Section 195 of the Income Tax Act – Select Propositions and Case Studies By CA.Kapil Goel Moblle: 91-11-9910272806 Advocate Delhi High Court
kapilnkgoelandco@gmail.com, cakapilgoel@airtelmail.in

Introduction

Section 195 of the Income Tax Act, 1961 (Act) deals with tax withholding (TWH) on payments being made to non residents (popularly called as foreign remittances). With increasing cross border trade and inflow of foreign technology in India, there is a radical increase in payments to non residents (like complex turn key projects involving foreign party as an equipment supplier etc). There is also an increased government and revenue attention to this aspect of tax deduction at source (TDS) vis v vis Non resident payments as is apparent from introduction of sub-section (6) in section 195 and corresponding rule bearing no. 37BB in Income Tax Rules. The Chartered Accountants have been given a special duty and responsibility in the form of a Certificate to be given in FORM NO 15CB which compounds the importance of the subject. Therefore it is required in view of increasing practical importance of the subject and statutorily envisaged professional responsibility, to have the broad understanding of the aspects and latest developments surrounding the subject, with special reference to Supreme Court latest verdict in GE India Technology & Samsung case ; Bombay High Court in Vodafone case and Section 206AA of the Act. The special emphasis in this note has been given to tax withholding on commission payments to foreign agents post withdrawal of CBDT Circular No 786 of 2000. At the time to writing this paper, I would be failing in my duty if I would not mention some important developments which are pending at Supreme Court level and Delhi High Court level in

cases of GVK Industries and Nokia;Lucent/Alcatel etc wherein respectively question relating to territorial operation of Income tax law (relating to Non residents) in light of constitution of India and software supply and Non resident taxation are reserved.

Extract from Memorandum Explaining Provisions of Finance Bill 2008 (www.indiabudget.nic.in) section 195(6) Form No 15CA and Form No 15CB: Legislative Object

"*…The purpose of the undertaking and the certificate is to collect taxes at the stage when the remittance is made as it may not be possible to recover the tax at a later stage from the non-residents. There has been substantial increase in foreign remittances, making the manual handling and tracking of certificates difficult. To monitor and track transactions in a timely manner, it is proposed to introduce e-filing of the information in the certificate and undertaking. The amendment therefore, proposes to provide that the person responsible for deduction of income tax shall furnish the information relating to payment of any sum to the non-resident or to a foreign company in a form and manner to be prescribed by the Board…..*"

Basic Nature of TDS/Tax Withholding Provisions in Income Tax Law (Ch XVII-B) – SC views in Eli Lily 312 ITR 225

The purpose of TDS provisions in Chapter XVII B is to see that the sum which is chargeable under Section 4 for levy and collection of income-tax, the payer should deduct tax thereon at the rates in force, if the amount is to be paid to a non-resident. The said TDS provisions are meant for tentative deduction of income-tax subject to regular assessment. (see Transmission Corporation of A.P. Ltd. and Anr. v. CIT reported in [1999] 239 ITR 587 at p. 594).

Similar views of ***Mum ITAT in IDBI Limited 104 TTJ 230 "17. In our humble understanding, conceptually, liability of TDS is in the nature of a vicarious or substitutionary liability which presupposes existence of a principal or primary liability. …"***

LATEST VERDICT OF SUPREME COURT OF INDIA IN GE INDIA TECHNOLOGY & SAMSUNG CASE: SECTION 195 WORKING MECHANISM CIVIL APPEAL 7541/7542 OF 2010 DATE 8/9/2010

Question posed before SC in aforesaid cases:

The short question which arises for determination in this batch of cases is – whether the High Court was right in holding that the moment there is remittance the obligation to deduct tax at source (TAS) arises? Whether merely on account of such remittance to the non-resident abroad by an Indian company per se, could it be said that income chargeable to tax under the Income Tax Act, 1961 (for short "I.T. Act") arises in India?

Analysis of Subject by SC in aforesaid case:

- **SCOPE OF OPERATION OF SECTION 195(1) VIS A VIS VOLUNTARY PAYMENTS ETC SC VIEWS**: The most important expression in Section 195(1) consists of the words "chargeable under the provisions of the Act". A person paying interest or any other sum to a non-resident is not liable to deduct tax if such sum is not chargeable to tax under the I.T. Act. **For instance, where there is no obligation on the part of the payer and no right to receive the sum by the recipient and that the payment does not arise out of any contract or obligation between the payer and the recipient but is made voluntarily, such payments cannot be regarded as income under the I.T.** Act. It may be noted that Section 195 contemplates not merely amounts, the whole of which are pure income payments, it also covers composite payments which has an element of income embedded or incorporated in them. Thus, where an amount is payable to a non-resident, the payer is under an obligation to deduct TAS in respect of such composite payments. The obligation to deduct TAS is, however, limited to the appropriate proportion of income chargeable under the Act forming part of the gross sum of money payable to the non-resident. This obligation being limited to the appropriate proportion of income flows from the words used in Section 195(1), namely, "chargeable under the provisions of the Act".

- **1922 ACT EARLIER RULING OF SC APPLIED IN PRESENT CASE TO ADDRESS THE SITUATION**: In CIT Vs. Cooper Engineering [68 ITR 457] it was pointed out that if the payment made by the resident to the non-resident was an amount which was not chargeable to tax in India, then no tax is deductible at source even though the assessee had not made an application under Section 18(3B) (now Section 195(2) of the I.T. Act). The application of Section 195(2) pre-supposes that the person responsible for making the payment to the non-resident is in no doubt that tax is payable in respect of some part of the amount to be remitted to a non-resident but is not sure as to what should be the portion so taxable or is not sure as to the amount of tax to be deducted. In such a situation, he is required to make an application to the ITO(TDS) for determining the amount. It is only when these conditions are satisfied and an application is made to the ITO(TDS) that the question of making an order under Section 195(2) will arise.

