

**PAYMENTS TO NON-RESIDENTS & APPLICATION OF TDS PROVISIONS***By***—S. BABU, Advocate****Bagh Lingampally, Hyderabad, A.P.**

Non Resident Indians have to pay tax only on Indian Income and to protect the tax revenues the Income Tax Department has made certain provisions to deduct certain amount of the earnings of NRIs towards Tax Deduction at Source and to smoothen this process the Department has fixed up the responsibility to the payer of Income to the NRI before reaching the income to their hands.

Section 195 of the IT Act deals with TDS on payments to Non-residents.

***Scope of Section 195***

All payments to Non-residents (other than salaries which fall under Section 192) are covered under Section 195. Unlike the other TDS sections, here there is no threshold limit, tax has to be deducted on the gross amount and the person deducting has to be aware not only of the IT Act but also of the relevant provisions of the Double Taxation Avoidance Agreement (DTAA), if any.

Tax has to be deducted only if there is an element of income embedded in the payment. Thus payment of loan may not attract any TDS as there is no element of income involved.

It is worthwhile to note that payments made to Non-residents, not only by residents, but by non-residents are also covered under this section. Thus, if a payment is made by one non-resident to another non-resident and if it results in income chargeable to tax in India for the first non-resident, the same would attract provisions of Section 195.

Payments in kind and payments to branches of foreign entities are also covered under this section.

***Income deemed to accrue or arise in India***

Before applying the provisions of Section 195 it is important to find out whether any income has accrued or deemed to accrue to the non-resident in India.

As per the provisions of Section 5(2) a Non-resident is chargeable to tax only on income which is received or deemed to be received and on income which accrues or deemed to accrue or arise in India. We have to go to Section 9 to find out what income is deemed to accrue or arise in India.

Section 9 of the IT Act has seven sub-sections dealing with:

Income arising because of 'business connection' Salary, if it is earned in India Salary payable by the Government of India, Dividend, Interest, Royalty, Fee for Technical Services

Unlike some of the other TDS provisions, Section 195 is applicable for all assesses whether they are doing business or not and the provisions are applicable to all types of transactions. Thus if a Non-resident is selling a property to an individual, the purchaser is required to deduct tax under Section 195.

***Relevance of OTAAAs***

Double Taxation Avoidance Agreements are agreements between two countries which provide relief to the tax payer where the same income is taxable in both the countries *i.e.*, the country of source and the country of residence.

Wherever a DTAA has been entered into it is important to know the provisions applicable to the payment in question. If the payment is not taxable in India as per the

provisions of the DTAA, the payer may not deduct any tax. Similarly, if the DTAA provisions provide for a lesser rate of tax than the domestic tax law rates, the DTAA rate may be applied to tax deduction.

It is also important to find whether the 'business connection' as contemplated under Section 9 of the IT Act exists or not. If it does, then the next question is what is the definition of 'Permanent Establishment' as per the DTAA. If the DTAA definition is more beneficial, the same can be applied by the assessee.

### ***TDS on reimbursement of expenses***

Generally there is no element of income embedded in a reimbursement transaction. The recipient is only recovering amount which is spent by him on behalf of the payer. However, there could be situations where the payment is partly for reimbursement and partly towards income. In such cases Section 195 would come into play and tax has to be withheld.

The department also looks for situations where the amount is being sent as reimbursement to avoid withholding tax. Thus if any part of the payment, if directly paid by the person reimbursing it, would result in taxable income to the final recipient, the same would attract withholding tax provisions.

### ***Time and Rate of deduction***

Tax has to be deducted at the time of credit or payment whichever is earlier. Explanation to Section 195(1) provides that a payer is liable to deduct tax although amount is credited to 'payable account' or 'suspense account'.

Tax has to be deducted and paid at rates as prescribed under the relevant Finance Act. However, the payer can deduct and pay at a lower rate if the same is prescribed as per the DTAA entered into by India with the other country.

For payments to non-resident sportsmen and sports associations whose income is taxable as per the provisions of Section 115BBA, the rate of deduction is 10% as provided specifically in Section 194E.

### ***Grossing up provisions***

Grossing up provisions under Section 195A are applicable where the tax deductible is borne by the payer.

Exchange Rate applicable to foreign currency payments - Rule 26 of the IT Rules provides that for TDS on foreign currency payments, the rate of exchange to be used is the TT buying rate on the date on which tax is required to be deducted.

### ***Provisions for deduction of tax only on portion of payment***

A payer can make an application to the Assessing Officer under Section 195(2) if he is of the opinion that only a portion of the payment is chargeable to tax in the hands of the Non-resident and hence tax has to be deducted only on part of the payment. In such cases the AO can issue an order quantifying the amount which is liable to TDS.

### ***Provisions of Section 195(3)***

As per the provisions of Section 195(3) the payee can make an application to the Assessing Officer requesting authorization for receipt of amount without deduction of tax. Here, it is worthwhile to note that the payer cannot make such an application and it is only the payee who is authorised to do so. Such application has to be in Form No.15D (for a banking company this has to be in Form No.15C). Such certificate shall be valid for the financial year specified in the certificate.

