TDS on Foreign Payments Section – 195 and 206AA

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SECTION 195

Importance of Section 195

- More and More cross border payments
- Increased Revenue's attention on compliances like Form 15CA and 15CB
- Professional diligence required by CA's.
- Default consequences for Payer:
  - Demand u/s 201; Interest u/s 201(1A)
  - Penalty u/s 221 &/or 271C
  - Prosecution u/s 276B
  - Disallowance of expenditure u/s 40(a)(i)

Objectives of Section 195

- **CBDT Circular No. 152 dated 27.11.1974 - 98 ITR (St.) 19**

  *"*The object of section 195 is to ***ensure that the tax due from non resident persons is secured at the earliest point of time*** so that there is no difficulty in collection of tax subsequently at the time of regular assessment. Failure to deduct tax at source from payments to a non resident may result in loss of revenue as the non resident may sometimes have no assets in India from which tax could be collected at a later stage.

  Tax should, therefore, be deducted in all cases where it is required to be deducted under section 195 before the payment is made to the credit of the Central Government as required by section 200 of the Income tax Act read with rule 30 of the Income tax rules, 1962. Failure to do so would render a person liable to penalty under section 201 read with section 221 of the Income tax Act, and would also constitute an offence under section 276B of the Income tax Act."

- **Vodafone International Holdings B.V. v. Union of India (2012) 341 ITR 1 (SC)**

  *"*The object of Section 195 is to ensure that tax due from non-resident persons is secured at the earliest point of time so that there is no difficulty in collection of tax subsequently at the time of regular assessment."

Overview of Section 195

Section	Provisions
195(1)	Scope and conditions of applicability
195(2)	Application by the “payer” to the AO
195(3)	Application by the “payee” to the AO
195(4)	Validity of certificate issued by the AO
195(5)	Powers of CBDT to issue Notifications
195(6)	Furnish the information relating to the payment of any sum
195(7)	Power to CBDT to specify class of persons or cases where application to AO u/s 195(2) compulsory
195A	Grossing up of tax

Section 195 (1) reads as under

- **195 (1)** Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest [(not being interest referred to in section 194LB or section 194LC)] [or section 194LD] or any other sum chargeable under the provisions of this Act (not being income chargeable under the head "Salaries") shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force:

  [**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.]

Unique Features of Section 195

- Unlike personal payments exempted in section 194C, no exclusion for the same in section 195 (all payments covered excluding salaries).
- No threshold limit.
- All payers covered irrespective of legal character HUF; Individual etc.
- Covers payments made to only non residents and not RNOR's.
- Unlike other provisions in Chapter XVII (TDS provisions), section 195 uses a special phrase "any sum chargeable under the provisions of this Act"
- Multi-dimensional, as involves understanding of DTAA
- Nature of payment to be determined from payee's point of view.
- WHT not conclusive – subject to regular assessment

Chargeability to Tax

- Income-tax Act : Taxability determined as per Sec.5 read with Sec.9.
- DTAA: Section 90A(2) provides that taxability would be governed by provisions of Act or Treaty, whichever are more beneficial to the assessee.

Chargeability to tax governed by provisions of Act / DTAA		
Nature of Income	**Act***	**DTAA (OECD model)**
Business/ Profession	S.9(1)(i)	A.5 and A.7
Salary Income	S.9(1)(ii), S.9(1)(iii)	A.15
Dividend Income	S.9(1)(iv), S.115A	A.10
Interest Income	S.9(1)(v), S.115A	A.11
Royalties	S.9(1)(vi), S.115A	A.12
FTS	S.9(1)(vii), S.115A	A.12
Capital Gains	S.9(1)(i)	A.13
**Apart from S. 5, wherever applicable*		

TDS on income element or gross element?

- In Transmission Corpn. Of A.P. Ltd vs. CIT (1999) 105 Taxman 742/239 ITR 587 (SC), the Supreme Court held that unless an order u/s 195(2) has been obtained by the tax payer, tax is deductible u/s 195 on the gross sum.