- **REASONABLE AUTONOMY AVAILABLE TO PAYER U/S 195 SC VIEWS: Hence, apart from Section 9(1), Sections 4, 5, 9, 90, 91 as well as the provisions of DTAA are also relevant, while applying tax deduction at source provisions…** *From this it follows that where a person responsible for deduction is fairly certain then he can make his own determination as to whether the tax was deductible at source and, if so, what should be the amount thereof.*

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

- **CHAPTER XVII AND TDS PROVISIONS : CONTRAST AND COMPARISION DRAWN BY SC JUDGMENT WITH SPECIAL FEATURE OF SECTION 195(1)**….On analysis of various provisions of Chapter XVII one finds use of different expressions, however, the expression "sum chargeable under the provisions of the Act" is used only in Section 195. For

example, Section 194C casts an obligation to deduct TAS in respect of "any sum paid to any resident". Similarly, Sections 194EE and 194F inter alia provide for deduction of tax in respect of "any amount" referred to in the specified provisions. In none of the provisions we find the expression "sum chargeable under the provisions of the Act", which as stated above, is an expression used only in Section 195(1). Therefore, this Court is required to give meaning and effect to the said expression.

- *The entire basis of the Department's contention is based on **administrative convenience in support of its interpretation.** According to the Department huge seepage of revenue can take place if persons making payments to non-residents are free to deduct TAS or not to deduct TAS.*

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

- **REVENUE SEEKING TRACK OF FOREIGN PAYMENTS VIA SECTION 195(2) AND SC VIEWS**: In other words, according to the Department Section 195(2) is a provision by which payer is required to inform the Department of the remittances he makes to the non-residents by which the Department is able to keep track of the remittances being made to non-residents outside India. We find no merit in these contentions

FINAL CONCLUSION OF SUPREME COURT IN AFORESAID CASE

In our view, Section 195(2) is based on the "principle of proportionality". The said sub-Section gets attracted only in cases where the payment made is a composite payment in which a certain proportion of payment has an element of "income" chargeable to tax in India. It is in this context that the Supreme Court (in Transmission Corpn case) stated, "If no such application is filed, income-tax on such sum is to be deducted and it is the statutory obligation of the person responsible for paying such 'sum' to deduct tax thereon before making payment. He has to discharge the obligation to TDS". If one reads the observation of the Supreme Court, the words "such sum" clearly indicate that the observation refers to a case of composite payment where the payer has a doubt regarding the inclusion of an amount in such payment which is exigible to tax in India. *In our view, the above observations of this Court in Transmission Corporation case (supra) which is put in italics has been completely, with respect, misunderstood by the Karnataka High Court to mean that it is not open for the payer to contend that if the amount paid by him to the non-resident is not at all "chargeable to tax in India", then no TAS is required to be deducted from such payment. This interpretation of the High Court completely loses sight of the plain words of Section 195(1) which in clear terms lays down that tax at source is deductible only from "sums chargeable" under the provisions of the I.T. Act, i.e., chargeable under Sections 4, 5 and 9 of the I.T. Act.*

Similar views by following Courts and ITAT Benches:

- ***Bombay High Court verdict in Vodafone case WRIT PETITION NO.1325 OF 2010 : September 8, 2010 (special observations on territorial operation of section 195(1):***

  (viii) Parliament, while imposing a liability to deduct tax has designedly imposed it on a person responsible for paying interest or any other sum to a non resident. Parliament has not restricted the obligation to deduct tax on a resident and ***the Court will not imply a restriction not imposed by legislation.*** *Section 195 embodies a machinery that would render tax collection effective and must be construed to effectuate the charge of tax****. There is no limitation of extra territoriality involved though Parliament is cognizant of the fact that the provisions of the law can be enforced within the territory to which the Act extends…. As the Supreme Court observed in Eli Lily, the provisions of Section 195 of the Income Tax Act, 1961 are in the nature of a machinery provision enacted in order to effectuate the collection and recovery of tax.*** *Given a*

sufficient territorial connection or nexus between the person sought to be charged and the country seeking to tax him, income tax may extend to that person in respect of his foreign income. ***The connection can be based on residence or business connection within the taxing State or the situation within the State of an asset or source of income from which the taxable income is derived****.* ***Once the nexus is shown to exist, the provisions of Section 195 would operate****.* ***Even though the revenue laws of a country may not be enforceable in another, that does not imply that the Courts of a country shall not enforce the law against the residents of another within their own territories****…. Chargeability and enforceability are distinct legal conceptions. A mere difficulty in compliance or in enforcement is not a ground to avoid observance. In the present case, the transaction in question had a significant nexus with India. The essence of the transaction was a change in the controlling interest in HEL which constituted a source of income in India. The transaction between the parties covered within its sweep, diverse rights and entitlements****. The Petitioner by the diverse agreements that it entered into has a nexus with Indian jurisdiction. In these circumstances, the proceedings which have been initiated by the Income Tax Authorities cannot be held to lack jurisdiction…)*

- *Delhi High Court in Van Oord case 230 CTR 365 (later explained by DHC in Maharishi Housing);*
- *Chennai Special Bench of ITAT in Prasad Productions 129 TTJ 641 and*
- *Mumbai Special Bench of ITAT in Mahindra and Mahindra 122 TTJ 577*

Important references on How to read Court rulings SC Larger Bench Srikumar Agencies: CIVIL APPEAL NO.4872-4892 OF 2000 November 27, 2008 : 2008(15)SCALE333

"4. Courts should not place reliance on decisions without discussing as to how the factual situation fits in with the fact situation of the decision on which reliance is placed. Observations of Courts are neither to be read as Euclid's theorems nor as provisions of the statute and that too taken out of their context. These observations must be read in the context in which they appear to have been stated. Judgments of Courts are not to be construed as statutes. To interpret words, phrases and provisions of a statute, it may become necessary for judges to embark into lengthy discussions but the discussion is meant to explain and not to define. Judges interpret statutes, they do

not interpret judgments. They interpret words of statutes; their words are not to be interpreted as statutes"

Similar views by SC in Sun Engg case reported at 198 ITR 297

CA Certificate etc Form 15CA/15CB etc

Section 195 [(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.]

