

# International Taxation

## Cross Border Taxation & Provision of TDS thereon



# **CROSS BORDER TRANSACTIONS & WITHHOLDING TAX**



# SCOPE OF DISCUSSION

- Section 195 of ITA , 1961
- Obligatory upon the Payer to a Non Resident to deduct tax at source from any credit / payment to the account of NR
- Non Resident as defined under the ITA & not under FEMA
- TDS not a substitute for the obligation of receiver of income to file the return of income and pay taxes . Receiver in any case liable whether TDS or no TDS .
  - Van Oord ACZ India Pvt. Ltd (2010) 230 CTR Del 365
- Deeming fictions – Sec. 9 of ITA
- Role of tax treaties - DTAA





# STATUTORY OBLIGATION OF PAYER

- Making of TDS is mandatory
  - When payer under a **bona fide belief** that payee liable to tax in India in respect of such payment
- When payer undertakes to pay net of taxes in India – payer obligated to gross up and pay TDS [195A]
- Tax deducted is income received [198]
  - Proviso provides exception wrt tax on perquisites vide sec 192 (1A)



# PROVISIONS DEALING SPECIFICALLY WITH NON RESIDENT TDS ONLY

Section	Topic
194E	Payments to non-resident sportsmen or to a sports associations
195	Payment of any other sums
196A	Income in respect of units held by a non-residents. <i>withdrawn w.e.f.01.04.03</i>
196B	Income from units to an off shore fund
196C	Income from foreign currency bonds or shares of Indian Company
196D	Income of Foreign Institutional Investors from securities





# TDS PROVISIONS ALSO APPLICABLE TO NON-RESIDENT PAYERS

## Section

## Topic

192

Salary ....*Eli Lilly & Co. 312 ITR 225 (SC)*

194 B

Winnings from lottery or crossword puzzle

194 BB

Winnings from horse race

194 G

Commission etc on the sale of lottery tickets



# CONSEQUENCES OF DEFAULT -- FOR THE PAYER

- Deemed to be assessee in default
  - Receiver's tax becomes payer's tax [201(1) & 220]
- Not to get deduction of underlying sum paid to non resident [40 a ]
- Pay interest @ 1% pm [201(1A)]
- Liable to penalty
  - ❖ up to 100 % of TDS amount [221]
  - ❖ up to 100 % of TDS amount [271 C]
  - ❖ of Rs. 100 per day for default in issuing TDS Certificate / filing quarterly returns [272A(2)]
- Imprisonment (3 months to 7 years) and fine [276B]





# Scope of Sec. 195

- ❖ Omnibus and general in nature.
- provision very wide and covers every income chargeable to tax in India .      Exception ....
  - salary ( sec. 192)
  - dividend ( sec. 115 O)
- no threshold limit
- source and mode of payment also not relevant





# Scope of Sec. 195 .....

- ❖ Any person making a payment to a non-resident is covered.

... Status of Payer not relevant

- even an **individual or HUF** making payment covered
- even a **non-resident** making a payment is covered
  - Eli Lilly & Co. 312 ITR 225 (SC)



# Scope of Sec. 195 .....

- ❖ Recipient should be a non-resident
  - Citizenship of payee not relevant . Residential status only relevant
  - Status of non-resident is to be determined as per tests outlined in section 6 of ITA
  - Non-resident definition in section 2(30) includes "not ordinarily resident" in some cases. Generally otherwise, payment to "not ordinarily resident" would be outside scope of section 195
  - Payment to a resident agent of non-resident covered.





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# Scope of Sec. 195 .....

