



# Section – 195 and Overview of tax treaties

*North Ex CA Study Circle*

**By: CA. Divya Mittal**  
**JDM & Associates**

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## SECTION 195

# 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*



# DOUBLE TAXATION AVOIDANCE AGREEMENT

# Tax Treaty – Meaning and objective

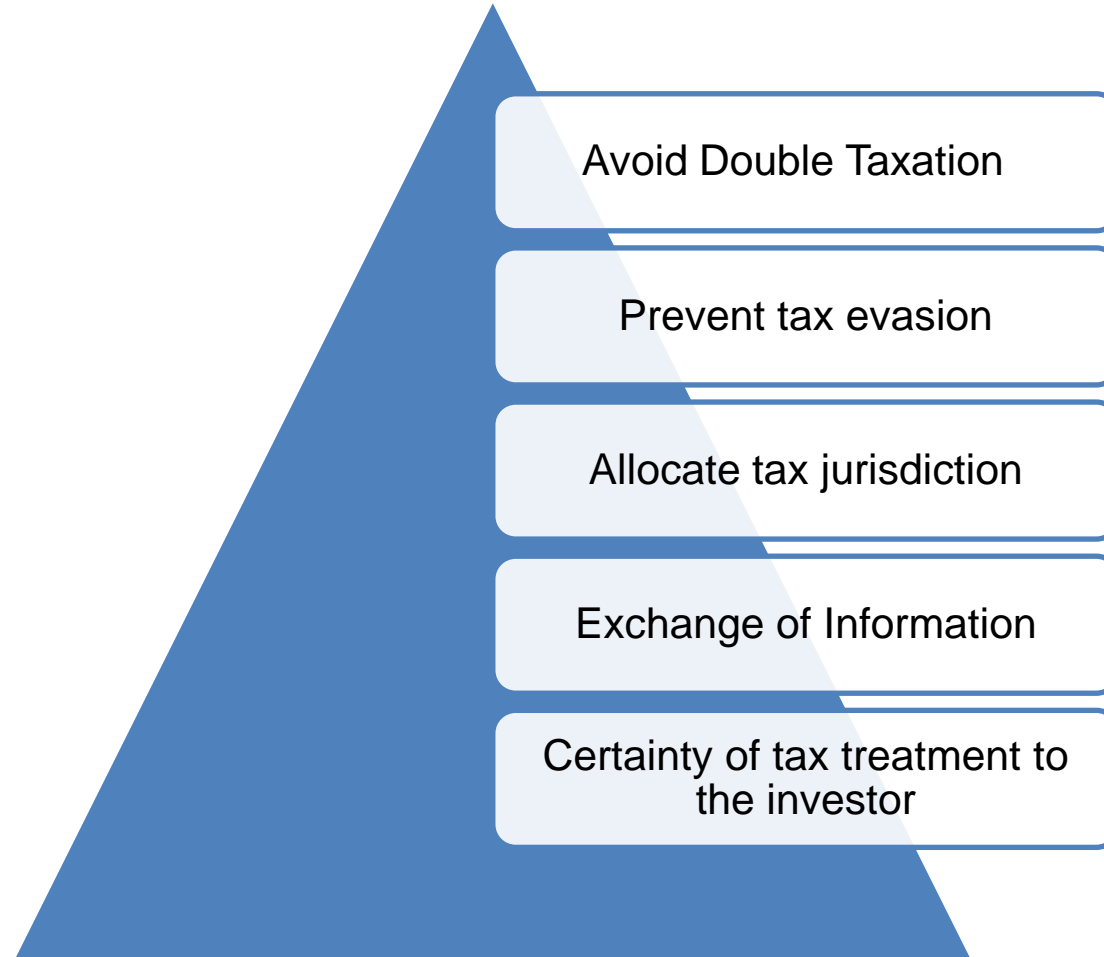
- ❑ A tax treaty is a formally concluded and ratified agreement between two independent nations (bilateral treaty) or more than two nations (multilateral treaty) on matters concerning taxation.