- The same was followed by Karnataka High Court in the case of Samsung Electronics [2009] 185 Taxman 313 (Karnataka)/[2010] 320 ITR 209.

- However, these issues were set at rest by the landmark judgment of the Supreme Court in the case of *GE India Technology Cen. (P.) Ltd. (2010) 193 TAXMAN 234 (SC)* wherein it was held that
  - Any payments to non residents will be subject to withholding tax only when such payments are chargeable to tax in India as per Sec.4 , 5 & 9 of the Act.
  - Sec. 195 covers not only pure income payments but also composite payments.
  - The obligation to deduct tax on composite payments would be limited to the appropriate proportion of income forming part of the gross sum.

Rate of tax deduction

- Taxes to be withheld at “Rates in Force”
- For purpose of tax withholding under Section 195, ‘Rates in Force’ defined under section 2(37A)(iii) of the Act as – **Rate as per Finance Act or Rate as per DTAA, whichever is more beneficial to the assessee**.
- As per Income Tax: Surcharge and Education-cess should be added if it crosses the limit specified.
- Rates prescribed by DTAA are inclusive of all taxes . No need to add Education-cess and surcharge.
  - *DIC Asia Pacific Pte. Ltd. v. ADIT [2012] 22 taxmann.com 310 (Kolkata),*
  - *CIT vs. Arthusa Offshore Co. [2008] 169 Taxman 484 (Uttarakhand HC),*
  - *Parke Davis and Company LLC v. ACIT [2014] 41 taxmann.com 193 (Mumbai - Trib.),*
  - *Sunil V. Motiani v. ITO [2013] 33 taxmann.com 252/59 SOT 37*

Exchange Rate

- Exchange Rate Applicable (Rule 26 - TT Buying Rate)
- Exchange rate of RBI on the day on which TDS is required to be deducted has to be considered.

Other Issues

- At what point of time withholding is to be done.
  - At the time of credit or payment whichever is earlier
  - Royalty and FTS –taxable on payment basis – as per OECD MC/ UN MC

    National Organic Chemicals Industries Ltd vs [2006] 5 SOT 317 (Mumbai)

    DCIT vs Uhde Gmbh [1996] 54 TTJ 355 (Mumbai ITAT)
  - Year end provisions – right to receive whether crystallized?

- Tax withholding on 'payments in kind'? - Yes

  Kanchanganga Sea Foods vs CIT [2004] 265 ITR 644 (AP)};

  BIOCON Biopharmaceuticals Private Ltd. v. ITO [2013] TS-347- ITAT-2013-Bang (Bang)

- Payments to agents u/s 163 of non-residents – covered

  Grindlays Bank Ltd 200 ITR 441 (Cal.) (HC)

  Narsee Nagsee & Co 35 ITR 134 (Bom.)

Explanation 2 to Section 195(1)

- Inserted by Finance Act, 2012. It reads as:

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

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

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

- The obligation to comply with section 195(1) applies to all payers, whether resident or non-resident and irrespective of whether they have a place of residence or business connection or any presence in India. This amendment is primarily to overcome the Vodafone judgment

Explanation 2 to Section 195(1)

Vodafone International Holdings B.V. v. Union of India (2012) 341 ITR 1 (SC)

- With respect to section 195 of the Act, the following principles were laid by the SC:

- Whether section 195 casts an obligation on payer to deduct tax at source from payments made to non-residents which payments are chargeable to tax and, therefore, where sum paid or credited by payer is not chargeable to tax then no obligation to deduct tax would arise - Held, yes

- *Whether section 195 would apply only if payments are made from a resident to non-resident and not between two non-residents situated outside India - Held, yes*

- Whether where there was a transaction of 'outright sale' between two non-residents of a capital asset (share) outside India and moreover, said transaction was entered into on principal to principal basis, no liability to deduct tax at source arose under section 195 - Held, yes

Way Forward???

