INTERNATIONAL TAXATION
- Practice Concepts

by Group Dynamics

- Introduction
- Income from Immovable Property
- Permanent Establishment and Business Profits
- Interest and Dividends
- Royalty and FTS
- Taxation on Artists, Sports Persons
- Dependent Personal Services & Independent Personal Services
- Tax Credits
- Taxation of Cross – Border Partnerships
- Provisions of Tax Deduction at Source

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ABOUT KSCAA

Karnataka State Chartered Accountants Association is an association of Chartered Accountants, registered under the Karnataka Societies Registration Act in the year 1957 having the following as its main objects.

1. To encourage friendly feelings and unanimity among the members and to ensure solidarity in the matters of interest concerning all of them.

2. To watch over, promote and protect the mutual interest of members and to better equip them in discharging their professional obligations.

3. To provide an organisation for Chartered Accountants and generally consolidate the interests of the profession and to do all such things from time to time as may be necessary to elevate the status and advance the interests of the profession.

4. To spread knowledge in the art and science of Accountancy in all its branches and in particular relating to matters of professional interest of Chartered Accountants.

5. To endeavor to bring about statutory legislation in any manner for the betterment of members and / or the profession, and / or the students of accountancy and also the public.

There are over 2400 members of the Association spread all over Karnataka. The association is serving the members for the past 58 years.

Activities

The Association regularly conducts seminars, conferences, workshops, study circle meetings of professional interest for members and public. The Association is conducting Endowment lectures also. It brings out News Bulletin for the benefit of members every month.

An abstract of the activities conducted is given hereunder.

Facilities / Activities of KSCAA for the Benefit of Members

- Regular Study Circle Meetings / Seminars / Conferences / Workshops / Endowment Lectures.
- Programmes in Mofussil areas.
- Conducting Corporate Training Programmes for corporate executives in the fields of Accountancy, Taxation, Auditing etc.
- Conducting State Level Conference every year.
- Assistance for members' employment.
- Publication of News Bulletin every month containing Articles of Professional Interest & other useful information.
- Cultural Programmes & Family get-togethers.
- Sports Activities.
- Representation before various Government Departments on general grievances of members.
- Honouring Chartered Accountant Examination Rank holders by giving prizes.
- Distribution of Books to needy and deserving students from the Students Welfare Fund.

PRESIDENT'S MESSAGE

At KSCAA,it is our belief and motto that **"Knowledge is Strength"**.

It gives me immense pleasure to place in your hands this publication – **"International Taxation - Practice Concepts"** on the eve of 28th Annual Conference our Association.

At KSCAA, it has been our constant endeavor to update and upgrade the knowledge of the members. We fully understand the important role books play in adding to the wealth of knowledge. Books has always been the trusted friend of mankind. Right from the initiation into the basic alphabets to the understanding of the complexities of the science of business, commerce, accounting, auditing, tax and other facets of education, have been possible through the print medium. We also firmly believe that this is the best gift we could give you at this conference apart from knowledge sharing exercise.

Q&A format of this book makes it very interactive and givesreaders, a feel of natural conversation. In this book, learned authors CA. Sachin Kumar B.P., CA. Cotha Srinivas, CA. Rani N.R., CA. K. Yathish, CA. D.S. Vivek, CA. Vinay T, CA. C.S. Srinivas and CA. K.L. Prashant have elucidated and simplified complex issues in International Taxation for your handy reference. We are sure that this book will be found very useful.

We thank the authors for their untiring efforts in authoring this publication.

It is a pleasure to have a sponsor for such a noble cause, we thank T L N Chowdhry Memorial Trust, Chennai, CA. I.S. Prasad, Bengaluru who have sponsored this book and CD sponsored by CA HBM Murugesh, Bengaluru.

It is but fair to thank the persons in the background who ensured that the books are published on time, we thank Chairman, Publications Committee CA. Maddanaswamy B.V., CA. H.B.M.Murugesh, Past President of KSCA and his team for their relentless efforts.

Warm regards,

CA. Dileep Kumar T.M.
President, KSCAA

MESSAGE

I am extremely happy to present you this book on – **"International Taxation - Practice Concepts"** on the occasion of 28th Annual Conference of KSCAA.

International tax issues have risen to prominence in public debate and are now attracting considerable attention from policymakers. Tax avoidance has emerged as a major risk to governments much-needed revenue.

Major conceptual differences do exist between tax systems. These include, but are not limited to, assessment vs. self-assessment means of determining and collecting tax; methods of imposing sanctions for violation; sanctions unique to international aspects of the system; mechanisms for enforcement and collection of tax; and reporting mechanisms.

The complexities of TP rules, DTAA has increased the obligation and responsibilities of the Statutory auditors and Tax auditors.

The CA Study Circle Group – "GROUP DYNAMICS" have optly dealt the various aspects, challenges faced by our fraternity in a novel interactive mode between a professional and client in this book.

I am grateful and indebted to contributing authors, CA K. Yathish, CA D S Vivek, CA Bhamini G S, CA Sachin, CA C S Srinivas, CA Vinay T, CA K L Prashanth, CA Rani N R, of CA Study Circle Group – "GROUP DYNAMICS" for sharing their rich experience, exposure and knowledge.

I wish to place on record my special thanks to CA Murgesh HBM for motivating, helping and guiding each one of us for publishing this book and also sponsoring the CD.

I am thankful to T L N Chowdhry Memorial Trust, Chennai and CA. I.S. Prasad, Bengaluru for sponsoring this publication.

I am also thankful to my publication team convenors and members for their unstinted support.

I do hope that this will provide in depth knowledge and understanding for sharpening of the professional skills of our members.

With warm regards.

B. V. Maddanaswamy
Chairman – Publication Committee

PREFACE

'VASUDHAIVA KUTUMBAKAM' is a phenomenal spiritual concept and the enormity of it can also be extended to the core of how the world has become a unified market place. Globalization and Liberalisation have blurred the borders which separates countries. Innovation and Technology have fundamentally changed the face of the most complicated tasks; sometimes all you have to do is just click a button. The commercial engagement with the world has led to a sizeable increase in the cross border transactions, with this has come a heap of issues in international aspects of income tax.

This book is a humble attempt to provide a primary understanding of the topics covered, relating to Basic Practical Aspects on International Taxation. In this attempt the existing law under the Income-tax Act, 1961, various judgments, Double Taxation Avoidance Agreements and the OECD, US and UN Model Conventions have been comprehensively considered to give a holistic understanding of the subject involved to the reader. The format of the book is a unique one being interactive in nature; it is threaded as questions and answers, to give the reader a feel of natural conversation. This approach has been carefully adopted to appeal to the keenness of a readers mind and to ensure smooth flow of understanding of all relevant aspects the author seeks to bring out.

The authors of the various chapters contained forthwith are part of a Informal Study Group of CAs in Bangalore called **Group Dynamics** founded in the year 2008. The book is structured as a dialogue between fictional characters, Mr. Gopal Rao and his family/friends, and a practicing CA. Mr. Gopal Rao is seeking advice and trying to comprehend tax matters related to international taxation with the

assistance of Group Dynamics. Each chapter brings out the pertinent tax matters in an interactive format between Mr. Gopal Rao or his family/friends and the author.

We profusely thank Shri HBM Murugesh, Chartered Accountant, Past President of KSCAA for motivating and encouraging us in bringing out this book in a short span of time.

As members of the Study Circle and as Practicing Professional Chartered Accountants we humbly thank the KSCAA for giving this opportunity to publish this book on Basics of International Tax on the occasion of 28th Annual Conference of KSCAA. Learning is a never dying endeavor we as professionals always have and this was yet another opportunity we had on account of assimilating this book together.

Group Dynamics

FOREWORD

Amidst the global headwinds, India has emerged as the fastest growing economy in the world. India's demographic advantage coupled with the encouraging economic scenario and liberalization of Foreign Investment norms will lead to a quantum leap in the volume of cross-border transactions. Hence, there is an increasing need for the professionals in our fraternity to understand the diverse subject of International taxation in order to provide meaningful and effective solutions. To cater to this need, the book 'International taxation - Practice Concepts' has been conceptualized and published by KSCAA.

'International taxation - Practice Concepts', is a useful and fascinating publication on the vast subject of International Tax. It has been carefully designed to capture the interest of Chartered Accountants irrespective of their areas of practice. It throws light on the fundamentals as well as the intricacies of International Taxation in a comprehensive manner. Many significant areas have been explored in depth by the authors and the relevant supporting material for further reference has been presented in the CD annexed.

One of the things that sets this publication apart from the rest is its novel approach to concepts of International Taxation. After significant deliberation, the Team of Authors concluded that the best way to present the information would be in a practical and interactive manner. Therefore, the nuances of the subject have been churned into a series

of dialogues between the Protagonist, Mr Gopal Rao and his family/ friends and a practicing Chartered Accountant. Not only does it make a captivating read, but it also serves as a source of quick reference to one and all.

We are thankful to the Team of Authors for their sincere efforts in bringing out this publication. They have accomplished the mammoth task of writing this book in a short span of time. It takes a true expert to present a complex subject in an easily comprehendible manner. With their experience and in depth knowledge, the authors have succeeded in delivering a unique, simple and invaluable publication to all readers.

In furtherance of the KSCAA Motto **"Knowledge is Strength"**, through this publication we hope to inspire the readers and empower them with the knowledge required to excel in the field of International Taxation.

CA H B M Murugesh
Past President, KSCAA
Co-Ordinator, Publishing Committee 2015-16

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CHAPTER – 1

Introduction

- CA Rani N R

It's Monday morning – 10.30 am – I was updating my work list for the week in my office.

'Namaskara Madam', - was surprised to see Mr. Gopal Rao in the month of February. He usually comes only in July for filing his Income Tax returns. Mr. Rao, an Engineer retired from BEML, settled in Bangalore has been our client since 15 years. His daughter, Kavya is a doctor settled in USA and son, Kiran is a software engineer working for Infosys.

Mr. Rao had indicated that he wanted to discuss some tax related issues. I was expecting questions like what is the maximum savings he can do before 31st March or which investment option is better - Fixed deposit or Mutual fund? But to my surprise, Rao had very interesting questions!!

a. Kiran has moved to UK in the month of May 2015 to work on a 3 year project- will his salary income be subject to tax in both India and UK?

CA Rani N R is a Fellow member of the Institute of Chartered Accountants of India. She completed Articleship training in K.Venkatachalam Aiyer & Co. and later worked as Tax Compliance Analyst with Ernst & Young Private Limited for about 1 year.

Since 2004, Rani is a partner in G.Anantha & Co., a Bangalore based firm of Chartered Accountants, and has garnered experience of more than 10 years in almost every facet of the accounting profession.

She has completed certification course on International Taxation from the Institute of Chartered Accountants of India (Bangalore).

She has authored a book on International Taxation - `Insights into the Basics of International Taxation'.

She is invited as speaker in various forums.

email: **rani.nr@ganantha.co.in**

b. Kiran will be in UK for the next 3 years. He will be transferring funds from UK to India. If those funds are invested in fixed deposits with Indian banks, whether interest income from the same will be taxable in both the countries? Should he continue to file tax returns in India during the next three years?

c. Kavya, who is now a USA citizen has 2 properties in Bangalore. Out of which, one is let out and the other is planned to be sold. Whether rental income from the let out property will be subject to tax in both countries? What about the capital gains arising on sale of the property? Whether she has to file tax returns in both the countries?

d. Mr. Rao and his wife are planning to visit their daughter in USA. They are planning to travel by the end of March 2016 and will be back to India in November 2016. What will be the tax implications on his pension and interest income in India? Should he be filing tax returns in India for the financial year 2016-17?

After listening to his questions, I realized that I need time to answer these as it involves International Taxation issues –not only the tax implications in India, but also that of USA and UK are to be addressed.

I thought this is an opportunity to introduce the basics of International Taxation to Anushree(Anu), Priya and Shravan from my office who were always keen to learn the concepts in International Taxation.

We started our discussion, as expected Shravan asked the first question:

1. What is International Taxation?

International Taxation is the study of implication of taxes on cross – border transactions. A country is free to levy tax on the returns from trade and investment within its jurisdiction as per its domestic tax laws. International Tax is best regarded as the body of legal provisions of different countries that covers the tax aspects of cross-border transactions. International tax, in this sense is concerned with direct taxes, (ie; income taxes, estate taxes, gift taxes, wealth taxes) and indirect taxes (ie; value added tax on goods and services, customs duties etc.). International Tax Law governs the taxing rights of sovereign nations.

2. Taxing rights! Ma'am, could you please explain the basis on which a country gets the right to tax? Anu asked

Yes, a country's sovereign right to tax is based on two connecting factors. They are:

i. the person ;

ii. the activity or the transaction or the event which generates income or capital

These two connecting factors give rise to:

i. the residence jurisdiction of taxation - based on the residence of a person

ii. the source jurisdiction of taxation - based on the activity or the transaction or the event which generates income or capital.

3. On hearing this, Priya told, Ma'am, let me try to explain the relevance of 'residence jurisdiction' of taxation.

Sure, go ahead, Priya

The country, in which a person is resident, gets the right to tax the income of that person based on the 'residence jurisdiction'.

Yes, you are right, Priya, the domestic tax laws of most of the countries, including India, grants unlimited taxation rights to the country of residence of the person. This means to say that the domestic tax laws of a country will want to tax the income or capital arising out of the person's activities in that country or in any foreign country. This is called 'Worldwide Income Principle'.

Thus as per section 5 of the Income Tax Act, in the case of a person who is resident in India, income received or deemed to be received or accrues or arises or deemed to accrue or arise to him in India or income which accrues or arises to him outside India (i.e.; Worldwide income) is subjected to tax in India.

4. Anu, could you please explain the relevance of 'source jurisdiction' of taxation?

Yes, Ma'am, based on the 'source jurisdiction' the country of source gets the right to tax the income that is derived from economic activities

carried out by a person who is a non-resident of that country. Thus the source of income is the subject matter of taxation. Under 'source jurisdiction', the country of source gets limited taxing rights.

Thus, as per section 5 of the Income Tax Act, in the case of a person who is non-resident in India, income received or deemed to be received or accrues or arises or deemed to accrue or arise to him in India is subjected to tax in India.

5. What is double taxation? I asked, Shravan.

Shravan's answer was perfect;

The co-existence or the interplay of the unlimited taxing rights of a country having residence jurisdiction and limited taxing rights of a country having source jurisdiction results in double taxation.

Yes, Shravan. I continued, there are two categories of double taxation; they are

i. Juridical Double Taxation

ii. Economic Double Taxation

i. Juridical Double Taxation

When the same income is subject to tax in more than one country and in the hands of the same person, it is called 'Juridical Double Taxation'. The focus here is on the '*taxable subject*' i.e. the taxpayer.

For example

Mr. Rao's daughter, Kavya is a citizen and resident of USA. So U.S. gets the right to tax global income of Kavya, based on the'residence jurisdiction' of taxation. Hence the rental income from house property in India will be subjected to tax in USA

Since the house property is situated in India, the source of rental income is in India, India gets the right to tax rental income based on the 'source jurisdiction' of taxation.

Thus, rental income of Kavya is subject to 'double taxation'

Let us examine the various scenarios which can result in 'Juridical Double Taxation'

'Residence – Source' Conflict

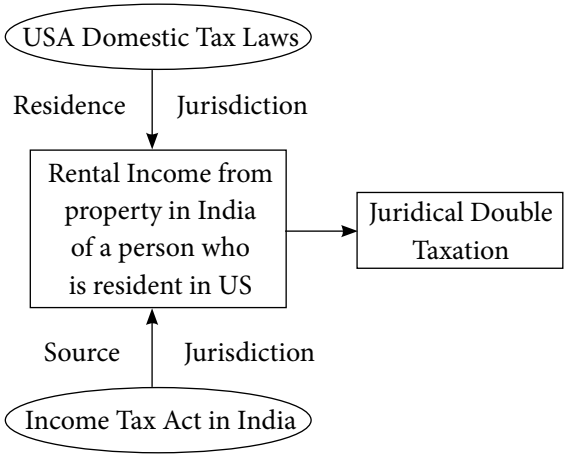
In this case one country asserts the right to tax a person's income based on Residence Jurisdiction and the other country asserts the right to tax the same income based on Source Jurisdiction.

Example:

As we have seen in Kavya's case, the rental income is subject to tax in USA based on 'Residence jurisdiction' and in India based on 'Source jurisdiction'

Priya, was very quick in drawing the diagrammatic presentation:

RESIDENCE –SOURCE CONFLICT



'Residence – Residence' Conflict

In this case, each country asserts the right to tax a person's income based on Residence Jurisdiction.

Example:

Let us assume during the financial year, Kavya was physically present in India for more than 182 days. Then India gets the right to tax rental income of Kavya in India based on 'Residence jurisdiction'.

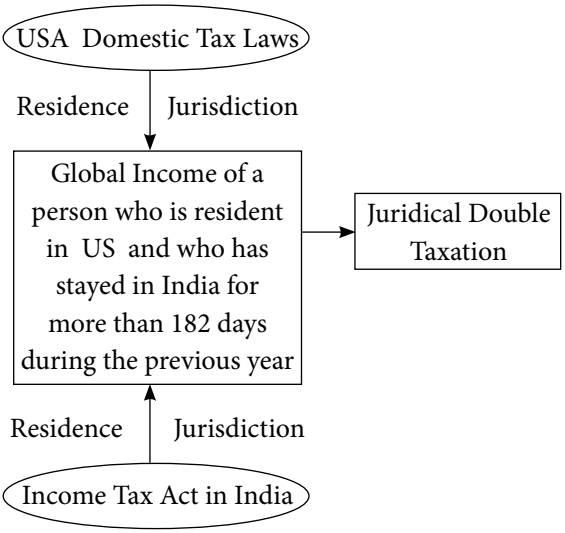
Shravan added, as per section 5(1) of the Income Tax Act, India gets rights to tax global income of Kavya, since she is resident in India.

Since Kavya is US citizen, USA also gets right to tax global income

(including rental income from India) based on 'Residence jurisdiction' (As per domestic tax laws of USA, citizens of USA are residents for tax purpose)

Thus global income (including rental income) of Kavya is subjected to juridical double taxation based on 'Residence-Residence' conflict.

RESIDENCE –RESIDENCE CONFLICT



<u>'Source – Source' Conflict</u>

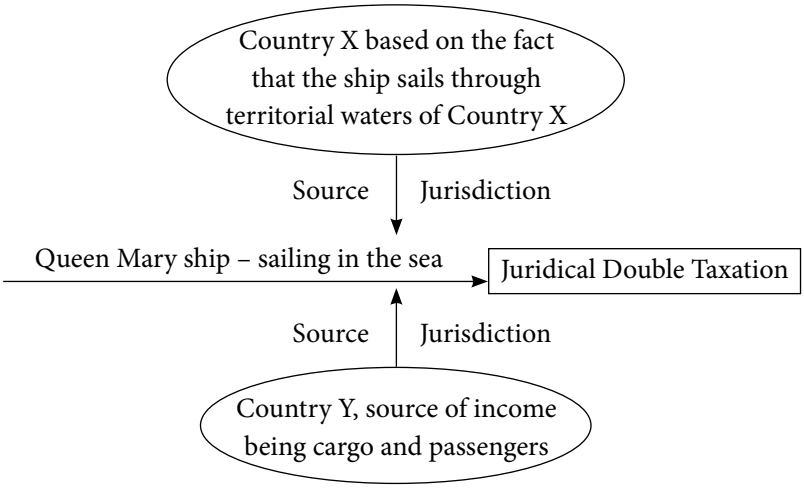
In this case, each country asserts the right to tax the income generated by the person in that country as per their respective domestic tax laws. Here the person is not a resident of both the countries as per their respective domestic tax laws.

Example

Queen Mary ship sails from country X to country Y carrying cargo and passengers. The Government of country X may claim that income from shipping operations is sourced from country X since Queen Mary sails through the territorial waters of country X. Mean while, the Government of country Y may claim that since the cargo and passengers that produce the income from shipping operations are sourced in

country Y, it has the right to tax the income from shipping operations of Queen Mary. Both the countries assert the right to tax based on the principle of 'Source Jurisdiction'. Consequently the shipping company which owns Queen Mary ship suffers tax twice on the same income in both country X and country Y.

SOURCE–SOURCE CONFLICT



At this point, Shravan raised an interesting issue.

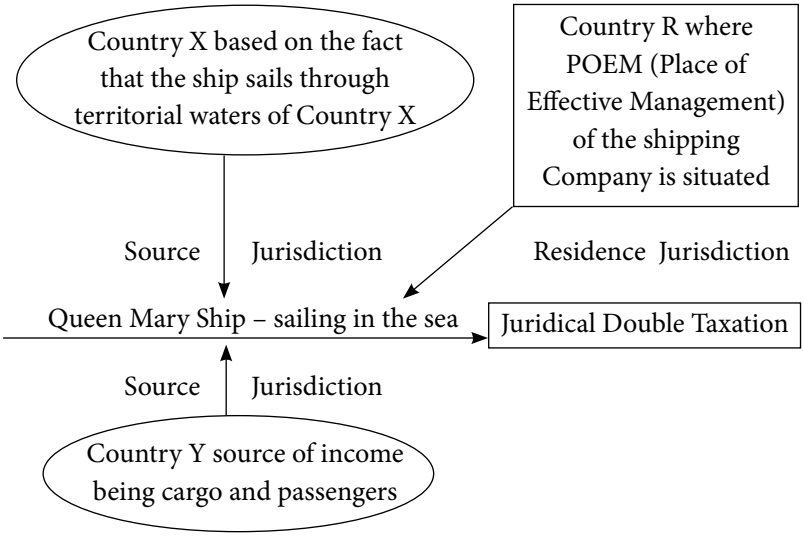
If the shipping company is registered in country R, then whether country R also will get right to tax income from the ship?

Yes, Shravan, you are right.

The shipping company will be resident of the country in which the place of effective management of the shipping company is situated. If we assume the registered office of the shipping company is the place of effective management, then country R will get right to tax the global income of the shipping company. Thus the income which is already subjected to tax in country X and country Y will be subjected to tax in country R also based on 'Residence Jurisdiction'. Then it becomes Residence- Source conflict.

RESIDENCE–SOURCE CONFLICT

SOURCE–SOURCE CONFLICT



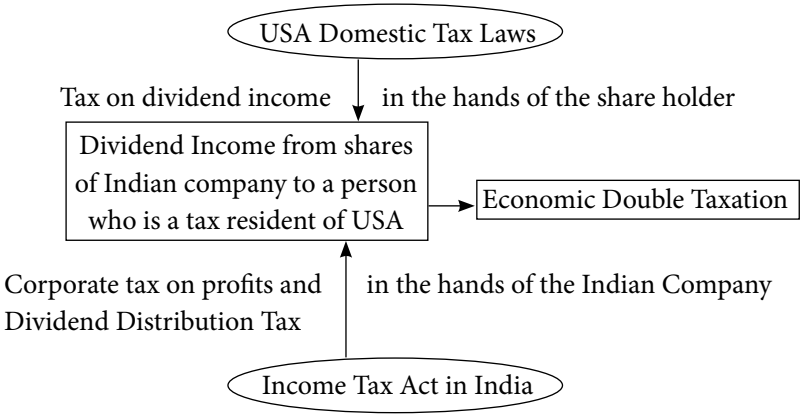
ii. Economic Double Taxation

The same income is subject to tax in more than one country in the hands of different persons. This is called 'Economic Double Taxation'. In 'Economic Double Taxation' the focus is on the 'taxable object' i.e.; the transaction or the economic event which generates the income.

Example:

Let us assume, Kavya had shares of an Indian company from which she received dividend. In India, the dividend is paid out of the profits of the company on which the company has paid Income tax and also dividend distribution tax. Let us assume this dividend income is subject to tax in USA, in the hands of Kavya. Then the dividend income is subject to 'double taxation'. So on the same income, the Indian company paid taxes in India, and Kavya paid taxes in USA.

ECONOMIC DOUBLE TAXATION



How to tackle such situations, Ma'am ? Anu was curious.

To tackle such situations, countries enter into Double Taxation Avoidance Agreements (DTAA), commonly known Tax Treaties.

6. Oh, wonderful Ma'am. Could you please explain the role of a Tax Treaty?

Sure, Anu.

A Treaty is an agreement between two countries (a 'bilateral' treaty) or between more than two countries (a 'multi lateral' treaty). The primary objective of a Treaty is to eliminate or mitigate the burden of juridical double taxation in cross border transactions.

The countries entering into Treaty agree to allocate the taxing rights between the resident country and the source country. The allocation of taxing rights is based on the principles of 'Source Jurisdiction' and 'Residence Jurisdiction' and also distinction between active income (salaries, business income, professional income etc.) and passive income (interest, royalties, dividends etc.).

Besides the allocation of taxing rights and eliminating double taxation, tax treaties also provide for prevention of tax discrimination [i.e., discrimination between the nationals/enterprises of the home country and the foreign country with respect to levying of taxes, resolution

of tax disputes due to differences in the interpretation or application of the tax treaty, preventing the evasion of taxation on international transactions or events, mutual assistance in tax collection]

Thus the Treaties are agreements which attempt to harmonize the conflicts arising from the overlapping of tax jurisdictions of more than one country.

Tax Treaties have also facilitated exchange of information on tax matters between the tax authorities of various countries, which has helped to ensure tax payer compliance and prevent tax evasion.

Please note that, Treaties as such do not impose tax, but relieve them.

7. Ma'am could you please explain the methods adopted in a Treaty for elimination of double taxation, Priya asked

Sure, Priya

Double taxation is eliminated by allocation of exclusive right to tax or sharing of taxing rights between the countries who enter into the Treaty.

Treaties adopt the following methods for elimination or reduction of double taxation:

i. Exemption method: taxing a particular income in any one of the contracting states (countries)

ii. Credit method : the residence country grants credit for taxes paid by its residents in the source country.

Shravan, can you tell the difference between the exemption method and the credit method?

Yes, Ma'am

a. Under the exemption method, *income* is the subject matter.

b. Under the credit method the *tax* is the subject matter

Perfect, Shravan!

There is another method apart from the ones mentioned above, i.e;

iii. Deduction of foreign taxes method, where in the residence country allows the taxpayer to claim a deduction for taxes paid

to a foreign government in respect of foreign source income subject to a limit. The extent of deduction is based on the relative tax rates of the source and residence countries. Unlike the exemption and tax credit methods, this method fails to give the tax payer full relief from double taxation.

8. I have often heard about OECD model and UN model conventions. Also it will be interesting to know about the history and evolution of Tax Treaties. Could you please explain, Ma'am ? Priya asked.

Sure Priya.

Model Conventions

Model Tax Conventions are internationally accepted format for the Treaties between Countries. The use of standard form of words used in the model tax conventions helps in the uniform interpretation of the Tax Treaties. The model convention seeks, wherever possible, to specify for each situation a single rule. For each of the Articles in the model convention, there is a detailed Commentary that is intended to illustrate or interpret its provisions. Since the Commentaries to model conventions have been drafted and agreed upon by the Governments of member countries, they are of special importance in the development of international fiscal law. The Commentaries can be of great assistance in the application and interpretation of the conventions and, in particular, in the settlement of any disputes.

History and Evolution of Model Conventions

With the increase in the number of the countries entering into the Tax Treaties, it was felt that the underlying rules for international Tax Treaties should be standardized. Therefore, in 1921, the League of Nations started proceedings which resulted in the publication of Bilateral Convention for the Prevention of Double Taxation in the Special Matter of Direct Taxes in 1928. In 1935, Double Taxation and Tax Evasion Convention for the Allocation of Business Income between States for the Purposes of Taxation were published. In 1943, Bilateral Convention for the Prevention of the Double Taxation of Income with Protocol was published and in 1946, Bilateral Convention

for the Prevention of the Double Taxation of Income and Property with Protocol known as London draft was published.

Further research and development work was then assumed by the 'Organization for European Economic Cooperation' (OEEC), and its successor, the Organization for Economic Cooperation and Development (OECD).

OECD Model Convention

The Organization for European Economic Cooperation (OEEC), and its successor, the Organization for Economic Cooperation and Development (OECD) is the predominant body driving international development of Tax Treaties. In 1963, the OECD Fiscal Committee edited a Draft Double Taxation Convention on Income and on Capital to which official commentaries were appended. Both the drafts were reviewed and amended in accordance with growing practical experience and it resulted in the publication of Model Tax Convention on Income and on Capital and its Commentaries in 1977. In 1991, recognizing that the revision of the Model Convention and the Commentaries to the Model Convention has become an ongoing process, the OECD adopted the concept of an ambulatory model convention with more timely updates, and without waiting for a complete revision every time.

UN Model Convention

Another model convention, the United Nations Model Double Taxation Convention between Developed and Developing Countries is of similar importance as the OECD Model Convention. This model was first published in 1980 by the United Nations Economic and Social Council. It had become evident that the provisions of OECD Model Convention, when included in a bilateral Tax Treaty between a developing and a developed Country in many cases resulted in an unacceptable flow of funds from the former to the latter. The reason for this is that the OECD Model Convention is mainly governed by the principle of residence, which is appropriate if the exchange of goods and services between the countries is more or less balanced. However, where the flow of goods, services, capital and know-how is mainly in one direction, as

it is often the case in the economic relations between developing and developed countries, it will be inequitable to allocate the right to tax income predominately to the Country of residence. Consequently, the UN Model Convention puts a much stronger accent on taxation at source than the OECD Model Convention. The UN model convention has been widely embraced by most developing countries.

Model conventions of Tax treaties lay down the guiding principles for the interpretation of tax treaties. Whereas the OECD has formally recommended to its members to conform to the OECD – Model convention when negotiating treaties, the United Nations has stated that the provisions of UN – Model convention should not be construed as formal recommendations of United Nations.

In short, it can be stated that OECD – MC besides being a set of rules in its own right, forms the basis for the other model conventions, as well. Furthermore, the recommendations and interpretations of OECD are permanently reviewed and updated in order to take account of new findings resulting from scientific research and practical experience.

It is recommended to use the commentaries to the OECD Model Convention for the solution of doubtful issues, even if the bilateral convention was designed in accordance with the UN Model Convention. It is evident, though, that the OECD commentaries must be used prudently in such a context, and only in cases in which the commentaries to the UN Model Convention do not offer adequate advice. Where totally different principles are applied, the commentaries to the OECD Model Convention cannot be used obviously, to solve a problem of a UN Model Convention. However, where the same rules are in force or where, based on the same basic principles, merely marginal, superficial or isolated differences occur, the commentaries to the OECD Model Convention may be suitable to provide a solution.

US Model

The United States of America has model convention of its own. The US Model Convention reflects its domestic policy as a major net capital exporter, on anti abuse rules such as a treaty shopping, tax sparing etc.

Other Model Tax Treaties

A model convention was also published in 1971 by the Andean group of countries – Bolivia, Chile, Ecuador, Columbia and Peru (later on, also joined by Venezuela).

Tax Treaty vs Domestic Law

In India, the Central Government is vested with the power to enter into Treaty with the government of any country outside India under the provisions of Section 90 of the Income Tax Act, 1961.

As per section 90(2) of the Income Tax Act, when the Central Government has entered into Treaty with the Government of any country outside India, for granting of relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income Tax Act shall apply to the extent they are more beneficial to the assessee.

The provisions of the Treaty override the provisions of the domestic tax law in case of a contradiction between the two.

The principle that the provision of a Treaty entered into by Government of India with the Government of any other country, prevail over the provisions of the Income Tax Act has also been approved by the Supreme Court of India in Azadi Bachao Andolan case and also in Kulandagan Chettiar's case.