## Types

- ❑ **Limited Treaties** – which cover
  - A. Income from operation of aircraft and ships
  - B. Estates
  - C. Inheritance
  - D. Gifts
- ❑ **Comprehensive Treaties** - which are wider in scope addressing all sources of income



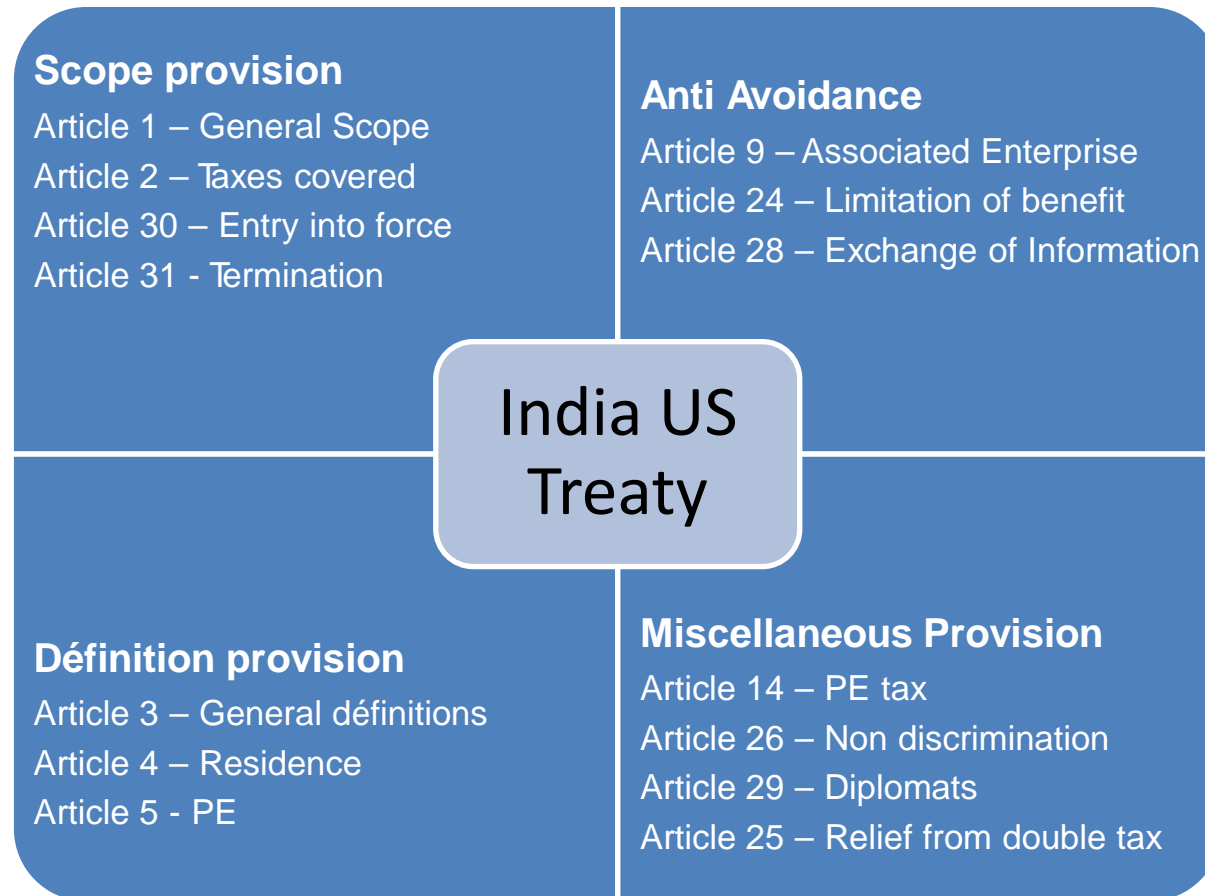
# Tax Treaty – Objective



# Treaty Position in India

- ❑ India presently has tax treaties with 88 countries out of which 85 are presently in force.
- ❑ Section 90(1) of the Income-tax Act, 1961 authorizes Central Government to conclude tax treaties
- ❑ Section 90(2) of the Income-tax Act, 1961 provides that taxability would be determined on the basis of the provisions of the Act or the provisions of the DTAA, whichever is more beneficial.
- ❑ Section 91 provides unilateral relief to cover countries with which no treaty has been signed.