Summary

Who is responsible to deduct TDS	**- Any person - as defined u/s 2(31)** **- Includes virtually everyone**
Payment made to non resident	- Includes all non- resident having presence in India or not
Determine-Status of NR	- Under sec 6 - In case of dual residence and if tie breaker - DTAA is applied
Payment covered	- Any sum chargeable under the Act - Except Salary and dividend referred u/s 115O
At what time TDS has to be Deducted	At the time of credit or payment whichever is earlier.
Rate of TDS	Relevant rate in force Sec. 2(37A)(iii)

Section 195(2)

Application by the <u>Payer</u> to the AO for determining appropriate portion of sum chargeable

- S. 195(2) – Requirement to apply to AO for determination of appropriate portion of sum chargeable to tax.
  - Plain paper application
  - amount chargeable to tax and **<u>not</u>** the rate of tax.

- AO cannot grant total exemption - Graphite Vicarb India Ltd vs ITO 28 TTJ 425 (Cal.)

- Is it obligatory to approach AO for non-withholding of taxes?
  - GE Technology Case
  - Instruction No. 02/2014 of CBDT dated 26.02.2014

- Revision of order u/s 263/264 possible. {Board of Control for Cricket in India vs DIT [2005] 278 ITR 83 (Mum ITAT)}

Section 195(3)

Application by the Payee to the AO for determining appropriate portion of sum chargeable

- Payee who is eligible as per the conditions in Rule 29B can make an application
- For Nil deduction certificate
- Rule 29B
  - Assessee has been regularly assessed to tax and has filed all returns of income due as on the date of filing of application;
  - Not in default in respect of any tax interest, penalty, fine, or any other sum;
  - Not subjected to penalty u/s 271(1)(iii);

Section 195(4) and 195(5)

- **Sec 195(4)- Validity of Certificate**

  A certificate granted under sub-section(3) shall remain in force till the expiry of period specified therein or, if it is cancelled by the Assessing Officer before the expiry of such period, till such cancellation.

- **Sec 195(5)- Power of CBDT to issue notification**

  The Board may 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) with the specified conditions.

Comparison – Application to AO

Particulars	195(2)	195(3)	197
Application by	Payer	Payee (subject to Rule 29B)	Payee
Purpose	To determine appropriate withholding **rate** for a specified Payment	For claiming **'Nil'** withholding rate for a specified receipt	For claiming **'Nil'/lower** rate of withholding for all receipts
Applicability	Applicable to specified payments	Applicable to specified receipts	Applicable to all receipts
Whether appealable?	Appeal u/s 248 denying liability to deduct tax after payment of tax	No appeal	No appeal
Whether revisable u/s 263 or 264	Yes	Yes	Yes
In all the above cases, unlike CA Certificate issued in Form 15CB, no interest or penalty is leviable in case the Assessing Officer takes a contrary view at the time of assessment proceedings.			

Section 195(6) – As amended w.e.f. 01-06-2012

- Amended provisions of section 195(6) read as under:

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

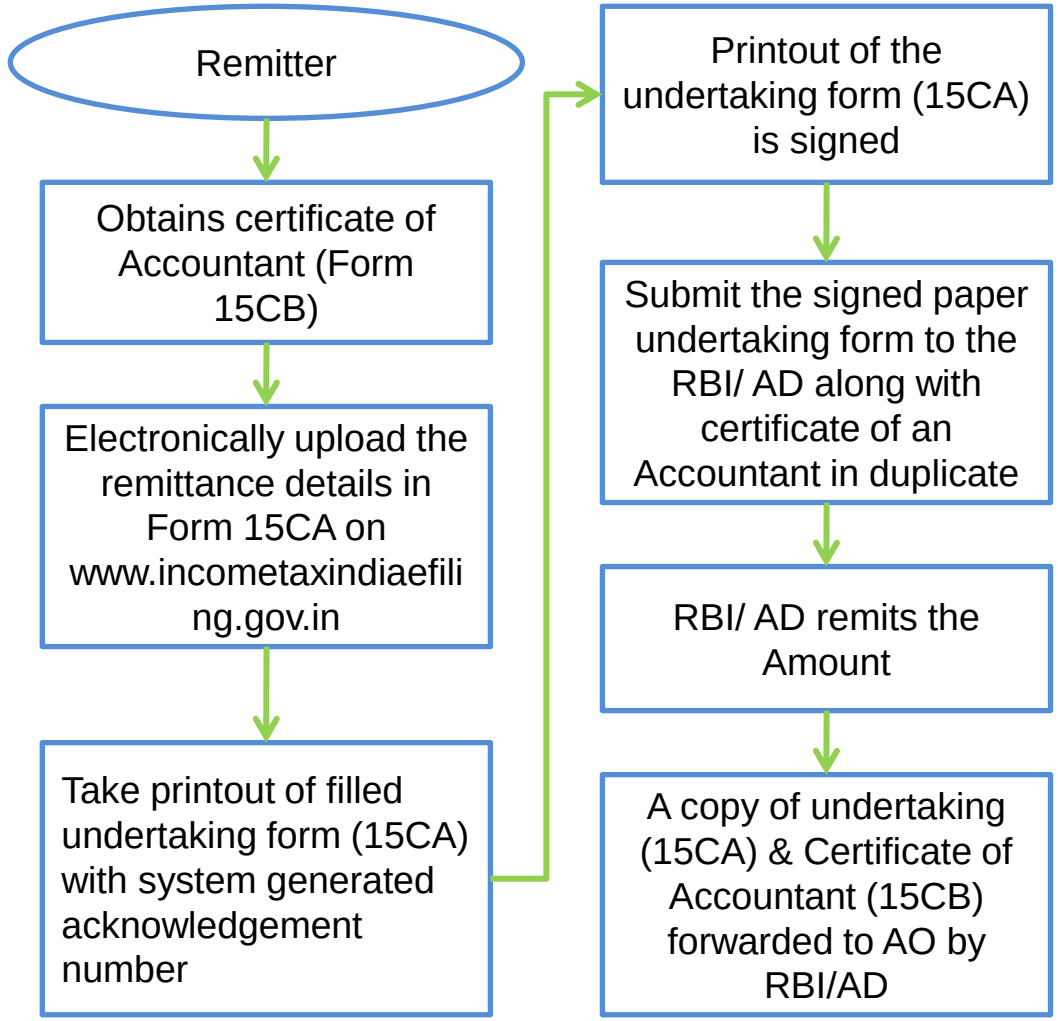
- Provisions of Rule 37BB continues to read as under:

  *"Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest or salary or **any other sum chargeable to tax** under the provisions of the Act, shall furnish the following, namely….."*

Section 195(6) read with Rule 37BB

- Only taxable remittance required to be reported in Form 15CA – *Call needs to be taken basis the Bank's requirement and amount involved*.
- Obtaining Form 15CB not required if, taxable remittance are covered by Part A of new Form 15CA – sum remitted does not exceed Rs 50,000 per transaction and aggregate of such payments does not exceed Rs 250,000 during the year.
- For other sums, 15CB required by CA.
- Form 15CA is mandatorily required by to be digitally signed by the person competent to sign the tax return.

Procedure – Form 15CA and 15CB (Circular 4/2009)



1. Every remittance required to follow procedure even if not chargeable to tax in India
2. Requires the payer to provide PAN of the non resident
3. Form 15CB need not be filed with the tax department – information requirement is same as Form 15CA

Documentation by CA (Indicative)

- **From Payer**
  - Agreement and Invoices
  - Payment Details
  - Relevant Correspondences
  - Technical Advise
  - Remitting bank details
  - Tax Residency Certificate

- **From Payee**
  - No PE Declaration (May be mentioned on Form 15CB if based on decleration);
  - Tax Residency Certificate;
  - Beneficial Owner;
  - Treaty Entitlement;
  - Indemnification for above;
  - Proposed Period of Stay