Contents of OECD Model Convention and UN Model Convention

OECD Model		UN Model
Chapter I - Scope of Convention		
Article 1	Persons covered	Persons covered
Article 2	Taxes covered	Taxes covered
Chapter II – Definitions		
Article 3	General Definitions	General Definitions
Article 4	Resident	Resident
Article 5	Permanent establishment	Permanent establishment

OECD Model		UN Model
Chapter III - Taxation of Income		
Article 6	Income from immovable property	Income from immovable property
Article 7	Business profits	Business profits
Article 8	Shipping, inland waterways transport and air transport	Shipping, inland waterways transport and air (Alternative A)
		Shipping, inland waterways transport and air (Alternative B)
Article 9	Associated enterprises	Associated enterprises
Article 10	Dividends	Dividends
Article 11	Interest	Interest
Article 12	Royalties and Fees for Technical Services	Royalties and Fees for Technical Services
Article 13	Capital gains	Capital gains
Article 14	Deleted in OECD MC 2000	Independent personal services
Article 15	Income from employment	Dependent personal services
Article 16	Directors' fees	Directors' fees and remuneration of top-level managerial officials
Article 17	Artistes and sportsmen	Artistes and sportsmen
Article 18	Pensions	Pensions and social security payments (Alternative A)
		Pensions and social security payments (Alternative B)
Article 19	Government services	Government services
Article 20	Students	Students
Article 21	Other income	Other income

OECD Model		UN Model
Chapter IV - Taxation of Capital		
Article 22	Capital	Capital
Chapter V – Methods for elimination of double taxation		
Article 23 A	Exemption method	Exemption method
Article 23 B	Credit method	Credit method
Chapter VI - Special provisions		
Article 24	Non-discrimination	Non-discrimination
Article 25	Mutual agreement procedure	Mutual agreement procedure
Article 26	Exchange of information	Exchange of information
Article 27	Assistance in the collection of taxes	Assistance in the collection of taxes
Article 28	Members of diplomatic missions and consular posts	Members of diplomatic missions and consular posts
Article 29	Territorial extension	
Chapter VII - Final provisions		
Article 30	Entry into force	Article 29 – Entry into force
Article 31	Termination	Article 30 – Termination

9. Summary of Articles of a Treaty

   Scope of convention (Articles 1 & 2)
   Definitions (Articles 3, 4, 5)
   Taxation of Income (Articles 6 - 21)
   Taxation of Capital (Article 22)
   Provisions for elimination of Double Tax (Article 23)
   Special provisions (Articles 24 - 29)
   Entry into force and Termination provisions (Articles 30-31)

10. Terms used in Treaties

    i. A country which enters into a treaty - Contracting State

    ii. A country wherein a person resides - State of residence

iii.	A country wherein income arises	-	State of source
iv.	Any taxable entity	-	Enterprise of a contracting state
v.	A fixed base of enterprise in the source country	-	Permanent establishment

For easy reading and understanding of a Treaty replace the words 'Contracting states' by the names of the respective countries.

By this time it was 4 o' clock. Ma'am, shall we go for coffee? Sure Shravan. All of us happily went to Puliyogere point restaurant near our office and had hot coffee and bajjis.

It is very interesting discussion Ma'am, can we continue the same? . Anu asked. Priya and Shravan agreed.

11. Ok, guys, now we will find out how to apply a Tax Treaty in a given situation?

Step 1: Find out which Treaty has to be applied.

Article 1 of a Treaty provides for application of tax treaty to a person who is a resident of one or both of the contracting states. This means that we have to ensure that the person in respect of whom we are planning to apply the treaty provisions has to be a resident of one or both of the contracting states.

Example

In the case of Kavya, she is a citizen of USA. As per USA domestic tax laws she is a tax resident of USA. Rental income from property in India is subjected to tax in USA. Since the immovable property, is in India, rental income is subjected to tax in India also. So rental income is subjected to tax in India and USA.

Hence we have to apply India – USA Tax Treaty to find out the methods to eliminate double taxation of the rental income in the hands of Kavya.

Step 2: Determine which Article of the Treaty applies?

i. Identify the category of income which is subjected to double taxation

ii. Find out the relevant Article which deals with the category of income

iii. Understand the allocation of taxing rights –

- whether exclusive rights only for the country of residence; or
- whether both the countries get right to tax ; or
- whether limited taxing rights for the country of source

Example

In the case of Kavya, – category of income is rental income.

Relevant Article is 'Article 6 – Income from immovable property (real property) of India – USA Tax Treaty'.

As per this Article,

" Income derived by a resident of a Contracting State from immovable property (real property), including income from agriculture or forestry, situated in the other Contracting State may be taxed in that other State"

So in the case of Kavya,

Income derived by a resident of USA (Kavya is a tax resident of USA), from an immovable property situated in India (other Contracting State) may be taxed in USA (that other state).

The rental income is subjected to tax in USA (based on residence jurisdiction) and India (based on source jurisdiction)

"Ma'am, this means to say even after applying the Treaty provisions, the income is subjected to double taxation". Also, where does it specifically say in Article 6 that the contracting state in which the person is a resident CAN tax the income too? Anu asked.

12. Good question, Anu.

In the case of immovable property the primary right to tax is with the country where the immovable property is situated. The words 'Income *may be* taxed in' used in this Article implies that the country of residence of the tax payer may also tax the same income. The country of residence may choose to tax the income and give credit for the taxes

paid on that income in the other country (credit method) or it may choose not to tax the income (exemption method).

In this context, I would like to mention the Treaty source rules for various categories of income for your understanding:

Source or Nature of Income	Rule for allocation of taxing rights
Immovable Property	Country where the property is situated
Business Profits and Professional services	Country of Permanent establishment or Fixed base
Dividend, Interest income and Directors' fees	County of Residence of the payer
Employment services, Artistes and Sportsmen	Country of work or performance
Government salaries and pensions	Country of the payer
Shipping and Air Transport	Country of 'Place of Effective Management'
Other Income	Country of residence of the recipient

So we now need to find out the methods to eliminate double taxation as per the Treaty?

We have already understood that in a Treaty double taxation is eliminated by:

- Allocation of exclusive right to tax the income to one country; or
- Sharing taxing rights between both the countries
- Country of residence giving credit for the taxes paid in the country of source.

In the case of Kavya, we have found that as per Article 6 of the Treaty,

- Both USA and India have retained their respective taxing rights.

Hence in this case, we need to adopt the Tax Credit method for elimination of double taxation.

'Article 25 – Relief from double taxation as per the India – USA Tax Treaty' explains the provisions for claiming Tax Credit.

As per Article – 25:

"In accordance with the provisions and subject to the limitations of the laws of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income"

(*a*) The income-tax paid in India by or on behalf of such citizen or resident;

So, Kavya can claim credit of income tax paid in India on rental income against the tax paid in USA on rental income when she files her tax returns in USA.

Thus by applying the provisions of India- USA Tax Treaty double taxation of rental income is eliminated.

"Superb, Ma'am. It is very interesting". Anu and Priya both were very happy that they understood how to resolve the double taxation issue of Kavya.

As expected, Shravan asked,

13. Ma'am, which are the important case laws which has discussed about Tax Treaties. (Shravan wants to start his own practice so he is very keen to know about case laws)

Yes, DCIT Shravan Kumar ! (We dearly call him so, in our office), Do read the following judgements which discuss the importance of Tax Treaties. Shravan seriously noted the citations in his newly bought Samsung galaxy phone cum tab.

i. Azadi Bachao Andolan (263 ITR 706)

ii. Kulandagan Chettiar (267 ITR 654)

iii. Ishikwajima Harima Heavy Industries Ltd. vs. Director of Income Tax (288 ITR 408)

We continued our discussion the following day too.

I thought of explaining to them the structure of Articles 1, 2, & 3 of a Tax Treaty

Article 1 – Persons covered

Article 1(1) states that: [OECD & UN model]

This convention shall apply to persons who are residents of one or both of the contracting states

The article states that the convention shall apply to 'persons who are residents of one or both of the Contracting States '.

The word 'residents of contracting states' is defined in Article 4.

For the purpose of applying the Tax Treaty provisions the determination of "person" is vital.

In most of the Tax Treaties, the definition of the term 'person' in Article 3 includes:

i. an individual;

ii. a company;,

iii. any other body of persons ;

iv. any other entity which is treated as a taxable unit for tax purposes under the taxation laws in force in the respective country

Types of definition for 'person' in Article 3 of India's Tax Treaties are as follows:

Type 1:

The term 'person' includes an individual, a company, a body of persons and any other entity, which is treated as a taxable unit under the taxation laws in force in the respective contracting state (country), with minor differences in wording.

Type 2:

The term 'person' shall have the meaning assigned to it in the taxation laws in force in the respective contracting state (country).

Type 3:

The term 'person' includes an individual, a company and any other body of persons.

Type 4:

The term 'person' includes an individual, a company and any other entity which is treated as a taxable unit under the taxation laws in force in the respective contracting states (countries), but, subject to para 2 of this article, does not include a partnership.

Paragraph 2: A partnership which is treated as a taxable unit under the Income Tax Act 1961, of India shall be treated as a person for the purpose of this convention.

Type 5:

The term 'person' includes an individual, an estate, a trust, a partnership, a company, any other body of persons, or other taxable unit.

Article 2 – Taxes covered

This Article describes the taxes covered by the Tax Treaty. As per the commentary to the OECD model convention the intention of Article 2 is as follows:

i. to make the terminology and nomenclature relating to the taxes covered by the convention more acceptable and precise;

ii. to ensure identification of the taxes of the contracting states (i.e.; countries who enter into the Tax Treaty) which are covered by the convention;

iii. to widen as much as possible the field of application of the convention by including, as far as possible, and in harmony with the domestic laws of the contracting countries the taxes imposed by their political subdivisions or local authorities;

iv. to avoid the necessity of concluding a new convention whenever the domestic tax laws of the contacting countries are modified;

v. to ensure that each contracting country is notified of the significant changes in the taxation laws of the other country.

Article 2 of a Tax Treaty essentially comprises of:

2(1)	Applicability
2(2), 2(3), 2(4)	Scope of taxes covered

1. Applicability

Article 2(1) states that: [OECD & UN model]

This convention shall apply to taxes on income and on capital imposed on behalf of a contracting state or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

2. Scope of taxes covered

Article 2(2) states that: [OECD & UN model]

There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amount of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

Article 2(3) states that: [OECD & UN model]

The existing taxes to which the convention shall apply are in particular,

a) (in State A) .....

b) (in State B) .....

Article 2(4) states that: [OECD & UN model]

The convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the convention in addition to, or in place of, the existing taxes. The competent authorities of the contracting states shall notify each other of any significant changes that have been made in their taxation laws.

i. The term 'tax' is defined neither in the model conventions nor in the commentaries to the model conventions.

ii. Therefore, the definition as per the domestic law of the respective countries have to be adopted.

iii. Duties and charges incidental to the basic taxes are included, whereas monetary fines and penalties are not included.

iv. Social security charges are excluded.

The provisions of Article 2 are applicable to taxes introduced in the domestic tax laws after the date of signature of the Tax Treaty. This is to avoid the necessity of concluding a new Treaty whenever the domestic tax laws of the respective countries who have entered into the Treaty are modified.

In Tax Treaties entered into by India, Income Tax under the Income Tax Act, 1961, including any surcharges, thereon, is covered without any exceptions.

Article 3 – General Definitions

This Article of a Tax Treaty defines some terms designated as 'general', which are necessary for the understanding and application of a Tax Treaty.

These terms are:

i. Person;
ii. Company;
iii. Enterprise;
iv. Enterprise of a contracting state;
v. International traffic;
vi. Competent authority;
vii. National;
viii. Business;.
ix. In the case of those terms used in conventions which are not specifically defined in Article 3 of the Tax Treaty, recourse must be had to the domestic tax law of the respective contracting countries who have entered into the Tax Treaty.

Article 3 of a Tax Treaty essentially comprises of:

3(1)	Definitions
3(2)	Applicability

1. Definitions

Article 3(1) defines the following terms: [OECD & UN model]

For the purposes of this convention, unless the context otherwise requires:

a. the term 'person' includes an individual, a company and any other body of persons;

b. the term 'company' means anybody corporate or any entity that is treated as a body corporate for tax purposes;

c. the term 'enterprise' applies to the carrying on of any business; ***[Missing in UN model]***

d. the term 'enterprise of a contracting state' and 'enterprise of the other contracting state' mean respectively an enterprise carried on by a resident of a contracting state and an enterprise carried on by a resident of the other contracting state;

e. the term 'international traffic' means any transport by a ship or aircraft operated by an enterprise that has its place of effective management in contracting state, except when the ship or aircraft is operated solely between places in the other contracting state;

f. the term 'competent authority' means

i. (in State A):……..

ii (in State B):……..

g. the term 'national', in relation to a contracting state means:

i. any individual possessing the nationality or citizenship of that contracting state;

ii. any legal person, partnership or association deriving its status as such from the laws in force in that contracting state;

h. the term 'business' includes the performance of professional services and of other activities of an independent character. ***[Missing in UN model]***

2. Applicability

Article 3(2) states that: [OECD & UN model]

As regards the application of the convention at any time by a contracting state, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the laws of that state for the purposes of the taxes to which the convention applies, any meaning under the applicable tax laws of the state prevailing over a meaning given to the term under other laws of that state.

Definition of the terms *'territory'*, *'tax'*, *'contracting states'*, *'fiscal year'* in the Tax Treaties of India are as follows:

Territory

The term '*India*' means the territory of India and includes the territorial sea and air space above it, as well as any other maritime zone in which India has sovereign rights, other rights and jurisdictions, according to the Indian law and in accordance with international law, in particular as laid down in the UN model convention on the Law of the Sea.

Tax

The term '*tax*' means Indian tax, as the context requires, but shall not include any amount payable in respect of any default or omission in relation to the taxes to which the model convention applies, or which represents a penalty or fine imposed relating to those taxes.

Contracting States

The terms'*a contracting state*' and '*the other contracting state*' mean India or another country, as the context required. Example, in the case of India – US DTAA, the other contracting state is the United States of America, when we read from the point of view of India.

Fiscal Year

The term 'fiscal year' means, in the case of India, 'previous year' as defined under section 3 of the Income Tax Act, 1961.

Article 4 – Residence

As per Article 1 – the Treaty shall be applicable to persons who are '*resident in one or both the Contracting states*".

Priya asked:

14. Ma'am, who is considered as 'resident of a contracting state 'for the purpose of a Tax Treaty?

I will explain, Priya.

Article 4 of a Tax Treaty which defines 'Resident' essentially comprises of:

4(1)	Definition
4(2)	Tie breaker rules for dual resident individuals
4(3)	Tie breaker rules for dual resident persons other than individuals

1. *Resident of a Contacting state*

Article 4(1) of the Treaty, states that: [OECD & UN model}

*For the purposes of this convention, the term **"Resident of a Contacting state"** means **any person** who**, under the laws of the State**, is **liable to tax therein** by reason of his **domicile, residence, (UN model includes place of incorporation also), place of management or any other criterion of a similar nature** and also includes that State, and any political subdivision or local authority thereof. This term however does not include any person who is liable to tax in that State in respect of only of income from sources in that State or capital situated therein.*

An analysis of this definition brings out the following:

i. any person:

"Person" for the purpose of a Treaty is generally defined in Article 3.

***ii. under the laws of the State*:**

The definition as per Article 4(1), requires us to revert to the domestic law of a country to ascertain whether, under the domestic law, a person is resident of that country.

iii. liable to Tax

This means the person who is a resident as per the domestic laws of the Country should be liable to tax in that country. In principle, this states that if the person has no liability to tax in the country as per domestic

law then the person does not fall within the scope of a "resident of contracting state" for the purpose of Treaty.

Example

a. Mr. A gets dividend income from shares of Indian company. In this case dividend income is specifically exempt from tax as per Income Tax Act, in India.

b. Mr.A has income but no tax liability since he has claimed deductions under chapter VI A of The Income Tax, Act 1961.

In the case mentioned above, Mr.A may be liable to tax in India, but he is not required to pay tax. Mr A may be considered as resident of India for the purpose of Treaty even though he has not paid any taxes in India.

There are various case laws and AAR rulings with different interpretation of "liable to tax" provision. The term 'liable to tax' has been examined in different cases and have held that this provision does not require the imposition of actual tax and the criteria to be looked at is whether the country has the right to tax the person and whether the fiscal domicile of the person lies in the respective contracting country.

Judicial decisions in this regard:

Azadi Bachao Andolan [2003] 263 ITR 706 (SC) – Liable to tax is not the same as payment of tax. Liability to tax is a legal situation and payment of tax is a fiscal fact.

Mohsinally Alimohammed Rafik [1995] 213 ITR 317 (AAR) – Liable to tax means a person who is liable to be subject to tax and does not mean the person should be factually charged to tax.

Cyril Eugene Pereira [1999] 239 ITR 650 (AAR) – Fiscal residence of a person is to be decided on the basis of his actual liability to pay taxes. Treaty is relevant only for tax payers who are liable to pay tax twice on the same income. (Contrary ruling from Rafik's case mentioned above)

iv. domicile, residence, place of management or any other criterion of a similar nature

The definition as per Article 4(1), requires us to revert to the domestic

law of a country to ascertain whether, under the domestic law, a person is resident of that country.

We need to find out if as per the domestic law of the country, the residence of a person is determined on the basis of any of the following:

a. Domicile – is a connection a person has with a country which may or may not be his place or origin or nationality or citizenship. Domicile of origin is by birth and domicile of choice is where the individual chooses to live and where he would be taxable.

b. Residence - is where a person normally resides. Residence implies some degree of permanence.

c. Place of management – is where the control is located and key decisions are taken. (this is relevant in the case of persons other than individuals)

d. Any other criterion of a similar nature.

In reality, most of the countries determine the tax residence of persons by at least one of the above mentioned criteria. Thus the definition of residence under domestic laws of the country is assimilated into the Treaty definition of a resident.

v. excludes the person who is liable to tax in the state only based on the sources in that state or capital situated in the state

This means if a person derives income from a country or owns capital in that country and pays tax in that country only on that income or capital, then that the person is not a resident of that country for the purpose of this definition of "resident of contracting state".

Example

In the case of Kavya, she has rental income from property situated in India. She pays tax in India only because she has a source of income in India. She does not satisfy the rules to be resident of India as per section 6 of the Income Tax Act.

Since she is not a resident as per the provisions of the Income Tax Act in India, she does not become resident of India as per Article 4 of India-USA Treaty also.

Priya asked:

15. Ma'am, can we conclude that:

If a person is not a resident as per the domestic tax laws of a country then he cannot be resident of that country for the purpose of Article 4 of the Treaty of that country.

This means, if a person is non- resident in India as per section 6 of the Income Tax Act, then the person cannot be resident of India as per Article of 4 of India's Tax Treaties

Yes, Priya, your understanding is basically correct. But I should say there could be some exceptional situations wherein this rule does not work, especially in the case of persons other than individuals.

16. Ma'am what will happen if a person becomes Resident of both the countries?

Good question, Anu . Here is the answer:

If based on the above definition of a "Resident of a Contracting State" as per the provisions of Treaty, a taxpayer becomes resident of more than one country, the tax payer is known as ***"dual resident".***

In such circumstances, the Treaty provides resident **"tie-breaker"** rules to ensure that the person is a resident of only one of the contracting states (countries) that claim his resident status, and thereby assign the resident based taxing rights to that state (country).

Dual Resident - Tie-breaker rules for Individuals

Article 4(2) sets out the hierarchy of tests, which are applied progressively to establish the state of residence of the individual.

These tests are applied to establish the residential status of the individual as per the Treaty and thereby to assign the residence jurisdiction based taxing rights to that country (contracting state) which has the closest nexus with the individual assessee.

Tie breaker test is applied based on the following criteria

i. Availability of Permanent home

ii. Centres of vital interest

iii. Habitual Abode

iv. Nationality

v. Mutual Agreement Procedure

Availability of Permanent home – The country, in which an individual permanently resides, would be considered as the resident country.

Priya asked :

17. What are the criteria to establish the availability of a permanent home?

They are as follows:

a. The home should be continuously available for permanent use as opposed to short duration of stay.

b. If the period of stay is uncertain then it does not qualify to be permanent home.

c. A home can be a house or apartment whether own or rented, including a rented furnished room.

d. In the case of mobile homes the individual must have arranged to have the dwelling available to him at all times continuously.

e. It is evident that in the case of a mobile home the stay must be in the country of residence exclusively, or at least, predominately.

f. To be determined on a case to case basis based on the facts of the case.

18. Who has the onus to prove the existence of a permanent home to the assessing officer?

It is on the assessee. (Guess – who asked this question?)– Yes you are right. It is Shravan.

19. What to do if the individual has permanent home available in both states?

Good one, Priya

In that case we need to apply "**Centre of vital interest"** test to establish the country of residence of the individual as per the Treaty.

20. What is “Centres of vital interests” test?

The test is to establish the country in which the individual has personal and economic connections. The country where the individual has personal and economic ties would be considered as resident country of the individual.

Following are some of the points which can be considered to establish the personal and economic interests of the individual in a country

a. marriage with a native

b. presence of family

c. existence of a business interest

d. ownership of property

e. financial indicators like bank account, investment etc

Please note that :

The onus to prove the existence of centre of vital interest to the tax officer is on the assessee.

21. Ma’am, what to do in the following cases :

i. if the individual has a permanent home in none of the countries (contracting states);

or

ii. if he has a permanent home in both countries, and it is not possible to determine his centre of vital interests,

Excellent, Shravan Bullseye !!!

In that case the individual is deemed to be resident of the country in which he has a **‘habitual abode’**.

“Habitual” implies repeatedly and persistently. An "abode" is a place of residence.

a. If a person has been staying in one place repeatedly for a continuous period it could be called his habitual abode.

b. In this test it is to be established where the taxpayer normally lives.

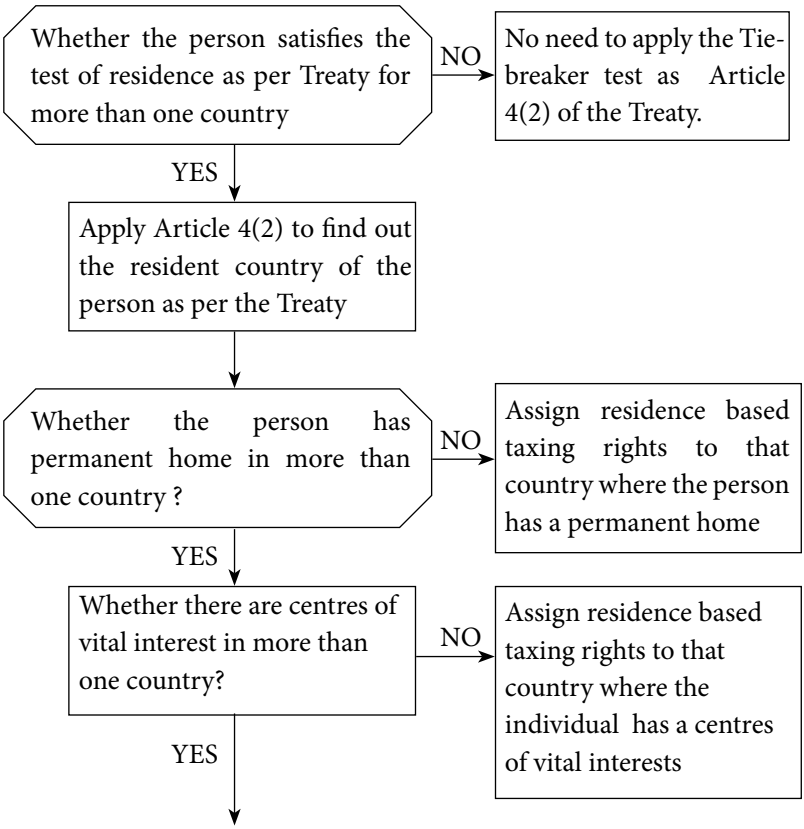
c. For making such a decision, a period of adequate length should be chosen and the length of the various period of sojourn within a specific year should not necessarily be the sole criterion.

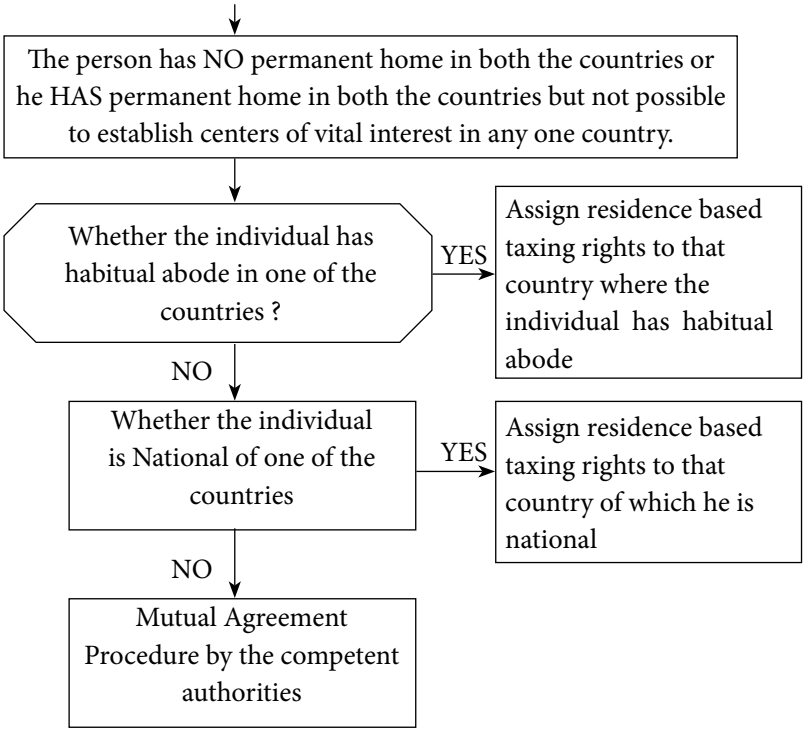
22. Ma'am, if he has habitual abode in both the countries or in neither of them, then what test to be applied?

Priya, in that case, we need to consider the **Nationality** of the person**.** The individual shall be deemed to be resident of the country of which he is a national.

Was wondering why Anu was silent all this while. She was working on a flow chart to illustrate the Tie- breaker Rules for an individual:

Dual Residence – Tie breaker Test for Individuals





Now applying the above principle let us assume Kavya, who is a USA citizen comes to India to stay with her parents. She is physically present in India for more than 182 days during the financial year 2015-16, so she becomes resident in India. Now as per the domestic tax laws of USA, she being a citizen of USA is tax resident of USA. So both USA and India gets the right to tax global Income of Kavya.

Now we will apply Article 4(1) of the Treaty. As per Article 4(1) also she becomes resident of both India and US since she is liable to tax in both the countries as per the respective domestic tax laws.

Kavya becomes dual resident as per the Treaty. So we need to apply tie-breaker rules.

Kavya's permanent home is in USA, also her centers of vital interests - personal (her family, children), economic interests (work, bank accounts etc.) are in USA.

So she is a resident of USA by applying tie-breaker test. So USA gets the right to tax her global income based on 'Residence jurisdiction'. India gets rights to tax only her income from sources in India (rental income) based on 'Source jurisdiction'.

USA being the resident country will give credit for the taxes paid in India on the rental income and thus eliminating the impact of double taxation on rental income.

23. Ma'am, what about tie-breaker rules for persons other than Individuals ?

Yes, Priya the rules are as follows:

As per Article 4 (1) in the case of persons other than individuals, country where the place of management is situated is the country of residence. Place of management is where the control is located and key decisions are taken.

Dual Resident - Tie-breaker rules for Persons other than Individuals

Article 4(3) states that, if a person other than an individual becomes resident of both the contracting countries, the tie – breaker rule provides that the country where the 'place of effective management" is situated will be considered as the country of residence.

Place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made

"Effective management" means the actual conduct of business, where the brain of the business is located.

The place of effective management will be ordinarily the place where the most senior person or group of persons (for example, board of directors) makes its decisions, the place where the actions to be taken by the entity as a whole is determined

This is to be determined based on the facts on a case to case basis. No definitive rule can be given and all relevant facts and circumstances must be examined to determine the place of effective management.

An entity may have more than one place of management, but it can have only one place of effective management at any one time.

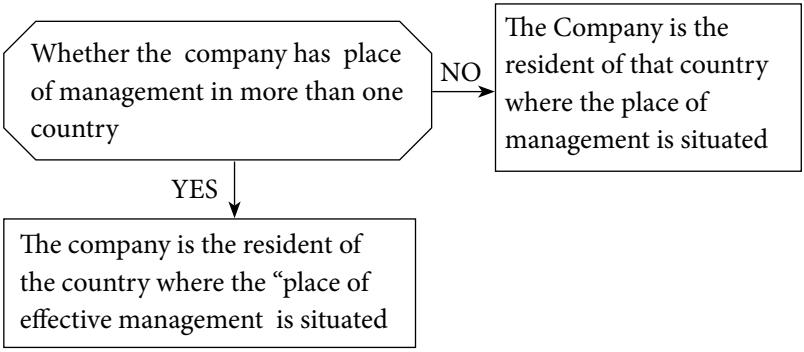
Shravan remembered an Amendment made by Finance Act, 2015 :

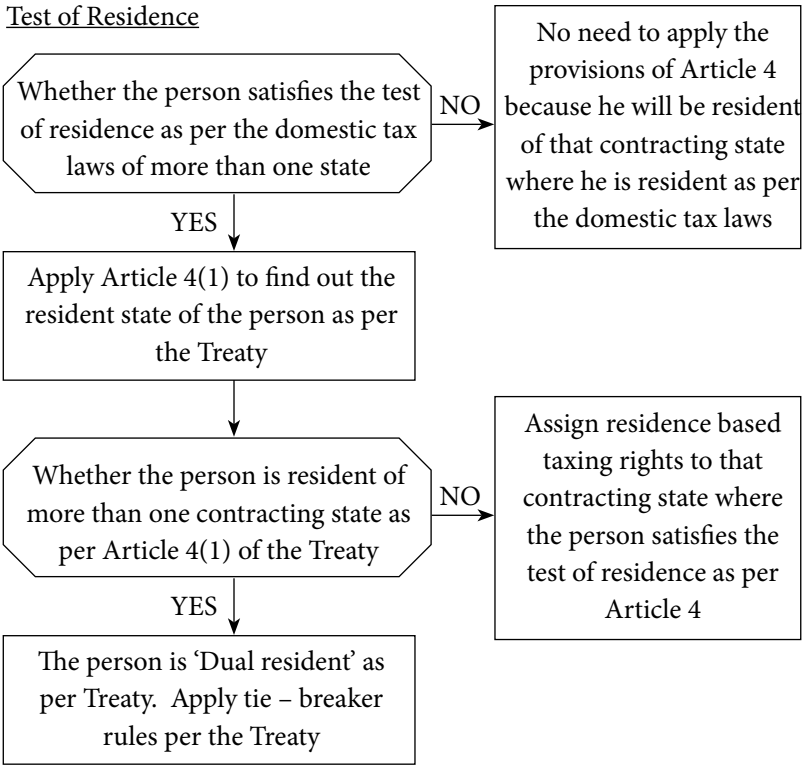
Section 6(3) (ii) of the Income Tax Act was amended where in a company is said to be resident in India in any previous year if, its place of effective management, in that year is in India.

The "Place of effective management" means a place where key management and commercial decisions that are necessary for the conduct of a business of an entity as a whole are in substance made.

The above is in conformity with the definition in the tie-breaking rule in Article 4(3) of the Tax Treaties.

Dual Residence – Tie breaker Test for Persons other than Individuals





24. Ma'am, please explain what is a Tax Residency Certificate (TRC) ?, asked Shravan

As per section 90(4) of the Income Tax Act, a non-resident shall be entitled to claim any relief under the Treaty only if a certificate of his residency in foreign country is obtained from the Government of that country. As we have understood to claim the benefit of the Treaty the person has to be 'resident of the contracting state'.

TRC is relevant to identify the Treaty to be relied upon to resolve an international tax issue.

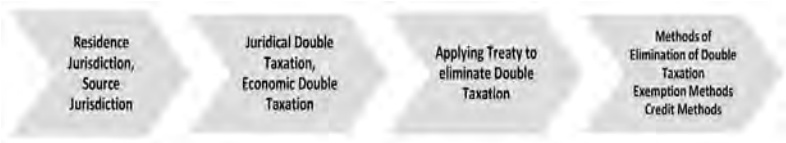
Example:

ABC Private Limited has taken legal opinion from a foreign Law firm. The invoice has Dubai address and remittance is also made to Dubai. The company asked for TRC to find out the rate at which TDS to be

deducted. As per the TRC the firm is registered in London. Since the control and management of its affairs happens in its head office in London, the firm is Tax resident of UK. Dubai is the branch office. In this case, India –UK Treaty has to be considered to resolve international tax issues.

After the discussions Anu, Priya and Shravan were very happy.

We formulated the below diagram to summarise our discussion.



Anu, Priya and Shravan made note of replies to Mr. Gopal Rao's queries:

a. Kiran has moved to UK in the month of MayJuly 2015 to work on a 3 year project- will his salary income be subject to tax in both India and UK?