- ❖ Section 195 applies if payment comprises income chargeable to tax in India
- Scope of income chargeable to tax determined under ***Sec. 5 read with Sec. 9***
- ***Treaty provisions, if beneficial can be opted ( Sec. 2 (37A) )***
- *Treaty provisions may be beneficial in many ways*
  - Rate of TDS may be lower
  - Definition may be narrower
  - Exemption may be built in





## Scope of Sec. 195 .....

- ❖ If Treaty rate applied , surcharge and cess not to be separately added

- As per practice education cess is being paid

- ❖ Payments could comprise

- Pure income payments
  - Pure capital payments
  - Payments partly representing income payments
    - No deduction of tax from "pure capital" payments
    - Nature of payments – whether capital or otherwise – to be decided from view point of payee and not payer



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# TIME OF DEDUCTION

- Credit or payment whichever is earlier
  - *Exception ...Interest by Government / public sector bank / public financial institution – tax deduction only at the time of payment*
- Credit to suspense account or any other account by whatever name called, covered. Explanation may not apply even when no income accrues to non-resident although accounting entry incorporating a liability is passed

Refer to Observations in :

- ACIT Vs Motor Industries 249 ITR 141
- Pfizer Corporation v CIT (2003) 259 ITR 391
- Cases relevant for credit accrual aspect
  - 44 ITR 720 Raghava Reddy v CIT (SC)
  - 125 ITR 525 CIT v Toshoku Ltd (SC)
  - ITR 391 v Standard Motor Triumph Co V CIT (SC).





# QUANTUM OF DEDUCTION

- At rates in force ... in ITA / Finance Act / DTAA ( Sec. 2 (37A)  
Beneficial rate under Treaty ( DTAA) – Circular No. 728 dated 30/10/95
- Rule 26 ....rate of exchange for deduction of tax at source on income payable in foreign currency
- Not open to parties to contract out of statutory obligation
  - If assessee agrees to remit a particular amount without deduction of tax, construed as to have undertaken to pay tax himself
- In cases where agreed to be paid net of tax in India , tax is required to be calculated on grossed up amount (Sec. 195 A)





# COMPLINACE ... contd.

- ❖ Information relating to payments to NR .  
Sec. 195 (6) by Fin. Act.,2008.
  - New Rule 37 BB .... Declaration in Form 15CA and Form 15CB w.e.f.01.07.09 Notific.No. 142 dt. 25.03.09
  - Issues & caution .... Online submission - Default fields - specific information –who is to sign declaration (Cir.4/2009 dt.29.06.09) –tax payment reference



# PERSON RESPONSIBLE FOR PAYING TDS

- Salary -- Employer
  - Location or place of management of the employer has no relevance . Extra territorial jurisdiction . SCI case.
  - Thus a foreign entity deputing & paying Salary to a person in India is liable
- Long Term Capital Gain –Authorized dealer
- Other chargeable sums – Payer
  - If payer is a company the company itself including the principal officer thereof
  - Even in case of payment for an asset – Prov. attracted –what amount ? Gross payment or only on appropriate proportion of income chargeable to tax – CIT v. Superintending Engineer, Upper Sileru – 152 ITR 753





# OTHER ISSUES

- **Source principal & Place of rendering services .**

Explanation to Sec. 9 (2) inserted by Finance Act 2007 w.e.f. 01.06.76 .  
Refers to and covers only clauses (v), (vi) & (vii) of section 9(1) .

- No deduction of tax if "income" does not involve credit or payment  
Ex.: (i) Transfer pricing adjustment under Chapter X  
(ii) Assessment of income under section 93
- No deduction under section 195 when section 172 applies – Circular No. 723
- No deduction under section 197A(1D) – when interest paid by "offshore banking unit " as defined under SEZ Act,2005 under certain circumstances
- NR Payee cannot furnish declaration in form 15G / 15H for non-deduction of tax at source
- TDS on payment basis under proviso to section 195(1) when interest is paid by Government, public sector bank or public financial institution
- Exemption from withholding on dividends referred to in section 115 O





# Lower or Nil deduction

## ■ Application by Payer . Sec. 195 (2)

- For determination of appropriate proportion of sums paid which are chargeable to tax. Only when considers that the whole of such payment not chargeable to tax .
- not in case of Non deduction on whole of payment to NR or for lower rate of tax .. *Conflicting decisions*
- No statutory form of application under section 195(2)
- Order under section 195 (2) is Appealable (Sec.248 – order when appealable..when tax having been deposited )
- Order u/s. 195(2) amenable to revision u/s 263  
.....BCCI v DL (2005) 278 ITR (AT) 83





