Exploring Provisions

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Practice Manual For Sec 195 Payments

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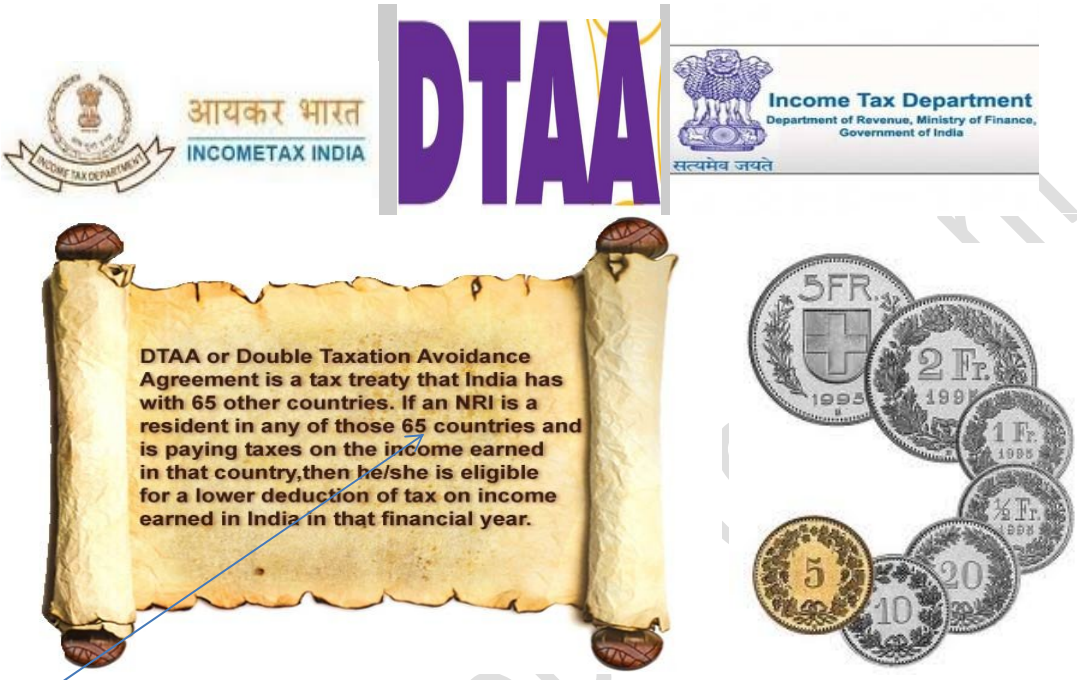
Sec 195– Practice Manual



* 80 countries now in place of 65

PREFACE

This document aims to facilitate the Clarity on payments made under section 195 of the Income Tax Act, 1961. With increasing cross border trade and inflow of foreign technology in India, there is a radical increase in payments to nonresidents. There is also an increased government and revenue attention to this aspect of tax deduction at source (TDS) vis v vis Nonresident payments. The manual provides a detailed understanding and guidance on the section.

Purpose of this Document

This document describes the various specifications and guidelines to be followed for payments made to nonresidents

Intended Audience

This document is intended for use by the companies and for the public users.

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PAYMENTS TO NON-RESIDENTS

PRACTICE MANUAL FOR S.195 PAYMENTS- FINANCE BILL 2012 COMMENTED

I. Part I-Relevant Sections

1. S. 195- AN OBLIGATION UPON PAYER

195. Other sums.--(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.

Provided that in the case of interest payable by the Government or a public sector bank within the meaning of clause (23D) of section 10 or a public financial institution within the meaning of that clause, deduction of tax shall be made only at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode.

*Provided further that no such deduction shall be made in respect of any dividends referred to in section 115-O.

Explanation.--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.

(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.

(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).

(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 referred to in sub-section (1) shall furnish the information relating to payment of any sum in such form and manner as may be prescribed by the Board.

1.1 Comment 1

The Supreme Court in Vodafone case held that s.195 would apply only if payments made from a resident to a non-resident and not between two non-residents situated outside India. To overcome such observation a new Explanation 2 is being inserted vide FINANCE BILL 2012 in sub-section (1) w.e.f. 1.4.1962which state as under:

" Explanat*ion* 2.—For the removal of doubts, it is hereby clarified that the obligation to comply with sub-section (*1*) and to make deduction there under 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."