CA certificate in Form 15CB

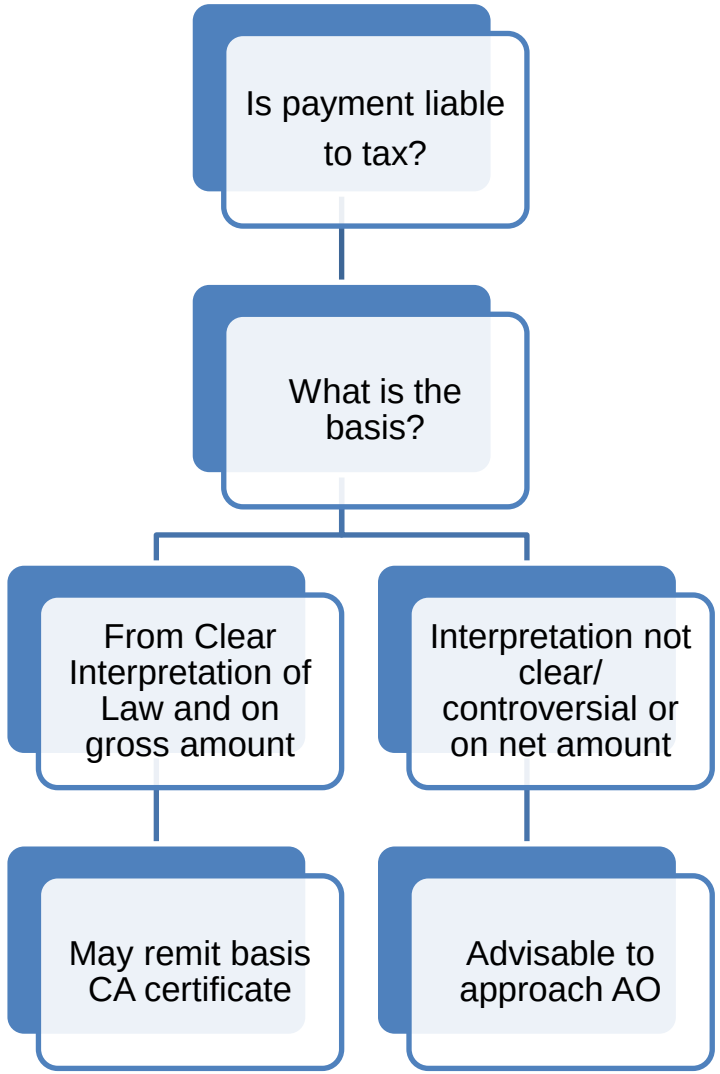
- Whether CA certificate is an alternate to Section 195(2)?

  Mahindra and Mahindra Ltd vs ADIT – 106 ITD 521 (Mum ITAT)

  - Chartered Accountant's certificate is not in substitution of the scheme of things envisaged under section 195(2) of the Act, but merely to supplement the same.
  - The certificates issued by the chartered accountants have no role to play so far as determination of withholding tax liability is concerned. These certificates cannot, and do not, impose any tax deduction liability on the assessee-tax deductors.
  - CA Certificates are not appealable u/s 248 to CIT(A) as these certificates are not issued by any legal authority but by an independent professional.

- CA Certificate – Consequences of non-deduction short deduction would follow. Possibility of claiming relief from penalty.

Summary


Is payment liable to tax?
What is the basis?
From Clear Interpretation of Law and on gross amount
Interpretation not clear/ controversial or on net amount
May remit basis CA certificate
Advisable to approach AO

Section 195(7)

- Sub. sec (7) was inserted by Finance Act, 2012 to partially neutralize the impact of ratio of GE Technology Centre (Supra) and thereby the Board may specify a class of persons or cases where the payer has to approach AO through an application to determine proportion of sum chargeable to tax for deduction of tax accordingly.

Section 195A – Grossing Up

- Grossing up required in case of net of tax payments.
  - Payer agrees to bear the tax
  - Sec 10(6A) amended w.e.f 01/04/2003 hence grossing up to be done.
  - Does not apply when profits of non resident covered by presumptive provisions – sec 44B, 44BB, 44BBA & 44BBB etc. – CIT vs ONGC 264 ITR 340 (Uttaranchal) (HC)

SECTION 90(4) Tax Residency Certificate

Section 90(4)

- Section 90(4) reads as:

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

- Section 90(5) reads as:

  "The assessee referred to in sub-section (4) shall also provide such other documents and information, as may be prescribed" – **Form 10F**

Section 90(4) read with Rule 21AB

- Rule 21 AB:
  - Specifies particulars to be prescribed under section 90(5)
  - Details not covered in TRC to be mentioned in Form 10F
  - 10F is on self attestation basis.
- All non residents to submit TRC – irrespective of nature of entity, even individuals.
- TRC issued for specific period of time. Validity to be checked at the time of deduction of tax.
- Requirement of TRC – if treaty benefit not availed?