Rule 37BB. (1) The information under sub-section (6) of section 195 shall be furnished by the person *responsible for making the payment to a non-resident*, not being a company, or to a foreign company, after obtaining a certificate from an accountant as defined in the *Explanation* to section 288 of the Income-tax Act, 1961

ROLE OF PAYEE'S DECLARATION IN GENERAL

Generally, it is a matter of concern whether payer in India making (say) payment for import of raw material to a foreign party, while taking a stand on requisite WHT/TDS on said remittance, how far can rely upon a declaration of the payee as to the effect that there is no Permanent establishment (PE) and Business Connection (BC) in India in respective terms of relevant DTAA (Article 5 generally deals with PE) and section 9(1)(i) of the Act, of the said non resident. In the considered view of author, after taking support from SC ruling in Samsung case (supra) and SC ruling in ITI & L&T cases (albeit in context of section 192), legislative intent behind 195(6) as reproduced above, it is possible to rely upon the declaration of the payee on the part of the payer and also its CA, as regards non existence of PE and BC are concerned under DTAA/Act (as the case may be). It is advisable that said declaration of payer is obtained on its letterhead accompanying the relevant provisions of Article 5 of relevant DTAA (if any) section 9(1)(i) of the Act, whereby payer considering the same certifies to the payer that there is no PE and BC resp. under DTAA and Act in light of

enclosed provisions of Article 5 and Section 9(1)(i) of the Act. Further, in case it is known to the payer through its dealings with the non resident that there is a business establishment of foreign payee in India for corresponding transaction (eg Indian agent of foreign party through which said transaction is concluded), it would not be permissible for CA of the payer to enter into exercise of attribution of income while giving Form No 15CB for payer as TDS/WHT has to be done in that case, in absence of AO's certificate u/s 195(2)/195(3)/197 etc on GROSS SUM at maximum APPLICABLE rate in governing Finance Act.

(more preferably, payer and its CA giving Form No 15CB can act on the corresponding opinion of non resident's CA thereby certifying non resident non PE/BC stand under DTAA and Act and wherever possible and stakes are large, Payee can also seek Advance ruling from AAR to the said effect (Inclusive options).

Note of Caution: CA of Payer certifying remittance in Form No 15CB should not enter into computation aspect of the transaction which is taken care of by section 195(2) of the Act as highlighted by SC in Samsung case.

- Particulars of Payee incl Legal Status of the same (taxability and rates depends upon same) **check whether payee is a branch (country 1) belongs to parent (country 2)?**
- Nature of Payment – in Certificate refer those documents which has been seen
- Determination of residential status of PAYEE
  - When year is far from over? Whether to go by status as on transaction date or preceding year status?
  - Where payee is resident as per Act and non resident as per Treaty? – So long as payee is resident as per Act- difficult to apply Treaty Tie Breaker rule for determining payee status under section 195….
  - Residential Status of Firms/other entities- SC in 19 ITR 168; 40 ITR 1; 34 ITR 1 (partners of a firm resident – rebuttable presumption – firm's control in India)
- Obtain TRC (Tax Residency Certificate) of Payee so as to examine treaty provisions (else obtain self declaration form (SDF) sufficiently detailed from payee as to tax residency of a country)- at appropriate places mention certificate based on declaration of payee eg declaration of payee on PE presence /income connection with PE may be required..)

- ***On verification of PE : at what point of time? And whether representation sufficient? ((SC in L&T whether applicable?)- Payer has limited information on PE…***
- ***Income taxable on net basis – Can CA compute? Refer Clause 13 (c) of Form No. 15CB***
- ***Immovable Property - Can CA rely on Computation of Income provided by the Non resident seller? Declaration of intension by the seller to invest long term capital gains u/s. 54EC?***
- Guarded caveat on "beneficary" is recipient of income …
- No appeal against CA Certificate (106 ITD 521 Mum ITAT M&M)- STATUTORY RECOGNITION IMPACT?
    - **Tax Treaty – whether applicable? Legal Status; Persons covered; Taxes covered; _ Residential status**
    - **Tax treaty – check: Entry into force & Termination; LOB clause; MFN clause Protocols and Memorandum of Understandings**
- Circular No. 9/2009 [f. no. 142/19/2007-tpl], dated 30-11-2009 while remitting consular receipts abroad, diplomatic missions in India will be required to submit only a self-certified undertaking in Form No. 15CA
- **Documentation to be maintained:**
    - Agreement and Invoices
    - Tax Residency Certificate
    - Certificate from payee for – no PE, tax residency, beneficial owner, treaty entitlement, etc and Indemnification from payee
    - Payment details
    - Correspondences
    - Technical Advice – prove bonafides
    - Proof of services being rendered in case of Group Company transactions

- E-mails etc regarding pricing in case of Group Company transactions

❖ Example of Certification language by CA:

Since subject services being advertisement charges are classifiable as business profits under India- USA DTAA, in absence of payee's PE under Article 5 of said DTAA, the subject remittance to payee is not taxable as business profits in India and hence it is concluded that no tax is deductible on the same" We place reliance upon following…

Since subject export commission payable to non resident payee is classifiable as business profits under India USA DTAA, in absence of payee's PE under article 5 of said DTAA, the subject remittance to payee is not taxable as business profits in India and hence it is concluded that no tax is deductible on the same"

❖ *POSERS ON ABOVE:*

- Whether section 195(6) read with rules governing Form No 15CA and 15CB can and should cross the principal provision of section 195(1)? Eg revenue account payments made for import of raw material not requiring any TDS u/s 195(1); education payments for children studies etc (not chargeable to tax in India); loan repatriation etc. admittedly having zero and nil chargeability in India as regards chargeable "income" is concerned.
- Whether banks can or should insist on Form No 15CB in case payment is made outside India to a resident? What if a Non resident takes his own money outside India from his own Indian NRO account?