1.2 Comment 2

The FINANCE BILL 2012 proposes to add a new sub- section (7) that requires mandatory clearance from ITO-TDS for prescribed nature of payments or in prescribed cases as under:

"(*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 to the Assessing Officer to determine, by general or special order, 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.".

2. Charge of tax Provisions

2.1 Section 4

Charge of income-tax.--(1) Where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with, and *subject to the provisions (including provisions for the levy of additional income-tax) of, this Act in respect of the total income of the previous year of every person:

Provided that where, by virtue of any provision of this Act income-tax is to be charged in respect of the income of a period other than the previous year, income-tax shall be charged accordingly.

(2) In respect of income chargeable under sub-section (1),
income-tax shall be deducted at the source or paid in advance, where it is so deductible or payable under any provision of this Act.

2.2 Section 5

Scope of total income.--(1) Subject to the provisions of this Act, the total income of any previous year of a person who is a 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 ; or
c. accrues or arises to him outside India during such year:

Provided that, in the case of a person not ordinarily resident in India within the meaning of sub-section (6) of section 6, 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.

(2) Subject to 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 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.

3. Legal Fiction

3.1 Section 9

Income deemed to accrue or arise in India.--(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 ;
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 ;
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 ;

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, unless his activities are limited to the purchase of goods or merchandise for 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 :

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.

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.

(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;

(v) income by way of interest payable by--

a. the Government ; or
b. a person who is a resident, except where the interest is payable in respect of any debt incurred, or moneys borrowed and used, 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 interest is payable in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person in India ;

(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:

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 lumpsum 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.

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 (v) ;

Explanation.—For the removal of doubts, it is hereby declared that income of the nature referred to in this clause payable for service rendered in India shall be regarded as income earned in India ;

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:

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 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 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".

(2) Notwithstanding anything contained in sub-section (1), any pension payable outside India to a person residing permanently outside India shall not be deemed to accrue or arise in India, if the pension is payable to a person referred to in article 314 of the Constitution or to a person who, having been appointed before the 15th day of August, 1947, to be a Judge of the Federal Court or of a High Court within the meaning of the Government of India Act, 1935, continues to serve on or after the commencement of the Constitution as a Judge in India.

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. (Unquote)

3.2 Comment 1 - sec 9(1)(i)

Two back dated explanations are proposed by the FINANCE BILL 2012 in clause (i) so as to convey a wider coverage by including even indirect transfers of interest in assets located in India impliedly to overcome the SUPREME COURT ruling in Vodafone case.

The SUPREME COURT therein held that section 9 covers only income arising from a transfer of a capital asset situated in India and it does not purport to cover income arising from the indirect transfer of capital asset in India. In the facts in that case, Vodafone on purchase of a single share in CGP, a Cayman Islands company, got indirect interest in Hutchison Essar Limited (HEL), an Indian company which is held to be exempt so the new explanations. It was argued by the revenue that the word "through" in Section 9 *inter alia* means "in consequence of" and that if transfer of a capital asset situated in India happens "in consequence of" something which has taken place overseas (including transfer of a capital asset), then all income derived even indirectly from such transfer, even though abroad, becomes taxable in India. The SUPREME COURT suggested that the question of providing "look through" in the statute or in the treaty is a matter of policy to be expressly provided for in the statute or in the treaty. Hence, it suggested application of look at substance test in a holistic manner in that case. Keeping such observation into account following look through Explanations 4 and 5 are therefore being inserted in the section.

3.3 *'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".

3.4 *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.'

3.5 Comment 2 – Sec 9(1)(vi) (Expl. (iva))

As many as three new explanations have found entry on back date in royalty definition in Explanation clause (vi) to subject software and right to use facility/equipment or service such as leased circuit, use of telecom bandwidth, use of broadband facility, electronic circuits etc. to tax. To beat the tax it is often contended that payments in such cases do not pass any copyright in computer software or in case of use of standard facility the equipment are not placed in the possession, access and control of the service user/payer. To strengthen sub-clause (iva) and (v) therefore Explanations 4 & 5 now finds a place in the section.

3.6 *'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 license) irrespective of the medium through which such right is transferred.

3.7 *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.

