Recent developments with respect to Withholding Tax under section 195 on payments to Non-Residents

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Section 195 of the Income-tax Act, 1961 provides that any person (whether resident or non-resident) making payment of any sum to a non-resident which is chargeable to tax is required to deduct tax at source at the rates prescribed in the Act or the treaties whichever are more beneficial to the non-resident. This provision applies to all payments to non-residents other than salaries or interest on infrastructure bonds or interest on certain foreign exchange bonds or interest to FIIs on certain rupee denoted bonds to which separate provisions apply.

Post the landmark Supreme Court decision in the case of *Vodafone*, there have been a host of retrospective and prospective amendments with a view to tighten the process. The following amendments have been made which impact withholding tax from payments to non-residents:

1. It has been clarified w.e.f. 1-4-1961 that the obligation to deduct tax at source u/s 195 applies to every non-resident whether or not he is a resident or has a business connection in India or any other presence in India.
2. Section 90 of the Act has been amended to make it compulsory for a non-resident to produce a tax residency certificate and to obtain a PAN if he/it wants to take advantage of a DTAA.

Revised rule 37BB and Revised Forms 15CA and 15CB

In pursuance of the above amendments, rule 37BB and the the forms for issuance of the remittance certificates by Chartered Accountants have been amended to include details of tax residency certificate and PAN of the non-resident where benefit of any treaty is sought to be taken. The amended rule 37BB requires the reporting to be made only in respect of Payment of Interest, Salary or any other sum, which are taxable under the Act.

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On 5th August,2013, the CBDT issued Notification No. 58/ 2013 amending rule 37BB and w.e.f 1st October,2013 the Form Nos. 15CA and 15CB for remittances to non-residents. Soon thereafter, on 2nd September,2013, CBDT again amended rule 37BB and these forms by way of Notification No. 67/ 2013 again w.e.f 1st October, 2013.

Notification No. 67/ 2013 has given a much narrower specified list of payments (it has deleted 11 items from the 39 items specified in Notification 58/ 2013) for which Chartered Accountants Certificate would not be required. The new Specified List is reproduced below:

- Indian investment abroad in equity/ debt/ branches and wholly owned subsidiaries/ subsidiaries and associates/ real estate
- Loans to non-residents
- Operating expenses of Indian shipping/ airline companies operating abroad.
- Booking of passages abroad-airlines companies
- Business travel, travel under basic travel quota, travel for pilgrimage, medical treatment, education
- Postal services
- Construction of projects abroad by Indian companies
- Freight insurance relating to import and export of goods
- Maintenance of offices/ Indian embassies abroad
- By foreign embassies in India
- By non-residents towards family maintenance and savings
- Personal gifts and donations,donations to religious and charitable institutions abroad, grants and donations to other Governments and charitable institutions established by the Governments, donations by Indian Governments to international institutions
- Payment or refund of taxes
- Refunds or rebates on exports
- By residents on international bidding.

The following items which appeared in the Specified List as per the earlier Notification 58/ 2013 are missing in the Notification 67/ 2013 and,thus, now the Chartered Accountants Certificate may be insisted upon by Banks for these :

- Payment for life insurance premium
- Other general insurance Premium
- Payments on account of stevedoring, demurrage, port-handling charges etc.
- Freight on imports-airline companies
- Booking of passages abroad –Shipping Companies
- Freight on exports- shipping companies
- Freight on import-shipping companies
- Payments for surplus freight or passenger fare by foreign shipping companies operating in India.
- Imports by diplomatic missions
- Payments towards imports-settlement of Invoice.
- Advance payment against imports

Some of the important and noteworthy features/ changes in this regard are as follows:

i. Import Payments:

While payments for imports are considered not taxable in India in a vast majority of cases, this issue is not dealt with in the revised rule 37BB, which otherwise exempts several types of payments for reporting requirements. In fact, in the proposed rule 37BB as per Notification No. 58, the specified list consisted of import payments, thereby casting lesser obligations on such remittances. Deletions of imports from the specified list by Notification No.67/ 2013 now creates confusion.

ii. Capital gains :

The revised Form 15CB requires the sum of long term and short term capital gains to be reported along with the manner of determination of capital gains. This would imply that a Chartered Accountant can certify quantum of tax to be deducted from capital gains. This runs counter to the current interpretation of section 195(2).