As per explanation to section 6 of the Income Tax Act, in the case of person who is a citizen of India, leaves India in any previous year for the purpose of employment outside India, and he was in India for less than 182 days in India during that year then he is not resident in India in that previous year.

So Kiran is non-resident in India during the financial year 2015-16.

As per section 9(1)(ii) in the case of a non-resident, salary earned in India for services rendered in India is taxable in India.

So in the case of Kiran, salary for the period from 1st April 2015 to 5th May 2015 (he left on 5th May 2015) is taxable in India. He has to file tax return in India.(Assuming his taxable income exceeded basic exemption limit)

Let us see, what will happen in UK. Assume as per UK domestic tax laws a person is resident if he is physically present in UK for more than 183 days in a fiscal year. Fiscal year is from 6th April in one year to 5th April next year (refer Article 3(d) in India – UK DTAA). So Kiran being physically present in UK for more than 183 days for the period

from 6th May 2015 to 5th April 2016 his salary income is taxable in UK. He has to file tax return in UK.

Since the salary income is subjected to double taxation, Article 16 (Dependent personal services) of India-UK Treaty has to be applied to find out the taxing rights and Article – 24 (Elimination of double taxation) of the Treaty to find out the methods to eliminate double taxation.

b. Kiran will be in UK for the next 3 years. He will be transferring funds from UK to India. If those funds are invested in fixed deposits with Indian banks, whether interest income from the same will be taxable in both the countries? Should he continue to file tax returns in India during the next three years?

Interest income from fixed deposits in India will be taxable in India, since the source of income is in India. Kiran has to file tax returns in India declaring the interest income. Bank where he has fixed deposits will do TDS on interest income under section 195, (since he is a non-resident) so he has to file return in India declaring the interest income and TDS.

Since he becomes resident in UK, he has to comply with the domestic tax laws of UK with respect to interest income in India. So he has to file tax return in UK.

If interest income is subjected to double taxation, Article 12 (Interest) of India-UK Treaty has to be applied to find out the taxing rights and Article – 24 (Elimination of double taxation) of the Treaty to find out the methods to eliminate double taxation.

c. Kavya, who is now a USA citizen has 2 properties in Bangalore. Out of which, one is let out and the other is planned to be sold. Whether rental income from the let out property will be subject to tax in both countries? What about the capital gains arising on sale of the property? Whether she has to file tax returns in both the countries?

Rental income will be subjected to tax in India. Since Kavya is a US citizen she is a tax resident of US. She has to comply with the domestic tax laws of US with respect to the rental income from property in India.

If there is double taxation, Article 6 (Income from immovable property) of India-USA Treaty has to be applied to find out the taxing rights and Article – 25 (Relief from double taxation) of the Treaty to find out the methods to eliminate double taxation

Capital gains arising from sale of property in India will be subjected to tax in India. Since she is resident of USA, she has to comply with the domestic tax laws of USA with respect to capital gains.

If there is double taxation, Article 13 (Capital Gains) of India-USA Treaty has to be applied to find out the taxing rights and Article – 25 (Relief from double taxation) of the Treaty to find out the methods to eliminate double taxation

She has to file tax returns in India and USA.

d. Mr. Rao and his wife are planning to visit their daughter in USA. They are planning to travel by the end of March 2016 and will be back to India in November 2016. What will be the tax implications on his pension and interest income in India? Should he be filing tax returns in India for the financial year 2016-17?

For the financial year 2015-16, since he is resident in India he has to file return in India. If they come back in November 2016, Rao will be in India for less than 182 days during the financial year 2016-17. However, he was in India for more than 60 days during the financial year 2016-17 and also stayed in India for more than 365 days during 4 years immediately preceding the financial year 2016-17. So he becomes resident in India during the financial year 2016-17 also. He has to file tax returns in India for financial year 2016-17.

* * *

CHAPTER – 2

Permanent Establishment and Business Profits

- CA Kusuma Yathish

Mr. Rahul Rao, a Non Resident Indian, nephew of Mr.Gopal Rao has plans of floating a software consulting and hardware manufacturing Enterprise in a Foreign Country M/s.Rahul Inc.

They intend to set up their manufacturing unit in India considering

i) the availability of resources - Mainly Human Resources;

ii) to take advantage of the ease of doing business; and

iii) to meet the prime minister's call for Make in India.

The Foreign Enterprise would manage and execute software consulting services and sale activity to the global market including India from a foreign country.

As far as consulting activity is concerned Mr.Rahul Rao intends to have

(i) a team executing the services from a Foreign Country and

(ii) a team in India only to ensure marketing of the services, provide support services to the client in India with employees from the

CA Kusuma Yathish is a Practising Chartered Accountant, partner in M/s. Shekar & Yathish. Heads the Direct Taxes and Corporate Audit & Compliance team. Having completed his graduation in commerce took up CA with article ship in M/s.Dagliya& Company apart from graduating in Law.

Has been a Member of the Committee on International Taxation of SIRC of ICAI.

He is an active member of Group Dynamics– a study circle on International Taxation.

He has presented papers at various Branches of ICAI and also at the DTRTI – The Income Tax department's training division for its officers.

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parent company visiting India periodically to review the processes, to assure itself that the execution is in accordance with the terms of the contract;

As far as the manufacturing activity is concerned

i. it is to be outsourced to India, contract manufacturing by the Indian Subsidiary;

ii. the execution of contracts for sale (raising of PO's, confirmation of orders, price negotiation, etc.,) will be retained by the foreign enterprise.

iii. The manufacturing concern in India will act as a place for display, storage of finished product for and on behalf of the foreign enterprise, advertise for the products manufactured (though traded by the foreign enterprise).

iv. The Indian entity would also help in dispatch of goods to the various customers in India and abroad of the foreign enterprise.

The Indian enterprise would be compensated for

a) the manufacturing process

b) the other auxiliary services including that of logistics in dispatching the goods.

c) Customer Support Services provided to global customers in respect of the traded goods as well as services rendered by the parent company.

Mr. Rahul Rao intends to understand the tax implications in setting up this unit in India.

The following are gist of the facts made available

a) There is a foreign Enterprise that is into consulting services as well as sale;-

b) The foreign Enterprise has a subsidiary in India for execution of the manufacturing activity and hence can be said to have outsourced the manufacturing activity to India;

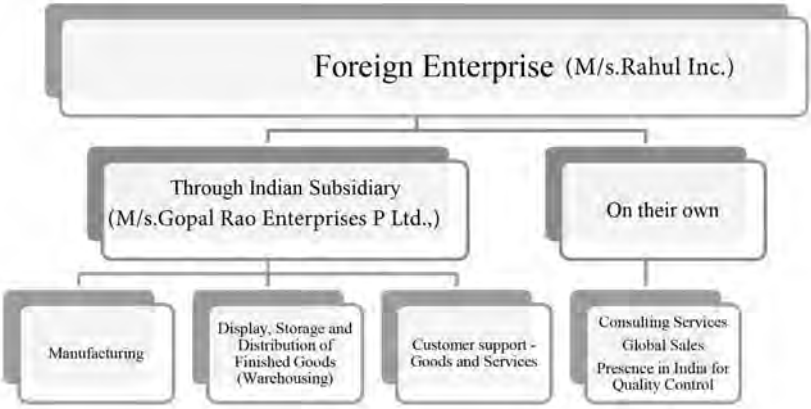
c) The Indian subsidiary (M/s.Gopal Rao Enterprises P Ltd.,) is also the front for the foreign enterprise in respect of the following activities

   i. marketing of manufactured goods (no conclusion of contracts)

   ii. advertisements

   iii. logistic support

   iv. customer support services in respect of the sale and consulting services of the foreign enterprise.



I. Why should Mr.Rahul get a doubt with regard to tax implication? It's just that the Foreign Enterprise should be Taxed in its country and the Indian Subsidiary should get taxed in India, simple and straight - was the question and the answer as well.

For that we need to understand the system and essence of taxation and in particular international taxation.

Every Country has a sovereign right to tax and it exercises its sovereign right to tax income accruing, arising or received in it on account of the activity carried on in its territory. This sovereign right to impose tax can be exercised by either the country where the income is generated or the country where the tax payer resides. Where it is based on Income

generated it is called Source Based taxation and where it is based on residence of the tax payer it is called Residence Based Taxation. The following summarises the same;

Where the residence of the tax payer is the connecting factor. When a person is a resident of India, Government of India has a right to tax his Global income.

Where connecting factor is the source of income. If the income is sourced in India, then the Government of India has the right to tax the same irrespective of whether the assessee is an Indian resident or a non-resident. In other words, if the income is sourced in India, the income earners from the entire globe can be taxed in India irrespective of their residential status.

If every nation resorts to a common basis of tax – that is predominantly either based on source or based on residence then there is no conflict of taxation at all.

However, generally, a hybrid system of taxation exists – taxation is on the global income of all its residents (Residence based Taxation) and also on the source based income of its non-residents.

This results into a transaction or a person getting taxed more than once.

Hence it is important for one to understand the tax implication when the operations are spread globally.

So does it mean that the Foreign Enterprise has to pay taxes in India as well as the Foreign Country?

In a cross border business activity - the government of a country is concerned about the business activities of its residents abroad and the source of income exploited by the non-residents in its country. A country would be interested in its share of taxes on profits earned by its resident or non-resident in respect of the business carried on in its territory. So as to say, India will be interested in the Foreign Enterprises only if sources of income is in India.

As far as the Indian Enterprise (Subsidiary) is concerned, as a resident of India, it is taxable in India in respect of its global income and hence in respect of its business operations one need not test whether the business is carried on in India or outside India.

In respect of the Foreign Enterprise, a Country would want to tax non-resident enterprises' profits in respect of the profits earned out of business carried out in its territory only if the non-resident enterprise has a real, significant and substantial economic nexus with the country and its territory.

When such real, significant and substantial economic nexus is presumed to exist when the transaction is carried out, then it is said to have been carried out through a Permanent Establishment. A non-resident dealing with a resident of India would be liable to tax in India if it has a Permanent Establishment in India as defined in the Double Taxation Avoidance Agreements that India has entered into with various countries.

So it is potentially possible for an enterprise to have made profits in more than one country - the residence country as well as in the source country.

But tax cost in both the countries would eat into the profits of the enterprise as a whole?

That's indeed an issue in respect of transactions that go beyond the geographical boundaries of a particular country. However, in the interests of international trade and commerce, this is taken care of by the tax credit mechanism that is part of the Double Taxation Avoidance Agreements as well as the Domestic Tax laws of various countries so as to minimise the impact of such double tax. Elimination of such double taxation is discussed elsewhere in this book.

I understood that India does not have a Double Taxation Avoidance Agreements with all the countries. Then how to determine existence or otherwise of a Permanent Establishment? Does it mean that if India does not have a Double Taxation Avoidance Agreement with a country then the Income of a non-resident is for sure doubly taxed or not taxed at all in India?

Provisions similar to that of Permanent Establishment is envisioned by the Indian Income-tax Act, 1961 and engrained in Section 9(1) of the said Act whereby a non-resident is liable to tax in India if he has a 'Business Connection' in India. So even where a Double Taxation Avoidance Agreement is not entered into with a particular country, the residents of that country would be subjected to tax in India if they earn business profits through a business connection in India.

So before we finalise on any structure we need to know the country of residence and country of source of the enterprises?

Very correct. This is very important because, the world wide income of an Indian resident company is subjected to tax in India and a Foreign Company is taxed, generally, in India only in respect of income attributable to source in India.

However, when a Foreign company is treated as a Resident in India then the world wide income of such Foreign Company is taxed in India. This situation of a Foreign Company taxed in India on its worldwide income occurs in the event of control and management of its affairs is

situated in India (Place of Effective Management - POEM; Section 6 of the Indian Income-tax Act, 1961).

This concept is present even in the Double Taxation Avoidance Agreements in the course of identification of the Residence of a Corporate Entity. The Double Taxation Avoidance Agreement provides that the entity will be deemed to be a tax resident of that country in which it's POEM is situated.

Hence it becomes important for a country as well as an entity to determine, whether

a) a Foreign Enterprise is a resident in India;

b) a non-resident has a Permanent Establishment in India; and

c) there is a tax treaty between the two countries

so as to test the taxability or otherwise of an international transaction.

We would already have understood the importance of transacting with a country with which India has a Double Taxation Avoidance Agreement.

If India has not entered into a Double Taxation Avoidance Agreement with the country of the non-resident Enterprise, then the tax liability of the non-resident Enterprise will have to be determined only in accordance with the provisions of the Indian Income-tax Act, 1961.

Under the Indian Income-tax Act, 1961 a non-resident is liable to tax in India on the business income only if it has a business connection in India as defined in Section 9(1) of the Indian Income-tax Act, 1961.

However, where there is a Double Taxation Avoidance Agreement with a country of the non-resident entity, then it is necessary to determine the tax liability under the Double Taxation Avoidance Agreement as well as under Indian Income-tax Act, 1961. Generally, the beneficial of the two will apply in determining the tax liability of the non-resident.

II. The activities of the Foreign enterprise and the Indian subsidiary are

By Foreign Enterprise

a) Gets goods manufactured in India;

b) Sell the goods to customers globally;

c) advertisement and marketing;

d) Provides consultancy Services globally;

By Indian Subsidiary

a) Manufactures goods

b) Display's goods

c) Storage and distribution services to the Foreign Enterprise.

d) Customer support services in respect of goods sold and services rendered by the Foreign Enterprise.

With regard to taxation, Indian Subsidiary will be liable to tax in India in respect of the profits derived from carrying out its activities specified above;

The Foreign Enterprise will be chargeable to tax in its country in respect of the profits it earns from out of the activities carried out from its country.

As already discussed, India would want to tax non-resident enterprises' profits in respect of the profits attributable to business carried out in India's territory if and only if the non-resident enterprise has a real, significant and substantial economic nexus with the country and its territory.

So how do we test the existence or otherwise of this real, significant and substantial economic nexus?

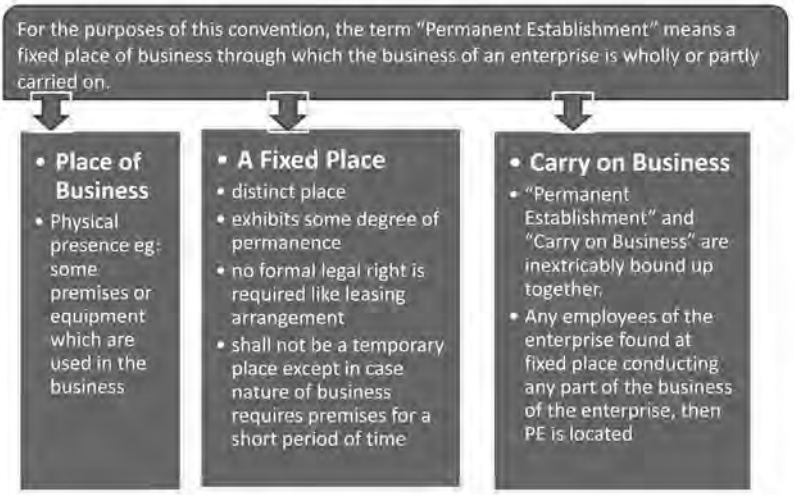
Under the provisions of the Income-tax Act, 1961, business profits of a non-resident enterprise is taxable if it has a "Business Connection" in India.

Under the provisions of the Double Taxation Avoidance Agreement a non-resident dealing with a resident of India may be liable to tax in India if he has a "Permanent Establishment" in India.

So one needs to understand what constitutes a "Permanent Establishment".

One needs to however, take note that it is difficult to identify the existence or otherwise of a Permanent Establishment and it is equally difficult to identify the residential status of a Foreign Enterprise. It becomes much more difficult when a Permanent establishment is hidden behind a dependent company (100% share holding, financial dependency, etc.,) similar to the present case where, in addition to its own business the subsidiary also carries on few of the activities of the parent company, on which it is dependant, as a fully owned subsidiary.

So what is a Permanent Establishment (Article 5)?



In simple words a non-resident enterprise is said to have a Permanent Establishment in India if it carries on its business, wholly or partly through a **fixed place** in India (Article 5(1)). Existence of a Permanent Establishment under this Article needs to be tested on a yearly basis; whether,

a) there is an enterprise carrying on business;

   Business would be a structured activity that is carried out continuously with profit as its objective;

b) there is a place of business;

"Place", though not defined, may be considered to include, based on precedents, a place that is at the disposal of the enterprise;

"Place", inter alia includes -

(i) premises, installation facilities, other facilities that are used by the enterprise though not exclusively for business (residence cum office spaces);

(ii) a customs depot that is permanently used ;

(iii) place can be in Joint holding as well (size of the place is not the consideration);

(iv) an internet website based on the location of the server where it is hosted (Note: Though this is India view contrary decisions are given in Western Union Financial Services (50 SOT 109, Delhi ITAT) where in it was held that intangible, such as an internet website, are not fixed place of business. In eBay International AG 25 taxmann.com 500- Mumbai ITAT it was held that sales carried out from websites operating from outside India was not taxable in India till unless there is a Permanent Establishment in India).

(v) a fishing vessel

(vi) a residence of a Manager used for the office address

(vii) employee stationed in a vendor's place for a long duration of time monitoring the contract compliances;

c) that the business is carried on from a place of business that is fixed;

the word permanent would lead us to believe that the place from which the business is carried on should have a degree of permanence, regularity of usage and continuity attached to it. Simply put business carried out in a source country through a telephone would not constitute a fixed place of the non-resident in the source country.

Is there an indicative list of such fixed Place of business?

Other than the fixed place as referred to in Article 5(1),Article 5(2) gives us a list of places which shall be termed Permanent Establishment;

a) Place of Management: Where control and management of the enterprise resides.

b) Branch: except where a branch is used for activities that are listed in the exclusions a branch is considered a permanent establishment

c) an Office : Project Office; Liaison Office, etc.,

d) a factory

e) Workshop

f) Sales Outlet

g) Warehouse

h) Mine

i) Oil or gas well, quarry

j) a building site or construction or assembly or installation project

k) Furnishing of managerial services.

So an activity of a non-resident has to fall within the definition of Article 5(1) and Article 5(2) of a Double Taxation Avoidance Agreement, for it to be considered as a Permanent Establishment.

We need to test each of the activities carried out by the Indian Subsidiary with those covered in Articles 5(1) & (2), to determine whether the activities carried out by the Indian subsidiary M/s Gopal Rao Enterprises P. Ltd., would constitute a permanent establishment of the Foreign Enterprise in India.

Any of the specified activities, if carried on by the Foreign Enterprise on its own, it would no doubt be covered by Article 1 & 2 - Fixed Place - considering that the Factory, Warehouse, etc., would be at the disposal of the Foreign Enterprise from which the foreign enterprise carries on its business of manufacturing and Sale of Goods.

However, since the activities in India are being carried out by M/s.Gopal Rao Enterprises P Ltd, Indian subsidiary which is a separate legal entity, it cannot *prima facie* be concluded that the factory, warehouse etc., are at the disposal of the foreign parent Enterprise.

Inclusions are defined but are there any specific activities that are 'excluded' from the definition of Permanent Establishment?

Yes, Article 5(3) lists out the activities carried out that would not result into a Permanent Establishment -

a. when the Indian facility is used **solely** for storage or display of goods or merchandise;

b. when the Indian facility provides the services of maintenance of the stock of goods **solely** for the purpose of storage or display;

c. services for maintenance of stock of goods or merchandise belonging to the foreign enterprise **solely** for processing by another enterprise;

d. maintained **solely** for purchasing goods or merchandise, or for collecting information, for the foreign enterprise;

e. maintenance of a fixed place of business **solely** for the purpose of advertising, for the supply of information or for scientific research, being activities solely of a **preparatory or auxiliary** nature in the trade of business of the enterprise.

This provision shall not apply in the event of the foreign enterprise maintaining any other fixed place of business in India for purposes other than advertising, supply of information or for scientific research, being activities solely of a **preparatory or auxiliary** nature.

None of the activities that are carried out by the Foreign Enterprise would get categorised under the above exceptions but for the activity of storage and display of goods. The foreign Enterprise uses India for storage and distribution of its goods. None of the activities attributable to India or carried out from India being, manufacturing, storage, distribution can be considered as activities of preparatory or auxiliary in nature and thus not covered under the exception list. Hence if these

activities were to be carried on by the Foreign Enterprise through a fixed place in India, then it would be considered as activities carried on from its permanent establishment.

But, since these activities are carried on by a subsidiary it may not *prima facie* be considered as activities carried on by the Foreign Enterprise and hence the subsidiary may not be considered as a Permanent Establishment of the Foreign Enterprise.

What are activities that can be considered as preparatory and auxiliary in nature?

An indicative list of activities might be

a) Market Survey

b) Maintenance of Books of Accounts and finance services

c) Technical presentation to potential customers

d) Invoicing

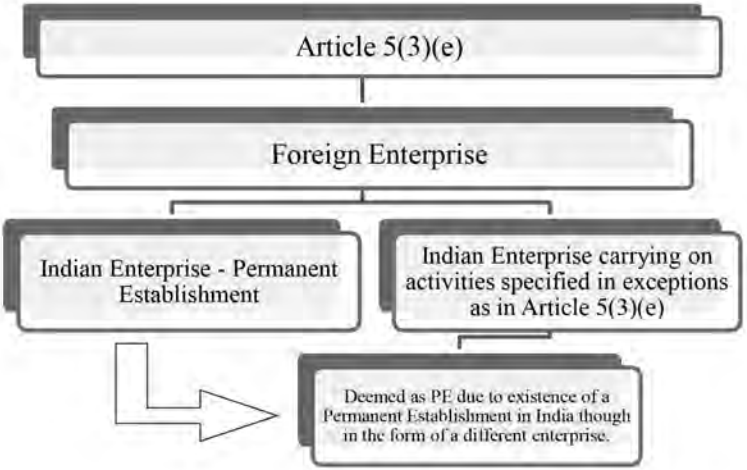
e) Collecting claims

f) Development of market opportunities, etc.,

We find in Article 5(3)(e) that there is an exception to the exemption available when the activity carried on is considered to be preparatory and auxiliary. What does that mean?

That's right. It is potentially possible that even when the activities are preparatory or auxiliary in nature, the Foreign Enterprise may not escape the possibility of its being considered as having a Permanent Establishment.

This is possible when there is an another enterprise in India that is carrying on activities that constitutes a Permanent Establishment for purposes other than advertising, supply of information or for scientific research, being activities solely of a **preparatory or auxiliary** nature. Shown below is its diagrammatical representation



Since the Subsidiary is the wholly owned subsidiary of the Foreign Parent Enterprise, can it be said that the subsidiary is a fixed place from where the foreign Enterprise carries on its business?

Prima facie a subsidiary cannot be termed as a Permanent Establishment until and unless the characteristics of a Permanent Establishment are attributable to such subsidiary.

Where M/s.Gopal Rao Enterprises P Ltd, an Indian subsidiary of a Foreign Enterprise, provides logistic support for the global business of the Foreign Enterprise, it was considered that the subsidiary would constitute a Permanent Establishment since the business of the Foreign Enterprise cannot be conducted successfully without its subsidiary M/s.Gopal Rao Enterprises P Ltd executing its role in India.

Hence, in a situation where a subsidiary gets construed as a fixed place from which the foreign enterprise carries on its business or is integral to its carrying on its business, it can be termed a Permanent Establishment.

III. Will the manufacturing activity carried out by the subsidiary of the Foreign Enterprise make it a permanent establishment?

Whether the wholly owned Indian subsidiary of the Foreign Enterprise, consequent to its catering to the manufacturing needs of the Foreign

Parent Enterprise only, constitute a Permanent Establishment of the Foreign Enterprise in India?

Factory: The term factory has been defined as a building in which goods are manufactured.

Article 5(1) speaks about a permanent establishment getting created consequent to the existence of a fixed place of business from where business is carried on.

Kevin Holmes has in his book International Tax Policy & Double Tax Treaties states that a factory, referred to in Article 5(2) would qualify as a permanent establishment only if it satisfies the general requirements laid down in Article 5(1).

So as to say, in case, the factory in question was owned and operated by an Indian Company, an entity separate and distinct from the taxpayer- a Foreign Enterprise, which held shares in it and was its parent. The Indian company produced articles and sold to the Foreign company and was duly paid for the articles supplied. On a question whether a factory catering especially for the needs of the Foreign company should be held to be a 'factory' within the PE clause. Since the Foreign Enterprise did not own the factory it was not be construed as a Permanent Establishment of the Foreign Enterprise so as to say that ownership is an important criteria for an enterprise to be considered a Permanent Establishment within Article 5(2).

In contract manufacturing, the manufacturing process is the proprietary property of the parent company and the subsidiary carries out the manufacturing process as per the specifications of the parent company. Under this arrangement, factory owned and used exclusively by an independent subsidiary cannot be said to be at the disposal of the parent merely because the goods will be used in the business of the parent company. An independent subsidiary carries on its own business of manufacturing products for the parent as it would have done under similar market conditions for another company that did not form part of the same business group. Therefore the factory of the subsidiary should not be considered a fixed place permanent establishment of the parent.

IV. Does the carrying out of the other activities by the subsidiary entity in India constitute a permanent establishment of the foreign enterprise in India?

Apart from the manufacturing activity, the Indian subsidiary carries out the following activities for the foreign enterprise

i) Storage of goods;

ii) Distribution of goods; and

iii) Support services in respect of the consulting services rendered and goods traded by the foreign Enterprise to the customers in India and abroad;

One of the ways in which a Foreign Enterprise can avoid its activity resulting into a permanent establishment is by appointing a resident of India as its agent to execute the activities which otherwise the foreign Enterprise would by itself have carried out in India.

The carrying out of the activity by such agent would negate the applicability of Article 5(1) and 5(2), whereby the foreign enterprise would not be considered to have a Permanent establishment in India.

Hence, as an anti avoidance provision a concept of Agency Permanent Establishment is introduced in Article 5(4).

So when would an agent be considered a permanent establishment of the Foreign Enterprise?

where a person, who is not a independent agent,

a) has and habitually exercises an authority to negotiated and enter into contracts in India;

b) habitually maintains in India stock of goods from which he delivers goods on behalf of the foreign enterprise;

c) habitually secures orders in India wholly or almost wholly for the Foreign Enterprise.

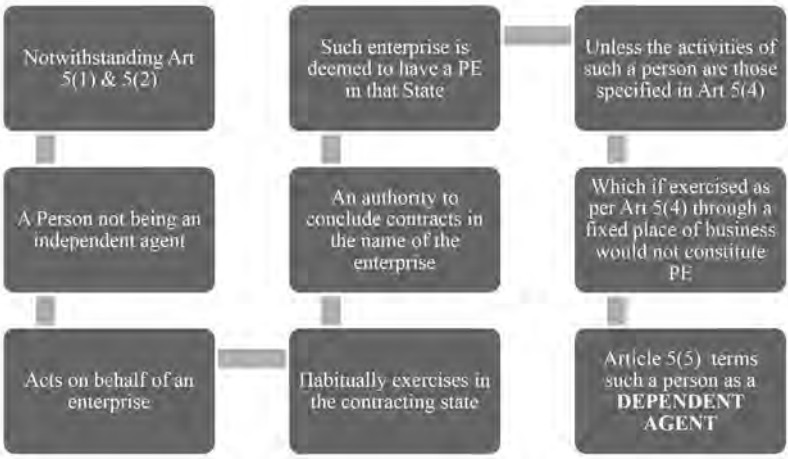
shall be **'deemed'** to be a Permanent establishment of the Foreign Enterprise.

The Indian subsidiary is supposed to habitually maintain stock of goods and deliver the same as per the directions of the Foreign Parent Enterprise. But the transaction between the parent and subsidiary is on principal to principal basis and hence is not a dependent agent. Does it mean that a Subsidiary in this case cannot be considered a permanent establishment of the Foreign Enterprise?

The Indian Subsidiary would not be deemed to be a permanent establishment merely because it carries on the business of the foreign enterprise, if it carries on its activities in the ordinary course of its business - Article 5(5).

However, where the subsidiary carries on these activities wholly or almost wholly for the foreign enterprise it shall lose out its characteristic of an independent agent.

The Indian Subsidiary is carrying out the activity of storage and distribution wholly for the Foreign Enterprise as stated in Article 5(4)(b) and hence would constitute its permanent establishment - A Dependent Agent Permanent Establishment (DAPE)



But did we not conclude that there is no permanent establishment of the Foreign Enterprise just because the subsidiary is providing warehouse service?

One needs to appreciate the fact that activities carried out by the Indian Subsidiary did not result into a Permanent Establishment under Article 5(1) and 5(2) (Fixed Place Permanent Establishment) but has now resulted into or is deemed a Dependent Agent Permanent Establishment under the provisions of Article 5(4).

Activities carried on by an Indian Enterprise needs to be tested under all the clauses of Article 5 before concluding about the existence or otherwise of a Permanent Establishment of a Foreign Enterprise.

Now that the Subsidiary constitutes a Permanent Establishment of the Foreign Enterprise consequent to the storage and distribution activity, would I be correct in presuming that all the activities carried out by the subsidiary would be treated as having been carried out by the Foreign Enterprise?

No. The subsidiary constitutes a Permanent Establishment only in respect of the activity, which upon being carried out by the Subsidiary, resulted into the existence of the permanent establishment of the Foreign enterprise.

So as to say,

a) manufacturing activity of the Subsidiary

b) advertisement activity

c) display of goods

d) support services rendered

are not an activity carried out by the foreign enterprise through a permanent establishment.

It is only the storage and distribution activities of the Indian Subsidiary that are considered as the activities carried out by the Foreign Enterprise through its permanent establishment.

One needs to take note that if the activities of the agent are limited to the activities that are part of the exclusions defined in Article 5(3), then it would not constitute a permanent establishment of the foreign enterprise and consequently the activities of advertisement and display of goods by the subsidiary would not constitute the permanent establishment of the Foreign Enterprise.

Before we understand the taxability of the profits of the Indian Subsidiary and the Foreign Enterprise's Permanent Establishment in India, we seem to have forgotten about the support services provided by the Subsidiary to the customers of the Foreign parent enterprise.

Activity of the Indian Subsidiary in providing support services to the customers of the Foreign parent Enterprise should be tested for the existence or otherwise of a permanent establishment.

This activity does not get covered under the provisions of Article 5(1) - Fixed place Permanent Establishment, since the Foreign Enterprise cannot be said to have the place at their disposal just because it is held by its wholly owned subsidiary, 5(2) - Permanent Establishment inclusions since none of the activities as are specified therein are carried out by the subsidiary resulting into a fixed place at the disposal of the foreign enterprise to carry on their business or 5(4) - Dependant Agent Permanent Establishment (discussed earlier) since the activity of providing support services does not fall within the three activities prescribed therein and hence may not result into a Permanent Establishment of the Foreign Enterprise.

Have we factored the presence of the personnel of the foreign enterprise in India for the purpose of protecting its interest in terms of quality control. Does their presence in Indian Subsidiary constitute a permanent establishment of the foreign enterprise in India?

Presence of personnel of a foreign enterprise resulting into a permanent establishment is referred to in Article 5(2) - Inclusions.

Permanent Establishment would be formed if the following three (3) conditions are satisfied:

a. The services are furnished within the source state (India). A non resident cannot be taxed in respect of services rendered outside the source state merely because the payment is made from a resident of India or just because the services are ultimately utilised in India. The services rendered should be connected with the source state.

b. the services are furnished by the foreign enterprise through employees or other personnel. Other personnel can be persons over whom the enterprise would be having a control.

Hence one more critical aspect for the presence of employees or other personnel to trigger service Permanent Establishment is the existence of control over such employees and personnel by the foreign enterprise. So as to say where

1. **Employees or personnel of a foreign enterprise** are instructed, controlled and supervised by another Indian Enterprise then there is no Permanent Establishment of the Foreign enterprise even if the employees and other personnel are paid by the foreign enterprise.

2. **Employees or personnel of an Indian Enterprise** are instructed, controlled and supervised by the Foreign Enterprise then it can trigger a Permanent Establishment of the Foreign enterprise even if the employees and other personnel are of an Indian enterprise.

3. **Employees or personnel of a foreign enterprise** are instructed, controlled and supervised by the Indian service provider / sub-contractor then there is no Permanent Establishment of the Foreign enterprise even if the employees and other personnel are paid by the foreign enterprise.