# Articles of India-USA Tax Treaty



## SUBSTANTIVE PROVISIONS

1. Article 6 - Immovable property
2. Article 7 - Business Profits
3. Article 8 - Shipping, etc
4. Article 10 - Dividends
5. Article 11 - Interest
6. Article 12 - Royalties & FIS
7. Article 13 - Capital gains
8. Article 15 – Independent personal Service
9. Article 16 - Dependant personal Service
10. Article 17 - Directors
11. Article 18 - Artists & Sports persons
12. Article 19 - Pensions
13. Article 20 - Government service
14. Article 21 – Students
15. Article 22 – Professors
16. Article 23 - Other income

# Prominent Articles – A Discussion

# Scope Provisions

- ❑ **Article 1 – Applicability:** Applies to a person who is resident of one or both the countries.
- ❑ **Article 2 – Taxes Covered:** Indian tax or US tax, does not include interest or penalty
- ❑ **Article 30 – Entry into force:** This article tells when and how a DTAA becomes operative
- ❑ **Article 31 – Termination:** This article tells when and how a DTAA can be terminated

# Definition Provisions

- ❑ **Article 3 – General Provisions:**
  - ❑ *Person*
  - ❑ *Company*
  - ❑ *Contracting State*
  - ❑ *Enterprise of a Contracting State*
  - ❑ *Competent Authority*
  - ❑ *National*

*Undefined Terms – Meaning to be as defined under the domestic tax laws applicable to the taxes covered in the treaty.*

# Definition Provisions

- ❑ **Article 4 – Residence:** A person is a resident of country if he is liable to tax in that country by reason of:
  - ❑ *Domicile*
  - ❑ *Residence*
  - ❑ *Citizenship*
  - ❑ *Place of Management*
  - ❑ *Place of Incorporation*
  - ❑ *Any other criteria of similar nature.*
  
- ❑ **Tie breaker Rules:**
  - a. *in which he has a permanent home available to him;*
  - b. *with which his personal and economic relations are closer (centre of vital interests);*
  - c. *in which he has an habitual abode;*
  - d. *of which he is a national.*
  
- ❑ *Where above rule fails, Competent Authority to decide.*

# Definition Provisions

- ❑ **Article 5 – Permanent Establishment:** PE means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
  
- ❑ **Inclusions**
  - ❑ Place of Management
  - ❑ Branch
  - ❑ Office
  - ❑ Factory/ Workshop
  - ❑ Service PE: Furnishing of services through employees or other personnel, other than included services for a period aggregating 90 days within any twelve month period or even for a single day for a related enterprise;
  - ❑ Construction PE: Construction, installation, assembly project or supervisory activities for a period of more than 120 days within any twelve month period;
  - ❑ Agency PE: Dependent agents (extends to agents securing orders also), etc.



# Definition Provisions

- ❑ **Article 5 – Permanent Establishment (Contd):**

- ❑ **Exclusions**

- ❑ A fixed place for the purpose of *advertising or for preparatory and auxiliary activities* or for purchase of goods and merchandise;
  - ❑ *Independent agents* acting in ordinary course of their business, etc.

# Substantive Provisions

## ❑ **Active and Passive Income**

### ❑ **Passive Income**

Refers to income derived from investment in tangible and intangible assets.

Eg:

- Dividend
- Interest
- Royalties
- Capital Gains

### ❑ **Active Income**

It is the income derived from carrying on active cross border business operations or by personal efforts and exertion as in case of employment.