# Lower or Nil deduction .....

- Application by Payee under Sec.195(3) for receiving payment without deduction of any tax
  - For No deduction of tax from the payment amount from the payer .
  - Onerous conditions for application under section 195 (3) Read with Rule 29B

## ....Form 15D

- Applicant has filed returns and has been regularly assessed for all past applicable years before due dates of the returns.
- He has not been in default or deemed to be in default – for tax, advance tax or self assessment tax, interest, penalty, fine or any other sum.
- Has not been subjected to penalty for concealment of income



# Lower or Nil deduction .....

## ■ Application by Payee under Sec. 197

- For no deduction / deduction at lower rate, but impractical in view of absence of details of total income or difficulty due to income particulars as per format

## ■ Chartered Accountant's Certificate U/s 195

Chartered Accountant in his Certificate ( Form 15CB) can certify :

- Payment not liable to tax in India and hence No tax or the beneficial Rate applicable as per the Treaty or the Act

### **CA Certificate cannot be for :**

- reduce the Rate of TDS, if income liable to tax in India.
- cannot determine the appropriate proportion of sums paid liable to tax





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# Chartered Accountant's Certificate U/s 195 ...

- Along with CA Certificate .... Declaration cum undertaking by Remitter / Payer ( Form 15CA) ....  
...continue to be liable for TDS if so held liable at any later stage.
- Chartered Accountant's Certificate – Circulars issued:
  - Circular No. 695 dated 20/11/94
  - Circular No. 759 dated 18/11/97
  - Circular No. 10 of 2002
  - RBI / 07-08 / 100 AP(DIR) Cir No. 03 dt. 19.07.2007.
    - Another later internal Cir. Exempting trade transactions.
  - Notification No. 30 dt.25.03.2009 for insertion of Rule 37BB





# SOME CONTROVERSIAL BOARD CIRCULARS

- Taxation of foreign telecasting companies
  - Circular No. 742 dated 02/05/1996 & Circular No. 765 Withdrawn by Circular No. 6 of 2001 dated 05/03/2001
- Payments to Indian lawyers by foreign companies
  - .....No deduction as per Circular No. 726 Withdrawn by Circular No. 766 dated 24/04/98 – 231 ITR (St) 13
- Payment of interest by branch to head office TDS required – Circular No. 740 dated 17/04/96
  - No need to withhold tax – decision of ITAT in ABN Amro Bank Vs ADIT (2005) 280 ITR (AT) 117
- Deductibility of expenditure in such circumstances is doubtful
- Observations of Supreme Court in CIT v Hyundai Heavy Industries 291 ITR 482 (SC)



# REFUND OF TAXES

- Possible under limited circumstances:
  - the contract is cancelled and no remittance is made to the non resident;
  - the remittance is duly made to the non-resident, but the contract is cancelled
  - tax paid erroneously when no income accrues to NR in India.
- Circular No. 769
- Circular No. 790 dated 20.04.00
- Circular No. 7 / 2007 dt. 23.10.07.





# ISSUES – TIME OF DETERMINATION OF RESIDENTIAL STATUS

- Residential status crystallizes at year end
- On going payments in the interregnum – how to decide residential status ???
- Section 195 does not refer to status in preceding previous year



# ISSUES – NON-RESIDENT MAKING A PAYMENT TO ANOTHER NON-RESIDENT- WHETHER COVERED U/s 195

- Whether Sec. 195 would operate beyond territorial limits
  - Yes when relates to a business activity in India
- Whether provisions of Sec. 195 could be enforced in another country
- Observations of AAR in 228 ITR 487, 509
- Whether attempt should be made to develop a rule of regulated enforceability
- Provisions of section 228A – recovery of tax from non resident in pursuance of agreement of Govt. of India with foreign country
- Provisions of section 173 – recovery from assets of NR located in India





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# ISSUES – AGENCY CONCEPT & TDS

- Whether agent of NR in India could be asked to discharge TDS liability of non-residents
- Whether section 163 is limited only to incomes falling under section 9(1)
- Definition of “agent of non-resident” in section 160(1)(i) is wider
- Observations in Sakalchand Babulal Vs. ITO 47 ITR 673
- Whether section 163 is limited only to statutory agents and contractual agents