3.8 Comment 3 – Sec 9(1)(vi) (Expl. (ii))

Further in the use of a standard facility whereas the revenue contends that in any such transaction the payer make use of or is conferred with the right to use a "process" and that

would turn the payment into royalty nature the Courts have
however often held that the provisions/treaties only refer to use of or the right to use a secret process. It is to remove this controversy that a new Explanation is getting inserted as under:

3.9 *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;'

4. General Anti Avoidance Rule-GAAR

4.1 Section 96 - Impermissible avoidance arrangement.

96. (1) An impermissible avoidance arrangement means an arrangement, the main purpose or one of the main purposes of which is to obtain a tax benefit and it—

a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;
b) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;
c) lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or
d) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for *bona fide* purposes.

(2) An arrangement which results in any tax benefit (but for the provisions of this Chapter) shall be presumed to have been entered into, or carried out, for the main purpose of obtaining a tax benefit unless the person obtaining the tax benefit proves that obtaining the tax benefit was not the main purpose of the arrangement.

(*3*) An arrangement shall be presumed to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit.

4.2 Section 97- Arrangement to lack commercial substance

97. (1) An arrangement shall be deemed to lack commercial substance if—

a. the substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part; or

b. it involves or includes—

i. round trip financing;

ii. an accommodating party;

iii. elements that have effect of offsetting or cancelling each other; or

iv. a transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of funds which is the subject matter of such transaction; or

c. it involves the location of an asset or of a transaction or of the place of residence of any party which would not have been so located for any substantial commercial purpose other than obtaining a tax benefit (but for the provisions of this Chapter) for a party.

(*2*) For the purposes of sub-section (*1*), round trip financing includes any arrangement in which, through a series of transactions—

a. funds are transferred among the parties to the arrangement; and

b. such transactions do not have any substantial commercial purpose other than obtaining the tax benefit (but for the provisions of this Chapter), without having any regard to—

A. whether or not the funds involved in the round trip financing can be traced to any funds transferred to, or received by, any party in connection with the arrangement;

B. the time, or sequence, in which the funds involved in the round trip financing are transferred or received; or

C. the means by, or manner in, or mode through, which funds involved in the round trip financing are transferred or received.

(*3*) For the purposes of this Chapter, a party to an arrangement shall be an accommodating party, if the main purpose of the direct or indirect participation of that party in the arrangement, in whole or in part, is to obtain, directly or indirectly, a tax benefit (but for the

provisions of this Chapter) for the assessee whether or not

the party is a connected person in relation to any party to the arrangement.

(*4*) The following shall not be taken into account while determining whether an arrangement lacks commercial substance or not, namely:—

i. the period or time for which the arrangement (including operations therein) exists;
ii. the fact of payment of taxes, directly or indirectly, under the arrangement;
iii. the fact that an exit route (including transfer of any activity or business or operations) is provided by the arrangement.

Part II- KEY CONCEPTS AND TERMINOLOGY

1. Concept of chargeable income

Sec. 195 application presupposes that the subject payment to a non-resident is chargeable under the Income tax Act, 1961. The payments may be incomes or gross receipts the whole of which may or may not be income or profits in the hands of the recipient. To know chargeability there are three options in the order of their preference:

1. Ponder over expert advice of a Chartered Accountant;
2. Approach the International Tax Section;
3. Approach Authority for Advance Rulings.

Option 1 is preferred to ensure fast track remittance to non-residents. Second option is preferable in case on the question of determination of permanent establishment in India where the remittance represent gross trading receipts that may have income embedded and it is required of the payer to estimate the income component of the payee such as turnkey projects, erection projects, etc. The third option is most common in case of related party transactions or where the transaction payments are not repetitive or where there is no precedence for instance, the case of joint venture agreements, foreign collaborations etc.

Sub-section (3) of s. 195 by which a person entitled to receive a sum on which income-tax has to be deducted under sub-section (1) may make an application to the Assessing Officer

for the grant of a certificate authorizing him to receive such sum without deduction of tax is rarely sought after by a non-resident.

2. Concept of Rates in force

The rate of deduction of TAS would be lower of the following:

1. Rate of tax deduction of TAS under relevant Finance Act;
2. Rate of tax prescribed by the Double Tax Avoidance Agreement, as applicable.