Section 206AA: since Section 206AA is starting with Non Obstante clause overriding whole

Objective of Section 206AA: Finance No 2 Act of 2009 Source: Memorandum Explaining Provisions of Finance No 2 Bill 2009

Statutory provisions mandating quoting of Permanent Account Number (PAN) of deductees in Tax Deduction at Source (TDS) statements exist since 2001 duly backed by penal provisions. The process of allotment of PAN has been streamlined so that over 75 lakh PANs are being allotted every year. Publicity campaigns for quoting of PAN are being run since the last three years. The average time of allotment of PAN has come down to 10 calendar days. Therefore, non-availability of PAN has ceased to be an impediment. In a number of cases,

the non-quoting of PANs by deductees is creating problems in the processing of returns of income and in granting credit for tax at deducted at source, leading to delays in issue of refunds.

In order to strengthen the PAN mechanism, it is proposed to make amendments in the Income Tax Act to provide that any person whose receipts are subject to deduction of tax at source i.e. the deductee, shall mandatorily furnish his PAN to the deductor failing which the deductor shall deduct tax at source at higher of the following rates

(i) the rate prescribed in the Act;

(ii) at the rate in force i.e., the rate mentioned in the Finance Act; or

(iii) at the rate of 20 per cent.

TDS would be deductible at the above-mentioned rates will also apply in cases where the taxpayer files a declaration in form 15G or 15H (under section 197A) but does not provide his PAN. Further, no certificate under section 197 will be granted by the Assessing Officer unless the application contains the PAN of the applicant.

These provisions will also apply to non-residents where TDS is deductible on payments or credits made to them. To ensure that the deductor knows about the correct PAN of the deductee it is also proposed to provide for mandatory quoting of PAN of the deductee by both the deductor and the deductee in all correspondence, bills and vouchers exchanged between them.

This amendment will take effect from 1st April, 2010."

Clarified vide Press Release Dated January 20, 2010

….All deductees, including non-residents having transactions in India liable to TDS, are advised to obtain PAN by 31st March 2010 and communicate the same to their deductors before tax is actually deducted on transactions after that date….REF no. 402/92/2006 MC (04 OF 2010).

Regarding aforesaid provision of the Act there can be inter alia possible dimensions from which the provision can be examined:

1. **Whether payments to non residents falling u/s 195 are covered in section 206AA:**

   Since section 206AA starts with the wording 'Notwithstanding anything contained in any other provision of this Act, where tax is deductible u/ch-XVII B..." which wording is

wider in scope as compared to other available language stating " notwithstanding anything to the contrary contained in any other provision of the Act", therefore by using former language, statute has also over-rided section 90 (where in DTAA's are enforced) and accordingly if tax is otherwise deductible (because of chargeability for Royalty/FTS) and payee is not having PAN, for TDS purposes, payer has to go by final rate of 20% (subject to points mentioned below).

This is also because of the reasoning that section 4/charging provision of the Act, under/explaining which SC in Azadi Bachao case, has held that DTAA's would override income tax act is because of the phrase "subject to other provisions of the Act" being used in section 4(1) of the Act. In present language of section 206AA totally different phrase is used whereby whole income tax is overrided as far as deductor is concerned. This is even though u/s 139A read with relevant rule a non resident is not obliged to obtain PAN under Income tax act, for being in receipt of income taxable u/Income tax Act, 1961***. However, there is a equally contrary school of though wherein it is viewed that section 206AA cannot be treated as a parallel provision requiring a payee receiving tax deductible income, to have mandatory a PAN u/s 206AA, as section 206AA cannot operate independent of section 139A (Rule 114C). This is further based on the reasoning that in case S. 206AA(1) is interpreted literally as extending to all persons, S. 139A(8)(d) would be rendered otiose and futile. Hence S. 206AA(1) is to be interpreted as limited to cases where obtaining PAN is mandatory. This school of though is respectfully dissented by the author for the reasons mentioned in above and below***.

This provision is not applicable where section 195 as such is not attracted to a non resident transaction say because of non resident not chargeable to tax in India because of Act or DTAA (eg general imports from foreign vendor who has no connection in India u/s 9(1)(i) and/or PE under relevant DTAA).

In author’s understanding, constitutional power to legislate on the subject in aforesaid manner is subject to doubts and needs constitutional scrutiny *on prima facie* tenable grounds of indirect violation of DTAA (doctrine of colorable legislation and unilateral modification of double tax agreements etc) and collecting higher taxes than due from payer as compared to final and ultimate tax liability of payee, may tantamount to excessive appropriation as something which is not legitimately due from ultimate assessee/payee whose primary liability is to pay income tax on its income, stands collected in tentative mechanism of TDS. In this regard useful reference may be made to SC ruling in Ashirwad Films and DHC ruling in Madhushree Gupta wherein it is discussed on freedom available in fiscal laws to legislature and related issue of fairness

and reasonableness. *Till this provision is not constitutionally held invalid or toned down, in personal opinion of author, it is advisable that we follow plain interpretation of section 206AA as advised above, instead of ourselves leaning into subjective and grey area of going by treaty rates, treating them as final in nature and further, treating them as superseding section 206AA content*. Further, there may be an constitutional issue as to how far absence of PAN which is a procedural and administrative matter, can allow the substitution of tax rates in force by a higher rate of 20% as SC in Samsung (supra, albeit not directly in context of section 206AA) has clarified that to view TDS provisions in isolation to chargeability of payee would be a fallacy.