SECTION 206AA

Section 206AA

1) ***Notwithstanding*** *anything contained in any other provisions of this Act, any person entitled to receive any sum or income or amount, on which tax is deductible under Chapter XVIIB (hereafter referred to as deductee) shall furnish his Permanent Account Number to the person responsible for deducting such tax (hereafter referred to as deductor), failing which tax shall be deducted at the* ***higher*** *of the following rates, namely:—*

(i) *at the rate specified in the relevant provision of this Act; or*

(ii) *at the rate or rates in force; or*

(iii) *at the rate of twenty per cent.*

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

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

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

Section 206AA

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

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

Applicability in the absence of TDS liability

- *Section 206AA uses the term 'any person entitled to receive any sum or income or amount, on which tax is deductible under Chapter XVIIB'*
- *Thus,* section 206AA should be applicable only if tax is liable to be deducted from income under consideration.
- If the income under consideration is not chargeable to tax, the payee/deductee is not required to furnish his PAN to the payer/deductor.
- Chargeability of income tax and WHT are very essential for applicability of section 206AA.
- The Karnataka High Court in case of **A. Kowsalya, Parvathamma, Sarvamangala [Writ petitions 12780 12782 / 2010 (T)]** held that WHT rate of section 206AA cannot be applied if payments are below exemption threshold of individual payees.

Interplay between section 206AA and section 90(2)

- Section 90 of the Act has empowered the Central Government to enter into agreement with the Government of any country outside India for avoidance of double taxation.

- Section 90(2) provides that, if the provisions of such DTAA are applicable to a non-resident, then the same would apply if they are more beneficial as compared to the provisions of the Act. **Circular No. 333** dated April 02, 1982 issued by the CBDT confirm the same.

- CBDT **press release** dated January 20, 2010, bearing number 402/92/2006 MC (04 of 2010) provided hereunder:

  "1. A new provision relating to tax deduction at source (TDS) under the Income tax Act, 1961 will become applicable with effect from 1st April, 2010. Tax at higher of the prescribed rate or 20 per cent will be deducted on all transactions liable to TDS, where the Permanent Account Number (PAN) of the deductee is not available. ***The law will also apply to all nonresidents in respect of payments/remittances liable to TDS.****..*

  2. …All deductors are, therefore, advised to intimate their deductees to obtain and furnish their PAN so as to avoid TDS at a higher rate. 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..."

View emerging

- Section 206AA is a machinery provision.

- The section only increases tax withholding rate. It does not increase the tax liability of the payee. Payee can obtain PAN, file the return of income and claim refund of excess taxes deducted. Hence, in effect there is no increase in tax liability by way of an unilateral provision of section 206AA.

Key Issues

Surcharge and Education cess is inclusive of 20% WHT rate?

- Section 206AA provides for flat rate of 20%
- Section 2 of the Finance Act, which provides the applicability of surcharge and education cess, does not include section 206AA.

What rate of tax to be applied in case of grossing up of contract

- Position can be taken that grossing up could be made at the "rate is force" and not the rate as arrived at under the provisions of section 206AA of the Act - Hon'ble Bangalore ITAT in case of Bosch Ltd. Vs ITO (ITA No. 552 to 558/2011)
- However, terms of the contract between the parties and the recent requirement of filing of return by the foreign companies may be critical to take a position.

Whether tax should be deducted @ 20% OR @ 25% in the years when the rate in section 115A(1) was 25%

- Between the three terms prescribed in section 206AA, section 195 does not specify any rate for tax withholding. It refers to 'rates in force'
- Rates in force as defined in section 2(37A)(iii) refers to rate as per relevant Finance Act or tax treaty rate whichever is beneficial

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