Relevant section: S. 90, Finance Act, s. 2 (37A).

3. Concept of Permanent Establishment

This concept is relevant only in case the non-resident or its representative is physically present in India for commercial purpose. Presence or otherwise will be regarded on the basis of maintenance of either of the following:

a) agent in India- agency PE;
b) Establishment in India- office PE;
c) Employees in India- service PE;
d) Supervisory services- supervisory PE;
e) Installation or construction or assembly permanent establishment

In the third case it would be desirable to know the presence of personnel in India and in case it exceeds the prescribed number of days it would sound of a PE in India. In that case the non-resident may either self-compute its tax liability and pay advance tax or approach the AO-TDS in International Tax section for determination of rate of tax in its case.

4. "Force of attraction" rule- On the line of article 7 of UN Model Convention

The force of attraction rule implies that when an enterprise sets up a permanent establishment in another country, it brings itself within the fiscal jurisdiction of that another country to such a degree that such another country can properly tax all profits that the enterprise derives from that country - whether through the permanent establishment or

not. It is the act of setting up a permanent establishment,
therefore, which triggers the taxability of direct transactions in the source State. Therefore, unless the permanent establishment is set up, the question of taxability does not arise - whether of direct transactions or the transactions routed through the permanent establishment (Deputy Commissioner of Income-tax v. Roxon Oy (2007) 291ITR AT 275, 294). In other words the treaty may provide for taxing income/profits from even direct transactions effected by the non-resident, provided the transactions are of the same or similar kind as that effected through the PE. This is termed as limited force of attraction principle. Some treaties may provide for taxing profits/income from all transactions whether they are attributable to PE or not or whether they are of the same kind of transactions carried on by the PE or not which are headed as Full Force of Attraction category. The OECD Model Conventions generally adopts the "No Force of Attraction Principle". The U.N. Model Conventions generally adopts the "Limited Force of Attraction Principle".

5. Rule of attribution or no force of attraction

The expression widely used in treaties article 7 as well as under the Act confine taxability of business profits of PE to “only so much of them as is directly or indirectly attributable to that permanent establishment”. In other words the treaties provide for taxing profits/ income only to the extent that they are attributable to the PE.

Part III

The treaty rules of interpretation- order of preference in the treaty rules/definitions

1. Definition rule

(1) At First, special treaty definitions, if any, or treaty rules of interpretation will be applied.

(2) If no such special rules are applicable, the question to be asked is whether the law of the State applying the treaty (lex fori) attaches a special meaning to the term to the extent it relates to the taxes covered by the treaty.

(3) If the law of the State applying the treaty uses the term,
the term's meaning needs to be ascertained in order to ask whether the context suggests a differential interpretation and, in the light of the weight given to the alternative interpretation, whether the context requires a different interpretation.

(4) If question (2) is answered in the negative, but the term is applied in domestic law outside the Scope of tax laws envisaged by the treaty, the general rules of interpretation should apply.

In other words there cannot be any residual presumption in favour of a domestic law meaning of a treaty term.

Ref: Dr. Klaus Vogel, at page 215 of Double Taxation Conventions (Third Edition 1997, published by Kluwer Law International Ltd.)

2. Rule of preference

If a tax liability is imposed by the Act, the Agreement may be resorted to for negating or reducing it and in case of difference between the provisions of the Act and the Agreement, the provisions of the Agreement would prevail over the provisions of the Act .

Reference: S.90 of the Act and SUPREME COURT decision in Azadi Bachao Andolan. (2003)263ITR706

3. Charging/taxability rule

When taxability in the hands of the assessee fails in terms of the applicable tax treaty there is no need to examine the matter on the touchstone of the legal provisions under the Indian Income-tax Act, 1961.

4. Rule on reimbursements

Following the decision of the Delhi High Court in CIT v. Industrial Engineering Projects P. Ltd. [1993] 202 ITR 1014 the reimbursement of expenses can be taken as exempt from payment of TDS. In this case the assessee had an agreement with a foreign company whereby some services were to be rendered by the latter to the former on payment of consideration of Rs.