# ISSUSE – Whether 195(2) application can be made only when tax quantum / rate is to be lowered and not for nil rate

- No reference to **NIL amount / rate** in section 195 (2)
  - But only to determination of approp. proportion chargeable to tax.
- Application for certificate that **no tax is due** would not amount to an application under section 195(2):
  - CIT Vs. Jay Engineering Works Ltd. 149 ITR 425 (Del)
  - Graphite Vicarb India Ltd. Vs. ITO 18 ITD 58
  - Czechoslovakia Deccan Shipping International Joint Stock Co v ITO 81 ITR 162 (Cal).
- Contrast ( compare) wordings of section 195(2) and 197
- CA's certificate as a substitute for section 195(2) provides for NIL rate
  - Practical reality – NIL rate certificates given
  - To suggest that NIL rate certificate is not permissible may not be in tune with purpose of TDS provisions





# **ISSUES – Appeal under Sec. 248 - only 195(2) covered & Not 195(3) & 197.**

- Appeal under section 248 – whether possible without an order
- Whether only part of tax could be paid and “appeal” filed under section 248 – “such tax”
- Section 248 provides for a “declaration” from CIT(A) that no tax was deductible
- Section 248 appears a substitute for section 195 (2) – but post pyt. of TDS





# ISSUES – whether application u/s 195(2) mandatory

- Observations of Supreme Court in Transmission Corporation's case 239 ITR 587 (SC)
- Observations of AP High Court in 152 ITR 753
- Samsung Electronics case .. 320 ITR 209 (Karnataka HC )
- Van Oord's Case .. 230 CTR 365 ( Delhi )
- Conflicting AAR & ITAT rulings
- Prasad Production Ltd. Case .. ITAT , Chennai Special Bench on 09.04.10
- Check out:  
Once TDS deducted in case of non residents on royalty or FTS u/s. 115A or on GDR u/s. 115AC or in case of a NR sportsman / association u/s. 115BBA – no obligation to file IT Return in case of NR where only investment incomes or LTC Gains Sec 115G.





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# DOUBLE TAX AVOIDANCE AGREEMENTS

## – AN OVERVIEW

- Every nation has sovereign right to tax its residents/nationals on their worldwide incomes.
- Consequence and remedy :
  - income of a person can get taxed in both countries i.e. in the home country (country of origin) as well the host country (country where he operates).
  - In a civilized society..... in home country, tax is an obligation, while in the host country, tax is a cost. Thus there is need to achieve tax efficiency.





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# Double tax avoidance agreements ( DTAA )

## – an Overview .....

- Tax Treaties come into play to mitigate hardships caused by subjecting same income being taxed twice in different jurisdictions .
- Tax Treaties
  - remove the obstacles and try to achieve balance and equity.
  - Aims at sharing of tax revenues by the concerned states on a rational basis without causing undue hardship to the taxpayers operating internationally.
- Tax treaties do not altogether eliminate Double Taxation, but maintain the incidence to a tolerable extent.





## DOUBLE TAX AVOIDANCE AGREEMENTS – AN OVERVIEW .....

- DTAA -----an “international agreement between two sovereign states reaching an understanding as to how their residents will be taxed in respect of cross border transactions in order to avoid double taxation on the same income”.
- Primary objective ----- to avoid double taxation and share revenue between states through compromise.



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# INDIAN TAX LAWS AND THE TAX TREATIES

- **Section 91**

of the Indian Income Tax Act gives unilateral relief in the case of doubly taxed income, where tax is paid in a country with which India does not have a tax treaty.

- **Sec. 90 (1)**

GOI empowered to enter into DTAA with any foreign country and notify same . No need for approval of the parliament .

- **Sec. 90 (2)**

For granting of relief from tax or for avoidance from double tax, in case of 'A' to whom DTAA applies, **provisions of I.T. Act to apply to the extent more beneficial**



# Choice of Beneficial Provision under DTAA / Tax Laws

## ■ Treaty Overrides

'A' has best of both the worlds. 'A' can **take recourse to DTAA, if favorable to him.** If provisions of IT Act more favorable, Opt for provision of the Act.

Thus, if, IT Act does not impose any liability to tax, question of resorting to DTAA does not arise.