It is not the object of law to first collect tax in excess of the charge and then refund the excess. One may refer to the decisions of the Supreme Court in Bhawani Cotton Mills Ltd. v. State of Punjab, (1967) 20 STC 290 (SC), the Full Bench of Supreme Court observed as under :

"If a person is not liable for payment of tax at all, at any time, the collection of tax from him with a possible contingency of refund at a later stage, will not make the original levy valid; because, if particular sales or purchases are exempt from taxation altogether, they can never be taken into account, at any stage, for the purpose of calculating or arriving at the taxable turnover and for levying tax."

Similarly, the Karnataka High Court in Hyderabad Industries Limited v. ITO and Another, (1991) 188 ITR 749 (Kar.) observed :

"The construction sought to be placed by the respondents is based on a distinction which has no substance in it. It is not understandable as to why a benefit which will not be included in the total income of a person, should be considered as 'income' for the purpose of deduction of tax at source at all. ***The purpose of deduction of tax at source is not to collect a sum which is not a tax levied under the Act; it is to facilitate the collection of the tax lawfully leviable under the Act.*** *The interpretation put on those provisions by the respondents would result in collection of certain amounts by the State which is not a tax qualitatively. Such an interpretation of the taxing statute is impermissible."*

2. **In case of cum tax arrangement (where tax has to be borne by deductor), after having grossed up the rates in force as contemplated u/s 206AA read with section 2(37A)(iii), for one part of the provision, whether rate of 20% needs to be taken on grossed up basis (if at all) or in alternative, after doing grossing up at 10% rate and computing gross taxable amount, rate of 20% can be applied?** ***Whether 195A grossing up can apply in context of section 206AA - 20% rate application and if yes, how should the payee account for the same while filing its return?***

From deductors' perspective, what should be the amount on which rate of 20% under section 206AA needs to be applied?

3. **Whether for tax withholding on a payment, when payee was not having PAN no. at the time of tax withholding, TDS was made at lesser rate, can it be subsequently ratified if payee takes PAN on subsequent date, vis a vis default made at the tax withholding stage?**
4. **Whether education cess/surcharge can be factored in TDS u/s 206AA for rate of 20%? Whether section 206AA covers salary payments also?**
5. **In case of possibility of subsequently found invalid PAN as given by payee, how far dedutor/payer can assure himself from apprehended higher liability u/s 206AA read with section 201?**
6. **Connotation of Word "entitle to receive" in section 206AA(1)**

CBDT Circular No 786 of 2000 and Payment to Outside Commission Agents : TAX WITHHOLDING REQUIREMENTS *POST WITHDRAWAL OF CIRCULAR*

"Commission" simpliciter is not Fees For Technical Services u/s 9(1)(vii) of the Act and same being in the nature of "business income" for recipient of income/payee/non resident, is also not taxable in India vide section 9(1)(i) in case of absence of business connection in India. Therefore, since chargeability for non resident agent providing services to Indian Party is clear as per aforesaid understanding and since there is NIL chargeability under the Act itself for non resident payee, option to approach AAR/AO u/s 195/197, in my considered view, is not required to be exercised, in facts of instant case. This is supported from SC/other rulings in

a) Shoorji Plaonji 39 ITR 775

b) Perofrming rights 106 ITR 11

c) Cal HC in 5 ITR 216

Further, one would be on much stronger footing, in case relevant DTAA contains in Article 12 (mainly) dealing with royalty and fees for included services "make available" concept. This concept not only requires rendering of technical services (which as mentioned below, services of simple agent procuring orders, are not technical services) but also making available of underlying technology/methodology as used by service provider (here

commission agent) so that service recipient can do relevant job subsequently on its own (without involvement of agent/service provider).

(Refer Advance Ruling in SPAHI case 315 ITR 374 (Para 10.1)

Since it was requested by learned organizers of the conference that firstly issues relating to aspects highlighted in Seminar Brochure are addressed therefore author is pleased to share following additional material on the subject, as available with him:

Some Principals to be followed for transaction with Non-residents:

1. How to approach taxability of non resident payee while proceeding u/s 195 of the Act:

Step 1: Make the classification of transaction (eg whether covered u/s 9(1)(vii) or u/s 9(1)(i) resp. dealing with Fees for technical services and Business transaction in general etc)

Step 2: Check the taxability under Income Tax Act

Step 3: If Above is in affirmative, Check as per treaty entitlement and DTAA (if any), taxability under DTAA

2. Taxation of Services : Important Concepts

- ***Exclusion for Construction and related services***
- ***Overseas Utilisation***

- ***Make Available Concept under DTAA***
- ***Independent Personal Services Protection under DTAA***

3. Payments for which stand can be taken on chargeability point by payer itself, without approaching AO/TDS u/s 195(2):
    - ***Payments for capital account: loan, gift remittance etc***
    - ***Payment for revenue account: Simpliciter raw material import***
    - ***Payment expressly exempt under the Act eg section 10***

Importance of Subject : Why section 195 of the Act needs to be studied as far consequences are concerned (for default on part of payer):

- Tax Deductor treated as Assessee in Default u/s 201(1) and TDS (Tax Deduction At Source)/WHT (Withholding of tax) may be recovered thereunder
- Interest u/s 201(1A) for default in TDS/WHT
- Penalty u/s 221 and/or section 271C -
- Prosecution u/s 276BB – for failure to pay TDS
- Disallowance of Expense u/s 40(a)(i)
- The payer may be held as an agent of the non-resident and be liable to tax in the like manner and to the same extent as the non-resident u/s. 160 to 163.