1,20,000 per year and certain costs and expenses incurred by
the assessee would be reimbursed. The controversy centered round the claim of the assessee for reimbursement of expenses only. The Income-tax Appellate Tribunal, on interpretation of the agreement and on considering the facts of the case, found that the assesse received no sums in excess of the expenses incurred by it on behalf of the foreign company under the agreement and that the reimbursement of expenses did not constitute income. On a reference, Division Bench of the High Court of Delhi, following the judgment of the hon'ble Supreme Court in the case of CIT v. Tejaji Farasram Kharawalla Ltd. [1968] 67 ITR 95 held that the reimbursement of expenses could, under no circumstances, be regarded as revenue receipt.

Further, to ensure that the amount paid is pure reimbursements it is advisable to get a certificate from the Chartered Accountant of the payee.

Also, the Kerala High Court in the case of Cochin Refineries Ltd. v. CIT [1996] 222 ITR 354, held that reimbursement of incidental expenses is required to be treated as a part of the fees for technical services for the purpose of the India-US tax treaty. In view of the difference of opinion among courts and further on account of disallowance provisions u/s 40(a)(i), it would be wise to even deduct tax on reimbursements that are incidental to the taxable services availed under a contract.

5. Concept of make available

The phrase "make available "in the context of FTS in article 12(4)(b) of the US DTAA is explained in the MOU as under :

"Paragraph (4)(b) of article 12 refers to technical or consultancy services that make available to the person acquiring the technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design to such person. (For this purpose, the person acquiring the service shall be deemed to include an agent, nominee, or transferee of such person.) This category is narrower than the category described in paragraph (4)(a) because it excludes any service that does not

make technology available to the person acquiring the service. Generally speaking, technology will be considered 'made available' when the person acquiring the service is enabled to apply the technology. The fact that the provision of the service may require technical input by the person providing the service does not per se mean that technical knowledge, skills, etc., are made available to the person purchasing the service, within the meaning of paragraph (4)(b). Similarly, the use of a product which embodies technology shall not per se be considered to make the technology available."

Hence make available clause has application if the services are technical. In other words it has no application in case of managerial services, consultancy services that are non-technical in nature.

* In case of fee paid on account of technical services along with right to enjoyment of equipment then rate would be 10%

6. Look at principle

Look at approach is more to do with substance over form approach where the AO may lift up the corporate veil and retrace the substance of the transaction. According to the SUPREME COURT in the context of application of look at test the task of the Revenue is to ascertain the legal nature of the transaction and, while doing so, it has to look at the entire transaction holistically and not to adopt a dissecting approach as in the case of look through test.

7. Look through approach

Look through approach is a dealing mechanism in judging the tax liability in cross border dealings or multitier structures or indirect transactions but any such mechanism must be provided for in the law or treaty and it cannot be assumed for. Explanation 4 and 5 in section 9 (1) (i) are meant to tax transactions on the basis of look through principle.

8. TRC-Tax Residency Certificate

The FINANCE BILL insert a new provision from 1.4.2013 (A.Y 2013-14) to the effect that a non-resident shall not be entitled to claim any relief under the treaty unless a certificate

(TRC), containing such particulars as may be prescribed, 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. However, a TRC may not be conclusive in the sense that the same does not prevent enquiry into a tax fraud, for example, where an OCB is used by an Indian resident for round-tripping or any other illegal activities where according to the SUPREME COURT nothing prevents the Revenue from looking into special agreements, contracts or arrangements made or effected by Indian resident or the role of the OCB in the entire transaction. It is thus keeping into account this very observation that a new Ss. 96 & 97 in Chapter X-A titled as General Anti Avoidance Rule namely GAAR have been inserted in the Act.

It would thus be advisable to seek TRC from non-residents at the time of placement of purchase order beginning 01.04.2012.

Part IV

Withholding Tax Rates

See annexure

Part V

Exempted Payments Instances

Few instances of payments generally where no withholding tax apply as they do not involve rendering any managerial, technical or consultancy services and further where the services are rendered outside India:

1. Subscriptions
2. Advertisements
3. Business information reports including electronic purchase by download
4. Data processing services
5. Certification and testing services
6. Sales commission
7. Recouping of actual costs or cost sharing agreements

8. Recruitment/referral services – exclusion by make available restriction
9. Generally reimbursement of expenses actually incurred does not constitute chargeable income and hence tax had not to be withheld there from under section 195 of the Income-tax Act. However considering sec 40(a)(i) provisions, it may be advisable to resort to deduction of tax even on such reimbursements.