   This also brings to the fore, the concept that - the residential status of the employees or the other personnel is not what triggers the existence of the Permanent Establishment but the control and supervision.

c. the period of furnishing of services exceeds the specified threshold period. The threshold period may vary from treaty to treaty.

i. if it's 90 days in a any fiscal year in the treaty with Singapore;

ii. it's 90 days within / in any twelve month period in the treaty with USA

iii. it's 9 months within any twelve month period in the treaty with UAE.

Also to be taken not here would be the change in the threshold period if the services are provided to an associated enterprise.

It can be a days (1 day) service that could trigger a service PE in the treaty with USA and 30 days in a fiscal year in the treat with Singapore.

Will it constitute a Permanent Establishment if the services rendered are in respect of the exclusions referred to in Article 5(3)?

Another question that may arise is the applicability of Article 5(3) - exclusions from PE, mainly the preparatory and auxiliary activities, in course of determination of the existence of a Service PE. The exclusions are mostly in the course of dealing in goods and hence may not be a reason for the existence or otherwise of a service permanent establishment.

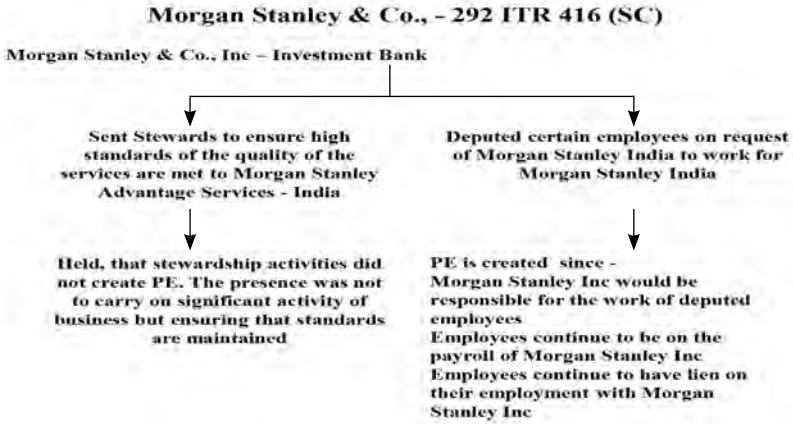
So does the presence of the employees or other personnel of the foreign enterprise to ensure that the terms of the contract are being executed by the Indian Subsidiary, constitute a Permanent Establishment of the Foreign Enterprise consequent to their presence in India?

In the instant case study the services of business support services are rendered by the Indian Subsidiary and by its employees to the foreign Enterprise and hence there is no possibility of a service permanent establishment coming in to force.

However, if the Foreign Enterprise were to have its employees assigned to India under their supervision and control to execute the services from India then the Foreign Enterprise would be considered to have a Permanent Establishment in India.

And, further, services rendered to self are not covered by the provisions of service Permanent Establishment. The concept of service permanent establishment is in the course of furnishing of services. One cannot furnish services to oneself.

Supreme Court in the case of Morgan Stanley and Co., (2007) 292 ITR 416 has held that stewardship activities were merely to protect its own interest and hence did not constitute a Service Permanent Establishment.



In view of the same the presence of the employees or personnel of M/s Rahul Inc., in the subsidiary would not constitute a permanent establishment of the foreign enterprise in India.

Now that the existence of permanent establishment or otherwise has been determined what is the implication of taxes, in India, in respect of the profits earned by the Indian Subsidiary and the Permanent Establishment of the Foreign parent Enterprise?

Business Profits (Article 7):

Business profits of M/s.Gopal Rao Enterprises P Ltd, is to be taxed in the country of its residence. However a non-resident may be taxed for the business profits that he earned from India as is attributable to its Permanent Establishment.

a) a resident is taxed in the residence state for the business profits sourced globally;

b) a non-resident is taxed in the source state in respect of the business profits earned from the business activity carried out in the source state.

The first part of Article 7 gives exclusive right of taxation of business income to the state of residence. The second part states that if there is a Permanent Establishment in the source state then the right to tax the business profit is not exclusive to the state of residence but may also be taxed by the source state.

Determination of Profits of the Subsidiary is fine but how do we determine the profit of the Permanent Establishment?

Business profit as is attributable to the activities that has constituted a permanent establishment of the foreign enterprise is taxable in India.

In the case study it is the storage and distribution function of the Indian Subsidiary that has constituted the Permanent Establishment of the Foreign Enterprise and consequently the profit as is attributable to the activity of storage and distribution is chargeable to tax in India in the hands of the Permanent Establishment.

What is attribution of profit?

Treaties are generally silent as to principles of attribution. Hence, one may have to rely on the domestic tax laws of the source state. Explanation 1(a) to Section 9(1)(i) of the Income-tax Act, 1961 states that profits that are attributable to the operations carried out in India would be subject to tax in India. However, when it comes to guiding principles in determining such reasonable attribution is not available.

The basic principle is that the profits that arise from the direct and proximate connection with the permanent establishment would be subjected to tax in the source country. In determining such profit all expenses incurred for its purposes shall also be allowed.

In the present case the permanent establishment is deemed to exist in the form of a DAPE [Dependent Agent Permanent Establishment]

consequent to the Indian Subsidiary rendering the storage and distribution services wholly to the foreign parent Enterprise (Article 5(4)). The service of storage and distribution rendered by the Permanent Establishment is compensated by the Foreign Enterprise. Once such Permanent Establishment is compensated at arm's length nothing further can be attributed to the Permanent Establishment. SET Satellite 307 ITR 205 (Bom).

What if the Indian subsidiary has incurred losses?

Attribution of profit needs to be checked even when the enterprise as a whole has not made any profits or has not realised the same. The simple reason is that it's not profit allocation that is called for but profit attribution to the activities carried on by the Permanent Establishment.

This is all fine, but, don't you think that since the transaction is between the foreign enterprise and its subsidiary, the remuneration / compensation for activities carried out by the Indian Subsidiary can be compromised so as to make it more tax effective?

This kind of a tax evasion is sought to be overcome by Article 9 - which provides for arms length pricing in respect of transactions between associated enterprises.

What constitutes an Associated Enterprises?

When one enterprise is said to participate directly or indirectly in the management, control and capital of another enterprise they are considered Associated Enterprises.

The Indian Subsidiary is said to be an associated enterprise of the Foreign Enterprise consequent to the fact that the Foreign Enterprise participates directly in the management, control and capital of the Indian Subsidiary.

Article 9 comes into force only when the income is in the nature of business income and not otherwise.

To summarise, Article 9(1) applies when the following conditions are satisfied

- There are two enterprises
- Such enterprises are 'associated enterprises'
- Such enterprises are of two different Contracting States
- Conditions are made or imposed between these two enterprises
- Such conditions are in their commercial or financial relations and
- These conditions differ from those which would be made between independent enterprises

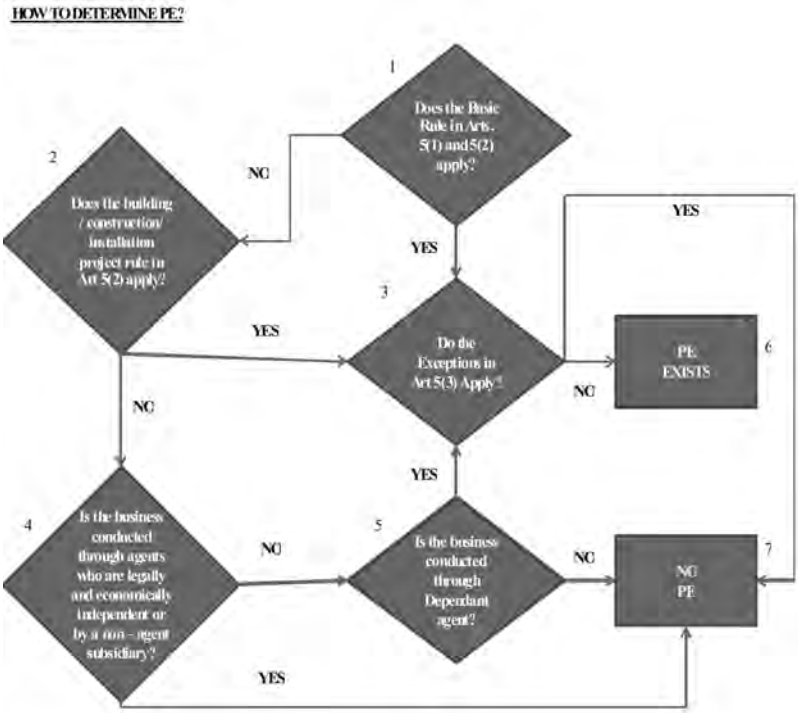
If above-referred conditions are satisfied, then

- Any profits made by one enterprise from dealings with an associated enterprise, may be adjusted to the level they would have been if the enterprises had been independent and dealing at arm's length
- Such adjusted profits are taxed accordingly

What is meant by Indirect Participation?

Indirect participation would be where two companies are construed as associated enterprise consequent to both the companies being controlled in respect of its management and capital by a common enterprise.

Any transaction between these two controlled companies would be termed as a transaction between associated enterprises and profits will have to adjusted to meet the arm's length pricing.



Note:

a. The article has predominantly gone by the contents of the Indo-UK Double Taxation Avoidance Agreement.

b. we need to also take note of an AAR decision in Seagate Singapore, 322 ITR 650, where an Independent service provider provided warehouse services to a non-resident entity that involved storage of goods and delivery of goods to the buyer, the non-resident was said to have a permanent establishment in the form of a fixed place of business in India.

The following table gives in brief the comparison between setting up a subsidiary vis-a-visa branch on various parameters.

Branch & Subsidiary - An overview**		
Category	**Branch**	**Subsidiary**
Requirement of Capital	No Minimum Requirement	Minimum Requirement prescribed in Certain countries
Compliance costs	Lower	Higher
Setting up Cost	Lower	Higher
Losses of the Entity	Branch losses are included in the head office's income statement	Losses of the subsidiary are generally not included in the parent company's income statement
Set-off of Losses	Branch Losses can be offset against home profits	No relief for losses of the subsidiary
Applicability of Treaty Provisions	Not Applicable	Qualifies as 'resident' for treaty benefits
Fund Transfers	Funds which are remitted to the head office will not be recognized as dividends but as inter office transfer of funds with no relevance to taxation	Transfers of funds between the parent and the subsidiary need to be classified within the following categories; payment of dividends, repayment of borrowings, payment of interest expense, payments of royalties and accounts payable. Tax withholding may be required for payments such as dividends.

Category	Branch	Subsidiary
Economic Double Taxation	No effect of economic double taxation on repatriation of profits to head office unless branch tax is payable	The dividend payments are subject to economic double taxation in countries using classical tax system
Expenses of the Head Office	Management fees, interest & royalty from & to H.O may be disallowed for tax purposes.	There is no scope for expense allocation since the subsidiary is considered to be a separate legal entity
Suitability	Unsuitable for Long-term overseas investments & brings unlimited obligations to the parent company	Suitable for Long-term commercial presence in a country & provides limited liability status.
Consolidation of Accounts	Branch accounts to be periodically updated with the head office accounts.	Prepare a consolidated Financial Statement of the company and of all the subsidiaries in the same form and manner as that of its own which shall also be laid before the annual general meeting of the company .
Levy of capital taxes, stamp duties,etc	No such taxes	Such taxes are to be paid on issue of shares
Transfer Pricing Regulations	may not be applicable	Applicable

Category	Branch	Subsidiary
Scrutiny by Revenue Authorities	Books of accounts of a branch is open to scrutiny by the Revenue authorities having jurisdiction over Head office	Books of accounts of subsidiary company is not open to scrutiny by the Revenue authorities of parent company
Eligibility for local financing	No such incentives available	Normally eligible for local financing through public listing or loan issue
Flexibility in Operations	Less flexible	More flexible
Permanent Establishment	Branch will constitute a PE	Subsidiary will not constitute a PE
Taxation of PE	Taxes levied on the profit attributable to the branch for a financial year in the country of source	Taxes are levied on global income irrespective of where it is earned

**This compilation is general in nature and may not be specific to India.

* * *

CHAPTER – 3

Income from Immovable Property

- CA Kusuma Yathish

Mrs. Kavya, daughter of Mr. Gopal Rao owns a residential property in Bangalore and also a vacant site near Nelamangala. These properties were purchased out of her earnings in US.

Residential property is let out.

She wanted to have a call to clarify her doubts regarding the transactions relating to her immovable properties in Bangalore. She being a US citizen, wanted to understand the relief she can avail under the Double Taxation Avoidance Agreements (DTAA)

To my surprise, she had already gone through India – US DTAA so her questions were very specific.

1. **Is it enough that taxes are paid in India, where the immovable property is situated? ?**

   India, the country of source does not get an exclusive right to tax 'Income from Immovable Property'.

   The words *'Income may be taxed in'* used in this article implies that state of residence may also tax the same income.

2. **How Double taxation can be mitigated, in case, the 'Income from Immovable Property' is taxed in both country of residence and country of source ?**

   Double taxation so arising is mitigated by way of exemption or tax credit mechanism available in governing DTAA. Tax credits are discussed in a separate chapter.

3. **What can be categorised as 'Immovable Property' ?**

   As far as Indian DTAA's are concerned, the term "Immovable Property" shall have the same meaning as is under the law of Country of Source and shall also include the following;

- Property accessory to immovable property;

  appurtenant properties that contribute to the composite asset that generates income would also be considered as immovable property. Even the income for services associated with the right to use the immovable property may be termed as income from immovable property.

- Livestock and equipment used in agriculture and forestry

  Though by characteristic these are movable in nature, the treaty may provide for it to be treated as immovable property and income earned there from would also be governed by Article 6. One has to be very careful in identifying the appropriate Article that is applicable to the nature of income considering the fact that by characteristic it may look different from what is expressly provided for.

- Rights to which the provisions of general law respecting landed property apply;

  right to develop, right to acquire, lease hold rights, etc.,

- Usufruct of immovable property;
- Rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources.

  Rights associated with the extraction of natural resources is also regarded as immovable property.

4. **Whether Income from Agriculture & Forestry be taxed as Income from Immovable Properties ?**

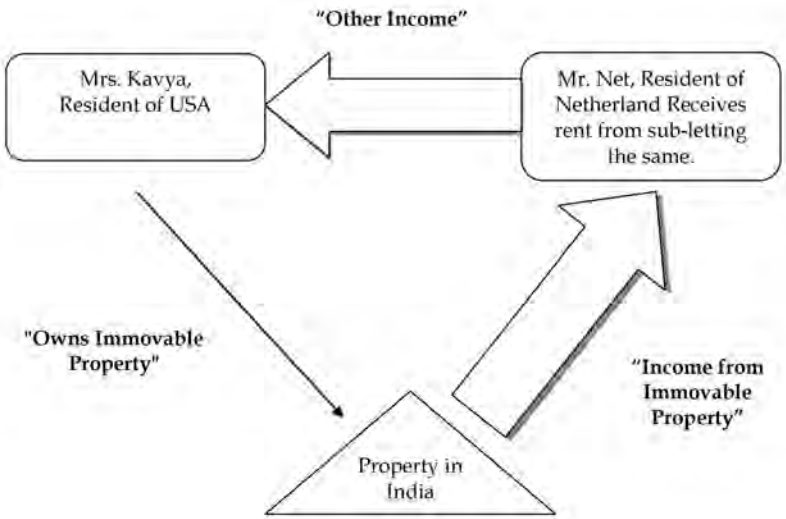
   As far as Indian tax treaties are concerned, few of the treaties do include income from agriculture and forestry as a part of income from Immovable Property.

   In cases where such income from agriculture and forestry is not included as part of income from immovable property such income would be governed by Article 7 - Business Profits.

5. **How is income from Immovable property located in third country dealt with?**

   The Article of Tax Treaty with respect to 'Income from Immovable property' deals only with income which a resident of one country derives from immovable property situated in Other Country. Therefore, it does not deal with the income from Immovable property located in third country. Hence, the same shall be treated as 'Other Income'.

Illustration 1:



   In the above illustration, the income earned by Kavya from Mr.Net, between USA & Netherlands, is not income from immovable property but income from 'other sources' since the rent is received from a country in which the property is not situated.

6. **Is it necessary for one to be the owner of the Immovable property to term an income derived there from as 'Income from Immovable Property'?**

   Income derived from the direct use, letting or use in any other form of immovable property shall be covered under 'Income from

Immovable Property'. The term "letting" shall be referred in tax treaty between the countries in the International Tranasaction. In the absence of the same, the term 'letting' shall be defined in accordance with the laws of "country of source". The term shall include sub letting.

In the above illustration,

Mr.Net (Resident of Netherlands) has derived income from sub-letting the property to a resident of U.K., though the legal owner of the property is Mrs. Kavya (resident of US). Such income from sub-letting is covered by Article 6 "Income from Immovable Property" of the Double Taxation Avoidance Agreement.

7. **Mrs. Kavya, Resident of USA, holds immovable property located in India. Mr.Gopal Rao, Resident of India, obtains loan from Indian Bank by pledging the Immovable Property of Mrs. Kavya for a fee. What would be the income characteristic of the fee received by Mrs.Kavya?**

   Such consideration denotes Indirect use of Immovable Property. Hence, the Income received by Mrs.Kavya shall be subject to Tax in India as income from immovable property within the provisions of Article 6.

8. **How should the business of trading or managing immovable property be dealt with?**

   If a Permanent establishment is engaged into the business of trading or managing immovable property, such business income shall also fall under "Income from Immovable Property" and not under "Business Profits". The income from such business shall be taxed in the country in which the immovable property is situated.

9. **Whether capital gains from sale of immovable property be treated as "Income from Immovable Property" ?**

   Income from alienation of immovable property is dealt separately as "Capital Gains" and not treated as "Income from Immovable Property".

10. **Amex Inc., a bank based in US, lends USD 100,000 to M/s.Rahul Inc a US Corporation. Mrs.Kavya provides her immovable property, in US as a security against foreign currency loan. M/s. Rahul Inc., is not in a position to repay the loan principal and accrued interest. Amex Inc., gets the immovable property sold and its dues settled. How are the sale proceeds of immovable property be taxes in the hands of Amex Inc., ?**

    M/s.Rahul Inc failed to repay its loan, consequent to which Amex Inc., sold the security and realised the repayable amount of loan. The proceeds received by the Amex Inc., is in the nature of recovery and shall not be treated as "Income from Immovable Property" in its hands.

    In the hands of Mrs.Kavya the same shall be treated as capital gains and not as income from immovable property.

11. **Whether Tax treaties prescribe mechanism for computing taxable income ?**

    No. Tax treaties, with regard to "Income from Immovable Property", provide guidance as to which country has the right to tax the Income from Immovable Property and does not lay down mechanism for computing taxable income. However, the mechanism of computing taxable income shall be in accordance with the laws of source country in which the income is to be taxed.

* * *

CHAPTER – 4

Interest

- CA D S Vivek & CA Bhamini G S

Today, as I was sitting in my office going through the work for the day, I got a call from Mr Gopal Rao. He introduced me to Mr Shyam of XYZ India (P) Ltd ('XYZ India') and said that Mr Shyam wanted to consult me with respect to a payment of interest to be made to the holding company of XYZ India based in USA. We agreed to have a conference call later in the day along with the concerned person in XYZ International Inc, USA ('XYZ Inc'). The gist of the call was that XYZ is taking a loan under External Commercial Borrowing ('ECB') from its parent company XYZ International Inc, USA ('XYZ Inc'). XYZ wanted to know taxation issues in respect of the interest to be paid by XYZ to it. After the call, I called my Article Assistant, Ms Bhavya and briefed

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Presented papers on Direct Tax at various forums of ICAI / KSCAA / Public Sector Undertakings, etc.,

Academics: Rank Holder in CA Final, Inter & Foundation exams.

Executive Member of International Fiscal Association, Bangalore Chapter

Other Significant Achievements/ Information

1. Involved in publication of ICAI titled "Carve a Career - The essential road map for young practitioners".
2. Co-author of "Digital Commerce - An analysis of Taxation".
3. Was Co-opted member of Ind AS (IFRS) Implementation Committee of ICAI during the year 2014-15.
4. Completed IFRS certification course conducted by ICAI.

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her on the case and told her to prepare a note on the taxation of interest paid by XYZ to XYZ Inc and gave her a time of 1 day to complete the same. Earlier this year we had a comprehensive discussion on the topic of 'Interest and Dividend' in Group Dynamics interactive session. This helped me in briefing Bhavya for the contents of the note. The next day Bhavya came to me with the draft note and told me that I can have a look at it. I called Bhavya and spoke to her.

Vivek: Hi Bhavya, I received your mail. Before I have a look at it, I will ask you few questions. Let me know if the same is covered in your note.

Bhavya: Ok Sure sir. Please ask the questions.

1. Can you tell me if your note covers the meaning of 'Interest' as per the Model Conventions?

Ans: Yes Sir. In both, the OECD and the UN model, Article 11 covers the term "interest" to mean:

   a. income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and;
   b. in particular, income from government securities and;
   c. income from bonds or debentures, including premiums and;
   d. prizes attaching to such securities, bonds or debentures.

2. Are there any specific exclusions from the definition of 'Interest' as per the Model Conventions?

Ans: Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.

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For past 5 years Partner in M/s Suresh & Co., a Chartered Accountants firm which is in practice for the past 46 years.

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Was earlier working with consulting firm M/s A F Ferguson & Co., Bangalore, in the Tax Division.

email: **bhamini.m@sureshandco.com**

3. What about the term 'interest' as per the Income Tax Act, 1961('ITA')?

Ans: Section 2(28A) of the ITA defines "interest" to mean interest payable in any manner in respect of any-

a. moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes;

b. any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilised.

4. What is the major difference between definition of Interest under ITA and Convention?

Ans: Under ITA it includes service fee in respect of a borrowing, such as processing fees, documentation fees, late payment charges, fore closure charges etc. All these do not partake "interest" under convention.

5. How do the provisions of the ITA deem interest to accrue/ arise in India?

Ans: The deeming provisions are covered by Section 9 of the ITA and interest is covered under Section 9(1)(v) of the ITA which is as under:

Interest is deemed to accrue in India, if Income by way of interest payable by:

a. The Government; or

b. A person who is resident, except where the interest is payable in respect of money's borrowed and used for carrying out business/ profession outside India; or

c. A person who is a non-resident, where the interest is payable in respect of money's borrowed and used for carrying out business/ profession in India

6. Whether tax rate applicable to interest is as per ITA or Tax Treaty?

Ans: As per Sec 90 (2), the provisions of the ITA or the Tax Treaty, whichever is beneficial to the foreign entity is considered for tax liability purpose.

7. In terms of accrual of Interest what are the beneficial provisions as per ITA and as per Convention?

Ans: ITA beneficial over Convention- Interest paid by resident to non resident for operations outside India is not liable for tax in India.

Convention beneficial over ITA - i) Interestis liableto tax in India only on payment basis and not just accrual. However, payment would mean where the money is made available to the recipient as per terms of contract as per customary.

8. Bhavya, Can you explain the above by way of an example?

Ans: Sure Sir. A, a resident of India has borrowed from B of Singapore for its mining operations in Philippines and pays interest to B, we shall examine the taxability of interest paid by A to B in India.

As per ITA - As already seen in the above questions, Section 9(1)(v)(b) says that where the interest is paid by a resident to a non-resident for business or profession carried out outside India, such interest would not be deemed to accrue or arise in India.

As per Convention –This would be liable to tax as per the provisions of the Articles 11 of the India-Singapore Tax Treaty. Article 11 (1) of the India-Singapore Tax Treaty says that interest is taxed in Singapore (State of Residence of recipient).

Article 11(2) of the said Tax Treaty says that India (State of Source) can also tax the interest, however this is taxed on payment basis and not on accrual basis [Article 11(1) and Article Article 24].

9. In the Model Conventions, the primary right is given to which country to tax the interest? Ans: In the Model Conventions, the primary right is given to the country of residence of the recipient of the interest.

10. What about the right to tax of the country in which the interest arises?

Ans: Article 11(2) of the Model Convention, on a secondary basis, the country where the interest arises, is given the right to tax such interest. However, it also says that where the recipient of the interest is the beneficial owner then the tax shall not exceed a certain percentage of the gross amount of interest. Under the OECD Model, the rate of tax is fixed at 10%, however UN Model does not specify any rate of tax.

11. What does Article 11(5) say about 'where interest is deemed to arise'?

Ans: Article 11(5) of the Model Convention says that interest is deemed to arise in the country in which the interest payer is a resident. If the payer is not a resident of such country, but

a. has a PE in such country in connection with which the indebtedness on which the interest paid in accrued, and;

b. Such the interest is borne by such PE

Then such interest shall be deemed to arise in the country in which such PE is situated.

12. What are the rates of taxes on interest as per the ITA and as per the tax treaties?

Ans: The table having the rates as per ITA and the tax treaties is as under

Particular	Rate	
	Tax treaty	IT Act
Interest payable by Government or an Indian concern on moneys borrowed or debt incurred in foreign currency (Sec 115A)	10%/15% **	20%
Interest payable to a person being a non-resident, or to a foreign company, by an infrastructure debt fund (Sec 194LB)	10%/15% **	5%
Interest payable by Specified company on monies borrowed in foreign currency from source outside India(Sec 194LC)	10%/15% **	5%
Any Income by way of interest is payable to a person being a Foreign Institutional Investor or a Qualified Foreign Investor (Sec 194LD)	10%/15% **	5%

Particular	Rate	
	Tax treaty	IT Act
Interest earned by the Govt and certain specified institutions, inter-alia, Reserve Bank of India	In majority of the Tax Treaties, this is exempt from tax in the country of source.	

** The rates of taxes prescribed by the tax Treaties is either 10% or 15% depending the country with which the tax treaty is entered into.

13. What are the mandatory documents required for availing tax treaty benefit?

Ans: The foreign company or the non-resident should obtain Tax Residency Certificate ('TRC') to take the beneficial provisions of the Tax Treaty. This is a mandatory requirement under Section 90(4) of the ITA. If the foreign company or the non-resident has not obtained the TRC then the provisions of the Tax Treaty cannot be availed and the provisions of the ITA would apply. This would mean, though the treaty gives certain benefits as compared to ITA, such benefits cannot be availed without a valid TRC.

14. How will the foreign company or the non-resident obtain the TRC?

Ans: The Foreign Company or the non-resident will have to obtain the TRC from their Govt. This is usually issued by the Revenue Department of the Government.

15. Whether the non-resident or a foreign company can avail the benefits of the Tax Treaty if it does not have PAN in India?

Ans: Apart from the TRC as mentioned in previous question, the non-resident should have also obtained PAN. Section 206AA speaks about penalty in case of a deductee not having a PAN in India. In case where the deductee does not have PAN in India, the rates at which TDS would be deducted would be higher of-

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.

However, recently Bangalore Tribunal in the case of Infosys BPO Limited *{DCIT Vs Infosys BPO Limited [TS-408-ITAT-2015(Bang)]}* has held that where the foreign company has provided the TRC, it can avail the benefits of the Tax Treaty, even if it does not have PAN in India. Section 90(2) of the ITA provides that the beneficial provisions of the Tax Treaty should be applied where the same is available and provisions of Section 206AA cannot be applied.

16. What would happen in case, the Indian entity has to bear the TDS on the interest paid (gross up) and the foreign company does not have PAN in India?

Ans: Sec. 195A of the ITA says that in case the TDS is to be borne by the person paying the interest, then the grossing up should be done at the rates in force for the financial year in which such income is payable, be equal to the net amount payable under such agreement or arrangement. Section 195A speaks only of the rates in force for the financial year in which such income is payable and does not refer to the rate applicable u/s 206AA of the Act.

In the case of Bosch Ltd. *{Bosch vs Income tax officer [TS-904-ITAT-2012(Bang)]}*, the ITAT held that grossing up of the amount is to be done at the rates in force for the financial year in which the income is payable and not at 20% as specified u/s 206AA of the Act.

17. What would be the taxability of interest in case the foreign entity has a Permanent Establishment ('PE') in India?

Ans: As per Article 11 of the OECD where the foreign company/ non-resident has aPE in India and the interest paid by the Indian Entity is effectively connected to such PE, then the interest would be in the nature of business income of the foreign entity.Once the interest assumes the nature of business income of the foreign entity, then the TDS on the interest paid to the foreign company would be at the rates applicable to a foreign company or rate mentioned in a certificate under Section 197.

Finance Act, 2015 has inserted an Explanation in Section 9(1)(v) which says that in the case of a company carrying on a banking business in India through a PE / Branch, for the purpose of income tax the branch shall be treated as a separate legal entity and interest that is payable by the branch to its Head Office would be liable to tax in India and the hence the provision of Section195 with respect to with-holding of taxes would also be applicable.

18. Whether discounting charges can be characterised under the definition of interest?

Ans: Discounting of a promissory note/export sale bills does not involve creation of a debt or a debtor-creditor relationship, amount of discount cannot be termed as 'interest' within meaning of section 2(28A) *(ABC International Inc. USA, In re (2011) 241 CTR 289) AAR); (CIT vs. Cargill Global Trading (P.) Ltd. [2011] 335 ITR 94 (Delhi))*.

19. Whether Upfront Appraisal Fees included under Interest?

Ans: In the case of *DIT vs. Commonwealth Development [TS-610-HC-2012(Bombay)],* the Bombay High Court held that the upfront appraisal fees was not in the nature of interest income from a debt claim. It was debt itself. This also cannot be said to be service fees or other charges 'in respect of moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized'. Thus, the income on account of the upfront appraisal fees was business income and would not be covered under Interest.

20. Can the unpaid purchase price of any plant/ machinery treated as loan?

Ans: In the case of *CIT v. Saurashtra Cement & Chemical Industries Ltd. [1975] 101 ITR 502 (GUJ.))*, the Indian Entity entered into agreement with foreign company for the import of certain plant and machinery. 30 per cent of price was to be paid against three bills of exchange to be drawn by foreign company and Indian Company was also to pay interest on said bills of exchange. ITO held that in respect of that interest, assessee would be liable to pay tax. The High Court held that, foreign company could not be said to have lent amount of unpaid purchase price to Indian Entity either in cash or in kind, there was no

question of interest payable by the Indian Entity to foreign company being deemed to be 'income' accruing or arising from any money lent at interest and brought into India in kind.

21. Whether Interest on compensation would be covered under the definition of interest?

Ans: The Bombay High Court in the case of *(Islamic Investment Co. v. UOI) [2002] 122 TAXMAN 719 (BOM.))* held that the amount assumes the character of judgement debt. Once such an amount assumes the character of a judgment debt, the decree passed by the civil court must be executed subject only to the deductions and adjustments permissible under the Code of Civil Procedure, 1908. There is no provision under the Income-tax Act or under section 195 in particular or under the Code of Civil Procedure where the amount of the interest payable under a decree was deductible from the decretal amount on the ground that it was an interest component on which tax was liable to be deducted at source. The Bombay High Court placed reliance on the Supreme Court judgement in the case of *All India Reporter Ltd. v. Ramchandra D. Datar AIR 1961 SC 943.*

22. Is Guarantee Fee covered under interest?

Ans: Guarantee fees are payments for a possible future action and thus be treated as compensation for services performed rather than interest.

In the case of *Container Corporation vs. Commissioner [134 T.C. No. 5 (February 17, 2010)],* Vitro, Mexico Parent, did not loan money to its U.S.-based subsidiary, International. Instead, Vitro promised to pay notes issued by International in the event of a default. International paid its parent company a guarantee fee in exchange for that service. The US Subsidiary paid a guarantee fee to the Mexican Corporation and did not withhold US Income tax from the guarantee. The tax court concluded that the Guarantee fee is not interest because the Mexican parent did not make a loan to the U.S. Subsidiary and that the guarantee fees is not compensation for services because the value of the guarantee stems from the promise made, not from an applied intellectual or manual skill.

Under the ITA, the term interest has been defined in India to include any service fee or charge in respect of money borrowed or debt incurred. Thus, going by the definition, it can be said that the guarantee fees partakes the character of interest. However, in view of the reasoning given in Container Corporation(above) it can be said that same is not a service fee and hence not in the nature of interest.Also, going by Article 11 of the Model Conventions, guarantee fees may qualify as business income under Article 7 or Other income under Article 21 but not as interest income. Hence, guarantee fees is not taxable in India as interest income.

