect to say that though charging Sections 4 and 5 of the Act (dealing with ascertainment of total income)are subordinate to the principle enshrined in Section 90(2) of the Act, but the provisions of Chapter XVII-B, governing tax deduction at source are not subordinate to Section 90(2) of the Act.
- Thus, even in the absence of PAN, payer not required to deduct TDS at 20% if case covered by DTAA

Tax Residency Certificate

- Fin Act 2012, has introduced sub-section 4 to Sec 90 to provide that a NR will not be entitled to claim treaty benefits unless he obtains a TRC from the Govt., of his residence country/territory certifying that he is a tax resident of that country.

Tax Residency Certificate

- Not.57/2013 dated 1st Aug 2013 mandates submission of following information in Form 10F if TRC doesn't contain these information:

(1) Status (individual, company etc) of assessee
(2) Nationality or country or specified territory of incorporation or registration
(3) Assessee's tax identification number
(4) Period for which the residential status is applicable
(5) Address of the assessee in the country of specified territory outside India

TAX RESIDENCY CERTIFICATE SUFFICIENT EVIDENCE TO CLAIM BENEFICIAL OWNERSHIP

- **DIT v. Universal International Music B.V (2013) 214 Taxman 19 (Bom.)(HC)**
- The tribunal arrived at the fact that the assessee was a beneficial owner of the royalty received on the basis of Tax Residency Certificate submitted by the assessee.
- Reliance was placed by the tribunal on CBDT Circular No 789 dated 13/04/2000 that certificate from revenue authorities is sufficient evidence of beneficial ownership.

RELEVANT RULES

Rule 26 – Computing Withholding Tax

For income payable in Foreign currency – Telegraphic Transfer buying rate of SBI on the date on which tax is "required to be deducted" is the relevant exchange rate

RELEVANT RULES…CONTD

Rule 37BB – Furnishing of Information-Amendment w.e.f. 1st October, 2013 vide Notification No. 67/2013

Assessee shall furnish information in Form 15CA in electronic mode on website of Income Tax

- When payment /remittance does not exceed Rs.50,000/- individually and aggregate payment during financial year does not exceed Rs.2,50,000/- to a Non Resident or to a foreign company - In this case, only information in Part A of Form 15CA is to be furnished. There is no requirement to furnish Form 15CB.
- When payments/remittances are of the nature specified therein (28 types of payments specified), no information, in Form 15CA or Form 15CB, is to be furnished.
- For payments other than referred to in (i) and (ii) above, information in Part B of Form 15CA after obtaining CA Certificate in Form No. 15CB to be furnished.
  - Signed Printout of Form 15CA & 15CB shall be furnished to banker prior to remittance of payment

RELEVANT RULES…CONTD

Rule 115 – Computing Income

- Telegraphic transfer buying rate of SBI on the "specified date" is the relevant exchange rate
- If tax deducted at source under Rule 26, specified date is the date on which tax was "required to be deducted"
- Else different dates are prescribed for different type of incomes

Representation Letter

- At the time of issuing Certificate in Forms 15CA & CB, a Representation Letter to be taken from the foreign party regarding confirmation of facts in connection with the remittance.
- The following points to be included therein :

1. Nature of Remittance
2. Confirmation that the beneficiary does not have any branch/liaison office/fixed place of business in India nor any agent working exclusively on their behalf in India.
3. Confirmation that the foreign party is a Tax Resident of respective country alongwith the Tax ID No.
4. Confirmation that the beneficiary is the beneficial owner of the service and the remittance shall be received by them for their own benefit and not as Trustee or Agent of Third Party.

Points to be noted while Issuing Form 15CB

- A copy of application for TRC to be obtained in case TRC of the relevant period (say calender year in case of US entity) is not available. This TRC application copy alongwith TRC of previous period may be sufficient for availing Treaty benefits. However, one should make it a point to obtain a copy of the latest TRC once it is received by the foreign party.
- There should not be apparent contradiction in country of raising of invoice and country of rendering of service.
- The names of the Partners rendering the service should be mentioned in the TRC. Further, all the partners involved in the assignment should also be Tax Residents of that country (in case of a pass-through entity)

Points to be noted while Issuing Form 15CB

- Since it is not possible to ascertain, on the date of issue of the certificate, the exact equivalent amount in Indian rupees, which would be based on the rate of exchange prevailing on the date of actual remittance; for the purpose of reporting in the certificate, it is safer to mention a note in the Certificate that the USD amount is converted into equivalent Indian rupees by applying the telegraphic transfer buying exchange rate prevailing **on the date of issue of this certificate.**

Checklist while Issuing Form 15CB

- Go through Form 15 CB & 15CA before starting with the real work.
- Analysis of documents received from the client (Invoice, TRC, Representation Letter)
- Check if the foreign party has any PE in India.
- If any order u/s 195(2)/195(3)/197 is obtained from Assessing Officer?
- Characterization of the remittance and determining TDS implications as per Income Tax Act, 1961
- Analysis of the DTAA for determining withholding rate (Limitation of Benefit Clause, MFN Clause, Force of Attraction etc)
- Exchange rate as on the date of issue of certificate and distinct Certificate No. for each Certificate

Any Questions??

THANK YOU

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