Part VI

CONSEQUENCES OF NOT KEEPING WITH OBLIGATION

Section 201 of the Act lays down the consequences of failure to deduct or pay. These consequences include not only the liability to pay the amount which such a person was required to deduct at source from the payments made to a non-resident but also penalties, etc. Also the same would attract the consequences provided under section 40(a)(i)) of the Act for disallowance of deduction.

PAYMENTS TO NON-RESIDENTS

IMPACTS OF NON DEDUCTION OF TAX AT SOURCE

SECTION	NATURE OF LIABILITY	LIABILITY
271C	Penalty	Amount of tax which such person has failed to deduct
201(1A)-mandatory	Interest	• Rate of interest- 1.5 per cent (per month or part of month) • Period of interest- From the date of payment to the date of deposit of TDS
40 (a)-mandatory	Disallowance	30% of amount of expenditure
201-mandatory	Tax Deductible at Source	Amount of tax deductible

Part VII

Relevant Rules

Section 195			
S.No	Rule	Subject	Relevant Form/reference
1	26	Rate of exchange for the purpose of tax at source on income payable in foreign currency	SBI TT Buying rate
2	28	Application for certificates for deduction of tax at lower rates	Form No. 13
3	28AA	Certificate for deduction at lower rates or no deduction of tax from income other than dividends	No prescribed Format
5	29	Certificate of no deduction of tax or deduction at lower rates from dividends	
6	29B	Application for certificate authorizing receipt of interest and other sums without deduction of tax	• For a Banking company- Form No. 15C • For any other person- Form No. 15D
7	30	Time and mode of payment to Government account of tax deducted at source	
8	31	Certificate of tax deducted at source to be furnished under section 203	• Deduction u/s 192- Form No. 16 • Deduction under any other provision of Chapter XVII-B- Form No. 16A
9	31A	Statement of deduction of tax under sub-section (3) of section 200	• Statement of deduction of tax u/s 192- Form No. 24Q • Statement of deduction of tax u/s 193 to 196D in: 1. Form No. 27Q for non-resident 2. Form No. 26Q for other deductees
10	31AB	Annual statement of tax deducted or collected or paid	Form No. 26AS
11	37BA	Credit for tax deducted at source for the purposes of section 199	

12	37BB	Furnishing of information under sub-section (6) of section 195	• Information to be furnished in-Form No. 15CA • Certificate shall be obtained in-Form No. 15CB

Part VIII

Relevant Circulars

Sec 195			
S.No	Circular No.	Dated	Subject
1	20(II-4)	08/03/1961	Persons wishing to make payments to branch office of foreign banks to apply to ITO having jurisdiction over such branches for a certificate authorising payment without deduction of tax at source
2	43	20/6/1970	Whether non-deduction of tax is only in respect of interest credited to Non-resident (External) Account and not to all types of non-resident accounts
3	152	27/11/1974	Where whole payment would not be income chargeable to tax in the hands of recipient non-resident, person responsible for paying such sum may make application for determination of appropriate portion
4	333	4/2/1982	Conflict between the provisions of the Income-tax Act, 1961, and the provisions of the Double Taxation Avoidance Agreement--Clarification.
5	370	3/10/1983	Clarification contained in Circular No. 155, dated 21-12-1974 reiterated to ensure proper computation of tax to be deducted at source in the case of non-resident whose tax

			liability is to be borne by payer
6	588	2/1/1991	Announcement by Finance Minister in Lok Sabha on 7-9-1990 regarding deduction of tax at source from payments in respect of systems software
7	682	3/30/1994	Clarification regarding agreement for avoidance of double taxation with Mauritius
8	695	28/11/1994	Streamlining the procedure for obtaining authorisation for payment of sums to non-residents after deduction of tax at source, under section 195(1)
9	732	12/20/1995	Issue of annual no-objection certificate--Section 172 of the income-tax Act, 1961.
10	723	19/9/1995	Tax deduction at source from payment made to foreign shipping companies
11	728	30/10/1995	Correct rates of tax applicable in case of remittance to a country with which Double Taxation Avoidance Agreement is in force
12	740	17/4/1996	Taxability of interest remitted by branches of banks to the head office situated abroad, under the Foreign Currency Packing Credit Scheme of Reserve Bank of India
13	734	24/1/1996	Applicable rates of taxes under the Double Taxation Avoidance Agreement between India and the United Arab Emirates
14	759	18/11/1997	Submission of No Objection Certificate in case of remittance to a non-resident
15	769	6/8/1998	Procedure for refund of tax deducted at source under