# Approach to Tax Treatise.

A Treaty unlike a taxing statute is required to be interpreted as an agreement between the two nations.

Difference in approach between the taxing statute and a treaty.

## Taxing Statute

- Interpreted with strict interpretation – at times even at the cost of equity & logic.
- The laws in India are ever changing

## Treaty

- Interpreted in good faith in accordance with the intent and attendant circumstances
- Ordinary meaning to be given to the terms of the treaty



Difference in approach between the taxing statute and a treaty.....

## Taxing Statute

## Treaty

- **Intent gathered** from correspondence preceding the formulation of treaty, preamble, exchange of notes, protocol, illustrative examples.
- Treatise are generally liberally construed.
- As per Vienna convention on Law of treaties, a treaty should be interpreted in **good faith with the ordinary meaning** of the terms used in the treaty
- Most treaties have Mutual Agreement Procedure (MAP ) .. Competent authorities notified for giving effect to the intent of the treaty..other remedies not a bar





# GENERAL HEADS OF INCOMES FOR TAXING IN A DTAA

- Business Profits  
..... Only when there is a PE in the source country
- Royalty & Fees for Technical Services
- Dividends
- Interest
- Capital Gains
- Independent Personal Services



# Advantages of Tax Treaties

- Income is not taxed solely on the grounds of “business connection” as it may happen under the all-pervading Sec. 9 of the Income Tax Act.
- Similarly, the income from Royalties, Fees for Technical Services, Dividend, Interest and Capital Gains are taxed in the source country at concessional rates. For such taxing PE not mandatory





# TREATY MODELS

- Different models developed which assist in maintaining uniformity in the format of tax treaties. Also serve as checklist for ensuring exhaustiveness of provisions to the two negotiating countries.
- OECD Model, UN Model, the U.S. Model are the most prominent and often used models. Final agreement could be combination of different models



# O E C D MODEL

OECD model is essentially a model treaty between two developed nations. This model advocates residence principle, that is to say, it **lays emphasis on the right of state of residence to tax**. The Model has been revised from time to time under changing business conditions internationally .





# U.N. MODEL

In 1968, the United Nations set up ad hoc groups of experts from various developed and developing countries to prepare a draft model convention between developed and developing countries. In 1980, this group finalized the UN Model Convention in its present form. It was further revised in the year 2001.

The UN Model is a **compromise between the source principle and residence principle**. It gives more weight to the source principle as against the residence principle of the OECD Model. UN Model is designed to encourage flow of investments from the developed to developing countries. It takes into account sharing of tax-revenue with the country providing capital. **Most of India's tax treaties are based on the UN Model.**





# Some Important Rulings

## ■ **Reimbursement of expenses**

- Timken India Ltd – 273 ITR 67 ( AAR)
- Cross charge of expenses .. Secondment Agreement  
..HCL Infosystems; AT&T; IDS Software
- Bangalore International Airport Ltd 307 ITR 295 Bang.
- Dunlop Holdings Ltd 142 ITR 493 ( Cal)
- Industrial Engineering Projects (P) Ltd .202 ITR 1014 Delhi
- Raymond Ltd. (2003) 86 ITD 791 (Mum)
- Modicon Network (P) Ltd 2007 14 SOT 204 TDel





# Rulings ....

## E commerce transactions

### ■ Software

- - Samsung, Sonata Software, Lenovo, PSI Data Systems, Lucent Technologies etc
- – Copyright v. Copyrighted article

### ■ Subscription charges for standard service/database

- - Wipro Ltd – 278 ITR 57 – TBang - annual subscription – no TDS
- – HEG Ltd – 263 ITR 230 – MP – Provision of info – no royalty
- – Dun and Bradstreet Espana – 272 ITR 99 - AAR



# Commission to Foreign Agent ...whether FTS

- Post withdrawal of CBDT Circular ???
- Rulings to Support
  - SPAHI projects Pvt. Ltd. .. ( 2009) 315 ITR 374 ( AAR)
  - Toshuku Ltd. 125 ITR 525 (SC)
  - DTAA definition & interpretation





Any

**Question**



# Thank You