Issues u/s 201 in light of latest amendment by Finance Act (no 2) of 2009: As per Memorandum Circular there is no time limit for initiating proceedings in case of payees being non resident

"…However, no time-limits have been prescribed for order under sub-section(1) of section 201 where—
(a) the deductor has deducted but not deposited the tax deducted at source, as this would be a case of defalcation of government dues,
(b) the employer has failed to pay the tax wholly or partly, under sub-section (1A) of section 192, as the employee would not have paid tax on such perquisites,
(c) the deductee is a non-resident as it may not be administratively possible to recover the tax from the non-resident.."

Whether can overrule court verdicts like Special Bench in Mahindra and Mahindra – till 6/4 years in commensuration with section 149, DHC NKH Japan Broadcasting 305 ITR 137 : Held where no time limit is provided reasonable time limit to be read into the law – order u/s 201 to be passed within four years from end of relevant financial year (underlying ITAT order at 101 TTJ 292), further refer: ITAT rulings in 83 ITD 11, 57 ITD 536, 2 SOT 389 etc- seems no because Circular/board understanding cannot be at variance with judicial precedents SC in R&B Falcon 301 ITR 309 and Rattan Melting etc.

- No Demand u/s 201(1) on payer in case payee assessed to tax/offered the amount in its return of income as on date of proceedings u/s 201(1) : SC in Hindustan Coca Co la 163 Taxman 355 and Eli Lily (supra)

- Both Penalties u/s 271C and 221 are not leviable for same default of TDS : **ITAT in Titagarh Steels 79 ITD 532 and IDBI case 104 TTJ 230** has held that penalty u/s 221(1) is not leviable for failure to deduct tax/ shortfall in TDS as section 271C is specific and will prevail over section 221 which is general in nature

- *DHC in Adidas 288 ITR 379; Majestic Auto 293 ITR 185: date of tax payment by payee –*

  endpoint for interest computation u/s 201(1A) (approved impliedly by SC inEli Lily case)

1. Peculiar Features of Tax Withholding provision in section 195:

- Omnibus Provision – Includes Any Payer (being responsible for making the payment) irrespective of legal status of payer (like Indl, HUF, whether carrying business or not etc)

  Issues:

  - ***Whether includes Non resident Payer? (in case of payment being made by one non resident to other non resident)***

    - ***Mum ITAT in STAR 99 ITD 91***
    - ***Mum ITAT in Srikomar Poddar 65 ITD 48***
    - ***SC Electronic Corporation 183 ITR 43***
    - ***Kanga/Palkivala Page 2105 9th edition***
    - ***Impact of SC in Eli Lily (if any)?***

  - ***Whether includes an agent - liable to make deduction- while making remittance to principal for collections in India for non resident?***

- Covers any payment (except salaries) to non resident
- No threshold limit – Once sum paid is "chargeable to tax"
- Since non resident may opt to be governed by treaty provisions/DTAA entered by India- Deductor to be familiar with DTAA and Their Interpretation – **Multi Dimensional**

- Situs of Payment apparently immaterial, if payee non resident ?

2. Payee – Non resident covers:

a) Branch/PE of Non resident Assessee CBDT Circular No 20/3-1-1961 – (foreign bank branch – practical way out – branches obtain 195(3) certificates)

b) Non Corporate Payees

c) Payment to agent of non resident (SC Narsee 35 ITR 134) – distinguished in Chd ITAT 33 DTR 469 – power of attorney holder of non resident selling property) – IF VENDOR OF PROPERTY NON RESIDENT – PURCHASER TO APPLY SECTION 195 113TTJ 863 (Bang)

d) Whether covers resident but not ordinarily resident as payee u/s 195? Seems No

e) Payment by branch to HO/another branch abroad whether payment by a "person" to a "payee" u/s 195? – 5 Member Special Bench ITAT Pending in **Sumitomo Mitsui Banking Corp (others incl 97 ITD 89 Kol ITAT SB ABN Amro; Mum ITAT Dresdner Bank; British Bank at 108 ITD 375; 19 SOT 730)**

3. Payments Covered: Issues

- Stated Interest should be chargeable to tax in India

- Payment in Kind – APHC in 265 ITR 644 (hire charges paid in the form of "fishes") **APPROVED BY SUPREME COURT OF INDIA IN 7/7/2010 ORDER**

- Remuneration to Non resident Partners (in case partners are carrying activities outside India for firm's business – could be argued that same is not chargeable to tax in India…)

- Award amount under court rule: DHC 127 DLT (2006) 401 = Held not applies ; same by BHC in 265 ITR 254

- Income Tax Refund- Interest Thereon- Yes 195 applies (but classification dispute whether covered u/art 12 Interest income or is covered under business income (max. rate)- Held by Del ITAT in Pride Foramer 116 TTJ 369 covered u/art 12 @ 10%

- Payment of Advance : In NR Payee follows accrual system- possible view- no chargeable income arises so as to attract TDS u/s 195 (However refer contra observations in AAR at 267 ITR 727)

- Void Agreements Payment – Delhi ITAT in Ericsson 81 ITD 77 – no TDS applies

- Constructive Payment – eg payment to NR adjusted from other proceeds – Covered Mum ITAT in 86 ITD 791 – SC J.B.Boda applied 223 ITR 271 (refer Special Bench of Mumbai ITAT in Mahindra and Mahindra)

- Some treaties creates chargeability at satisfaction of "payment" of Royalty etc- Whether tds arises at the time of provision or at payment stage (where chargeability gets completed) divided views – AAR (adverse) in 267 ITR 727 ; Mum ITAT 96 TTJ 765 (fav)