23. What is the taxability in the case of 'Compulsory Convertible Debentures'?

Ans: In this case, the Indian non-banking financial company borrowed money from LMCC, USA by issuing fully convertible bonds. The AAR held that the payment made to LMCC in form of interest up to date of conversion of bonds into equity shares is nothing other than interest paid on money advanced to applicant or debt incurred by it and it satisfies definition of 'interest' under section 2(28A) as well as article 11 of DTAA between India and USA and it is, accordingly, liable to be taxed as income of LMCC.*(LMN India Ltd., In re [2008] 307 ITR 40 (AAR))*

24. Is Prepayment Discount in the nature of interest on which Tax has be deducted at source ?Ans:Pre-payment discount given by an Indian taxpayer to foreign buyers in absence of any mention in purchase contract that assessee was obliged to give said discount, was in nature of interest and tax was deductible at source under Section 195 *(DCIT v. Kothari Food & Fragrances [2014] 50 taxmann.com 213 (Lucknow – Trib.)*.

In this case, the facts were that the Indian Entity had received advance payment from the foreign buyers and had mutually agreed that pre-payment discount would be allowed to the foreign buyers. In this case, the court held that the discount given would be interest and since TDS was not deducted on this, it was disallowed under section 40(a)(i).

25. Is Usance Charges in the nature of interest?

Ans: Usance charges paid to non-resident on import purchase by assessee would be considered as 'interest' income *(ACIT v. Bhavani Enterprises [2014] 52 com 489 (Panaji – Trib.))*

26. Is Usance Interest covered under the definition of interest?

Ans: 'Usance interest' paid to non-residents by Indian company for availing credit under irrevocable letter of credit for delayed payments for purchase of raw materials is interest under section 2(28A), being an income deemed to have accrued or arisen in India under section 9(1)(v)(b) *(Uniflex Cables Ltd. V. DCIT [2012] 136 ITD 374 (Mumbai))*

27. Is Usance Interest on Ship breaking Activity covered under 'Interest'?

Ans: In this case the Honorable SC held that the usance interest paid partook the nature of purchase price of vessel for shipbreaking and hence the same is exempt and assessee was not liable to withhold tax at source. *(CIT v. Vijay Ship breaking Corporation (2008) 314 ITR 309 (SC))*

28. Is the interest on income tax refund paid to a non-resident covered under 'Interest'?

Ans:

a. The Uttarakhand HC in the case of B. J. Services Company*{M/s B. J. Services Company Middle East Limited v. ACIT [TS-420-HC-2015(UTT)]}*, held that interest on refund by IT Dept. to a non-resident is assessable as business income as per Article 7 of India-UK DTAA as the foreign company had a PE in India.

b. The Chennai Tribunal in the case of *AnsaldoEnergia SPA [TS-686-ITAT-2015(CHNY)]* ITAT upheld the CIT(A) order imposing TDS u/s 195 on interest on income tax refund u/s 244A. It opined that such interest is not covered by definition of 'interest' under Article 12(4) of India-Italy DTAA, therefore Article 12(1) and therefore would be taxed in both India and Italy.

29. Y Investments, a Company incorporated in Mauritius sold 12,000 shares of R Pvt Ltd, an Indian Company to A Pvt Ltd on 1.5.2014 for a consideration of Rs 12,00,000/-. Both R Pvt Ltd and A Pvt Ltd are companies incorporated in India. A Pvt Ltd could not pay the consideration on time, hence had to pay interest @ 10% p.a.ofRs 84000/-. What is the tax liability of Y investments on this interest of 'Rs 84000/-?

The interest as envisaged above is penal in nature and as per the provisions of Article 11(5) of the India-Mauritius Tax Treaty, penal charges for late payment would not be covered under this Article and hence this would not be in the nature of interest.

30. Indian Entity, A (P)Ltd has taken an ECB Loan from X International Inc. USA for the setting up a manufacturing plant. The ECB was taken on 1.4.2014 and the plant was put to use on 1.1.2015. Here the interest paid on the loan for the period 1.4.2014 to 31.12.2014 would be capitalised and taken as the cost of manufacturing plant in the books of A(P) Ltd. The interest is paid to X International Inc on a quarterly basis. What would be the tax impact on the interest paid to X International Inc.

Ans: The differential treatment of the interest in the books of the payer would not have an impact on the taxability of the interest income in the hands of X International Inc. So while deciding on the TDS liability, A(P) Ltd has to look into the applicability of the India-USA Tax Treaty and the ITA provisions and deduct the appropriate rate.

The interest which is capitalised in the books of A(P) Ltd would not be a capital receipt in the hands of X International Inc. It would still be in nature of interest income liable to TDS.

31. In the case of loan from Head Office ('HO') whether branch has to do TDS on interest paid to HO ?

Explanation to Section 9(1)(v) of the ITA says that in the case where the branch of a foreign banking company is paying interest to its HO, the branch would be treated as a separate legal entity and the branch has to deduct TDS at the applicable rates before remitting the same.

As per the Model Convention also, it would be the same and the interest payment would be liable to TDS in the country where the PE is located provided such interest is effectively connected to such PE.

32. Bhavya, are there any documents that should be verified for the interest expense and to ascertain the TDS liability?

Ans: Sir, below is the checklist which we can use for ascertaining the TDS on Interest.

Sl No	Particulars	Yes / No
a.	Loan Agreement and document of amendment if any	
b.	Invoice from the foreign company;	
c.	A declaration from the foreign company stating they do not have a business connection or a PE in India.	
d.	TRC issued by the Government of the foreign company.	
e.	PAN of the foreign company	
f.	Basis of arriving at the TDS rate to be deducted.	

Vivek: So Bhavya, in the present case if XYZ India has to pay interest to XYZ Inc. XYZ Inchas a TRC and PAN. It has also declared that it does not have a PE in India. In such a case, what would be the TDS liability of XYZ Incin India?

Ans: Sir, in this case, interest is being paid by XYZ India to XYZ Inc USA. The applicable tax Treaty would be India-USA Tax Treaty. The nature of income is interest and Article 11 of the said Tax Treaty covers this. As XYZ Inchas TRC, it can can take the benefit of the Tax Treaty. The rate of tax as per this Article is 15% [Article 11(2)(b)]. So TDS has to be deducted at 15%.

Vivek: So Bhavya, should I have a look at the note that you have done or would you be required to make some changes to the same based on our discussion now.

Bhavya: Thanks for the exhaustive discussion sir. I will go through the note once again and make some changes that I have noted down. Post that you can review and send it to the client.

* * *

CHAPTER – 5

Dividends

- CA D S Vivek & CA Bhamini G S

As I was sitting in office today having a discussion with my staff regarding the upcoming tax seasons, I got a call from Mr Gopal Rao. He said he wanted to meet me to find out about taxation of dividends. We set up an appointment and to meet the following day. The next day Mr Rao came to our office. Over a cup of coffee, we discussed some of the investments that he was planning to do. I mentioned that all dividends he would be receiving from Indian Companies would be exempt. He told me he had the following queries regarding Dividend. My replies are mentioned along with his queries.

1. What is the definition of Dividend?

Under both the UN Model and the OECD Model, the term 'dividend' as per Article 10 (3) means:

a. income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights,

b. not being debt-claims,

c. participating in profits, as well as income from other corporate rights

d. which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

2. What is "jouissance" shares?

Jouissance shares are the securities, different from the share certificates, which do not provide its holder with any shareholder rights but which carry some financial rights such as share in profits, but the investment should not be treated as debt of the company.

3. How is Dividends defined under ITA?

Section 2(22) of the ITA defines the term 'dividend'. As per this section, the term 'Dividend' has a wider meaning to include any kind

of distribution, whether on reduction of share capital or liquidation or even as payment by way of advance or loan to a shareholder to the extent of accumulated profits in every case. The definition under the ITA is an inclusive one by deeming certain distribution to shareholders as dividend to extend the ordinary concept of dividend under the company law. ITA definition is enumerative and not exhaustive.

4. Are there any specific exclusions?

Section 2(22) of the ITA lists the following cases where it would not be in the nature of dividend

- any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956;
- any distribution of shares made in accordance with the scheme of demerger by the resulting company to the shareholders of the demerged company whether or not there is a reduction of capital in the demerged company.
- any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (e), to the extent to which it is so set off.

5. In the Model Conventions, the primary right is given to which country to tax the dividends?

Ans: In the Model Conventions, as per Article 10(1) the primary right is given to the country of residence of the recipient of the dividend

6. What about the right to tax of the country in which the dividend arises?

Ans:

a. Article 10(2) of the OECD Model Convention, on a secondary basis, gives rights to the country where the dividend arises, to tax such dividend. However, it also says that where the recipient of the dividend is the beneficial owner then the tax rate shall not exceed:

i) 5% of gross amount of the dividends if the beneficial owner is a company (other than a partnership firm) which holds directly 25% or more of the capital of the company paying dividends.

ii) 15% of the gross amount of the dividends in all other cases.

b. Article 10 of the UN Model Convention which covers the taxability of Dividend is the same as already explained as above. However, in UN Model the rates for taxing the dividends is not prescribed and also where the recipient of the dividend being a company would be treated as a beneficial owner if it holds directly 10% or more of the capital of the company paying dividends. This is as against the requirement of 25% or more of the capital as mentioned in OECD Model.

7. Explain the significance of 'beneficial owner' concept for taxation of dividends.

Ans: there are two kinds of ownership (a) Legal Ownership and (b) Beneficial Ownership.

(a) Legal Ownership - Legal ownership of an asset means that the legal person or individual ("Person") claiming legal ownership is regarded to be the legal owner under the (civil) laws of the country in which the Person and/or the asset is located. Under the civil laws of most countries, legal ownership will be assumed for a Person who has "possession" of the asset. "Possession" of the asset means either physical possession or official registration of the asset in the name of a Person. Initially, a legal owner also has full economic ownership of the asset.

(b) Beneficial Ownership –The beneficial owner is the individual or entity that enjoys the benefits of owning an asset, regardless of whose name the title of the property or security is in. The person is said to be a beneficial owner of an asset, if he is taking the risks, decisions, rights over the income over such an asset.

Eg: Mr A buys 100 shares of stock in Company ABC via a brokerage house. Even though the stock is recorded under the broker's name, Mr A is the beneficial owner.

8. How can we ascertain if the legal owner is the beneficial owner?

   Ans: We can obtain a declaration from the legal owner confirming that he is / is not the beneficial owner of shares.

9. B Investing Co. a Singapore Investing firm invested in shares of A Co., an Indian Company as an agent of Mr A, resident of USA. How will the dividends paid by A Co be taxed?

Ans: In this case, the legal owner is B and the beneficial owner is Mr A. The Tax Treaty between India-USA would be applicable to ascertain the TDS on dividends paid by A Co. (This is a hypothetical example to understand the concept of Legal and Beneficial owner. In respect of the dividends paid by an Indian Company, Section 115-O of the ITA requires Dividend Distribution Tax to be paid by the Indian Company and such dividends in the hands of the recipient would be exempt).

10. A Inc a Company incorporated in USA has a Project Office ('PE') in India. This PE has invested funds in a Joint Venture Y (P) Ltd (Y India) in India and in the FY 2014-15 Y India declared dividend. Analyse the tax treatment for this.

Article 10(4) of the Model Convention says that where the resident has a PE in India and the dividends paid by the Indian Company is effectively connected to the PE in India, in such case the dividends would be treated as business profits (Article 7) in the hands of PE in India and shall not be in the nature of Dividends.

In this case, the dividends received by the PE is effectively connected to the PE as the funds were invested by the said PE. So the dividends would be in the nature of business profits of PE.

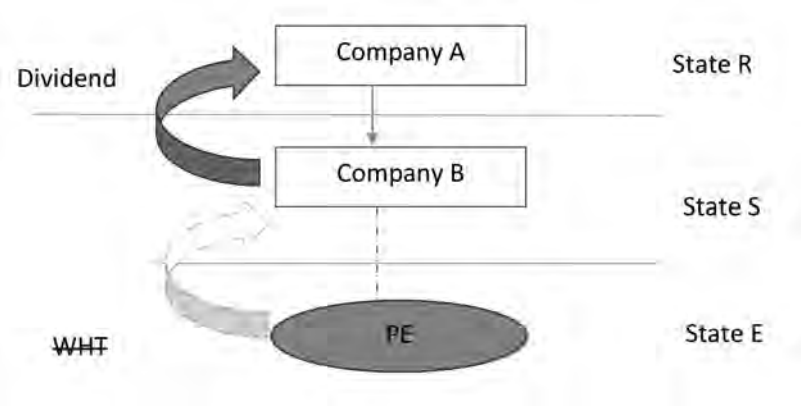
11. What is the meaning of 'denial of extra-territorial taxation of dividends'?

Article 10(5) of the Model Convention says as under-

"Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively

connected with a permanent establishment situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State."

Let us understand the above with an example



In this case, State E cannot tax dividends paid by Company B to Company A solely because Company B's profits, from which the distribution is made, are originated in its territory (for instance, through a permanent establishment situated therein)

12. How is dividend taxed in India?

Currently India exempts the dividend distributed/ declared/ paid by domestic company provided the dividend distribution tax ('DDT') at 15% (plus applicable surcharge and cess) is paid on distribution of such dividend as per Section 115-O of the ITA. Hence this is not taxed in the hands of the recipient of the dividend [(Section 10(34)]. Considering this, as the income is exempt in the hands of the recipient and as the provision of ITA are more beneficial than that of Tax Treaty, India would not levy or with-hold any tax on the dividends paid to a Non -Resident.

However, Section 115-O does notcover the deemed dividend as mentioned in Section 2(22)(e) of the ITA.

13. What is the meaning of the term 'Deemed Dividend'?

Ans: The concept of Deemed Dividend is embedded in Section 2(22)(e) of the ITA. In nutshell, the concept envisages taxing certain payments made by closely held companies by way of loans or advances to certain shareholders of the company or to the concerns/companies in which they have substantial interest. Whenever any payment is made by way of loan or advance, the recipient of the loan or advance will be liable to be taxed on this amount as a dividend, to the extent to which the company has accumulated profits, under the deeming provisions of section 2(22)(e) although such loan or advance may have been given for genuine business purposes and even if the paying company may have received back the loan amount. Thus the section deems certain payments as dividend income which is not income under ordinary commercial parlance. Therefore, the name Deemed dividend.

14. Are there any caselaws with respect to deemed dividend?

Ans:

a. In the case of Kishori Lal Agarwal [TS-634-ITAT-2013(LKW)], the ITAT held that the exception clause to Sec 2(22)(e) not available to assessee as advances given by companies were not in the ordinary course of business. Merely because Memorandum of company permits temporary investment of surplus money, doesn't mean company is engaged in money lending business. The object to invest and deal with funds as required was listed in ancillary objects and were not main objects. ITAT held that the advances received were hit by the provisions of Section 2(22)(e).

b. In the case pf Girishbhai M Patel [TS-70-ITAT-2014(Ahd)], the ITAT ruled that loan advanced by a closely held company, having accumulated profits, to its director having more than 10% voting power is taxable as deemed dividend u/s 2(22)(e).

<u>No Deemed Dividend</u>

c. The Mumbai Tribunal in the case of Goldman Sachs (India) Securities Pvt. Ltd [TS-72-ITAT-2016 (Mum)] held that amount remitted by assessee to its 100% Mauritian holding company under

share buy-back scheme is not taxable in India. The Tribunal also clarified that this transaction cannot fall under the ambit 'deemed dividend', but will be subject to capital gains in view of Sec 46A which would not be taxable in India in terms of Article 13 of India-Mauritius DTAA. Further observed that even if payment is considered as deemed dividend u/s 2(22)(d), TDS provisions would still not be attracted in view of exemption u/s 10(34) on such dividend which is liable to dividend distribution tax ('DDT') u/s 115O.

d. In the case of Manoj Murarka [TS-669-ITAT-2015(Kol)], the ITAT excluded exempt capital gain for reckoning 'accumulated profits' for the purpose of deemed dividend u/s 2(22)(e) for AY 2007-08. It ruled that "exempted capital gains shall not enter the stream of the expression 'accumulated profits' and the company has got only negative accumulated profits after exclusion of exempted capital gains and hence the provisions of section 2(22)(e) of the Act cannot be invoked.

e. In the case of Sarva Equity Pvt. Ltd. [TS-98-HC-2014(KAR)], the Honorable High Court held that the advance received from fellow subsidiary company (having common family shareholders) was not taxable as deemed dividend income u/s. 2(22)(e). The taxpayer received loan and he was not a shareholder and Sec 2(22)(e) applicable only to a registered shareholder. The Deemed dividend fiction cannnot be extended for enlarging concept of shareholders.

15. What would be the Tax treatment in terms of Deemed dividend u/s 2(22)(e)?

As already mentioned, in India, the Indian Company pays DDT on the dividends and therefore this is exempt in the hands of the recipient of the dividend. However, the company does not pay DDT on Deemed Dividend as mentioned in Section 2(22)(e) of the ITA. It has to deduct TDS on the amount of deemed dividend as per the provisions of Section 194 of the ITA.

Such deemed dividend is taxed in the hands of the recipient of the deemed dividend under Section 56 of the ITA. Section 2(22)(e) does not distinguish between a Resident or Non-resident shareholders.

Further, it is pertinent to note that by virtue of Section 9(1)(iv), "anydividend paid by an Indian company outside India" is 'Income deemed to accrue or arise inIndia'. Therefore, Deemed Dividend u/s 2(22)(e) is subject to tax in India in the hands of a non-resident shareholder subject to benefit given under the applicable Tax Treaty.

16. Whether the Tax Treaty covers the concept of 'Deemed Dividend'?

Ans:The definition of 'dividend' as per Article 10(3) of the Model Convention which is mentioned in point 1 above has the wordings ´……. as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a *resident'*. In this there is a mention of the treatment of the said 'deemed dividend' would be as per the tax laws of the source country. However, these wording 'income from other corporate rights' may imply that the income should flow from the shareholding rights, however deemed dividend would not be with respect to such rights. It is related to loans and advances taken by shareholders from the company. Hence there is ambiguity in this and there are no judicial pronouncements as of now regarding this. In the absence of any clarity on the treatment of deemed dividend under the Model Convention, judicial developments and pronouncements regarding this is awaited.

17. What is the concept of 'Underlying tax credit'?

Ans: This concept is with reference to dividend income. It eliminates 'economic double taxation' i.e same income taxed twice in the hands of two or more persons. Article 23A, 23B of the Model Conventions cover this and day that the Resident Country shall grant credit for the taxes with-held on dividends and for the corporate taxes paid on the underlying profits out of which dividends have been paid. Some of the Tax Treaties that cover this are

a. Article 24 of India-UK Tax Treaty

b. Article 23 of the India-Singapore Tax Treaty.

Lets see the below illustration to understand this concept better:

Particulars		Amount in INR
Taxation of Indian Subsidiary (UK Holding Co) In India		
Profit of Indian Subsidiary Co in India (Source Country)		1,00,000
Taxes (30%)		-30,000
Profits after tax		70,000
Dividend Distributed		50,000
Dividend paid to UK Holding Co (70% Holding)		35,000
Dividend Distribution Tax on above (15%)	(A)	-5,250
Taxation of UK Holding Co in UK		
Profit of UK Holding Co in UK		2,00,000
Dividend income		35,000
Taxable income		2,35,000
Tax Rate (40%)	(B)	94,000
Underlying Tax Credit [35,000 * 30,000 / 70,000]	(C)	-15,000
Total Tax Credit (A) + (C)		20,250
Total Tax after Relief		73,750

18. Whether buy-back of shares would be covered under the ambit of dividend?

However, AAR in the case of XYZ Limited [TS-196-AAR-2012] had denied capital gains benefit to Mauritius entity on the buy-back arrangement. It said that buy-back arrangement was a 'colourable device' to avoid payment of DDT and further held income from buy-back, liable to tax in India as 'dividend'.

* * *

CHAPTER – 6

Royalty and Fees for Technical Services (FTS)

- CA B P Sachin Kumar & CA Omar Abdullah

Introduction

Fig. 1.1

Starting of a Chapter with a diagram is unorthodox. However, we are living in times of massive disruption where traditional businesses have been turned on their heads by young nimble start-ups leveraging technology. In Figure 1.1we can see how relatively new Start- Ups have gained massive Billion Dollar valuation within a short span of time gaining the popular adjective of unicorns, the mythical Norse character. The main reason for these sky-high valuations is the Intellectual Property possessed by these new breed of Companies. As the world itself shifts to a service oriented economy, Intellectual Property Rights will only gain in value and prominence. The owners of Intellectual Property rights

monetise their assets by earning Royalty income. Generally royalties are the payments for the use of or right to use the intellectual property rights. For instance, Startup Inc resident in Country X operates in IT and ITES segment. It has developed a unique app relating to healthcare. It has obtained a patent for the app. It has development and marketing centre in India, Outsource Co - as the cost of labour is lower in India. Startup Inc licenses patent to Ind co for a consideration of $10 per user per year. In this case, the Outsource co is resident of India and India is likely to tax the royalty income as the source is in India. On the other hand, Startup Inc is a resident of Country X. The Country X would tax the Startup Inc on its worldwide income. As a result, the payment made

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by the Outsource Co to Startup Inc will be subject to double taxation – In India on the source basis of taxation and in Country X on the resident based taxation.

In order to avoid such juridical double taxation countries have entered into Double Taxation Avoidance Agreements (DTAA) with one of the first agreements being entered on 16 April 1869. Since 1869 travelling through time, Pre-World War 1 DTAAs also normally did not contain any special article on royalties. The first special provision on royalties in respect of copyrights and patents is to be found in the 1931 draft multilateral convention of the League of Nations.

The potential double taxation in the above case is relieved by allocating the taxing rights between the resident country and the source country and enabling the resident country to provide the tax credit of the taxes paid in the source country.

Currently as mentioned in other places in this book, the Treaties are broadly based on either the OECD Model, UN Model or the US Model conventions, with alterations as per choice of the Contracting Countries. Normally, Royalty is covered by Article 12 of the Model Conventions and the main difference between the OECD Model/ US Model and the UN Model being, the UN Model allocates limited taxing rights of royalty to the source state on gross basis and unlimited taxing rights to the resident state on a Net Basis, whereas the OECD and the US Model do not allocate any taxing rights to the source state and all the taxing rights are allocated to the residence state. In case of India, the Royalty clause in all our DTAAs are based on the UN Model Convention and even in the India- USA DTAA the royalty clause is based on the UN Model Convention rather than the US Model.

With regard to Fees for Technical Services (FTS), there is no article on FTS either in the OECD, UN or US Model conventions. However, some Countries have broadened the concept of Article – 12 by adding Fees for Technical Services and allowing taxing rights to be allocated similar to the UN Model for Royalties. In many of India's DTAAs, an FTS provision is present as part of the royalties article or as a separate article.

In keeping with the theme of the book I have attempted to analyse the critical aspect of international taxation of Royalty & FTS through interactive Q & A with a friend & colleague of our favourite Mr Gopal Rao from Chapter – 1.

Analysis

9:30 AM - Wednesday Morning

Mr Gopal Rao the famous retired engineer from BEML has been recalled to consult on a prestigious project BEML is undertaking as part of our Prime Minister's Make in India campaign. The project will be undertaken through a newly formed subsidiary and will entail many international financial transactions. Mr Gopal Rao along with his colleague in the finance team Mr Madhav in the ensuing conversation seek to gain a perspective on the subject of International Taxation of Royalties & FTS:

Madhav: Q1-Dear Sir, under the new project, we will be making cross – border payments for using Patented Technology, to the foreign owner of the patent. I know this will be covered by Sec. 9(1)(vi) of the Income-tax Act, 1961, as Royalty Payments. However, what are the implications under Double Taxation Treaties?

Answer: Dear Madhav, Royalty as per DTAAs includes payments,

- "for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematograph films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or
- for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience."

This definition is similar in all the DTAAs entered into by India barring minor variations. The above definition is also broadly similar to the OECD, UN and US Model Convention on Royalties. Under the Act, Royalty has been defined in Explanation 2 to Sec. 9(1)(vi). Though the definition begins with the expression "means", indicating an exhaustive

coverage, the use of the phrase "or similar property" at the end of some of the limbs of the definition indicates an expansive coverage having wide explanation.

Payment for the use of **patents** is considered as royalty as per Clause 1 of Explanation 2 to Sec. 9(1)(vi) of the Act. Once the international payment is covered by the Act, one should look at the provisions of the governing DTAA to check if it is beneficial to the assessee.

In the OECD Model Conventions, Royalty payments are only chargeable to tax in the State of Residence of the recipient. The UN Model Conventions allocate limited taxing rights to the Source State on a gross basis and the State of Residence full taxing rights on a net basis. The Royalty Clause in the DTAAs entered into by India is in line with the UN Model Convention. Therefore, payments being made by Mr. Madhav's company for the use of any patent to the foreign owner of the payment, will suffer tax deduction at source as per rates prescribed in Sec. 115-A Clause (b) of the Act or the rates prescribed in the respective DTAA, whichever is more beneficial to the assessee.

Madhav: Q2- Sir, under the new project we will be making payments for the use of proprietary design to an Indian branch of a foreign company. What is the tax treatment for the same?

Answer: Well Madhav, as explained earlier (Q-1) for chargeability to income tax of royalty payments, we will have to look at the payment from the aspect of the Act and the governing DTAA. Payments for the use of proprietary designs are covered by the definition of Royalty given in Explanation 2 to Sec. 9(1)(vi) of the Act. The DTAAs entered into India also recognise payments for the use of design as Royalty payment. However, **there is a key difference between Question No. 1 & 2.** In Q.1 the payment is being made directly to the Foreign Owner/Company, whereas in Q.2 the payment is being made to the Indian Branch of the Foreign Owner/Company. The Indian branch will constitute a Permanent Establishment (PE) of the Foreign Owner and the payment is being made to such PE.

As per the Act, where royalty payment being made is connected to a PE in India, taxation moves from Sec. 9(1)(vi) to Sec. 44DA of the

Act, where such royalty is chargeable on Net Basis rather than gross basis and at the rate applicable to a Foreign Company i.e. 40% + Cess & Surcharge. Even as per DTAAs, if Royalty payments are connected to the Permanent Establishment in the Source State (India), then Source State may tax such Royalty Income as Business Profits in line with Article – 7 of the OECD, UN Model Conventions. Thus income though characterised as Royalty will be treated as business profits in the presence of a PE in India. (refer fig 1.2)

Therefore Madhav, if the royalty payments are effectively connected with a PE in India, the tax deduction at source will have to be done at the rate of 40% plus surcharge & cess subject to Sec. 195(2) and Sec. 195(3) of the Act.

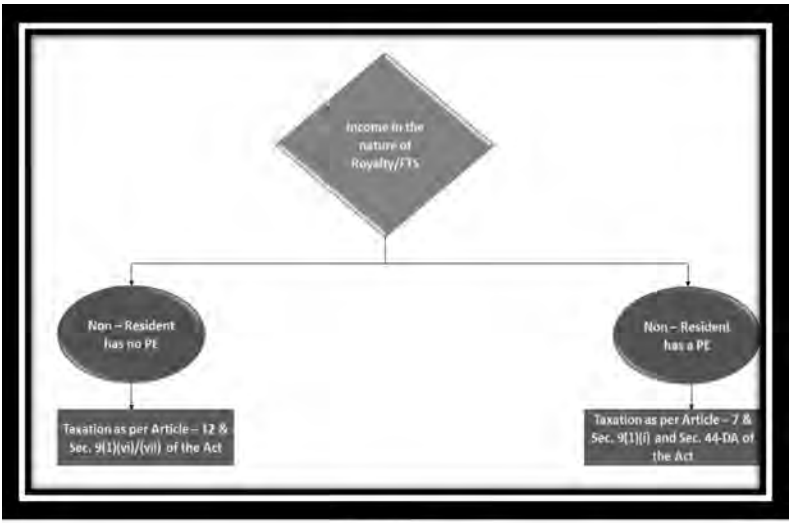

Figure 1.2

Madhav: Q-3: In the ensuing new project we will be making cross-border Royalty payments to related parties located in various foreign jurisdictions. Are such payments subject to the Arm's Length Principles under the Income-tax Act, 1961?

Answer: Dear Madhav, all cross-border related party expenses will be covered by the Transfer Pricing provisions as contained in the Act. With respect to DTAAs, most of the DTAAs entered into by India contain a

sub-clause in the Royalty Article, which is similar to Para – 4 of Article – 12 of the OECD, US Model Convention & Para – 6 of the UN Model Convention.

As per Para – 6 of Article – 12 of the UN Model Convention, limited taxation of royalties on gross basis by the source state is applicable only to the arm's length amount of royalties paid for the right to use the intangible property rights granted by one party to the other. Prima facie, the excess amount of royalties is left to be treated according to the domestic laws of each state and again that could mean that the excess amount of royalties is deemed to be a dividend, and taxed as such in Source State and State of Residence.

Madhav: Q-4: Sir, under the new project we will be making cross-border payment to a Russian Satellite Service provider to use the data transmitted by satellites in the guidance system of the Unmanned Ariel Vehicles manufactured by our company. How will these payments be taxable?

Answer: Madhav, as per Sec. 9(1)(vi) of the Act, Royalty includes payments for transfer of all or any rights in respect of a process. In reference to the DTAAs, there is a fair bit of controversy, although as per Model Conventions and the DTAAs entered into by India, Royalty includes payments for transfer of all or any rights in respect of a process, the OECD commentary on Article – 12 does not consider payment for satellite operator under transponder leasing agreements as Royalties. The Indian judiciary has delivered conflicting decisions on whether payments under transponder leasing agreements are Royalty payment. In the case of ***Asia Satellite Telecommunications Co. Ltd. vs. DIT (2011) 332 ITR 340*** it was held that, payments for transponder leasing cannot be considered as Royalty payments as per Sec. 9(1)(vi) of the Act and in the case of ***New Skies Satellites N.V. vs. ADIT (Intl. Taxation) (2009) 121 ITD 1*** it was held that payments for transponder leasing will be chargeable to tax as Royalty.

In view of the controversy & to settle the controversy, Finance Act – 2012 has introduced explanation 6 to Sec. 9(1)(vi) of the Act to clarify that process includes and shall be deemed to have always included

transmission by satellite. However, even though the Act has been amended retrospectively in respect of process, the DTAAs which had been entered into have not been amended & it could be argued that the introduction of an explanation in the Act explaining the expression "process" is specific to the definition contained in the source rules of the Act and may not be extended to apply where a DTAA exists. But a counter argument would be that OECD Commentary has been considered as only of persuasive value by the Indian judiciary and the DTAAs incorporate that any term not defined therein shall, unless the context otherwise requires, have the meaning which it has under the laws of that State primarily concerning the taxes to which the Agreement applies.

Madhav: Q-5: Dear Sir, under the new project we will be making cross-border payment to procure an expensive software to use it as a designing tool. How will these payments be taxable?

Answer: Dear Madhav, as per Sec. 9(1)(vi) of the Act, Royalty includes payments for transfer of all or any rights in respect of a literary work. Computer programme is protected in India as a literary work. In addition to rights in relation to a literary work such as reproduction of work, issuing copies of the work to the public, translation and adaptation, a right to sell the computer programme or give it on commercial rental or offer for sale or for commercial rental any copy of the computer programme is available to the copyright owner for commercial exploitation of the copyright. Also the Finance Act, 2012 has introduced Explanation 4 to Sec. 9(1)(vi) of the Act w.r.e.f. 1-6-1976, where it has been clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a license) irrespective of the medium through which such right is transferred.

Characterization of cross-border software payments, as either royalty or business profits, has been a contentious issue in India. The issue is concerned with whether a software transaction is "transfer of a copyright" or whether it is only "transfer of a copyrighted article" akin to purchasing a book.