# PASSIVE INCOMES - DISTRIBUTION OF TAXING RIGHTS

Article Ref.	Nature of Income	Taxing Right of Source State	Taxing Right of State of Residence	Remarks
6	Income from Immovable Property	Also has the right to tax. No restriction on rate.	<b>Reserves the right to tax</b>	
10	Dividend Income	<b>Has the right to tax provided rate does not exceed the agreed rate of tax as per DTAA</b>		Dividend is not taxable in India. DDT is levied upon the company declaring dividends
11	Interest Income			
12	<b>Royalties and Fees for Technical Services</b>			
13	Capital Gains	Also has the right to tax. No restriction on rate.		Tax can be determined as per the domestic law

# ACTIVE INCOMES - DISTRIBUTION OF TAXING RIGHTS

Article Ref.	Nature of Income	Taxing Right of Source State	Taxing Right of State of Residence	Remarks
19	Pensions	Cannot tax pension	Can tax pension	
7	<b>Business Profits</b>	<b>Yes, if PE exists in the source state</b>	<b>Reserves the right to tax</b>	<b>Income attributable to PE alone can be taxed in source state</b>
8	Shipping & Air Transport	Cannot tax this income		
15	Independent Personal Services	Yes, if the person has a fixed or his stay extends beyond 90 days		Income attributable to Fixed Base alone can be taxed in source state. Professionals.
16	<b>Dependent Personal Services (Employment)</b>	<b>Yes if employment is exercised in the source state. Cannot tax if stay is less than 183 days</b>		<b>If salary is paid on behalf of foreign employer and is not borne by PE, then source state cannot tax the salary</b>

# ACTIVE INCOMES - DISTRIBUTION OF TAXING RIGHTS

Article Ref.	Nature of Income	Taxing Right of Source State	Taxing Right of State of Residence	Remarks
17	Director's Fees	Yes, the source state can tax the same	<b>Reserves the right to tax</b>	
18	Artiste & Athletes	Yes, the source state can tax the same		DTAA may specify the extent to which the income may be exempt
19	Government service Remuneration	No, unless the person rendering service happens to be a resident of and national of the source state		
21	Students & Apprentices	No taxing rights		
23	Other Income	Yes, the source state can tax the same		

# ANTI AVOIDANCE AGREEMENTS

Article Ref.	Nature of Income	Taxing Right of Source State	Remarks
9	Associated Enterprises	Adoption of <u>Arms Length Price</u> in transactions between Associated Enterprises	
28	Exchange of Information		
27	Assistance in collection of taxes	Both the contracting states shall assist each other in collection of revenue claims	

# ELIMINATION OF DOUBLE TAXATION

- ☐ **Can be by way of following methods:**

- ☐ The Exemption Method

- ☐ Full Exemption

- ☐ Exemption with progression – foreign sourced income included only to compute average rate of tax

- ☐ Foreign tax credit Method

- ☐ Full Credit – As it is.

- ☐ Ordinary Credit – Restricted to tax on doubly sourced income.

- ☐ Tax Sparing Credit

# TAX SPARING CREDIT

- ❑ Income exempt in State S as a measure to promote economic development therein (eg special economic zones)
- ❑ Income taxable in State R but State R provides for deemed tax exemption or deemed tax credit of taxes so exempted by State S too
- ❑ Domestic tax laws of countries generally do not provide for tax sparing credit
- ❑ Some treaties provide for tax sparing credit like India-Mauritius tax treaty; India-Singapore tax treaty
- ❑ OECD Model Convention 2008
- ❑ Generally attached to income like dividend, interest, royalties, foreign branch / permanent establishment income
- ❑ May provide for equal to or less than the State S tax waived (eg India-Cyprus tax treaty limits tax sparing credit on interest at 10 percent)



# TAX SPARING CREDIT - EXAMPLE

Tax liability	Tax sparing credit absent (INR)	Tax sparing credit exists (INR)
State R (Income INR 100,000) # 50 percent on 100,000	50,000	50,000
State S (Income INR 20,000) # Normal rate 40 percent # Special rate 10 percent (30 percent exempted)	2,000	2,000
Tax credit # Tax Credit (tax charged in State S) # Tax Sparing credit (tax exempted in State S)	2,000 -	2,000 6,000
Total Tax Credit	2,000	8,000
Net tax liability in State S	48,000	42,000

# Applying Tax Treaties

Step 1

- Does the Treaty Apply?