- Where regulatory approval required whether TDS liability arises before approval stage? Adverse views in Kar HC in United Breweries Ltd 211 ITR 256 (fav views in BHC in 259 ITR 391 & 249 ITR 141)

- Adhoc – Provision – Whether attracts TDS liability? Refer SC in 48 ITR 1 ; 55 ITR 699; - Kanga Palkivala etc- Possible view TDS liability is attracted when service provider etc can claim payment of amount credited)

4. Concessional TDS Certificate by Payer application u/s 195(2)- no format;

- whether also can be made for NIL withholding ? Contrary decisions in 113 ITD 85 (YES) ; 81 ITR 162; 28 TTJ 425 (NO) – Better view : YES

- whether for all phases of work – separate certificate is required? Held Yes in 113 ITD 85
- Appeal against order u/s 195(2) – by payer/deductor- where tax to be borne by it- U/section 248 (whether must that there is an order u/s 195(2)..?)

- Whether revision u/s 263 possible for 195(2) order? Yes as per 97 TTJ 751 till remittance power u/s 263 can be exercised

- However, deductor de-hors section 248 can appeal against orders passed on it u/s 201 as per section 246A(1)(ha)

5. Certificates on behest of Payee u/s 195(3) and/or 197

- Classical Writ Rulings of Bombay High Court in McKinsey & L&T cases:

Held in Mc Kinsey cases: denial of certificate u/s 195(3) mechanichally is subject to correction in Writ jurisdiction (as also refer BHC Diamond Services case – writ allowed on make available etc in India Singapore DTAA on adverse 197 certificate 304 ITR 201)

Held in Mc Kinsely : 197 determination constitutes order for making revision u/s 264 to CIT (also in L& T case) ; in case AO u/s 197 ignores earlier 264 favorable order – Writ possible & allowed (as not necessary that all remedies are exhausted)

- Whether AO at 197 stage required to examine all facts including whether or not PE exists? Yes as per DHC 200 CTR 262]

- Incorrect 197 certificate unless cancelled/revoked- binding on revenue- Bang ITAT Bovis Lend case (applied 246 ITR 254; 155 ITR 476)

- Bang ITAT intel 2/4/2009 order in ITA 71/2009: Held : deductor cannot be supposed to deduct tds in respect of adjustment if any made by AO in respect of income tax assessment of deductee

Whether 264 FAVORABLE order over 197 application is binding on AO in assessment of deductee? Seems to be NO

6. **Reimbursement of Expenses:** Whether TDS attracted u/s 195? Documentation important; to ensure same is on actual: Refer

- Guj High Court ruling in the case of SCARLET DESIGNS PVT LTD TAX APPEAL No. 1849 of 2008;

- Delhi ITAT Grand Prix 34 DTR (Del)(Trib) 248; *Expeditors International 118 TTJ 652;*
- *Bang Bench in International Airport Ltd 116 ITD 446;*
- Krupp Udhe *GMBH INCOME TAX APPEAL NO.2626 OF 2009*
- *CIT vs Siemens Aktiongesellschaft 310 ITR 320 (Bom)*
- *Information Architechts BHC*
- *Tekmark Global Solutions LLC Mum ITAT ITA No. 671/Mum/2007 February 23, 2010*

7. **Payment to foreign shipping company / its agent:**

Income from shipping is governed by section 172. The section applies notwithstanding anything contained in any other provision of the income tax act. Section 172 is a self contained code. The non-resident shipping company has to pay tax at the prescribed rate within 30 days of the departure of the ship. The master of the vessel has to arrange for payment of tax. Only then does he get the clearance for departure.

The payment by Indian residents can be made to the shipping company or the agent. CBDT has issued a circular No. 723, dated 19-9-1995 stating that tax has to be paid in terms of section 172. Section 195 has no application. Therefore no tax has to be deducted at source as the master of the ship has to make arrangements for the tax payment before the departure

8. Practical Case Studies:

a) **Reimbursements to Group Co:** An issue came up before the Hon'ble Delhi Bench of the Tribunal as to applicability of sec.195 to payments which are reimbursement of expenditure to a non-resident. Assessee-company reimbursed expenses to a non-resident-Hong Kong company (HK) towards service charges of consultancy agency incurred by HK company. This was done to bear expenses for bidding a contract for operating GSM based

cellular services in India. It was argued by the assessee that the payment to non-resident did not include any element of income. Hence, provisions of sec.195 should not apply. HK company being one of the consortion partners took the lead of preparing pre-bid documents. However, it did not have necessary expertise to do the same. It engaged services of a consultancy firm in HK and got the job done. Assessee-company reimbursed its share of such consultancy part by HK. Revenue argued that the remittances are to be treated as payment of technical services fee. However, the transaction between assessee and HK is reimbursement of expenses simplicitor. Therefore, it was held by the Hon'ble Tribunal that sec.195 has no application. ACIT vs. Modicon Network (P) Ltd. (2007) 14 SOT 204 (Delhi).