The Indian judiciary has issued several rulings appreciating the difference between "copyright" and "copyrighted article", at the same time there have been some rulings, where this distinction has not been accepted. Significantly in the Karnataka High Court ruling in the case of ***CIT vs Samsung Electronics Co Ltd & Ors [2009] 320 ITR 209*** where the High court had to rule on *whether the Tribunal was correct in holding that since the assessee had purchased only a right to use the copyright i.e. the software and not the entire copyright itself, & the payment cannot be treated as royalty as per the DTAA and treaty is beneficial to the assessee and consequently Sec. 9 of the Act should not be taken into consideration*, the Karnataka High Court appears to have taken a broad interpretation of the expression, "consideration for the use of, or right to use, any copyright" in a DTAA and "transfer of all or any rights (including the granting of a license) in respect of a copyright" in the Act to reach a conclusion that mere purchase of a product protected by copyright is likely to result in the payment of royalty. However, the Delhi High Court in the case of ***DIT vs Infrasoft Ltd. [2014] 220 TAXMAN 273*** where the assessee is an international software marketing and development company opened a branch office in India and imports package in form of floppy disks or CDs customized according to requirements of customers, it was held that, *to be taxable as royalty income covered by Article 12 of DTAA, income of Assessee should have been generated by "use of or right to use of" any copyright. License granted to licensee permitting him to download computer programme and storing it in computer for his own use is only incidental to facility extended to licensee to make use of copyrighted product for his internal business purpose. Said process is necessary to make programme functional and to have access to it and is qualitatively different from right contemplated by said paragraph because it is only integral to use of copyrighted product. Apart from such incidental facility, licensee has no right to deal with product just as owner would be in a position to do. There is no transfer of any right in respect of copyright by Assessee and it is a case of mere transfer of a copyrighted article. Payment is for a copyrighted article and represents purchase price of an article and cannot be considered as royalty either under Income Tax Act or under DTAA*. This decision at the same time has also distinguished the Samsung Decision of the Karnataka High Court.

Madhav: Q-6: Dear Sir, under the new project we will be making cross-border payment for the outright purchase of certain Intellectual Property. How will these payments be taxable?

Answer: Dear Madhav, as per Sec. 9(1)(vi) of the Act, any consideration which would be the income of the recipient chargeable under the head "Capital Gains" is excluded from being chargeable to tax as Royalty. Even as per DTAAs where a sum is paid in consideration for the alienation in full, of rights attached to intellectual property, the consideration cannot be a royalty because the definition of "royalties"in Article 12(2) of the OECD and UN Model Convention requires that the payment be made "for the use of, or the right to use," the property. Where the rights are alienated in full, the payment cannot be for the use of (or the right to use) those rights. The payment is for the rights themselves. The sum paid in consideration is therefore generally treated as business income of the alienator (which falls within Art. 7) or a Capital Gain (which falls within Art. 13). However, following the US Model Convention, the United States of America reserves the right to treat as a royalty a gain derived from the alienation of property referred to in Art. 12(2) of the OECD model convention if the gain is contingent upon the productivity, use or disposition of the property.

Madhav: Q-7: Dear Sir, under the new project we will be making cross-border royalty payment to a non-resident company. However, the said non-resident company has a branch in India carrying out some activity unrelated to the Royalty payments. In Q-2 earlier you have mentioned when making payment to a PE of the non-resident company for Royalty it will be considered as Business Income chargeable to tax in India. Will such cross-border royalty payment to a non-resident company in the present case also be considered as Business Income chargeable to tax in India as the non-resident company has a PE in India?

Answer: Dear Madhav, in the DTAAs entered into India and as per the OECD & UN Model Convention, the royalties that arise through a permanent establishment of a non-resident in the Source State are chargeable to tax as business profits and do not qualify for the concessional treatment available under the Royalty Article of a

DTAA. However, to be chargeable as business income all the Model Conventions and the DTAAs entered into by India require such income to be **"effectively connected"** to such PE. The Income-tax Act does not clarify what is 'effectively connected'; generally it would mean 'related to' or 'arising from the activities of'. A right or property in respect of which royalties are paid will be effectively connected with a PE, if the "economic" ownership of that right or property of that right or property is allocated to that PE to exploit the asset.

Madhav as in your case, the PE is not carrying out any activity relating to the exploitation of Intellectual Property for which the Royalty payments are arising, such payments will be taxable in India as Royalty Income itself under the Royalty Article of the DTAA and not as Business Income of the PE.

Madhav: Q-8: Dear Sir, under the new project we will be making cross-border payments for obtaining services from non-resident entities. How will these be taxed?

Answer: Dear Madhav, performance of services is generally considered as an active stream of income. In case these services satisfy the definition of Fees for Technical Services (FTS), they are taxed as a passive stream of income (like royalties) based on the tax residence status of the payer of the income. Accordingly, the source rules also have a separate provision for taxation of FTS. As in the case of royalty, the term 'FTS' is defined in the Act vide explanation 2 to Sec. 9(1)(vii) of the Act. The definition of FTS is of wide application. It comprises consideration for the rendering of managerial, technical or consultancy services. An explanation is also included to clarify that income of a Non-Resident shall be regarded as sourced in India irrespective of whether or not the Non-Resident has a residence or place of business or business connection in India or has rendered services in India.

With respect to DTAAs, there is no separate article on FTS either in the OECD, UN or US Model Conventions. However, in many of India's DTAAs, an FTS provision is present as part of the royalties article or as a separate article.

Therefore, if the payment for services obtained fall within the scope of the definition contained in Explanation -2 to Sec. 9(1)(vii) of the Act and the relevant DTAAs, the same will be chargeable to tax on a gross basis at the rate prescribed under Sec. 115-A of the Act or the relevant DTAA whichever is lower, similar to cross-border payments of Royalties.

Madhav: Q-9: Dear Sir, under the new project we will be making cross-border payments for obtaining services from a non-resident entity based in the USA. For taxing payments made on technical services obtained from USA does any additional condition need to be fulfilled in reference to other Countries?

Answer: Dear Madhav, Broadly, there are two approaches which India has adopted in negotiating its DTAAs in case of FTS:

- The "broad approach" under which the term is defined to include all managerial, technical or consultancy services (similar to the Act definition). DTAAs with countries such as Germany, Austria, Ireland, Japan, adopt this approach.
- The "narrow approach" under which the term is defined to cover only those technical services which "make available" technical know-how, skill etc. to the recipient of the services. DTAAs with countries such as US, UK, Canada, Singapore, adopt this approach. This is popularly referred to as the FIS (Fees for included services) provision.

In most of the cases where a "narrow approach" is adopted, it is normal to have a broader definition of the term Permanent Establishment (PE) to cover furnishing of services (Services PE Clause).

DTAAs entered into by India with USA, UK, Canada, Singapore cover only technical services which **"make available"** technical know-how, skill etc. to the recipient of the services and fall under the narrow approach. The concept of "make available" is explained in the memorandum of understanding (MoU) to the India – USA DTAA. The USA MoU explains that "Generally speaking, technology will be considered "made available" when the person acquiring the service is

enabled to apply the technology." The provision of service may at times require technical input by the service provider. This does not mean that technical knowledge, skills, etc. are "made available" to the service recipient. Similarly, use of a product which embodies technology does not, per se be considered to make the technology available since the person would not be enabled to apply the technology. In the Singapore DTAA, this concept is captured in the text of the DTAA itself where "make available" is explained as, "which enables the person acquiring the services to apply the technology contained therein."

Several decisions have dwelled on the issue. The following conclusions drawn by the Karnataka High Court in the case of ***CIT vs De Beers India Minerals (P) Ltd. [2012] 346 ITR 467*** are relevant:

- The service provider rendering technical service should "make available" technical knowledge, experience, skill, know-how or process to the service recipient, so that the recipient also acquires technical knowledge, experience, skill, know-how or process so as to render such technical services
- Once such technology is "made available", it is open to the recipient of service to make use of the said technology and the taxation is not dependent on use of the technology by the recipient
- Merely because a business is dependent on the technical service received from the service provider, it does not follow that the recipient is making use of the technology which the service provider utilizes for rendering technical services
- What is relevant is that, after rendering of such technical services by the service provider, whether the recipient is enabled to use the technology which the service provider had used

To conclude in simple terms, the idea of not making available vs make available can be equated with giving a man a fish vs. teaching him to fish. The fact is that the service recipient must be equipped to do the service thenceforth is the key criteria of the 'make available' clause which therefore restricts from the classification of all and every technical service as FTS which is taxable in India.

Madhav: Q-9: Dear Sir, under the new project we will be making cross-border payments for obtaining services from non-resident entities. The definition of FTS in the Act includes Managerial Services Fees. Please explain the scope of the same?

Answer: Dear Madhav, the term 'management fee' is not defined in the Act or any of the DTAAs entered into by India with various countries.

Advanced law Lexicon defines the term 'management' as:

- Government, control, superintendence, physical or manual handling or guidance
- The act of managing by direction or regulation, or administration
- A group of persons responsible for smooth running of business. The group may divide their responsibilities within themselves, or work collectively, to fulfil their obligations towards planning, directing, organising, controlling and running efficiently various affairs of the organisation…..

The Supreme Court in the case of ***R. Dalmia vs CIT [1977] 106 ITR 895***, while referring to the term 'management' held that, "*in the context of business, "manage" means "to control, to guide, to administer, to conduct or direct affairs; carry on 'business'"*. The Mumbai Income Tax Appellate Tribunal in the case of ***Linde AG vs ITO [1997] 62 ITD 330***, observed as follows, "*the managerial services as aforesaid, is towards the adoption and carrying out the policies of an organisation. It is of permanent nature for the organisation as a whole*".

In the other words, the term 'management' refers to the activity of controlling, directing or supervising any particular function or task and thus, payment made for any such activity is covered within the ambit of 'management fees'.

It may be noted that some of India's DTAAs do not contain the term 'managerial' in the FTS/FIS definition (e.g.: US, UK etc.) In such cases, an issue arises as to whether such services get covered under the FTS/FIS article or whether these should be considered under the business profits article of the DTAA. The matter has been subject matter of

a number of rulings. Some have held that is the absence of the FTS clause, the receipt should be taxable as business profits under Article 7, ***McKinsey & Company (Thailand) Co. Ltd. vs DDIT [TS-332-ITAT-2013-Mum]***, whereas some others have held that in the income should be taxable as "other income" under the relevant DTAA, ***Lanka Hydaulic Institute Ltd., In re [2011] 337 ITR 47 (AAR)***.

Madhav: Q-9: Dear Sir, under the new project we will be making cross-border payments for obtaining services from non-resident entities. The definition of FTS in the Act includes Technical Services Fees. Please explain the scope of the same?

Answer: Dear Madhav, the term Technical Services has not been defined in the Act. The Supreme Court in the case of ***CIT vs Bharati Cellular Ltd. [2010] 330 ITR 239*** held that, *"the term 'technical services' appears between 'managerial' and 'consultancy services' in the FTS definition. Accordingly, all three limbs – technical, managerial and consultancy services – would require some element of human intervention*".

The OECD has taken a view that services are of technical nature when special skills or knowledge related to a technical field are required for the provision of services. The techniques related to applied science or craftsmanship would generally correspond to such skills or knowledge whereas the provision of knowledge acquired in fields such as arts or human sciences would not. The fact that technology is used in providing a service is not indicative of whether the service is of a technical nature.

Madhav: Q-10: Dear Sir, under the new project we will be making cross-border payments for obtaining services from non-resident entities. The definition of FTS in the Act includes Consultancy Services Fees. Please explain the scope of the same?

Answer: Dear Madhav, the term 'Consultancy Service' has not been defined the Act. The MoU to the India – USA DTAA states that consultancy services could be advisory in nature. The advisory service may or may not require expertise in a technology for its performance. The Delhi High Court in ***CIT vs Bharati Cellular Ltd., [2009] 319 ITR 139***, referred to the meaning of the word 'Consult' to arrive at the meaning of consultancy services and noted that, "*Similarly, the*

word consultancy has been defined in the said Dictionary as the work or position of a consultant; a department of consultants. Consultant itself has been defined, inter alia, as a person who gives professional advice or services in a specialized field. It is obvious that the word consultant is a derivative of the word consult which entails deliberations, consideration, conferring with someone, conferring about or upon a matter. Consult has also been defined in the said dictionary as ask advice for, seek counsel or a professional opinion from; refer to (a source of information); seek permission or approval from for a proposed action. It is obvious that the service of consultancy also necessarily entails human intervention. The consultant, who provides the consultancy service, has to be a human being. A machine cannot be regarded as a consultant".

The OECD in one of its reports is of the view that provision of advice by a professionally qualified person would be 'consultancy services'. In ***Intertek Testing Services, In re [2008] 307 ITR 418 (AAR)*** it was held that advisory services which merely involve discussion and advice of routine nature or exchange of information cannot be appropriately be classified as 'consultancy services' under a DTAA which requires an element of expertise or special knowledge. This ruling was rendered on the context of India – UK DTAA which contains a 'make available clause in the FTS definition'.

Madhav: Q-10: Dear Sir, under the new project we will be making cross-border payments for obtaining services from non-resident entities. The definition of FTS in the Act excludes consideration for any construction, assembly, mining, or like project. Please explain the scope of the same?

Answer: Dear Madhav, in the definition of FTS one of the exceptions that is carved out is consideration for any construction, assembly, mining or like project undertaken by the recipient. The Delhi High Court in ***DIT vs Rio Tinto Technical Services [2012] 340 ITR 507*** has explained the intent of the legislature in carving out this exclusion. Some key points from the decision are enumerated below:

- Construction, assembly or mining projects are normally not regarded as services relating to FTS

- FTS definition makes and draws a distinction between income earned by way of rendering services in contradistinction to income earned from manufacturing or trade activity.
- Construction, assemble or mining activities may not strictly fall within and be regarded as the manufacturing or trading activity, when interpreted in a narrow manner, and the intention of the legislature is that such narrow interpretation is not warranted
- The exclusion given by the legislature to the aforesaid projects is, therefore, merely clarificatory
- Use of the term 'project' in the said expression mandates that there should be a construction project, an assembly project, a mining project or a like project undertaken by the recipient and the consideration paid should be on the said account

Further in other judicial rulings it has been held that a service provider cannot be engaged in mere supervision or rendering services for construction, assembly, mining or like project to apply this exclusion but should be engaged in actual construction, assembly, mining, or like project.

Madhav: Q-11: Dear Sir on going through the above summary I gain an understanding that FTS can be construed in a broad manner& is capable of covering a host of services. However, are there any specific exclusions from FTS apart from Q-10?

Answer: You are correct when you say that FTS can be construed in a broad manner. However, Article 12(5) of Indian DTAAs lists several categories of services which are not intended to be treated as FIS/FTS **even if** they satisfy the tests of Paragraph 4 of such Indian DTAA. These are exception clauses which cover the following areas:

(a) Services which are ancillary and subsidiary, as well as inextricably linked, to the sale of property other than a sale described in paragraph 3 of Article – 12;

(b) Services which are ancillary and subsidiary to the rental of ships, aircraft, containers, or other equipment used in connection with the operation of ships or aircraft in international traffic;

(c) For teaching in or by educational institutions;

(d) Services for the personal use of the individual or individuals making the payment;

(e) To an employee of the person making the payments or to any individual or firm of individuals (other than a company) for professional services as defined in Article 15 (Independent Personal Services);

These exceptions seem quite logical; they cover the important point that when the preponderance of the arrangement is a sale then certain services linked to it should not be treated as FTS. This has been quite hotly debated because the revenue authorities would in these cases, like to make the sale divisible into its component parts and treat the service as FTS. The other exception is for educational purposes as well as for personal use. Finally, to ensure that those services that come under Independent Personal Services should not be construed as FTS there is an exception clause in Article 12(5)(e).

Conclusion

With the above interactive analysis I have aimed to provide the reader with a basic understanding of international taxation on cross-border payments of Royalty & FTS. With increased globalisation and digitisation, we practicing professionals come across a gamut of payments proposed to be made by clients for varied services, & it is pertinent to be aware of the governing tax laws to give the best advice. There is an ocean of literature on the subject of Royalties & FTS for the interested & I hope through this Chapter I have provoked the curiosity of the reader to discover this fascinating area of international taxation.

Wish you Happy Reading

* * *

CHAPTER – 7

Dependent Personal Services and Independent Personal Services

- CA C S Sreenivas

DEPENDENT PERSONAL SERVICES

That day being Friday, I attended the Group Dynamics study circle meeting at Sachin's office. We discussed on the BEPS Action Plan 5. By the time I reached office it was 11.30AM. As soon as I entered my cabin, prayed for a while and sat in my chair. I was about to open my mail box and noticed that Madhuri my articled assistant knocking at the door.

Madhuri: May I come in sir

Myself: Yes, what's the matter

Madhuri: Sir, I need one hour permission. My cousin Rohith has arranged a party and we have to go for shopping.

Myself: Ok, you can go

Madhuri: Sir, Mr. Rohith is here and would like to say hello to you.

CA C S Sreenivas has a Bachelor's degree in Commerce from Sri Venkateswara University, Andhra Pradesh. Fellow member of the Institute of Chartered Accountants of India-Qualified as a Chartered Accountant in the year 1991. He has completed certification course in DISA in the year 2003 and certification course in International Taxation in the year 2008.

He has more than 25 years of professional experience in income tax advisory and compliance assignments. He started his practice in the year 1993 as proprietor of M/s C S Sreenivas and Co.,. In the year 2003 he became a founder partner in M/s SSB and Associates, Chartered Accountants based in Bangalore. Specialises in International Taxation and Charitable Trusts matters.

He has presented papers on Direct Taxes in different forums.

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Rohith: Hi Uncle, How are you?

Myself: I am fine. What Rohith, I am seeing you after a long time. I heard that you are hosting a party. It's birthday party or engagement party?

Rohith: No Uncle, if it is engagement party, definitely I would have invited you.

After my graduation as a software engineer, recently I have joined a start up company which is into software development. The company has agreed to send me to US for an onsite project work. Knowing this my cousins are forcing me to host a party. That's why I am here.

Myself: Did you plan for your taxes?

Rohith: Uncle, I have not even planned for my trip and you are asking for taxes!!

Myself: Yes, you are right. Established companies will have properly defined policies on both inbound and outbound employee assignments. Since you mentioned that you are working for a start up, it would be better if you discuss the tax implications with your finance team.

Rohith: Thanks Uncle, I will discuss with Madhuri on this. If any help is required, I will come back to you. Saying this both Madhuri and Rohith left the cabin.

In the afternoon, I called up Sowmya and enquired whether topic on ***Hypo Tax and Tax Equalisation*** was covered in Monday study circle classes. She said that it was done two years back. Since most of the present team comprises of new joiners, I told her to plan for a session.

In our office, every Saturday we will conduct a technical session for all the staff between 10.30 AM and 12.00 Noon. The topic and the speaker's name will be announced two days in advance. The speaker for the session will be either an articled assistant or a paid assistant.

Apart from this every division will have their own study circle classes on a weekly basis. Our division's study circle class will be on Mondays.

Sowmya reviewed Monday Classes schedule and allotted the following topics to Mythri and Amulya.

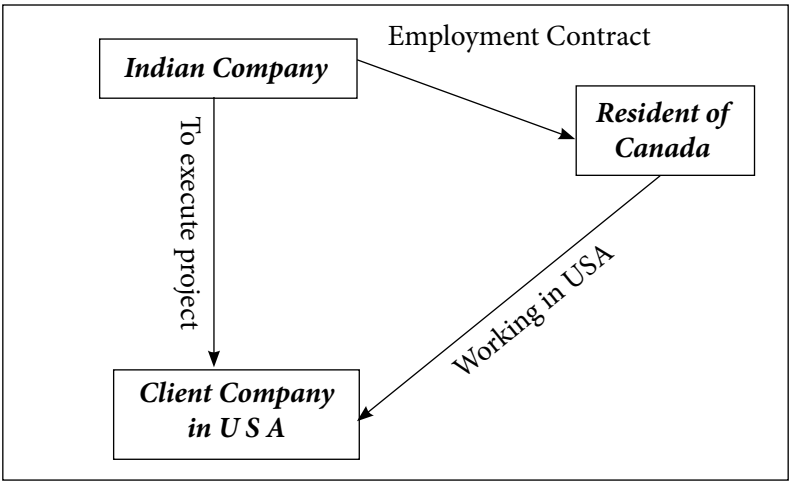
For Mythri - Overview on International Assignees

For Amulya - Concept of Tax Equalisation

On Monday class, Mythri narrated on Overview on International Assignees as under:

For today's discussion let us consider an inbound employee or an outbound employee as an "International Assignee". Globalisation leads to Multi National Companies, having operations in multiple countries need to employ people across countries. Global mobility of employees has become even more critical due to the requirement of specialised technical skill and expertise.

To illustrate, a company located in India is in a position to employ a person from Canada for a project to be executed in USA. The Indian company may or may not have a presence in USA either through Permanent Establishment or through a subsidiary. The employee from Canada was sent to USA only to execute a specific job and the employee's stay in USA is only for a limited period.



Now the critical issue would be to determine the taxation on salary received by the employee viz., whether the salary is taxable in India or Canada or USA??

As discussed under the Introduction chapter, this would be a classical example of ***Juridical Double Taxation*** wherein country of residence would like to tax the employee on his worldwide income, the country of source, where the employee performed his duties would also like to tax the income under source rule viz.,

- Canada being a country of residence would like to tax the employee;
- USA being a source country would like to tax the employee claiming that the services were rendered in USA; and
- India being a source country would like to tax the employee claiming that the employment agreement was entered in India

Double Taxation Avoidance Agreements between the countries have addressed this kind of scenarios by making appropriate provision under the Article "Dependent Personal Services".

The Dependent Personal Services article under UN model and OECD model are more or less on similar lines.

Normally the Dependent Personal Services article would contain 3 paragraphs.

- The first paragraph provides the taxing rights for both the countries
- The second paragraph would prescribe three conditions. They are cumulative conditions. Upon fulfilling the prescribed conditions, the resident country would get the taxing rights
- The third paragraph would deal with the employment exercised aboard a ship or aircraft operated in International traffic

Until now whatever I have narrated enable us in determining the taxability of income. The method of claiming double taxation relief can be known only when we understand the Article on Tax Credits.

Amulya narrated on the Concept of Tax Equalisation as under:

Multinational Companies are facing challenges of managing their international manpower effectively, both from a tax perspective as well

as a most sought after employer in the current competitive market for global talent. There are various tax issues concerning mobility.

Under a cross-border assignment, an employee is based out of one country (home country) to work in another country (host country). This leads to two foremost concerns for the employee (assignee), i.e., the risk of being subjected to ***tax in both countries*** as well as the risk that the ***tax rate in the host country is higher*** than that of the home country, resulting in a higher tax burden. DTAAs will generally address the first concern. The second concern can be resolved by the implementation of a tax equalisation plan.

A tax equalisation plan denotes neutralisation of tax impact of the International assignment on the employee. In other words tax equalisation is a concept where an employee who has been seconded to work in a foreign country would end up 'tax neutral', i.e., he would not pay more or less tax than what he would have paid on the same level of compensation in the home country had he remained working at home.

Considering a situation, where Rohith (Madhuri's cousin) is deputed to US to work on a 2 year project. His employer company has got a tax equalisation plan. In such a case, Rohith would be liable to tax in India for the financial year as if he is employed in India and the tax cost relating to his assignment in US would be taken care by the employer company. ***The concept works on the principle that an employee should be no better off or no worse off as a result of being assigned abroad.*** In compliance with the tax equalisation plan, the amount of tax that an employer has to bear is considered as Hypo Tax.

In the afternoon, I called Srilatha, Manager to review the daily work allocation report. While I was going through the works allotted to the staff for the day, I noticed that drafting an opinion was allotted to Pratik. I called Pratik to understand the issue on which the opinion was to be provided.

Pratik narrated me that a mail was received from M/s Techspin requesting for an opinion on the taxability of salary received by a foreign citizen from a non resident employer during the deputation period. I asked Pratik to explain the facts in detail.

FACTS

M/s Techspin India Private Limited is a company which is in the field of Software Development and is incorporated in India. M/s Techspin wishes to install specialized telecommunication network equipment in its premises and has contracted M/s Fusion Networks Europe Limited. M/s Fusion Networks Europe Limited is a company incorporated in UK. M/s Fusion Networks Europe Limited is a leading supplier of state of the art telecommunications services and technology to enterprises, network and service providers across South East Asia.

M/s Fusion Networks Europe Limited has sent Mr. John, an employee who specializes in equipment installation to India to install the telecommunication network and provide training to the Employees of M/s Techspin in India. Mr John is a citizen and resident of UK. He arrived to India on 6th July,2015 and left India on 30th September, 2015. He receives Salary from M/s Fusion Networks Europe Limited during his stay in India. M/s Techspin shall provide free accommodation to the employees of M/s Fusion Networks Europe Limited while they are in India. M/s Fusion Networks Europe Limited does not have any Business Connection / Permanent Establishment in India.

After hearing to the facts of the case I started questioning Pratik.

Myself: Are you clear about the facts furnished by M/s Techspin

Pratik: Yes Sir

Myself: Then, how do you start to ascertain the taxability?

Pratik: Sir, first we need to know the residential status of Mr. John and then we can look at the taxability of the salary.

Myself: Then, what is the residential status of Mr. John

Pratik: Mr. John is a Non resident

Myself: Whether Salary received by a Non resident is taxable in India?

Pratik: As per Section 9(1)(ii) of the Income Tax Act, Salary will be deemed to be accrued or arise in India, if it is earned in

India. Further if the services are rendered in India, then it will be deemed to be earned in India.

Myself: Where Mr. John has rendered the services?

Pratik: Mr. John rendered services both in India and UK, but he rendered services in India during 6th July 2015 to 30th September 2015 in India

Myself: Whether salary earned by Mr. John, for the services rendered in India, is taxable in India?

Pratik: Applying provisions of Section 9(1)(ii), read with Section 5 and 4, the same shall be taxable in India.

Myself: Did you go through the Short Stay Exemption provision

Pratik: What is that Sir?

Myself: Section 10(6)(vi). I asked him to get the Income Tax Act and to read out the provision

Pratik: Read out the provision as under

In the case of an Individual who is not a citizen of India, the remuneration received by him as an employee of a foreign enterprise for services rendered by him during his stay in India. Provided the following conditions are fulfilled—

(a) The foreign enterprise is not engaged in any trade or business in India;

(b) His stay in India does not exceed in the aggregate a period of ninety days in such previous year; and

(c) Such remuneration is not liable to be deducted from the income of the employer chargeable under this Act

Myself: Apply the said provisions to the present case

Pratik: As per Section 10(6)(vi), John (UK Citizen) received remuneration from M/s Fusion Networks Europe Limited (employee of a foreign enterprise) for the services rendered by him India is ***not taxable in India*** since all the three conditions (cumulative) are fulfilled in the present case viz.,

(a) M/s Fusion Networks Europe Limited is not engaged in any trade or business in India

(b) Mr. John's stay in India (87 days) does not exceed in aggregate a period of ninety days

(c) The said remuneration is not liable to be deducted from the income of M/s Fusion Networks Europe Limited (no Business connection or no PE in India)

Myself: Whether the free accommodation provided by M/s Techspin to Mr. John forms part of Salary?

Pratik: No Sir

Myself: Why not perquisite?

Pratik: Sir, Mr. John has come to India to work on a specific project. As per the contractual obligation, M/s Techspin has to incur the incidental expenses in providing accommodation to the employees of M/s Fusion Networks Europe Limited. It is just like when we go for outstation audit, the client provides the accommodation for the audit staff. So, it cannot be a perquisite.

Myself: What would be the taxability, if Mr John had left India on 30th November, 2015 instead of 30th September, 2015?

Pratik: Since Mr. John's stayed in India for 148 days, he will not be fulfilling one of the cumulative conditions of Sec 10(6)(vi) ie., 90 days and accordingly the ***salary will be taxable in India***.

Myself: Why are you restricting yourself to Income Tax Act, take out the DTAA between India and UK and read out the applicable article to see whether any relief can be taken

Pratik: Yes Sir, I will browse for India-UK DTAA.

Sir, Article 16 of India-UK DTAA deals with Dependent Personal Services and as per Article 16(2) the number of days stay can be upto 183 days.

Myself: Can you tell me the subtle difference between Section 10(6)(vi) and Article 16(2) ?

Pratik: Number of days.....

Myself: What else?

Pratik: ???????

Myself: Section 10(6)(vi) applicable only in case of an ***Individual being a foreign citizen*** whereas as per the DTAA Article, citizenship doesn't matter.

Also remember that, number of days stay is not uniform in all the DTAAs

Now that you have all the points prepare a draft opinion and get it vetted from Sowmya.

Make sure to include a point on Tax Residency Certificate.

Pratik: Why Sir?

Myself: As per Section 90(4) of the Income Tax Act, every assessee not being a resident of India shall obtain a Tax Residency Certificate (TRC) from their resident country tax authorities to establish that they are the residents of that country. TRC will enable us to identify the applicable DTAA. Without TRC non resident will not be entitled for relief under DTAA.

Pratik left the cabin and I called CA Sowmya, Tax Manager to come in

Sowmya: Hello Sir!

Myself: Hi Sowmya! Day before yesterday we had received a mail from Mr. Vineeth friend of Mr. Gopal Rao asking for a clarification. What is the status?

Sowmya: I had allocated the work to Abhishek and he was working on that.

Myself: Then let me call Abhishek so that we can discuss and try to conclude the same now itself.

Abhishek: Hello Sir!

Myself: Hi Abhi! What's the status of Mr. Vineeth's query?

Abhi: Sir, I have gone through the mail and I understand that Mr. Vineeth is in employment and works in a 'vessel' in the deep seas and would like to know the taxability of his salary. I have compiled the facts of the case and shared it with Sowmya madam.

FACTS

Mr. Vineeth, is being employed by ***Mangalore Ship Management (India) Pvt Ltd*** which is acting in the capacity of an ***agent of Titanic Offshore MMI, Dubai***. The employment agreement / contract is being entered into and signed in India between Mr. Vineeth and Mangalore Ship Management (India) Pvt Ltd (as an agent of Titanic Offshore) to render services for Titanic Offshore MMI, Dubai. The employment duties are to be performed in the 'vessels' in the deep seas, and the vessels belong to Titanic Offshore MMI, Dubai. ***The duties shall be performed in deep seas***. The remuneration to Mr. Vineeth is paid by Mangalore Ship Management on behalf of Titanic Offshore MMI, Dubai into his ***Indian bank account***.

In the year 2014-15, Mr. Vineeth stayed in India for 90 days. On employment duty Mr Vineeth stayed 95 days in a vessel stationed in the deep sea waters near Karachi, 135 days in a vessel stationed in the deep sea waters near Saudi Arabia; and 45 days in Dubai.

Myself: Are you clear about the facts of the case?

Abhi: Yes Sir, The summary of the case are:

Vineeth is an employee

Employment contract / agreement are signed by Vineeth and Mangalore Ship (agent of Titanic Offshore)

Vineeth works on the vessels belonging to Titanic Offshore in the deep seas

Vineeth receives his salary into his Indian Bank account

Myself: What about the taxability?

Abhi: It is taxable in India.

Sowmya: How do you say that it is taxable in India?

Abhi: It's simple. Since the employment contract is signed in India, salary accrues to Mr. Vineeth in India and the same is taxable in India.

Myself: Are we supposed to look at the accrual etc., in the first instance or the residential status?

Sowmya: Residential Status

Myself: What is the residential status of Mr. Vineeth

Abhi: He is a non resident as per Section 6 of the Indian Income Tax Act

Myself: For a non resident when salary is taxable in India? Just now we discussed in the previous case with Pratik.

As per Section 9(1)(ii), in case of a non resident, if services ***are rendered in India***, then the same shall be ***considered to be earned in India*** and shall be deemed to accrue or arise in India

Now, tell me whether Mr. Vineeth has rendered any services in India?

Abhi: No Sir, he has not rendered any services in India.

Myself: You say that Mr. Vineeth is a non resident and he has not rendered any services in India. In such a case whether salary received by Mr. Vineeth is taxable in India?

Abhi: No

Sowmya: Sir, I have a doubt here?

Myself: Tell me, what is it?

Sowmya: In case of a non-resident, section 5(2) governs the Scope of total income. There are two limbs in Section 5(2). Just now whatever we discussed covers under the second limb of Section 5(2) viz., 5(2)(b); but

As per Section 5(2)(a), if income is received or is deemed to be received in India, the same will be part of total income.

I am of the opinion that, since Mr. Vineeth has received salary into his Indian bank account the same shall be part of total income and chargeable to tax in India

Abhi: Ya!!!, I never thought in those lines. Whenever any query comes up for a non resident, I was always looking at Section 9 alone and was drawing my conclusions. I was committing a great blunder.

Myself: Sowmya, you are right that one needs to look at both Section 5(2)(a) and 5(2)(b) in arriving at the total income.