Step 2

- What is the nature of Income?

Step 3

- Determine which Article applies?

Step 4

- How are the taxation rights assigned?

Step 5

- How is the income calculated?



## Form 15CA and 15CB

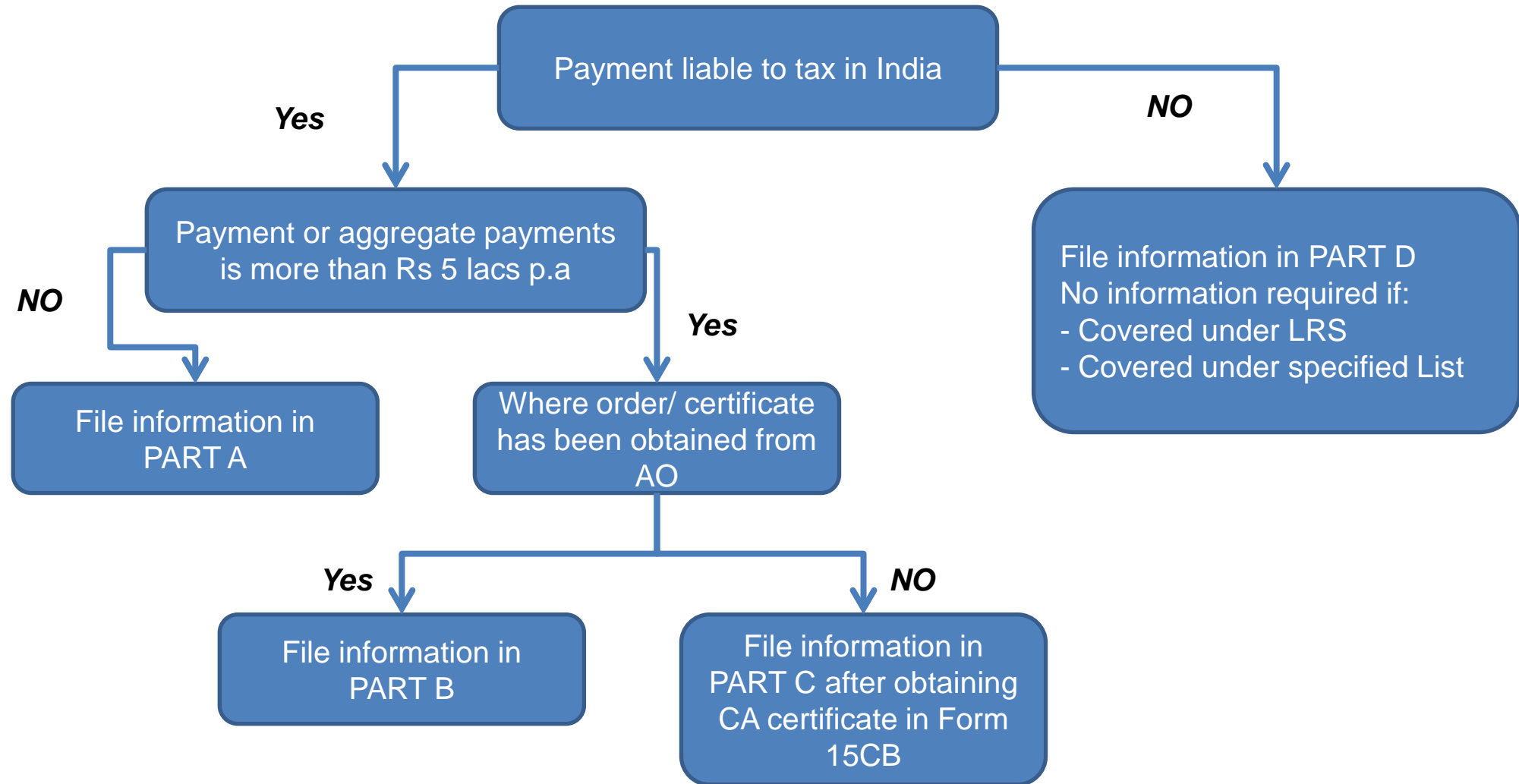
# Section 195(6) – As amended w.e.f. 01-06-2012