(**Applied by Bang ITAT in CGI INFORMATION SYSTEMS & MANAGEMENT CONSULTANTS PVT LTD on software cost reimbursement; for costs contributions refer E&Y Advance ruling; HMS Real Estate advance ruling; Case of M/s. Invensys Systems Inc. USA Applicant (no technical services involved etc) ; Advance Ruling in ABB Ltd; Held the reimbursement of research and development ("R&D") expenses under Cost Contribution Agreement ("CCA") is not liable to tax in India.**)

b) Training Fees: ITAT ruling in Lloyds Register Industrial Services (India) Pvt. Ltd Mumbai Bench of ITAT

… in the case before us surveyors were highly technically qualified but such persons may need to learn practical aspects of examining various electrical and other equipments Such training in our view is a continuous process because technology is changing very fast and one needs to keep touch with such technology and therefore, expenses incurred towards training cannot be termed as "fee for technical services". In any case, the case before us major amount has been paid by way of reimbursement for boarding and lodging arrangements also for which no separate claims have been made. Therefore, according to us, the training fee cannot be termed as "fee for technical services..

c) Shares issued in discharge of revenue obligation? Whether TDS attracted? SC in EMICO.

same is not expense at all (issuance of share capital in lieu of an obligation- Delhi ITAT Ranbaxy case)

d) X Ltd hiring A Gmbh to market its product on commission basis...A Gmbh sends balance receipts after deducting its commission – whether XLtd to deduct TDS on said commission retained by A GmBH?

e) Indian entity receiving newspaper (of foreign language) – remittance of charges to foreign co for payment to newspaper (aborad)

f) Translation Services being taken by a Indian Company

g) Subsidiary Providing Outside India local support to customers of ICO – Reimbursement plus charges to Sub CO.

h) Spare Parts fit outside India by foreign vendor/job worker into Machine sent to abroad for repairs- Whether charges thereof TDS u/s 195 is attracted?

i) Normal Machine Repair Repairs – remittance abroad- TDS attracted u/s 195? Refer Jaipur Bench in Jaipur Vidyut and Delhi ITAT in Parasrampuria Synthetics (in context of section 194J – 9(1)(vii) can be applied here also; also refer Delhi ITAT Lufthansa Cargo etc)

j) Connectivity/Internet/Bandwidth Charges: Mum ITAT Kotak Mahindra Primus; DHC in Bharti Cellular; Mad HC in Skycell; AAR in Cargo Community etc

k) Payment to Fashion Designer (NR) by Indian Export House for clothes designing etc..

l) Autobiography Publication Charges abroad by an INDIVIDUAL

m) Animation by Foreign Entity of certain document/file/picture etc

n) Advertisement in Foreign Media – Charges thereof (Al Nisr Publishing , UAE [1999] 239 ITR 879 (AAR) & Speciality Magazines Pvt Ltd. [2005] 274 ITR 310 (AAR))

o) Remittance of Indian Company Incorporation expenses to Foreign Co ? Whether Pure reimbursement?

p) **Web Hosting Payments for server usage?**

q) Remittance of Gifts to person abroad?

r) TDS u/s 195 on Subscription Charges ABC Ltd in. re.:(2006) 284 ITR 1 (AAR); Dun & Bradstreet Espara S.A. (2005) 272 ITR 99 (AAR); Wipro Ltd vs ITO (2005) 278 ITR (AT) 57 (Bang) / 1 SOT 663 (Bang)/92; TTJ 796 (Bang); CIT vs HEG Ltd. (2003) ITR 230 (MP) and several other decisions.

s) SC in Cable and Wireless on 23/07/2010 (AAR/UPHELD International Half Circuit/Call Route Payment Held Not Technical Services)

9. **Refund of sums deducted: CBDT Circular no 7 of 2007 23/10/2007-** Contract cancellation (when no remittance to non resident, in case amount remitted to non resident- same is returned to payer); Subsequent exemption under law; deduction of tax twice; by mistake; higher tds rate applied when law provides lower rate, order is passed to deductor u/s 195 – giving relief in section 154;264 etc)

10. **Rates in Force**

Defined in s.2(37A)(iii) for purposes of s.195 to mean rate or rates specified in the Finance Act of the relevant year or the rates of tax specified in the DTAA, whichever is applicable, by virtue of provisions of section 90 of the IT Act; Circular No.728 dated 30.11.1995 - DTAA rates to be applied for TDS under section 195, if more favourable to the assessee

-No Surcharge/Education cess if treaty rates applied

- Section 44BB/44BBB/ section 112 application

Other Interesting Aspects:

Section 40(a)(i) cannot be applied to disallow depreciation component on "cost" capitalized in section 43(1)- Delhi ITAT in SMS Demag & SC in Nectar Beverages

Section 40(a)(i) cannot be applied to disallow expense when assessee is governed by special regime of taxation u/s 42 Cairns Energy ITA No 208/2009 Madras High Court

POSERS:

1. Whether a non resident payee in receipt of rental of Indian property by filing declaration to payer, that saying/declaring, he is only having rental income which is below "tax slab", can claim immunity from TDS? What if, if he further requests payer to take into consideration actual basis section 80C investment?

2. In case of transaction between two non residents having no presence in India, for sale/purchase of capital asset in India, if payer Non resident seeks to approach AO/TDS u/s 195(2), to which AO/TPO such jurisdiction shall lie in India?

3. Whether section 195 as such is attracted on payments by Foreign branch of Indian Company for its foreign (day to day) payment vis a vis territorial operation of section 195?

4. If AO/TDS u/s 195(2) issues a certificate u/s 195(2) holding the field for a period of time, if payer based on the same makes some payment (partly), whether AO by cancelling and issuing/revising fresh 195(2) ask the payer to withhold the tax on revised say increased rate for earlier remittances also, contending that payer is having sufficient balance in his possession, to take care off the same?

5. Whether mutuality concept can come in picture while making remittance to Non resident organization of which payer is member?

6. Whether while making remittance Indian bank (acting as agent) for sale/purchase of securities for Non resident assessee, should make compliance with Section 195 of the Act vis a vis transaction between agent and NR principal?

7. Whether after having negative/adverse 201 order in hands of payer for a foreign remittance, can non resident payee in contemplation of apprehended action in

variance with DTAA, approach under MAP/ Mutual Agreement Procedure under DTAA?

8. Whether after having negative/adverse 201 order in hands of payer for a foreign remittance, can payee approach Advance ruling authority (AAR)?