			section 195
16	767	22/5/1998	Submission of No Objection Certificate in case of remittance to a non-resident
17	789	4/13/2000	Clarification regarding taxation of income from dividends and capital gains under the Indo-Mauritius Double Tax Avoidance Convention (DTAC)
18	790	20/4/2000	Procedure for refund of tax deducted at source under section 195 to the person deducting the tax
19	10/2002	9/10/2002	Submission of No Objection Certificate in case of remittance to a non-resident
20	7/2007	23/10/2007	Section 239 of the Income-tax Act, 1961 - Refunds - Procedure for refund of tax deducted at source under section 195 to the person deducting the tax - Supersession of Circular No. 790, dated 20-4-2000
21	7/2009	10/22/2009	Section 9 of the Income-tax Act, 1961 - Income - Deemed to accrue or arise in India - Withdrawal of Circulars No. 23, dated 23rd July, 1969, No. 163, dated 29th May, 1975 and No. 786, dated 7th February, 2000
22	4/2009	29/6/2009	CBDT on remittance to non-residents under section 195
23	9/2009	30/11/2009	Section 195 of the Income-tax Act, 1961 - Deduction of tax at source - Payment to non-resident - Clarification regarding remittances of Consular receipts to non-residents

PART IX

UN and OECD Model Conventions

Article no.	Version	Particulars
5(1)	OECD	For the purpose of this convention, the term “Permanent Establishment" (PE) means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
	UN	Same as OECD
5(2)	OECD	The term PE includes : a) place of management ; b) a branch ; c) an office ; d) a factory ; e) a workshop , and f) a mine , an oil or gas well , a quarry or any other place of extraction of natural resources.
	UN	OECD
	Modified	Treaty countries follow modified version and therefore include some or all of the following: 1)Sales outlet , farm , plantation or other agriculture activities carried on; 2) a warehouse providing storage facilities 3) An installation or structure or plant equipment, used for exploration or exploitation of natural resources or only if so used for a period of more than 120 days in any 12 month period or some countries for more than 183 days 4) A building site or construction, installation or assembly project or supervisory activities in connection therewith or shall be continued for a certain period as prescribed under relevant DTAA.
5(3)	OECD	A building site or construction or installation project constitute a PE only if it lasts more than 12 months.
	UN	The term PE also encompasses : a) A building site, a construction , assembly or installation project or

		supervisory activities in connection therewith , but only if such site , project or activities last more than 6 months. b) The furnishing of service , including consultancy services, by an enterprises through employees or other personnel engaged by the enterprises for such , but only if activities of that nature continue (for the same or a connected project) with in a contracting state for a period or periods aggregating more than 6 months with in any 12 months period.
	Modified	Countries follow modified version which may be same as OECD and UN with following addition a) where the building site, a construction, assembly or installation or supervisory activities which is incidental to the sale of machinery or equipment and such activity continuous not exceeding 6 months and charges for such activities are exceed 10% of sale price if machinery and equipment etc.
7(1)	OECD	The profits of an enterprise of a contracting state shall be taxable only in that state unless the enterprise carries on business in the other contracting state through a PE situated therein. If the enterprises carries on business as aforesaid , the profits of the enterprises may be taxed in the other state only so much of them as is attributing to that PE.
	UN	The profits of an enterprise of a contracting state shall be taxable only in that state unless the enterprise carries on business in the other contracting state through a PE situated therein . If the enterprises carries on business as aforesaid , the profits of the enterprises may be taxed in the other state but only so much of them as is attributable to: a) that PE; b) sale in that other state of goods or merchandise of the same or similar kind as those sold through that PE; or c) other business activities carried on in that other state of the same or similar kind as those effected through that PE.
	Modified	Same as OECD and UN with the following exceptions;