As a consequence, it appears that the revised Form 15CB cast the duty of computation of capital gains income on the Chartered Accountant and a remittance/payment can be made to the payee on the basis of his certificate without making an application to the AO.

iii. Small Payments Exempted From CA's Certificate:

Small payments, not exceeding ` 50,000/- individually or aggregate ` 2,50,000/- for the financial year,to be reported in Part A of Form 15CA. Form 15CB is not required where Part A of Form 15CA is to be filled in *i.e.*,in case of small payments

Coupled with the above amendments, there have been a number of Court/Tribunal decisions interpreting section 195 as also adjudicating on some controversial issues governing taxation of non-residents. An attempt is made below to cover some of the important Court decisions dealing with this aspect:

1. Decisions dealing with interpretation of section 195:

(i) Validity of NIL withholding certificate obtained by payer from the Income Tax Authorities for payments outside India

The Hon'ble tribunal relied on the observations made by the Hon'ble Supreme Court in the case of *GE India Technology Centre (P.) Ltd.* v. *CIT* [2010] 193 Taxman 234/7 taxmann.com 18 held that as per the language employed under the Indian Income-tax Act a NIL withholding certificate can only be obtained by payee *i.e.* the recipient of the payments u/s 195(3) & payer can approach Income Tax Authorities u/s 195(2) only when he believes that only part of the payment may not be taxable. Accordingly NIL withholding certificates issued to payer is not valid as per law. [**BIOCON Biopharmaceuticals (P.) Ltd. v. ITO (International Taxation) [2013] 36 taxmann.com 291 (Bang.)**

(ii) Whether taxpayer can be treated as assessee in default u/s 201 & u/s 201(1A) for non deduction of TDS on payments to non-residents which is refunded back on cancellation of contract?

Tribunal held that once, the contract has been cancelled and the money has been received back, tax already paid for such remittance is no longer payable (as there is no income which accrues or arises in India) to the credit to the Government as per law on behalf of non-resident and accordingly assessee cannot be treated as an assessee in default. **ITO, (International Taxation) v. Sun Pharmaceutical Industries Ltd. (IT Appeal No. 6100 (Mum) of 2011, dated 10-7-2013)**

(iii) Issue of shares to non-resident against technology transfer - is such transaction liable to withholding tax in India?

The tribunal agreeing with the contentions of the tax authority held that as per the language employed in the Indian Income-tax it covers such situation when payment to non-resident is made otherwise than in money & accordingly it is chargeable to tax in India.

2. Interpretation of definition of "Royalty":

Whether payments/contributions made under Franchise Agreement and the International Sales & Marketing Agreement for marketing services outside India amounts to Royalty under India-Netherland DTAA?

The Hon'ble tribunal as per Article 12(4) of the India-Netherlands DTAA held that in order to cover any amount within the purview of "royalties" it is imperative that the payment must be a consideration for use or right to use any copyright of the literary artistic work etc. or any patent, trademark etc. (defined property) & such property should exist at the time of payment. If the payment instead helps in creation of such defined property then it can't be brought within the purview of Royalties. Accordingly, payments made towards marketing activities are in the nature of creating the defined property & not for use of existing property & consequently does not amount to Royalties. - **Dy. CIT (IT)** v. **Marriott International Licensing Co. BV [2013] 35 taxmann.com 400 (Mum.)**

3. Interpretation of definition of " Fees For Technical Services " and "make available":

(a) Whether application of "make available" clause results in absurd situation when a

Individual has some core competence within himself and he trains other person so as to result in a situation that the recipient of services will not recourse to him in future?

The Hon'ble tribunal relying on *DIT* v. *Guy Carpenter & Co. Ltd.* [2012] 346 ITR 504 / 207 Taxman 121/ 20 taxmann.com 807 (Delhi High Court) held that services might get covered within the definition of "fees for technical services" but such services should be of such nature that it results in transfer of technology to fall within the "make available" clause. Accordingly, services which are of general nature & which don't result into transfer of technology fall outside the purview of make available. - **ITO, International Taxation v. Veeda Clinical Research (P.) [2013] 144 ITD 297/35 taxmann.com 577 (Ahd.)**

(b) Whether for services to be regarded as "Fees for Technical Services" human intervention is must?