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

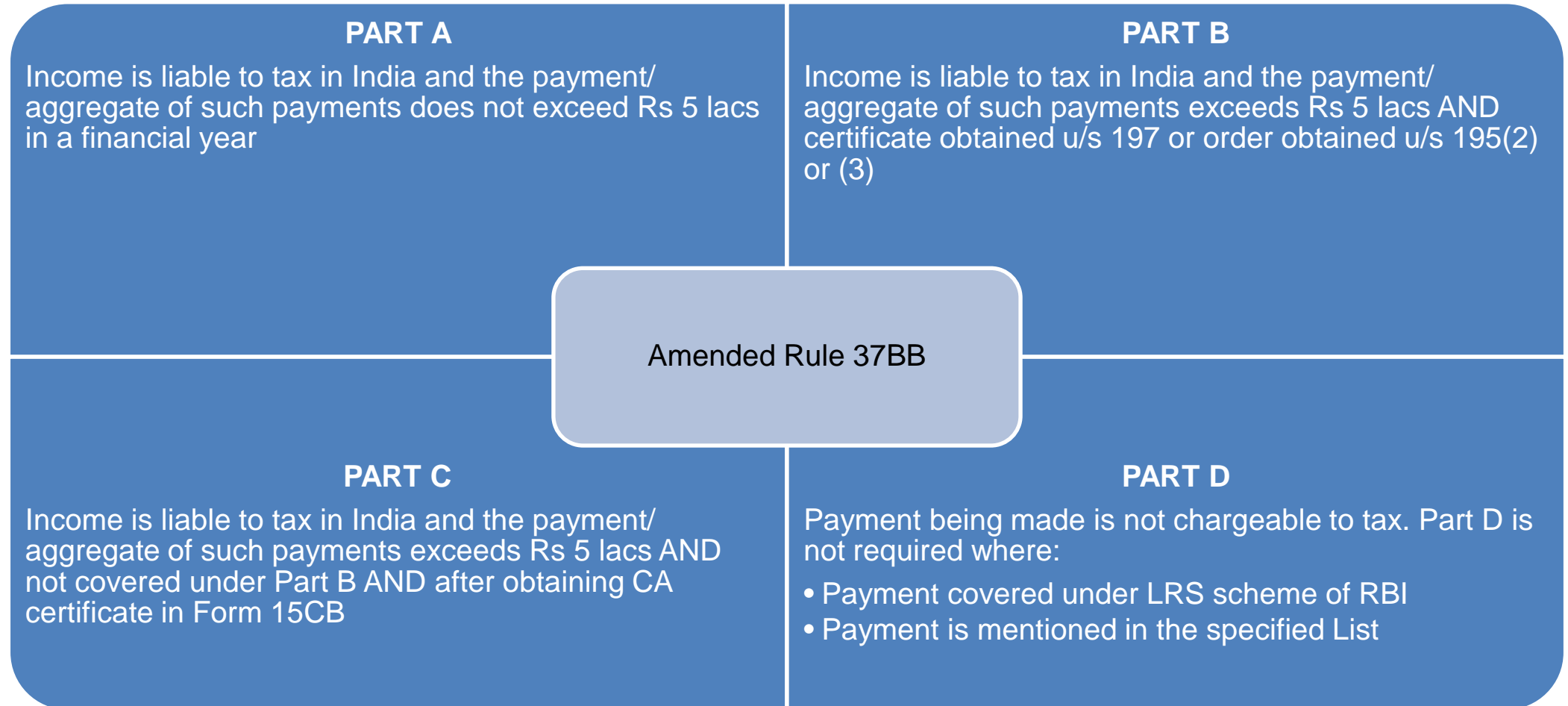
*“The person responsible for paying to a non-resident, not being a company, or to a foreign company, **any sum, whether or not chargeable under the provisions of this Act**, shall furnish the information relating to payment of such sum, in such form and manner, as may be prescribed.”*