### ***Application for lower rate of deduction***

Under the provisions of Section 197 the payer can make an application for lower rate of deduction.

***Appeal provisions under Section 248***

Section 248 contains provisions for appeal. Such appeal can be filed by a payer of TDS if the liability is borne by him, he has paid the liability and the payer denies his liability to pay such tax.

It is important to note that orders passed under Section 195(2) only are appealable, and orders passed under Section 195(3) as well as orders passed under Section 197 for lower rate of deduction are not appealable.

***Issue of certificates by Chartered Accountants for foreign remittance***

New formats have been introduced with effect from July 1, 2009 for certification of foreign remittances by Chartered Accountants. Now payers are required to obtain CA's certificate in Form No.15CB and on receipt of this certificate the payer is required to submit Form No.15CA online, printout a copy of the acknowledged form and submit the same to the banker along with copy of the CA's certificate. Only after obtaining all the above documents the banker is permitted to release the payment to the Non-resident.

***Consequences of Non-deduction of tax and/or non payment***

Any expenditure on which tax is deductible and if tax is either not deducted or deducted but not paid on time attracts disallowance of such expenditure under Section 40(a)(i).

In addition to the disallowance of expenditure, interest at 1% pm is also payable on such non-deduction or non-payment.

Penalty is also imposable under Section 221 (assessee in default), under Section 271C (failure to deduct tax), under Section 272A (failure to file TDS return).

Section 276B also provides for prosecution proceedings for failure to pay tax deducted at source.

***Refund on TDS paid under Section 195***

As per Circular No.790 dated 20.4.2000 and Circular No.7/2007 dated 23.10.2007 the CBDT has permitted refund of TDS made under Section 195 if the conditions given in the circulars are fulfilled. Basically the conditions refer to situations where, after the TDS payment, the contract is cancelled or modified.

***Advance Rulings***

Sections 245N to 245V deal with advance ruling provisions. A Non resident can make an application for seeking an advance ruling in regard to his/its tax liability.

A resident who has undertaken or proposes to undertake a transaction with a non-resident may seek a ruling for determination on any question of law or fact in relation to such transaction involving the tax liability of the non-resident.

***Specific issues on withholding tax******On Payments made for purchase of Software***

Payments made for software could fall either under Section 9(1)(vi) dealing with royalty or under Section 9(1)(vii) dealing with fee for technical know how. The definition of royalty given under Section 9 covers payments made for 'licence fee' also and hence payments made for 'off the shelf products' or 'shrink wrapped software' would also be covered. What is to be seen is whether there is a different definition given to royalty under the relevant DTAA and if yes, whether as per that definition can the payment be out of the purview of TDS provisions.

***On payments made for purchases of material***

The most frequently encountered payment is the payment for purchase of material where there is no service involved. The first thing to be decided in deciding the TDS issue is whether such payment results in

income accruing or deemed to accrue to the recipient in India. As per Section 9 income is deemed to accrue only if there is business connection. If the party has no branch or any other business connection, income does not accrue and hence there is no TDS. Where ever India has entered into DTAA's you also have to see the definition of permanent establishment 'PE' as given under Article 5 of the relevant DTAA. If the supplier has no PE in India there is no income deemed to accrue and hence there is no TDS.

#### ***On Payment of Fee for Technical Services***

Fee for technical services (FTS) is also covered under Section 9 of the IT Act. Most of the DTAA's have a separate article for FTS and one has to see the definition of FTS to arrive at the TDS liability. Some of the DTAA's define FTS to mean only that FTS which 'makes available' the technical know how. In such cases only where the technology is 'made available' TDS provisions would be attracted.

#### ***On Payment of sales commission for services rendered outside India***

No payments made to Non- residents for sales commission for services rendered outside India attract withholding tax. Cases where services are rendered outside India

and when payment is made to the non-resident by direct transfer of money to an account outside India were covered under Circular Nos.23 of 1969 and 786 of year 2000. However both these circulars have been withdrawn by the CBDT in October 2009. Even if the circulars are withdrawn the principle underlying the circulars which is clearly laid down in Section 9 would apply and where payment is being made for services rendered by a non-resident outside India and where this is for export sale (*i.e.*, to earn income from a source outside India).

#### ***Payment for bandwidth charges***

As held by judicial authorities in *Software Technology Parks of India v. ITO*, 3 SOT 529 (Bangalore), *Wipro Ltd v. ITO*, 80 TT J 191 (Bangalore), provision of standard facilities by service providers has been held not to constitute payment for use of process/fees for technical services.

#### ***Conclusion***

whether the payment is made in India or outside India or whether by a resident or Non Resident to a Non Resident on the income earned by Non Resident in India, the provisions of Section 195 applies and Tax has to be deducted in advance from the NRIs in the interest of revenue by the Income Tax Department.

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## **CHARITABLE INSTITUTIONS UNDER INCOME TAX ACT**

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India is known for its charity and there are innumerable charitable institutions whether formal or informal and whether registered under the respective Acts or not are established and working for the public welfare either in general or for specified

purposes. The Charitable Institutions are mostly in the form of public trusts registered under the Indian Trusts Act or societies registered under The Societies registration Act. Thus the Institution shall become the legal entity governed by its own rules and