The Hon'ble Tribunal relying on *CIT* v. *Bharti Cellular Ltd.* [2009] 319 ITR 139/ [2008] 175 Taxman 573 (Delhi) held that the expression "fees for technical services" has been given as consideration for rendering managerial, technical or consultancy services. The word "technical" as appearing in *Explanation* 2 is preceded by the word "managerial" and succeeded by the word "consultancy". Thus, it cannot be read in isolation as it takes colour from the words "managerial and consultancy" between which it is sandwiched & accordingly, the meaning of the word or expression is to be gathered from the surrounding word *i.e.* from the context. The words "managerial and consultancy" is a definite indicative of the involvement of a human element. Managerial services and consultancy services has to be given by human only and not by any means or equipment. Therefore, the word "technical" has to be construed in the same sense involving direct human involvement without that, technical services cannot be held to be made available.

Accordingly, when any technology or machinery is developed by human and put to operation automatically, wherein it operates without much of human interface or intervention, then usage of such technology cannot *per se* be held as rendering of 'technical services' - **Siemens Ltd. v. CIT (Appeals) [2013] 142 ITD 1/30 taxmann.com 200 (Mum.)**

(c) Whether payment to a foreign university an education institution is covered within exclusion category of Fees for Technical Services of India-Singapore DTAA?

The AAR held that payments made to a registered education institution outside India for the purpose of teaching would fall within the exclusion category "**teaching in or by educational institutions**" of FTS clause of India-Singapore DTAA. - [**Eruditus Education (P) Ltd., In re [2013] 37 taxmann.com 337 (AAR – New Delhi)**]

(d) Whether Advertisement charges paid to Internet search engines like Yahoo & Google is liable to withholding tax?

The tribunal made an extensive step by step analysis of transaction and same is highlighted below:

- **Whether a web-site can be constituted as a Permanent Establishment?**

The tribunal held that a website does not constitute a 'permanent establishment' unless the servers on which websites are hosted are also located in the same jurisdiction. As the servers of Google and Yahoo are not located in India, there is no PE in India.

- **Whether such advertisement charges can be assessed as "Fees for Technical Services"?**

Applying the ratio laid down in *CIT* v. *Bharti Cellular Ltd.* [2009] 319 ITR 139 (Delhi) the Tribunal held that the services are not "managerial" or "consultancy" in nature as both these words involve a human element. If there is no human intervention in a technical service, it cannot be treated as a technical service u/ s 9(1)(*vii*). On facts, the service rendered by Google & Yahoo is generation of certain text on the search engine result page. This is a wholly automated process. In the services rendered by the search engines, which provide these advertising opportunities, there is no human touch at all.

- **What would be the taxability in absence of PE?**

The tribunal held that as the advertisement charges are in nature of business income of Google & Yahoo and not Fees for Technical Services such charges in absence of PE of Google/ Yahoo are not chargeable to tax in India & accordingly resident payer is not required to withheld income-tax from such payments - **[ITO v. Right Florists (P) Ltd. ([2013] 143 ITD 445/32 taxmann.com 99 (Kol.)]**

4. Withholding Tax on reimbursement of expenses

Whether third party payments directed/routed through related party would amount to reimbursement under section 195 and consequentially not to liable to withholding tax?

The tribunal laid down some fundamental principles for deciding the taxability of reimbursement of expenses:

- Payments to third party only because it is routed through the Holding Co. would not amount to reimbursement.
- The provision would apply as if the Indian Co. has made the payments to third party.
- It is only where the payment is ultimately stopping with the related party that it can be considered as payment to the associated concern and not otherwise.