- ☐ Provisions of Rule 37BB – as amended w.e.f. April 1, 2016 :
  - ☐ The furnishing of information for payment to a non-resident
    - ☐ not being a company, or
    - ☐ Foreign company
  - ☐ In Form 15CA has been classified into 4 parts- Part A, Part B, Part C and Part D.

# Amended Rule 37BB – w.e.f. 01<sup>st</sup> April 2016



# Amended Rule 37BB – w.e.f. 01<sup>st</sup> April 2016



# Specified List

Sl. No.	Purpose code as per RBI	Nature of payment
1	S0001	Indian investment abroad-in equity capital (shares)
2	S0002	Indian investment abroad-in debt securities
3	S0003	Indian investment abroad-in branches and wholly owned subsidiaries
4	S0004	Indian investment abroad-in subsidiaries and associates
5	S0005	Indian investment abroad-in real estate
6	S0011	Loans extended to Non-Residents
7	S0101	Advance payment against imports
8	S0102	Payment towards imports-settlement of invoice
9	S0103	Imports by diplomatic missions
10	S0104	Intermediary trade
11	S0190	Imports below Rs.5,00,000-(For use by ECD offices)
12	S0202	Payment for operating expenses of Indian shipping companies operating abroad.
13	S0208	Operating expenses of Indian Airlines companies operating abroad
14	S0212	Booking of passages abroad - Airlines companies
15	S0301	Remittance towards business travel.

# Specified List

Sl. No.	Purpose code as per RBI	Nature of payment
16	S0302	Travel under basic travel quota (BTQ)
17	S0303	Travel for pilgrimage
18	S0304	Travel for medical treatment
19	S0305	Travel for education (including fees, hostel expenses etc.)
20	S0401	Postal services
21	S0501	Construction of projects abroad by India companies including import of goods at project site
22	S0602	Freight insurance - relating to import and export of goods
23	S1011	Payments for maintenance of offices abroad
24	S1201	Maintenance of Indian embassies abroad
25	S1202	Remittances by foreign embassies in India
26	S1301	Remittance by non-residents towards family maintenance and savings
27	S1302	Remittance towards personal gifts and donations
28	S1303	Remittance towards donations to religious and charitable institutions abroad
29	S1304	Remittance towards grants and donations to other Governments and charitable institutions established by the Governments
30	S1305	Contributions or donations by the Government to international institutions



# Specified List

Sl. No.	Purpose code as per RBI	Nature of payment
31	S1306	Remittance towards payment or refund of taxes
32	S1501	Refunds or rebates or reduction in invoice value on account of exports
33	S1503	Payments by residents for international bidding.



## Fee for Included Services

# FEES FOR INCLUDED SERVICES

- ☐ Payments for rendering of any technical or consultancy services, if such services:
  - ☐ are ancillary and subsidiary to application or enjoyment of right, property, or information for which royalty is received, or
  - ☐ **make available** technical knowledge, experience, skill, know-how, or processes, or consist of development and transfer of a technical plan or technical design.
  
- ☐ Exclusions
  - ☐ Services that are ancillary and subsidiary as well as inextricably and essentially linked to sale of property;
  - ☐ Services for the personal use of individual;
  - ☐ Teaching in or by educational institutions; etc
  - ☐ to any individual or firm of individuals (other than a company) for professional services as defined in Article 15 (IPS).
  