Same income cannot be brought to tax twice. I mean once as accrued and second as received. To understand better we need to look at all the Sections viz., 5(2)(a); 5(2)(b); 9(1)(ii) and Section 15

Section 15 contemplates tax on salary which is due, whether paid or not, as well as on salary which is paid whether due or not. The words 'due . . ., whether paid or not' occurring in Section 15(a) cover all sums which are due irrespective of whether they are paid or not paid, and, therefore, the portion of salary ***due and paid*** as well as the portion ***due and not paid*** are both covered under Clause (a). Section 15 does not give an option to offer the income in the year of accrual or in the year of receipt according to one's choice. ***The provision contained in Section 15 fixes the liability at the point of accrual*** except in case of salary paid in advance.

In the present case to decide on the taxability we need to consider the accrual and not the receipt. Hence we need to consider Section 5(2)(b) and Section 9(1)(ii). Since Mr. Vineeth's salary is accrued outside India as per the provisions of Section 9(1)(ii) the same is not taxable.

What Sowmya? Do you agree with me or not?

Sowmya: Yes Sir, I am convinced.

Also, since the salary income is ***not taxable*** under the provisions of ***Income Tax Act*** itself, we need not have to look at ***DTAA***. Am I right sir?

Myself: Yes. You are right. Normally we refer to a DTAA to see whether any relief can be claimed. When the income is not taxable under the Income Tax Act there is no need to look at DTAA.

Abhi!, based on the discussion, prepare a reply and send it to Mr. Vineeth. Before sending get it reviewed by Sowmya

Abhi left the cabin

Sowmya: I just wanted to remind you that we have yet to reply two more mails

Myself: Which mails??

Sowmya: One that was received from Mr. Kiran, Gopal Rao's Son and the other from Mr. Karthik, Kiran's friend.

Myself: Whether anyone has worked on it or not?

Sowmya: Both were ready for discussion. If you can review it now I will call Lakshmi who has worked on Mr. Kiran's query.

Myself: Ok. Let us call Lakshmi

Lakshmi: May I come in sir

Myself: Yes come in.

Lakshmi: We had received a mail from Mr. Kiran. Brief facts of the query are

FACTS

Mr. Kiran is a software engineer working in Infosys. Kiran has moved to UK on 5th May 2015 to work on a 3 year project. Mr. Kiran would like to know, whether his salary income be subject to tax in both India and UK?

Lakshmi: Sir, even I have collected relevant information from Mr. Kiran and ascertained the residential status of Mr. Kiran. He will be a non resident under the provisions of Income Tax Act for financial year 2015-16

Myself: Then what about taxability?

Lakshmi: Since Kiran is a non resident, salary earned in India for the period from 1st April, 2015 to 5th May, 2015 is taxable

in India. Kiran being a resident of UK, global income is taxable in UK ie., both Indian Salary and UK Salary.

Myself: You mean, Indian salary will be taxed both in India and UK?

Lakshmi: That is where I stuck?

Sowmya: Can you recollect the recent Monday class where Mythri dealt on a topic - International Assignees?

Lakshmi: No, I am confused

Sowmya: Whenever the same income is taxed in more than one country we need to go through the relevant DTAA to ascertain the relief. ***Keep in mind that in Kiran's case the doubly taxed income is salary earned in India***. In Kiran's case we need to go through the DTAA between in India and UK. The relevant articles are Article 16 and Article 24. Takeout the relevant provisions and read it

Lakshmi: Article 16 of India-UK DTAA deals with Dependent Personal Services. I will read out the provisions by replacing UK with "Contracting State" and India with "other contracting state" for an easy understanding

Paragraph 1 of Article 16 states that, Salaries derived by an UK resident ie., Kiran in respect of an employment shall be taxable only in UK unless the employment is exercised in India. If the employment is exercised in India, such salary as is derived may be taxed in India.

However, Paragraph 2 of Article 16 states that, salary derived by a UK resident ie., Kiran in respect of employment exercised in India shall not be taxable in India if he fulfills the following conditions:

- Kiran's stay in India doesn't exceed in aggregate 183 days during the relevant fiscal year;
- Salary is paid by, or on behalf of an employer who is not a resident of India; and
- Salary is not deductible in computing the profits of an enterprise chargeable to tax in India

The above three conditions are cumulative in nature and all the three conditions shall be fulfilled for application of Paragraph 2.

In Kiran's case, since Kiran's stay in India was 34 days during the financial year 2015-16, he fulfills the first condition. Kiran received salary from Infosys, a resident of India, hence the second condition is not fulfilled. Kiran's salary would have been deducted in computing the profits of Infosys, even the third condition is not fulfilled.

Since Kiran doesn't fulfil the cumulative conditions, the salary shall not be taxable in India and shall be taxable in UK only.

The third paragraph deals with employment exercised aboard a ship or aircraft in international traffic and not relevant in Kiran's case.

Sowmya: Quickly summarise.....

Lakshmi: Kiran is a non resident as per Section 6 of the Income Tax Act and a resident of UK. Article 16 of India-UK DTAA is relevant to ascertain the taxability of Salary earned in India. By applying provisions of Paragraph 1 and 2, the salary earned in India is not taxable in India.

Sowmya: By applying the provisions of DTAA Kiran's Salary is not taxable in India. In order to claim the DTAA benefit, Kiran shall obtain a Tax Residency Certificate from UK tax authorities in compliance with Section 90(4) of the Income Tax Act.

Having understood the taxability, one may have to go through Article 24 of India-UK DTAA in arriving the double taxation relief. The mechanism involved in claiming the relief will be dealt in detail under the Tax Credit chapter.

Lakshmi left the cabin.

Sir, Sathyan has worked on Mr. Karthik's query. Shall I call him?

Myself: Sure....

Sathyan: May I come in sir?

Myself: Yes Sathyan

Sathyan: Sir, I had received a mail from Mr. Karthik.

Myself: Which Karthik ??

Sathyan: Mr. Karthik was referred by Mr. Kiran

Myself: Ok. What's the query?

Sathyan: The summary of Mr. Karthik's mail

FACTS

Mr. Karthik is an employee director in Air Wick Inc., an US company and was deputed to it's Indian Subsidiary Air Wick India as director of Air Wick India. For the last 3 years he is working in India. Mr. Karthik gets salary from both Air Wick Inc., as well as Air Wick India. Mr. Karthik is a Resident and Ordinary Resident for the financial year 2014-15 as per the provision of Income Tax Act. Following are the Salary details:

Indian Salary for the Financial Year 2014-2015

Sl No.	Description	Amount in Rs.	Amount in Rs.
1	Basic	20,00,000-00	
2	DA	5,00,000-00	
3	HRA	10,00,000-00	
4	Other Allowances	15,00,000-00	
	GROSS SALARY		**50,00,000-00**
	Less: Deductions		
1	Provident Fund	2,40,000-00	
2	Profession Tax	2,400-00	
3	Income Tax	12,50,000-00	
	TOTAL DEDUCTIONS		14,92,400-00
		NET SALARY	**35,07,600-00**

US Salary for the Financial Year 2014-2015

Sl No.	Description	Amount in Rs.	Amount in Rs.
1	Salary	50,00,000-00	
2	Bonus	10,00,000-00	
	GROSS SALARY		**60,00,000-00**
	Less: Deductions		
1	401 K	20,00,000-00	
2	Social Security Tax	2,52,000-00	
3	Medicare Taxes	87,000-00	
4	Federal Taxes	8,95,000-00	
	TOTAL DEDUCTIONS		**32,34,000-00**
		NET SALARY	**27,66,000-00**

Mr. Karthik wants to know the amount of deduction he can claim with respect to contribution made towards 401 K under the Income Tax Act.

Myself: So what's your answer to Mr. Karthik's query

Sathyan: I was not aware of 401 K. Just now I read an Article published in the branch news letter.

Myself: Did you understand?

Sathyan: I am not sure, but let me narrate what is 401K. If I am wrong any how you are there to correct me.

In USA, 401(k) plan is a tax-qualified, defined-contribution pension account defined in subsection 401(k) of the Internal Revenue Code. It is one of the retirement plans. Individual tax payer may contribute (and sometimes proportionately matched by employer) to 401(k) to avail the benefit of tax deferral. A 401(k) plan is subscribed to when the tax payer is in employment. The tax shall be payable only when the payout benefit from the retirement plan is initiated or on premature withdrawal. Most plans offer a spread of mutual funds composed of stocks, bonds, and money market investments. The return on 401(k) plan is in the form of capital gain, dividend and interest. These returns on 401(k)

will get credited to the account and are tax deferred in USA. These returns are liable to tax only on withdrawal.

I could only read to this extent and I didn't validate the taxability under Income Tax Act.

Myself: What you understood is right

When it comes to taxability under Income Tax Act, the contributions made to 401(k) will not be exempt. Apart from that, accretions to 401(k) are taxable in India.

If you notice US Salary, deductions like social security taxes and medicare taxes are deducted from US Salary. Whether the said deductions are allowed under Income Tax Act

Sathyan: No sir.

Myself: Yes, you are right

CONCLUSION

To sum up, both inbound employee and outbound employee will be considered as International Assignee. Computation of salary, both Indian salary as well as other country's salary shall be done as per the provisions of Income Tax Act. Any double taxation issue arising out of such employment needs to be addressed as per the provisions of Income Tax Act along with Dependent Personal Services Article and Tax Credit Article of the applicable DTAA. In case if there is no DTAA, double taxation relief can be claimed as per the provisions of Section 91.

* * *

INDEPENDENT PERSONAL SERVICES

Introduction

From an Indian perspective, there is a significant rise in International Trade in Services. We are witnessing a tremendous increase in number of persons going abroad and coming to India for providing services. Services include Personal Services. Personal services can be categorised as Dependent Personal Services and Independent Personal Services. In the previous chapter we have understood the concept of Dependant Personal Services. Now, it is important to understand Independent Personal Services. Before that, let us look at the ordinary meaning of Personal Services.

Personal Services means

- Intellectual or manual work performed by a service provider in serving a customer
- Talents of a person which are unusual, special or unique and cannot be performed exactly the same way by another
    - Professional services rendered by professionals like artists, actors, writers, lawyers, doctors, engineers, accountants etc.
    - Value of personal services is greater than general labour

Accordingly, Professional Services rendered by independent professionals shall constitute Independent Personal Services.

Background

Article 14 of the UN Model Convention 2001 deals with Independent Personal Services (IPS). OECD Model Convention 2000 has deleted this article and the provisions of this article have been clubbed with the provisions of Article 7 (Business profits). The reason for such deletion was largely due to very thin line between "business" and "profession". However, in almost all the DTAAs which India has entered with the other countries, Article 14 has been very much in existence.

For a better understanding of this article let me take you through a case where we had recently issued a Certificate in Form 15CB. Let me call Sneha, articled assistant who has handled this case.

Myself: Sneha, can you come inside. While coming bring the recently issued Form No. 15CB in case of M/s Lavanya Enterprises along with the relevant documents

Sneha: Yes Sir, I will bring the file.

Sir, may I come in

Myself: Yes, come in

Sneha: Sir, Certificate has been already handed over to the client. Anything wrong in the certificate?

Myself: No..No...No... I just wanted to understand from you regarding the validation process adopted by you in determining the taxability.

Sneha: Shall I narrate the facts of the case and how I have determined the taxability?

Myself: Yes

Sneha: Narrated the facts of the case as under

FACTS

M/s Lavanya Enterprises approached us for issuing a certificate in Form No. 15CB. They were supposed to make a final payment of GBP 25,000 to a solicitor firm M/s Guru and Amaresh a UK based firm. We have released the certificate considering the nature of payment as Independent Personal Services with NIL withholding tax.

Myself: How did you ascertain the nature of payment and the withholding tax rate?

Sneha: Sir, to be frank, six months back we had released the certificate towards the 2nd instalment payment and the present certificate is for the final payment. So referring the previous certificate I have compiled the present certificate and showed it to Sowmya Madam.

Myself: Sowmya knows this and updated me

Is that the way to learn?

That is why I called you to read the provisions.

Sneha: Sorry Sir

Myself: How to start the certification process?

Since you have brought the file, go through the documents and tell me.

Sneha: I need to identify the nature of service provided by the overseas vendor. For that let me review Invoice; Purchase Order; Agreement etc.,

I could find Invoice and Agreement. As per the agreement, M/s Lavanya Enterprises engaged M/s Guru and Amaresh, a solicitor firm to take care of the legal matters in setting up a solar power plant. The legal matters include:

- Drafting supplier contracts
- Drafting shareholders / Loan agreements
- Vetting investment agreements
- Consultation on legal matters

The total contract value is GBP 1,00,000. Payment terms are: Advance payment of GBP 50,000; second instalment GBP 25,000 and the final payment GBP 25,000 will be paid upon completion of the project

Since the project is complete, the invoice was raised for final payment

Myself: What is the nature of service?

Sneha: As per Section 9(1)(vii) of the Income Tax Act, the nature of service rendered by M/s Guru and Amaresh shall be considered as Fee for Technical Services. Even as per Article 13 of India UK DTAA, the same shall be considered as Fees for Technical Services

Myself: As per Income Tax Act you are right, but as per DTAA I feel you are wrong

Sneha: Sir, Looking at the nature of service I referred to Article 7 – Business Profits and Article -13 Royalty and Fees for Technical Service. Since it is not a business, I have considered the said service as Fees for Technical Services.

Myself: Did you go through IPS Article?

Sneha: IPS!!

Myself: Yes, IPS. I mean Independent Personal Services and not Indian Police Service

Sneha: No Sir. I am hearing IPS for the first time. Let me take out the Article and read. First I will read the Article and then analyse the present case by applying the provisions of the Article

Article 15 of India UK-DTAA deals with the Independent Personal Services.

Provisions

As per paragraph 1, An UK resident being an individual or as a member of Partnership derives income in respect of ***Professional Services*** or ***other independent activities of similar character*** may be taxed in UK.

In case that UK resident stayed in the other country (India) for a period or periods aggregating to 90 days in the relevant fiscal year or he has a fixed base in the other country (India) for performing his activities, then so much of income as is attributable to those services may also be taxed in the other country (India).

As per paragraph 2, In case the UK resident is a Partnership firm, then period of stay shall be considered for all the members of that Partnership whether it is for that particular assignment or for any other independent activities of similar character during that fiscal year

Paragraph 3 defines "Professional Services" to include independent, scientific, literary, artistic, educational or teaching activities as well as the independent activities or physicians, surgeons, lawyers, engineers, architects, dentists and accountants

Application of the provisions to the present case

Sir, first I will apply first limb of paragraph 1 to identify to whether the payee is covered under this Article. In the present case since M/s Guru and Amaresh being a Partnership firm they are covered.

Second, I will ascertain whether the said partnership firm has rendered Professional Services as defined in Paragraph 3. Since, the independent activities of lawyers are covered under Professional Services, services rendered by M/s Guru and Amaresh will be considered as Professional Services.

Since the provisions of Paragraph 1 are fulfilled, the same may be taxed in UK. Before concluding the same we may have to validate the second limb of the provisions of Paragraph 1 viz.,

(a) whether the number of days stay in India by the members of M/s Guru and Amaresh aggregating to 90 days in the fiscal year; or

(b) M/s Guru and Amaresh has got a fixed base in India

Sir, I remember that I have seen in the client file, a declaration which was obtained from M/s Guru and Amaresh along with the Invoice, agreement etc., as part of our office documentation.

As per the declaration, number of days stay in India by the members of M/s Guru and Amaresh in aggregate does not exceed 90 days and they also declared that their firm do not have a fixed place available to them in India to perform their services.

Sir, to sum up the Independent Personal Services rendered by M/s Guru and Amaresh is taxable in UK and not in India.

Sir, along with the declaration, I also find Tax Residency Certificate (TRC). In order to claim the DTAA benefit, M/s Guru and Amaresh had obtained TRC from UK tax authorities in compliance with Section 90(4) of the Income Tax Act.

Now, I understood why the certificate was issued with NIL withholding tax

Myself: That is OK. Tell me, what will happen if M/s Guru and Amaresh has got a fixed place in India or the number of days stay in India by their members exceed 90 days?

Sneha: In such a case India will have right to tax such services

Myself: Tax on the whole amount?

Sneha: No sir. Only to the extent of income attributable to those services are taxable in India

Myself: While issuing a certificate in Form 15CB withholding tax will be applied on the Gross amount or net income?

Sneha: On the Gross Amount

Myself: Yes. You are right. The detailed explanation on the certification will be dealt with under the chapter Section 195

Through the above case study, hope you understood the basics on Independent Personal Services.

Sneha: Yes Sir, I could understand the basics of Independent Personal Services. But still I have one doubt in Paragraph 1 of the Article.

Myself: Paragraph 1?

Sneha: Yes Sir. In paragraph 1 words used are ***Professional Services or other Independent Activities of a similar character***. Professional services are defined in Paragraph 3 where as

other independent activities of a similar character were not defined. What constitutes independent activities of a similar character??

Myself: At first we need to identify the nature of service and then look for similar character i.e., similar to Professional Services. To understand this better we can look for following characteristics:

- Primarily it should be a service
- It should be distinguishable from Business Profits
- Capital is of Secondary importance
- Requires more intellectual capital

Sneha: Now my doubt is clarified.

Myself: Then, I will give you some home work. Go through the provisions once again and then compile

(i) a list of intricacies that you may find ***between articles*** and intricacies ***between DTAAs***

(ii) Illustrious list of IPS Services

You need to update me tomorrow morning

Sneha: Surely I will do it sir.

Next day morning.....

Sneha: May I come in Sir

Myself: Yes, come in

Sneha: Sir, I would like to say my sincere apologies once again

Myself: What happened? You didn't do the home work is it?

Sneha: No Sir, I am ready with the lists. I apologised for the way I handled the certification work. Inspite of me doing the mistake, you made me read the provisions and not only that, you made me to do a bit of research on the subject to have a better understanding of the provisions

Myself: Articleship is meant for learning and not for earning

OK, leaving that apart, tell me what is that you have done

Sneha: You had asked me to work on three aspects. I have done some exercise on this and read out the issue as well as the answers as per my understanding.

The first one being intricacies between the articles – India-UK DTAA:

(1) Whether the Persons covered under Article 7 – Business Profit; Persons covered under Article 13 – Royalties and Fee for Technical Services; and Persons covered under Article 15 – Independent Personal Service are one and the same?

"Any person" is covered under Article 7 and Article 13, whereas "Individual in his own capacity or as a member of a partnership" alone are covered

(2) If an Individual has rendered some technical service viz., A software engineer being an individual has provided some technical consulting services, whether such service is covered under Article 13 or Article 15?

Normally technical consulting services are covered under Article 13. Since the service provider being an individual one shall apply Article 15 rather than Article 13. The reason being that, the provisions of Article 15 being ***specific provisions for professional services***, will override the relatively general provisions of Article 13 which apply to broader category of 'managerial, technical or consultancy services."

(3) Normally, whenever we talk about Fee for technical services under India-UK DTAA, we say that whether such technical services have **"make available"**. Whether this **"make available"** applies even to Professional Services covered under Independent Personal Services?

No. Specific provision of **"make available"** is referred to in Article 13 alone and the same is not there in Article 15. Accordingly **"make available"** clause doesn't apply to Independent Personal Services

(4) Under India-UK DTAA, professional services rendered by a company will fall under which article?

Since Person being "Individual in his own capacity or as a member of a partnership" alone are covered under Article 15, professional services rendered by a company will not fall under Article 15

Incase, the professional services rendered can be fit into the provisions of Article 13, then the same may be considered as Fees for Technical Services, otherwise they shall be considered as Business Profits under Article 7

The second one being intricacies between DTAAs:

(1) It is commonly understood that professional services are always rendered by individuals or group of individuals. Such group of individuals can be a partnership firm or they may incorporate themselves into a company. There are different views. One such view is that personal services would mean the services of a human being or a living person. The other view is that even company rendering professional services can be covered by the provisions of Independent Personal Services. It's a matter of debate. To illustrate Brazil, China, Japan, Mauritius are few DTAAs which India has entered into, contains IPS article referring to companies.

The third one being Illustrious list of IPS:

(1) Independent training services provided by an individual trainer

(2) Erection, assembling and commissioning services provided by Individuals

(3) Managerial, technical, consulting services provided by individuals

(4) Accounting and auditing services provided by Individuals

(5) Consulting services by an Individual Architect

(6) Commission to an Individual for providing Marketing consultancy services

(7) Professional Fees paid to Non whole time director of an Indian company who is non resident for rendering technical and marketing services

CONCLUSION

To sum up, any professional services rendered while in employment are considered as Dependent Personal services and if they are rendered by independent professionals then they will be considered as Independent Personal Services. Income from ***Professional Services*** or ***other independent activities of a similar character*** are generally taxable in the state of Residence of the service provider, however, these services may be taxable in the state of Source in a case where the service provider has a fixed base or fulfills the minimum number of days stay in the source state.

* * *

CHAPTER – 8

Taxation on Artists, Sports Persons

- CA Vinay T

Case Study 1

"Appa!we are going to have fusionmusic by a band from London for our school Anniversary" my son told me with full excitement.In this regard his piano Sir, Mr. Sam who is the Arts club secretary in his school wants to talk to me and my son has shared my phone number to him. In this context, I remembered Mr. Gopal Rao was quite unhappy that the even BasavangudiGaneshaSevaMandali roped in an artist from abroad to perform during theGanesha festival last September.

I thought Globalisation has not only made an impact on business, but in Arts,Culture also.

As expected, Sam Sir called me and explained the whole process:

The music band "Death by fire" (the artist) is from London. An agreement is entered between the school and the agent (Big Banners) of the artist. The agent is from Netherlands. As per the agreement, the school has to pay 'Performance Fees' subject to taxes in India and also meet the expenses for visa, travel and accommodation when the artist comes to India for the performance.

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As per the agreement, the school has to pay 50% of the performance fee, USD 7500 as advance. The bank has asked for Form 15 CB and Form 15 CA to transfer the funds. Mr. Sam requested me to brief the process and importance of 15 CB and TDS.

Now, I had to address the following issues:

1. Whether school has to do TDS on this payment?

   Yes, as per section 195, the school has to do TDS on the payment made to a non-resident.

2. As per the agreement the remittance will be made to the agent of artist. So whether TDSto be done in the name of the agent (Big Banners) or the artist (Death by fire)?

   In this case the beneficiary is the artist. So TDS has to be done in the name of the artist, though the remittance is made to the agent.

3. What is the rate of TDS as per the Income Tax Act?Does Treaty benefits available to the artists and agents?

   As per section 115 BBA of the Income Tax Act, TDS Rate is @ 20 %

   Treaty benefits can be availed by artists. Article 18India UK DTAA states that the Source country is having right to tax such income. Hence Income is taxable in India as per Income Tax Provisions.

4. Which Tax Treaty is relevant to determine the rate of TDS?

   In this case the beneficiary is the artist. The artist is the resident of London (UK). So rate of TDS as per Article 18 of the India–UK Tax Treaty has to be considered. The funds are transferred to the agent who is based in Netherlands. He is only the recipient. So India – Netherlands Treaty should not be considered.

5. Suppose the, state government awarded the prize money of Rs.10.00 Lacs to artist, is this prize money taxable?

   Yes, as per Article tax shall be paid at source country on prize money received. Such prize money should be related to his performance. Hence the prize money, bonus, award etc. received by such artist attract taxes in India.

Case Study 2

Friday morning, I was in a meeting witha client. Meanwhile, I could, hear my audit manager shouting at Bharath, the Article student. I came out of my cabin and found shouting because Bharath was browsing IPL T20 6th season during office hours without finishing priority works for the day.On seeing me, Bharathcame running and explained that he got a call from one of his friends, doing Articleship in ABC CA Firm, who had questionson the tax impact on payment to be made to James Faulkner selected for Gujarat Lions team in IPL 6th season and his remuneration is fixed at Rs. 5.50 Crores. Bharath was trying to find answer in the IPL-T20 website. I found the query very interesting …

James Faulkneris, anAustralian citizen and non-resident Indian-

1. Whether remuneration received from Gujarat Lions team is Taxable in India?

   Yes, Income Accrues and Arise in India, hence the income is chargeable to tax in India since the source of income is from India.

   Article 17 of the Treaty specifies the treatment of income of Entertainers including athletes. The term athletes also includes sports person like golfers, footballers, cricketers as per commentary to OECD convention

   As per this Article, the country where the athlete earns income from exercise of their activities (Source country) has the right to tax the income arising from such activities. So in this case India gets the right to tax the remuneration earned by an athlete from IPL matches played in India.

2. Is TDS attracts, if so what is the Rate of TDS?

   a. Yes, since the remuneration payable by Gujarat Lions team in IPL 6th season, to James Faulkner is chargeable to tax in India, Tax has to be deducted at source as per section 195 of the Income Tax Act. In order to determine the rate of TDS we need to find out the rate of Tax as per Income Tax Act or Rate as per the Tax Treaty whichever is beneficial.

b. Since there is no specified rate mentioned in the Treaty, the rate of tax as per the domestic tax laws of source country can be considered as the tax ratefor tax to be deducted at source.

c. As per section 115BBA of the Income Tax Act, the rate of tax is 20%.

d. James Faulkner is a citizen of Australia. Let us assume he is a resident of Australia as per the domestic tax laws of Australia. He being resident of Australia we need to consider India-Australia Tax Treaty to determine the taxing rights of India and also the rate of tax if any as per the Treaty.

e. So in this case India being the source country, rate of tax as per section 115 BBA i.e. 20% is TDS Rate on remuneration payable to James Faulkner

3. Apart from remuneration, Gujarat Lions has agreed to pay Rs.1.00 Crore towards preparation and training in Australia before IPL 6th Season starts, so that he can equip himself to play well in India. Is this payment falls under Article 17 and is taxable in India?

   Yes, payment towards preparation and training in relating to performance is taxable in India.

4. James Faulkner got injured during the practice, not able to play for IPL 6th Season. However he supported as commentator in IPL 6th Season. Being a commentator, IPLhas made a payment of Rs.2.00 Crores. Is the amount received in the capacity of commentator is Taxable in India?

   Yes, this is taxable in India as per Income Tax Act. This payment is not covered U/s. 115BBA.

   Commentary on Art 17 issued byOECD Model convention, any income of aninjured sportsman from any activity other than performance would not be covered by Art 17. Hence in this case income earned as commentator will be covered by Art 7 (Business profits)or Art 14 (Independent Personal Services) of the Treaty

5. Decathlon India Private Limited entered into agreement with James Faulkner to promote and advertise its Cricket related Products. Agreed compensation to James Faulkner is Rs.1.00 Crore. Is this amount taxable in India?

   Yes, this income is directly linked to his performance and would be taxable in India and Article 17 shall be applicable.

   (Sportsmen often receive income in the form of advertising or sponsorship fees. commentary on OECD states that income from royalties or intellectual property rights will be covered by Art 12. However income from general advertisements directly related to performance would be covered under Art 17 only)

6. Flipkart India Private Limited entered into agreement with James Faulkner to be a brand ambassador. For this Faulkner will be paid Rs.2.00 Crores. Is this amount covered as per Art 17?

   No, this income is not directly linked to performance in India, hence not covered by Art 17. It may taxable under Article 7 (business profits) or Article 15 (independent Personal Services)

   (Few case laws referred Agassi V/s. Robinson and Set, Duce and Ball)

7. During stay in India, James Faulkner has written an article on Cricket in Times of India. Times of India pay the honorarium for his contribution. Is this honorarium taxable?

   Yes, income from contribution of articles relating to any game or sport in India in newspapers, magazines or journals is covered U/s. 115BBA (a) (iii).

   Commentary on OECD on Article 17 includes income by way of contribution of article, advertisement having direct relation to his performance.

8. What happens if payment is made to restrain or to cancel the performance of sportsmen?

   Payment is made to restrain or cancel the performance, is not covered under Art 17. Sec 115BBA of Income Tax Act mentions

payment towards performance, actual this is payment for not to perform, hence 115 BBA is not attracted.

Either Article 7 (Business Profits) or Article 15 (Independent personal services) can be applicable for such payments

9. Indian company pays to James Faulkner for his performance in Srilanka?

   Since the source of Income is from India, taxable in India only even though the performance is in Srilanka. India and Australia treaty is applicable.

10. Should James Faulkner file Income Tax Returns in India?

    Not necessary, Sec 115BBA (2) exempts James Faulkner to file return in India as the payer has made the TDS @ 20% on the total payments made to him.

11. If James Faulkner stay in India exceeds 182 days during the previous yearwill he be treated as resident in India and will 115BBA applicable or Not?

    As James Faulkner stay in India exceeds 182 days during the previous year, he will considered as Resident as per Income Tax Act. 115 BBA is not applicable. Provision of Income Tax Act applicable.

SL No	Nature of Income of James Faulkner	Taxability of Income in India	Article	Note
1	As a player – performance	Yes	17	Source Country having first right to tax
2	As a Commentator for IPL Match	No	7 or 14	
3	Decathlon India Private Limited	Yes	17	Advertisement Income related to his performance

SL No	Nature of Income of James Faulkner	Taxability of Income in India	Article	Note
4	Flipkart India Private Limited	No	7 or 14	Not related to his performance
5	Cancellation fees in case of cancellation of match and his performance	No	7 or 14	Not related to his performance
6	Honorarium for Article in sports column of Times of India News paper	Yes	17	Honorarium Income related to his performance

Case Study 3 -

Last Sunday, I was invited for Bharatanatyamarangetram function of my friend's daughter in Chowdiah hall. To my surprise I met Mr.Gajendra, a good friend of mine. He happened to be the Guru of the girl who was performing. During the course of our discussion he told me that he and his wife Anupama who is also a dancer has got an invite from Bharatiya Kala Academy, USA to perform Shiva Leela dance drama on MahaShivaratri. As per the contract the Academy will reimburse the expenses for visa expenses, travel and accommodation. Performance fees will be Rs.15.00 Lacs subject to withholding taxes as per US Tax laws. In addition to Gajendra and Anupama, the show will have 50 students from Bharatiya Kala Academy, USA. Gajendra asked me to apprise him of the taxability issues of the performance fees.

I had the following question to my international tax team in my office:

1. Mr.Gajendra and Anupama are residents in India, then whether they have to pay tax in USA on the performance fees received for the Shiva Leela show. ? Why tax should be paid at USA as they are Indian resident? How tax filing happens in India?

    a. Being both are resident Indians as per Income Tax Act, global income is taxable in India. However source of income from

USA, USA is having right to tax on such income. (Article 18 to DTAA between India and USA)

b. USA withholds the taxes before making payment to artists Mr. Gajendra and Mrs. Anupama. Balance amount shall be payable.

c. Bharatiya Kala Academy, USA, having deducted and remitted the TDS amount, shall issue a withholding tax certificate to artists.

d. Artists Mr. Gajendra and Mrs Anupama, compute their tax liabilities as per Income Tax Act, including income from Bharatiya Kala Academy, USA.

e. Tax deducted / withheld by Bharatiya Kala Academy, USA shall be considered as Tax Credit (as per Article 25) and reduce from tax liability in India.

f. While filing the Income Tax Returns by Mr. Gajendra and Mrs Anupama, Tax Credit shall be mentioned under Relief U/s.90 of Income Tax Act and reduce from total tax liability.

g. As Tax credit doesn't reflect in 26 AS against the PANo, Assessing officer may issue a notice and call for assessment before allowing such Tax Credit.

2. Since the show involves 50 artists, I realized that the in the show Gajendra will have two roles and responsibilities – one as director of the show and also as performer. I remember he will be given additional fees for directing the show. Will there be any difference in the taxation of 'fees received for directing the show' and 'performance fees'?

a. In the present scenario, Mr. Gajendra and Mrs Anupama is directing the show for 50 artists and both are performing in it. In this case it is necessarily to look at either direction is dominated or their individual performance is dominated.

b. Fee for individual performance is covered in Article 18 and tax accordingly.

c. Fee for directing the 50 Artistes is received separately. This income is either considered under Business profits or independent personal services.

d. As per commentary to OECD convention if the individual performance is negligible element, the whole of income will fall outside this Article, Then other Article like Business Profits or Independent personal services applicable.

3. Is Gross Amount received is taxable or any threshold is mentioned?

a. India and US DTAA having threshold amount (surplus in excess of USD 1500 or equivalent to INR), if it exceeds threshold amount, source country tax on such exceeded amount, i.e., State of source waives its right to primary taxation for reason of practicability.

b. Commentary to OECD convention mentions that if any expenses reimbursed in connection to performance, then such reimbursement shall not be considered for the purpose of threshold.