		a) if the enterprise proves that the above activities could not have been reasonably undertaken by PE or have no relation with PE. b) if the enterprise proves that such sale or activity in (b) and (c) above could not have been reasonably undertaken by the PE etc.
10(1)	OECD	Dividends paid by a company which is a resident of a contracting state to a resident of the other contracting state may be taxed in that other state.
	UN	Same as OECD
	Modified	a) Dividends paid by a company which is a resident of one territories to a resident of the other territory may be taxed only in the first mentioned territory. b) Dividends paid by a company which is resident of one contracting state for the purpose of its tax, to the other contracting state , may be taxed in that other contracting state etc.
11(1)	OECD	Interest arising in a contracting state and paid to resident of the other contracting state may be taxed in that other state.
	UN	Same as OECD
	Modified	Same as OECD with following modifications; a) Interest on bonds, securities , notes, debentures or any other form of indebtedness derived by a resident of one of the territories from the sources in the other territory may be taxed only in the other territory . b) Interest arising in a contracting state and paid to resident of the other contracting state may be taxed in the both states. c) interest on funds directly connected with the operation of aircraft shall be regarded as income from operation of such aircrft. d) Interest includes gains or on debt claims.
12(1)	OECD	Royalties arising in a contracting state and beneficially owned by a resident of the other contracting state shall be taxable only in that other state.
	UN	Royalties arising in a contracting state and paid to a resident of the

		other contracting state may be taxed in that other state.
	Modified	a)Royalties arising in a contracting state may be taxable in that state. b)Royalties and payments for the use of equipment arising in a contracting state and paid to resident of the other contracting state may be taxed in that other contracting state.
12(2)	UN	However, such royalties may also be taxed in the contracting state in which they arise and according to the laws of that state , but if the beneficial owner of the royalties is a resident of the other contracting state, the tax so charged shall not exceed..... percent(the percent is to be established through bilateral negotiation of the gross amount of the royalties . The competent authorities of the contracting state shall by mutual agreement settle the mode of application of this limitation)
	Modified	Royalties may also be taxed at multiple rates for different rights as mentioned in the Annexure on withholding rates
14(1)	UN	Income derived by a resident of a contracting state in respect of professional services or other activities of an independent character shall be taxable only in that state except in the following circumstances when such income may also be taxed in the other contracting state a) if he has a fixed base regularly available to him on the other contracting state for the purpose of performing his activities, so much of the income as is attributable to the fixed base may be taxed in that other contracting state; or b)if his stay in the other contracting state is for a period amounting to or exceeding in aggregate 183 days in any 12 months period commencing or ending in the fiscal year concerned , in that case, only so much of the income as is derived from his activities performed in that other state may be taxed in that other state.
	Modified	Same as UN for following modifications: a) if the person stays in the other contracting state for a Period exceeding 120 days in the previous year.

		b) if the person stays in the other contracting state for a Period exceeding 90 days in the relevant taxable year.
14(2)	UN	The term “Professional services" includes especially independent scientific. Literary ,artistic, educational or teaching activities as well as independent activities of physicians, lawyers, engineers, architect , surgeon , dentists and accountants.
	Modified	The term “Professional services" means independent activities according to the laws and regulation in the force in each contracting state.

Part X

New 2011 Update of the UN Model Double Taxation Convention between Developed and Developing Countries- Extracts

Article 5

PERMANENT ESTABLISHMENT

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” includes especially:

(*a*) A place of management;

(*b*) A branch;

(*c*) An office;

(*d*) A factory;

(*e*) A workshop;

(*f*) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

3. The term “permanent establishment” also encompasses:

(*a*) A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months;

(*b*) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned.

Article 7

BUSINESS PROFITS

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (*a*) that permanent establishment; (*b*) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.

Article 10

DIVIDENDS

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

(a) ___ per cent (the percentage is to be established through
bilateral negotiations) of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 10 per cent of the capital of the company paying the dividends;
(b) ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends in all other cases.
The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations.
This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

Article 11
INTEREST

1. Interest 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 interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

Article 12
ROYALTIES

1. Royalties 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 may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of

the royalties. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

Article 14

INDEPENDENT PERSONAL SERVICES

1. Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State:

(*a*) If he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State; or

(*b*) If his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelvemonth period commencing or ending in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.

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