- ☐ The definition does not include the term **'Managerial Services'**.

# FEES FOR INCLUDED SERVICES

## ☐ **What is make available?**

- ☐ Technology will be considered 'made available' when person acquiring service is enabled to apply the technology.
- ☐ The fact that the provision of the service requires 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.
- ☐ The use of a product which embodies technology shall not *per se* be considered to make the technology available.

# Illustration on Article 12

## **Example 1:**

- ☐ An Indian manufacturing company produces a product that must be manufactured under sterile conditions using machinery that must be kept completely free of bacterial or other harmful deposits.
- ☐ A U.S. company has developed a special cleaning process for removing such deposits from that type of machinery.
- ☐ The U.S. company enters into a contract with the Indian company under which the former will clean the latter's machinery on a regular basis. As part of the arrangement, the U.S. company leases to the Indian company a piece of equipment which allows the Indian company to measure the level of bacterial deposits on its machinery in order for it to know when cleaning is required.
- ☐ Are the payments for the services fees for included services?

## **Analysis:**

- ☐ Cannot be treated as Fee for Included Services

# Illustration on Article 12

## **Example 2:**

- ☐ A U.S. manufacturer has experience in the use of a process for manufacturing wallboard for interior walls of houses which is more durable than the standard products of its type.
- ☐ An Indian builder wishes to produce this product for its own use. It rents a plant and contracts with the U.S. Company to send experts to India to show engineers in the Indian company how to produce the extra strong wallboard.
- ☐ The U.S. contractors work with the technicians in the Indian firm for a few months. Are the payments to the U.S. firm considered to be payments for "included services"?

## **Analysis:**

- ☐ Classified as Fee for Included Services

# Illustration on Article 12

## **Example 3:**

- ☐ A U.S. manufacturer has experience in the use of a process for manufacturing wallboard for interior walls of houses which is more durable than the standard products of its type.
- ☐ An Indian builder hires the U.S. Company to produce wallboard at that plant for a fee. The Indian company provides the raw materials, and the U.S. manufacturer fabricates the wallboard in its plant, using advanced technology.
- ☐ Are the payments to the U.S. firm considered to be payments for "included services"?

## **Analysis:**

- ☐ Cannot be classified as Fee for Included Services - Since no technical skill is being made available.

# Illustration on Article 12

## **Example 4:**

- ☐ An Indian company purchases a computer from a U.S. computer manufacturer.
- ☐ As part of the purchase agreement, the manufacturer agrees to assist the Indian company in setting up the computer and installing the operating system, and to ensure that the staff of the Indian company is able to operate the computer.
- ☐ Also, as part of the purchase agreement, the seller agrees to provide, for a period of ten years, any **updates** to the operating system and any training necessary to apply the update. Both of these service elements to the contract would qualify under paragraph 4(b) as an included service.
- ☐ Would either or both be excluded from the category of included services, under paragraph 5(a), because they are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of the computer?



# Illustration on Article 12

## **Example 4 - Analysis:**

- ❑ The installation assistance and initial training are ancillary and subsidiary to the sale of the computer, and they are also inextricably and essentially linked to the sale. The computer would be of little value to the Indian purchaser without these services, which are most readily and usefully provided by the seller. The fees for installation assistance and initial training, therefore, are **not** fees for included services, since these services are not the predominant purpose of the arrangement.
- ❑ The services of updating the operating system and providing associated necessary training may well be ancillary and subsidiary to the sale of the computer, but they are not inextricably and essentially linked to the sale. Without the upgrades, the computer will continue to operate as it did when purchased, and will continue to accomplish the same functions. Acquiring the updates cannot, therefore, be said to be inextricably and essentially linked to the sale of the computer.

# Open House



# Contact Details

## **JDM & Associates**

411, RG Trade Tower,  
Netaji Subhash Place, Pitampura  
Delhi – 110034  
(L) 011-47038657  
(E) [divya.mittal@jdma.co.in](mailto:divya.mittal@jdma.co.in)