[**C.U. Inspections (I) (P) Ltd. v. Dy. CIT [2013] 142 ITD 761/34 taxmann.com 75 (Mum.)]**

5. Taxability of indirect transfers

Capital Gains - Where a French company transferred its interest in Indian concern to another French company, the transferor was not liable to any tax in India as per India-France DTAA

Facts of the case

SBL, Hyderabad was an Indian company. 80 per cent of its shares were held by ShanH (French Company). ShanH in turn a JV between two French companies – GIMD and MA. GIMD and MA sold their shares in ShanH to another French company Sanofi. GIMD and MA had applied for Advance Rulings to AAR. Issue was taxability in India of capital gains arising out of sale of shares in ShanH to Sanofi in terms of Article 14(5) of Indo-France DTAA. AAR held the deal to be taxable. Hence, GIMD and MA filed separate writ petitions before the High Court challenging the ruling of AAR. Sanofi was held assessee in default for non-deduction TDS under section 195 from payments to GIMD and MA *vide* order dated 25-5-2010 and rectification order under section 154 dated 15-11-2011. These impugned orders were challenged by Sanofi by filing writ petition before High Court. Thus, instant case involved a bunch of three writ petitions before the AP High Court.

Andhra Pradesh High Court held as under:

Issue (i)-persona of ShanH : ShanH is an independent corporate entity registered and resident in France. It has a commercial substance and a purpose – FDI in SBL. Its neither a mere nominee of MA and/ or MA/ GIMD nor is a contrivance/ device for tax avoidance. ShanH is an investment vehicle; FDI in SBL is its commercial substance and purpose.

Issue (ii)-Whether ShanH a colourable device for tax avoidance justifying lifting corporate veil? ShanH was conceived and incorporated in consonance with MA's established business practices and organizational structure as a WOS (Wholly Owned Subsidiary) to serve as an investment vehicle. ShanH eventually evolved as a JV. ShanH was established as a SPV to facilitate FDI and to cushion potential investment risks of MA/ GIMD on direct investment in SBL. Uncontested assertion by petitioners that a higher rate of tax on capital gains (what would have been if liable in India) is payable in France and has been remitted to Revenue in France lends further support to the inference that ShanH was not conceived, pursued and persisted with to serve as an Indian tax avoidant device. Since revenue failed to establish its case that genesis or continuance of ShanH established it to be an entity of no commercial substance and/ or that ShanH was interposed only as a tax avoidant device, no case made out for piercing or lifting of the corporate veil. Even on piercing the corporate veil of ShanH, the transaction in issue was clearly one of the transfer by MA/ GIMD of their ShanH

shareholding (and of the marginal shareholding of Mr. Georges Hibon in ShanH as well) to Sanofi; and was not expressly or by any legitimate inference of the transactional documents and surrounding circumstances,a transfer of SBL shareholding,which continued with ShanH. Subsequent to the transaction in issue and currently as well, ShanH continued in existence as a registered French resident corporate entity and as the legal and beneficial owner of SBL shares. The transaction in issue clearly and exclusively was one of transfer of the entire shareholding in ShanH, by MA/GIMD in favour of Sanofi. Transfer of SBL shares in favour of Sanofi was neither the intent nor the effect of the transaction.

Issues (iii) & (iv) - Act, Retro Amendments of FA 2012 and the relevant DTAA:

As per article 14(4) of DTAA gains from the alienation of shares of the capital stock of a company the property of which consisted directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that Contracting State. For the purposes of this provision, immovable property pertaining to the industrial or commercial operation of such company shall not be taken into account. Gains from the alienation of shares other than those mentioned in paragraph 4 representing a participation of at least 10 per cent in a company which is a resident of a Contracting State may be taxed in that Contracting State. –Article 14(5) of DTAA. The Revenue's contentions that retrospective amendments by Finance Act, 2012 would override DTAA provisions deserved to be rejected for the following reasons. The Finance Act, 2012 introduced GAAR provision (sections 95 to 102) which override treaties in case of abuse of treaty provisions which was proposed to be operationalized with effect from 1-4-2014. Section 90(2A) inserted by Finance Act, 2012 enables application of GAAR even if same is not beneficial to assessee. In contradistinction, retrospective amendments relied upon by revenue- *Explanation 2* to section 2(*47*) and *Explanations 4* and *5* to section 9 are not fortified by a *non-obstante* clause to override tax treaties. There is a presumption against a repeal by implication and the reason underlying this principle is based on the theory that Legislature while enacting a law has a complete knowledge of the existing laws on the same subject matter, and therefore, when it does not provide a repealing provision it signals an intention not to repeal existing legislation. *Sanofi Pasteur Holding SA* v. *Department of Revenue, Ministry of Finance* [2013] 213 Taxman 504/30 taxmann.com 222 (AP)