Case Study 4

Sunday Morning, having a cup of coffee and reading Business Standard. A special edition was published on Cricket players and their remunerations for various performances, it was interesting to read The income of MS Dhoni for the previous year -

1) Salary from Indian Railways as employee – Rs.6.00 Lacs

2) Salary from BCCI – Rs.60.00 Lacs for Asia Cricket tournament

3) Remuneration from Chennai Super Kings Team Rs.800 Lacs for IPL tournament in South Africa

4) Advertisement Income from Boost, Orient Fans – Rs.250 Lacs

5) Entered a contract in South Africa for a Local Companyas Brand Ambassador and received USD 1.00 Lac.

On calculation of no of days in that year MS Dhoni spends 120 days in South Africa for IPL tournament and 50 days at Srilanka, 30 days at

Bangladesh for Asia Cup cricket tournaments. Total No of Days stay in India during previous year is only 165 days….

Framing the questions on his residence, taxation on such Income…

1. Is MSD is considered as Resident or Non Resident?

   Being MSD stays in India less than 182 days during the previous year, However stayed in India more than 60 days during previous Year and must have stayed in India more than 360 days during 4 years preceding to previous year.

2. Is these income is Taxable in India?

   Yes, being resident, Global Income is Taxable in India, Including Income from South African Company as Brand Ambassador.

   Amount withheld by South African Country, can be considered as Tax Credit in India.

3. Consider if MS Dhoni continued his stay in South Africa after tournaments for another 120 days, would be any difference in income and Taxes?

   Yes, No of days stay outside India would become 320 days. He will become Non Resident for the previous Year.

   Only Income accrued and received in India would be Taxable.

   Income received from South African Company as Brand Ambassador would not be taxable in India, being Non Resident…. South Africa can tax this income as per its Tax Laws.

* * *

CHAPTER – 9

Tax Credits

- CA K L Prashanth & CA Sridhar M G

After discussion on various types of income such as salary income, professional income, business income, property income, capital gains, royalty, technical services, interest, dividend and its taxability, as included in the previous units, we suddenly realised that even though there is an arrangement between India and other country's with regard to taxing of different kinds of income, double taxation still exists.

While discussing on the above with Mr. Gopal Rao, my Articled Assistant Ms. Mohanambika who was working on issuing of CA certificates for foreign remittances started questioning me on double taxation.

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Mohanambika had following questions….

She said, "What is the concept of double taxation"? Can you brief?

As she was working for international transactions, it was important for me to explain her in detail about double taxation and its associated topics.

I started explaining her the concept, "Where a taxpayer is resident of one country but has source of income situated in another country it gives rise to double taxation, this arises from the two basic rules namely:

- Residence rule – (i.e., based on OECD Model Convention)
- Source rule – (i.e., based on UN Model Convention)

The above rule enable the country of residence, as well as the country where the source of income situated in another country imposes tax".

I further went on explaining the concept in depth on seeing her keen interest in the subject.

I explained her that, tax treaties were entered into to avoid double taxation of the same income in the hands of the same person in more than one country. The base objective of the treaty is to avoid double taxation, by which an exclusive right of taxing the income is assigned to either of the country for different nature of income by defining the jurisdiction and the residential principles in the treaty.

As I was moving further she interrupted me by asking that, every treaty says that the country of residence has an exclusive right to tax the income arising to its resident. In this case how is it possible to avoid double taxation if country of source is also taxing the same?

However, in many scenarios giving exclusive right is not practically possible and conflicting claims of tax are not reconciled and both the countries insist upon exercising their right, which results in double taxation arising due to variation in the approaches adopted by the countries during treaty negotiation.

The model convention based on which countries broadly negotiates their treaties are:

1. The OECD Model Convention; andWhich emphasis that income arising anywhere to its residents is to be taxed in the residence country. Whereby the priority of taxation is given to residence country over the country of source.
2. The UN Model Convention; Which emphasis the priority of taxation to source country over the residence country.

Do you mean that, every treaty is framed considering these two model conventions as a base? She asked.

No, there are other models as well, but the fundamentals are either from OECD or UN Model Convention. The other model of conventions are US Model (The United States of America, has model convention of its own) and other Model Tax Treaties by the Andean group of countries – Bolivia, Chile, Ecuador, Columbia and Peru (later on, also joined by Venezuela).

Each treaty negotiation is unique and a combination of the model convention. When treaties are negotiated between the countries various criteria are examined including, the trade and commerce balance, the defence implications, exchange of information, socio-political and economic relations between the countries etc., The benefit and exemption in taxation may not be the only criteria based on which the treaties are negotiated, through relief from double taxation is what the treaties provide for.

Can you give me an example where an income in the course of international transaction is doubly taxed?

Of course. There is an interesting case study for the same. One of our client AKC Ltd., is in the business providing product design engineering services,the company provides designing services for its customers in India and in USA. They receive Fees for Technical Services for the same, which is the main source of income for the company.

This fees for technical services received from USA is subject to be taxed at the rate of 15% in USA as per Article 12 (as the referred payment is towards transfer of technical plan or designs) of the treaty between India and USA. The company is taxed in India on its total income as it is Domestic Company in India (Resident in India).

In this case the same income is getting taxed in the hands of same assessee company twice in different jurisdiction, finally this results in juridical double taxation.

Then in this case, how can the double taxation be eliminated?

To eliminate the double taxation AKC Ltd., has to be given relief of the tax paid in USA, in India, as the responsibility to eliminate double taxation is of the residence country. There comes the concept of Relief under the domestic tax laws and the tax treaty.

What relief does the Indian Tax Authority provide?

We already know the concept of Treaty entered into by India with foreign countries and also that the central Government has been empowered to enter into such conventions by the Income-tax Act, 1961 to eliminate double taxation.

The double taxation is eliminated by providing relief to the taxpayer. I already told you that it is the responsibility of the country of residence to eliminate double taxation, hence it will always be the country of residence who will provide relief to the tax payer.

What kind of reliefs are provided?

There are two kinds of Relief, they are:

- Bilateral Relief and
- Unilateral Relief.

Where is it provided in the Income-tax Act, 1961 to provide relief?

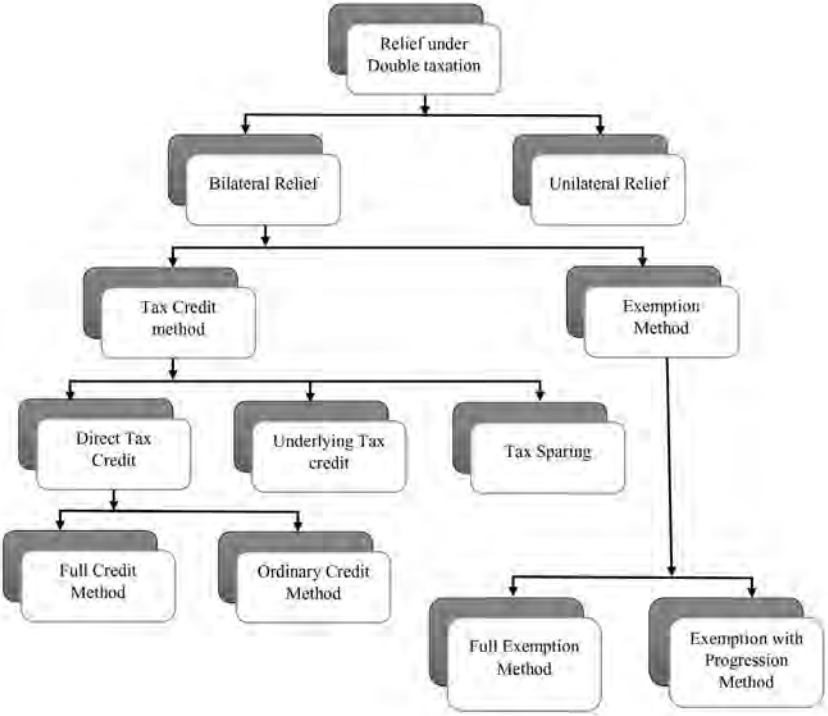
The legal background is like this, "Chapter IX of the Income-tax Act, 1961 provides for double taxation relief".

Bilateral Relief is provided under section 90 and 90A of the Income-tax Act, 1961.

Section 90 is applicable for those cases where Republic of India have agreement (i.e., Treaty) with foreign countries or specified territories and section 90A of the Income-tax Act, 1961 is applicable for those cases where agreements (between Specified Associations) adopted by the Central Government.

Unilateral Relief is provided under section 91 of the Income-tax Act, 1961. This is applicable for those cases where Republic of India does not have agreement (i.e., Treaty) with the countries.

Globally the methods for claiming relief from double taxation are:



How is relief granted under tax treaties?

GRANT OF CREDIT IN TAX TREATIES

Each country has different manner /method for granting tax credit for the income which are double taxed. Article 23 of the UN as well as the OECD Model Convention contains the provisions relating to elimination of double taxation.

The said Model Conventions under bilateral relief specify two approaches for elimination of double taxation:

a) **Tax Credit Method (Article 23A of OECD model):** Income is taxed in both the contracting states in accordance with their domestic tax laws read with the treaty. However the Country of residence of the tax payer allows him credit for the tax charged thereon in the Country of source.

b) **Exemption method (Article 23B of OECD model):** Taxing a particular income in any one of the contracting states (country) ONLY.

Generally the treaties entered into by India follow the credit method. However the treaties with certain countries such as Austria, Greece and Brazil follow the exemption method, either fully or for specified sources of income.

What is Foreign Tax Credit?

FOREIGN TAX CREDIT (FTC)(or just TAX CREDIT) is the mechanism to provide tax relief to the taxpayers who has foreign sourced income on which tax may have been paid or withheld in the country of source of income and such income is also taxed in the country of residence of taxpayers by virtue of domestic tax laws of that country.

In simple words, it is the credit of tax given by a state (residence country) for a tax paid in another state (source country) is known as "Foreign Tax Credit". The foreign tax paid by the Assessee is generally available as a Tax Credit while computing taxes payable in India.

It is a universally accepted principle that the same income should not be subjected to tax twice. In order to take care of such situation, the concept of double taxation relief / tax credit has been introduced.

To eliminate this dual taxation countries enter into bilateral treaties, with which the taxing rights is allocated amongst the country of residence and source. These Bilateral Treaties are the Double Taxation Avoidance Agreements (DTAA).

Under this arrangement, the countries either exempt a particular income from tax in one country or stipulate a maximum rate of tax for a particular source of income.

Further, if any person pays tax in the source country on income received in that country, the country of residence allows it as a credit while computing his tax liability.

Also, most countries provide for unilateral relief under its domestic law, which would aid in eliminating tax cascading where no Double Taxation Avoidance Agreement exists.

How to compute the relief amount under Tax Credit method?

There are various types of Tax credit methods available to compute the amount of tax credit, they are:

1. **Ordinary Tax Credit Method (is also known as Proportionate Tax Credit Method):**

This method provides for **"Maximum Deduction Rule"**. The amount of tax paid in foreign country which is available as a credit, limited to the tax paid in foreign country or tax payable in India on such foreign income, whichever is less. Also, the ordinary tax credit is to be computed on net income basis.

Can you explain me the method with an example? She asked.

I asked her to take a pen and paper and started with an example. "We shall consider the case of AKC Ltd. AKC Ltd. is an Indian resident and has an income of Rs. 1,000,000 in India and the company also has a foreign income of Rs. 500,000. Now, the company would be liable to tax at the rate of 30% in India, and shall consider two cases:

- Case I – with the foreign tax rate of 25% which is lower than Indian tax rate and
- Case II – with the foreign tax rate of 35% which is higher than Indian tax rate

She noted the above in the following format and started working on the same to arrive at the relief amount.

Particulars		Amount	Amount
		Case I	**Case II**
Income in India		1,000,000	1,000,000
Income in foreign country		500,000	500,000
Total income		1,500,000	1,500,000
Tax rate in India		30%	30%
Tax rate in foreign country		25%	35%
Workings			
Income tax on total income	A	450,000	450,000
Indian tax on foreign income	B	150,000	150,000
Foreign tax on foreign income	C	125,000	175,000
Total tax credit allowed(Lower of B & C)	D	125,000	150,000
Tax payable in India (A) – (D)	**E**	**325,000**	**300,000**

Finally she understood the scenario, and concluded that,"Under Ordinary Tax Credit Method, tax credit amount will be lower of Indian tax on foreign income orforeign tax on foreign income".

We continued with the next method……..

2. **Full Tax Credit:**

Under this method the amount of tax paid in source country is fully available as a credit in residence country.

We took the same example of AKC Ltd., and computed the tax relief as under:

Particulars		Amount	Amount
		Case I	Case II
Income in India		1,000,000	1,000,000
Income in foreign country		500,000	500,000
Total income		1,500,000	1,500,000
Tax rate in India		30%	30%
Tax rate in foreign state		25%	35%
Workings			
Income tax on total income	A	450,000	450,000
Indian tax on foreign income	B	150,000	150,000
Foreign tax on foreign income	C	125,000	175,000
Total tax credit allowed	D	125,000	175,000
Tax payable in India (A) – (D)	**E**	**325,000**	**275,000**

This was her conclusion, "Under Full credit method, the entire amount of tax paid in the country of source is allowed as credit to the resident in the country of residence, irrespective of whether the rate and amount of tax in the source country is higher or lower than that of the residence country".

"You are right, but still there is a restriction on the same". I said.

"Restriction!" She did not understand what I meant. That was the right time for me to discuss the concept that the Income-tax Act, 1961, also provides that, **as a result of grant of credit of foreign taxes while computing the tax payable in India, the effective tax rate in India would not exceed the tax rate applicable on income in India.**

And I worked out the following:

AKC Ltd., a resident of India, earns an income equivalent to INR 1,000,000 from US and INR 500,000 from India. The withholding rate on the income in US is 15 per cent while the tax rate in India is 30 per cent. In such case, the following position would emerge where credit

for tax withheld in US is available vis-à-vis a scenario where credit is not available:

Particulars	Foreign tax credit not available	Foreign tax credit available
Income earned in US	1,000,000.00	1,000,000.00
Income earned in India	500,000.00	500,000.00
Tax rate in India	30%	30%
Tax rate in US	15%	15%
Workings		
Tax payable on income earned in US (1,000,000 x 15%) [A]	150,000.00	150,000.00
Total income in India (1,000,000 + 500,000)	1,500,000.00	1,500,000.00
Total tax on income in India (1,500,000 x 30%)	450,000.00	450,000.00
Tax Payable in India [B]	450,000.00	300,000.00
Total tax paid on the income [A+B]	600,000.00	450,000.00
Effective tax rate for AKC Ltd.,	**40.00%**	**30.00%**

The effective tax rate after providing credit is 30%, it is not below the normal rate of income tax applicable in India.

By the time I explained this, it was already time for lunch and we were starving. I remembered that I had invited my friend Ganesh for lunch that day.

Ganesh, is one of my very close friends. He is a Chartered Accountant and does his own practice in Mumbai. He rarely comes to Bangalore and we had planned to discuss so many things that day.

I knew, he will not forget the route to my home, even when the streets, buildings and other areas in Bangalore undergo changes, renovation very often.

I suddenly saw somebody waiting near the gate from window. Yes, it was Ganesh!!

I introduced Ganesh to all of them present. We all left for a restaurant nearby for lunch. We went on talking about our past days moved to the present. As both of us were Chartered Accountants, we had so much to discuss about our professional experience too. I told him about what I do as a CA and was eager to know about his practice.

He said that he is currently practicing only in international taxation. What a co-incidence, you have come at the right time Gani! I said. I asked him about foreign tax credit and briefed him about what we discussed till then.

He added these are not the only credit methods. We still have two very important and very interesting concepts of "Foreign Tax Credit"… It made me realize that, the knowledge of Taxation is not limited. It is an ocean, one keeps learning it throughout his / her life.

I was excited and had the urge to learn the concepts in Foreign Tax Credit… looking at my excitementand interest to lean. He continuedexplaining those concepts to me**:**

- Underlying Tax Credit; and
- Tax Sparing

UNDERLYING TAX CREDIT

This is a credit method which eliminates the **economic double taxation of the income**. Remember the previous two methods operates to eliminate both economic and juridical double taxation.

It operates only when there is dividend income.

What is Underlying Tax Credit (UTC)?

"Underlying Tax Credit" refers to the credit that may be given in the residence country for the tax paid on the underlying profits out of which dividend is paid by a company in the country of source.

Whether these concepts are included in Tax Treaties?

Treaties entered into by India with countries like Singapore, Mauritius, United Kingdom, Australia, etc., provide for Underlying Tax Credit in situations where an Indian company is shareholder in a foreign company.

Who gets the relief under UTC?

Underlying Tax Credit relief provides tax relief to the recipients of dividend income and under this concept if dividends are paid by the company, the shareholder gets credit for **Tax on dividend + Corporate tax on profits out of which dividends are paid**

Corporate profits are subject to two-tier taxation. First at the corporate level as corporate income tax and then at the shareholder level as and when profits are distributed as dividend.

In case of international transaction the corporate profits are subjected to three-tier taxation, where the dividend is paid to the shareholder and he is taxed on the same in his residence country, it results in both juridical and economic double taxation.

But, Underlying Tax Credit relief may only apply / be eligible on satisfaction of substantial shareholding requirements.

When he explained the above, I wanted him to explain the same with a practical example.

I was looking for a pen and paper, Ganesh had a pen in his pocket and paper?

I did not get any paper. As it was a restaurant to my luck I got writing pad from the billing counter. He quoted an example of Underlying Tax Credit.

Suppose, there are two entities, X Co., an Indian company which is a Subsidiary company of Y Co., a foreign company (in UK) holding 70% in X Co. The income of X Co., is Rs. 100,000 and it distributes 50% of its profits as Dividend to its shareholders. On the dividend distributed 15% DDT will be charged. Assume that the UK Govt. taxes the companies at 40%. The Dividend income will also be taxed.

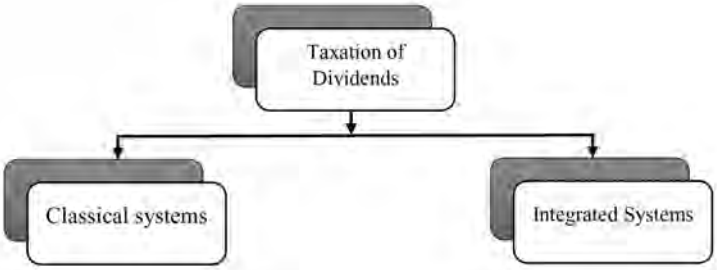
But if Underlying Tax Credit is available, these Economic and Juridical double taxation is eliminated and explained me as to how it gets eliminated with the help of the following computation.

Particulars		Amount in INR	
		With UTC	Without UTC
Taxation of X Co.,			
Profit of X Co.,		100,000	100,000
Taxes at 30%		30,000	30,000
Profit after tax		70,000	70,000
Dividend distributed to Shareholders (50%)		35,000	35,000
Dividend paid to Y Co.,		24,500	24,500
Dividend Distribution Tax on above (15%)	A	3,675	3,675
Taxation of Y Co., in UK			
Profit of UK Holding Co in UK		200,000	200,000
Dividend income		24,500	24,500
Taxable income		224,500	224,500
Tax Rate at 40%	B	89,800	89,800
Underlying Tax Credit [24,500 * 30,000 / 70,000]	C	10,500	-
Total Tax after Relief		79,300	89,800

Is this the only method to provide relief in case of dividend income and corporate tax?

No, there are different methods of taxing dividend income.

Taxation of Dividend income



Classical System of Taxing dividends

Under this system the Economic double taxation is not addressed. This is similar to the above illustrated example (without UTC).

Particulars	Without UTC
Taxation of X Co.,	
Profit of X Co.,	100,000
Taxes at 30%	30,000
Profit after tax	70,000
Dividend distributed to Shareholders (50%)	35,000
Dividend paid to Y Co.,	24,500
Taxation of Y Co., in UK	
Profit of UK Holding Co in UK	200,000
Dividend income	24,500
Taxable income	224,500
Tax Rate at 40%	89,800
Total Tax after Relief	**89,800**

This is the oldest method which is not followed now.

Integrated System of Taxing Dividends

The Integrated System is a step undertaken to eliminate economic double taxation. There are different kinds of Integration systems, they are as follows:

1. **Full Integrated System:** Under this system the income of the company is entirely allocated though not distributed, to the shareholder who pays tax on the same and the company does not pay corporate tax on its income.
2. **Dividend Exemption System:** Under this system the shareholders are not taxed on their dividend income, whereas company suffer corporate tax on its income.
3. **Dividend Deduction system:** Underthis system the dividend distributed to shareholders is not considered for the computation

of corporate tax purposes and the shareholder pays tax on the dividend received by him.

There is another concept called as "Imputation System"….

What is Imputation System?

This is the most technical and accurate method of taxing dividend income, where the shareholder gets credit of the corporate tax paid by the company. In this case the Dividend is grossed up by the attributable corporate tax and subject to the ordinary tax rate applicable to the shareholder who then gets a credit for the tax paid by the company.

Particulars	Amount in INR
Taxation of X Co.,	
Profit of X Co.,	100,000
Taxes at 30%	30,000
Profit after tax	70,000
Dividend distributed to Shareholders (50%)	35,000
Dividend paid to Y Co.,	24,500
Taxation of Y Co., in UK	
Net Dividend income	24,500
Dividend received grossed up [24500*100% / (100%-30%)]	**35,000**
Tax Rate at 40%	**14,000**
Credit for underlying tax (30000*50%*70%)	**10,500**
Tax payable	**3,500**
Total Tax after Relief	**10,500**

Note: 70% used in the above illustration represents percentage of holding in X Co.

After Underlying Tax Credit, the next concept is…… Tax Sparing.

TAX SPARING

What is Tax Sparing?

Tax Sparing Credit is a term used to denote a special form of double taxation relief in tax treaties with developing countries. Where a

country grants tax incentives to encourage foreign investment and that company is a resident of another country with which a tax treaty has been concluded, the other country may give a credit against its own tax for the tax which the company would have paid if the tax had not been "spared" under the provisions of the tax incentives.

Tax sparing clauses can be found in treaties entered into by India with UK, Australia, Canada, China, Japan etc.**This concept may also lead to double non – taxation.**

It may be noted that in certain treaties entered into by India, the Tax sparing clause specifically states the incentives granted under the Act against which benefit of Tax sparing is available while in certain treaties the clause is generic in nature.

In many cases it is seen that tax is not levied in the country of source as measure of fiscal incentives, particularly the developing countries as means to encourage more investment. Generally, the incentives are in the form of a tax holiday for a certain period of time i.e., a taxpayer is not required to pay tax in such a country for a specified period of time if it undertakes certain specified activities or does business in certain specified areas etc., (e.g. section 10AA, section 10B etc., of the Act). However, the country of residence of such company may not extend similar incentives and thereby levy tax on the income derived from the source country. In such a case, the benefit which was intended for the taxpayer does not reach him as he has to pay taxes in its country of residence. In fact, in such situations, it is actually the country of residence that is benefited as in absence of payment of tax in source country, the taxpayer would not have any tax credit and therefore, the country of residence would be entitled to levy as well as collect tax on such untaxed income of its taxpayer in the country of source.

To address this anomaly, the concept of tax sparing was formulated. Under this concept, the country of residence grants credit for the taxes which would have been levied by the country of source had the tax exemption been not granted by it.

Which Article talks about Tax Sparing?

The concept of Tax Sparing has been explained by the Commentary on Article 23, Methods for the Elimination of Double Taxation under the UN Model Convention. Relevant extracts of the same are as under:

"One of the principal defects of the foreign tax credit method, in the eyes of the developing countries, is that the benefit of low taxes in developing countries or of special tax concessions granted by them may in large part inure to the benefit of the treasury of the capital-exporting country rather than to the foreign investor for whom the benefits were designed. Thus, revenue is shifted from the developing country to the capital-exporting country. The effectiveness of the tax incentive measures introduced by most developing countries thus depends on the interrelationship between the tax systems of the developing countries and those of the capital-exporting countries from which the investment originates. It is of primary importance to developing countries to ensure that the tax incentive measures shall not be made ineffective by taxation in the capital-exporting countries using the foreign tax credit system. ***This undesirable result is to some extent avoided in bilateral treaties through a "tax sparing" credit, by which a developed country grants a credit not only for the tax paid but for the tax spared by incentive legislation in the developing country."***

The concept Tax Sparing can be easily understood with the help of the following example.

Particulars		Tax sparing - Absent	Tax sparing - Present
Assumptions		**Amount in INR**	**Amount in INR**
Income in State R		1,000,000	1,000,000
Income in State S		500,000	500,000
Aggregate taxable income in State R		1,500,000	1,500,000
Tax rate in State R		35%	35%
Tax rate in State S (exempted 30%)			
-normal tax rate		30%	30%
-special rate		0%	0%

Particulars		Tax sparing - Absent	Tax sparing - Present
Workings			
Tax payable in State R	A	525,000	525,000
Tax payable in State S	B	-	-
Tax credit (tax charged in State S)	C	-	-
Tax credit (tax exempted in State S) (500,000 * 30%)	D	-	150,000
Total tax credit (C) + (D)	E	-	150,000
Total tax after relief – (A) – (E)		**525,000**	**375,000**

Ganesh added few more aspects on Tax Credit Method:

1. The loss to the resident country under credit method is much lower than loss under Exemption method.
2. The foreign tax credit is non-refundable if it is exceeding the tax payable in the resident country.
3. The tax credit can be availed against Minimum Alternate Tax (MAT). However the credit should be restricted to MAT liability.
4. Tax credit on Dividend Distribution Tax (DDT) is not available under treaties. (As under treaties, tax credit is typically available for tax on income and/or on the profits of the company from which dividend is declared (i.e., Underlying tax credit – UTC).

Ganesh had an appointment with one of his client in Bangalore and he had to leave. We were very happy for having spent some time with him. Myself and Mohanambika thanked Ganesh for having explained the concept of Tax credit in such a realistic way.

We gave nice send off to Ganesh. Both of us made note of all what he had explained and went back to office.

But, she knew that the discussion was incomplete as the second method of relief under Bilateral Relief was still pending. Now I have to continue with the exemption method.

Before I start with the topic, she started asking me questions on exemption method.

What is EXEMPTION METHOD?

This is a method under which the whole income which is taxed in the Source country is exempt i.e. not taken into account by the Resident Country for its tax purposes, i.e. the income taxable in the source country is not considered.

Types of Exemption Method

1. **Full Exemption Method:** The entire income taxed in the source country is allowed as exemption by the residence country for tax purposes. The income taxed in the source country is not considered for the purpose of determining the income taxable in the Residence country.

Again it was felt that it would be better to explain the concept with the help of an example.

We considered Mr. Iyengar who is our client, an Indian resident having foreign income. In his case he has an annual income of Rs. 450,000 in India, taxable as per slab rates and a foreign income of Rs. 100,000, taxable at the rate applicable in that foreign country.

We considered two cases, in Case I the foreign income of Mr. Iyengar is taxable at 10% and in Case II the foreign income of Mr. Iyengar is taxable at 20%.

Resident country			
		Amount (In INR)	
Income		450,000	
Tax rate up to 500,000		10%	
Tax rate from 500,000 to 1,000,000		20%	
Source country			
		Situation I	Situation II
Income		100,000	100,000
Tax rate		10%	20%
Particulars		**Situation I**	**Situation II**
Income in the resident country		450,000	450,000
Tax rate applicable		10%	10%
Tax amount in the resident country	A	45,000	45,000
Income in the source country		100,000	100,000
Tax rate in source country		10%	20%
Tax amount in the source country		10,000	20,000
Relief in the resident country			
Total income		550,000	550,000
Tax rate applicable		20%	20%
Total tax	B	110,000	110,000
Total relief (A-B)		**65,000**	**65,000**

In this method the foreign income was not considered to decide on the rate at which the Indian income is taxable.

2. **Exemption with Progression Method:**

This is a method adopted to inflate the rate at which the income can be taxed.

How does this concept work? She asked.

The entire income taxed in the source country is allowed by the residence country for tax purposes. The income taxed in the source country is considered for the purpose of determining the income taxable in the Residence country. Therefore, level of income in Source Country matters.

The same example taken for Full exemption was considered. But in this case, the foreign income was also considered to decide upon the tax rate at which the Indian income is taxable.

Resident country			
		Amount (In INR)	
Income		450,000	
Tax rate up to 500,000		10%	
Tax rate from 500,000 to 1,000,000		20%	
Source country			
		Situation I	Situation II
Income		100,000	100,000
Tax rate		10%	20%
Particulars		**Situation I**	**Situation II**
Income in the resident country		450,000	450,000
Tax rate applicable		20%	20%
Tax amount in the resident country	A	90,000	90,000
Income in the source country		100,000	100,000
Tax rate in source country		10%	20%
Tax amount in the source country		10,000	20,000
Relief in the resident country			
Total income		550,000	550,000
Tax rate applicable		20%	20%
Total tax	B	110,000	110,000
Total relief (A-B)		**20,000**	**20,000**
Tax rate applicable		20%	20%
Total tax	B	110,000	110,000
Total relief (A-B)		**20,000**	**20,000**

Key highlights of the exemption method:

1. It may reduce the tax collectionof the resident country as compared to Tax credit method.
2. It encourages the use of low or no tax countries as source country (Tax havens)
3. It may result in double non-taxation of an income if the source country exempts such income for tax purposes

What is the difference between Tax Credit Method and Exemption Method?

Sl. No	Tax Credit Method	Exemption Method
1	This Method looks at tax	This Method looks at income
2	The total tax payable is usually equal to higher of the rates in two countries	Tax could be lower than the rate in Country of residence
3	The benefit of tax reliefs in Country of Source are enjoyed by Country of residence	The country of source can give fiscal benefits which industry can enjoy
4	Losses in the country of source is considered in the country of residence	Losses in the country of source is ignored
5	Investment export neutrality	Investment import neutrality

It was 5 PM then, Mr. Gopal Rao had to leave to his place. We all had tea to refresh ourselves and he left the office telling that, he will come next day at 10 AM.

But, me and my article did not feel like discontinuing the topic for the day, we continued with our discussion. After discussion on various concepts of Foreign Tax Credit we were quite clear on one thing that there will be relief from double taxation either by way oftax credit or exemption of income,in caseswhere there is an arrangement between Country of residence and country of source by way of a treaty.

But how is unilateral relief provided? And what are the methods of obtaining Unilateral Relief?

Unilateral Relief:

Section 91 of the Income-tax Act, 1961 is applicable for those cases where Republic of India does not have agreement (i.e., Treaty) with the countries.

The Indian Income-tax Act, 1961 grants unilateral relief in respect of income which has suffered tax both in India and in a country with which no Treaty exists. Where there is a treaty, relief has to be granted only under such treaty.

Method of computation of relief under Section 91 of the Income-tax Act, 1961:

Step 1	Identify the income which has been subject to double taxation
Step 2	Calculate the average Indian rate of tax and the foreign rate of tax on such income
Step 3	Relief is granted by way of deduction from the tax liability of an amount equal to the tax calculated at the Indian rate of tax or the amount of tax paid at the foreign rate of tax on the doubly taxed income, whichever is less.

Ordinary Tax Credit Method is followed in providing Unilateral Relief to the assessee.

Foreign Tax Credit = Lower of "Indian rate of income-tax" or "the foreign rate of tax" on doubly taxed income.

In case of loss in India, whether refund can be claimed in India in respect of foreign taxes paid?

Section 91 provides relief by way of deduction against the Indian income-tax payable, in respect of taxes paid in any country with which there is no agreement under section 90, a sum calculated on the doubly taxed income at the Indian tax rate or rate of tax of the said country, whichever is lower.

In this case as no Indian income tax is payable on account of loss, no relief under section 91 can be taken in respect of foreign taxes paid and thus no refund may be claimed.

Whether credit may be taken in respect of excess taxes paid in the other country (source country)?

In respect of any excess taxes paid in the source country, a refund can be claimed only by approaching the tax authorities of the source country. Up to the extent of normal tax payable in the foreign country, a relief can be taken under Section 91. No refund can be claimed in India for the excess taxes deducted in the source country.

How to claim tax credit in the resident state where there is income earned from one or more foreign jurisdictions

Let us consider the following illustration to understand this:

- Company ABC is a tax resident in India
- Company ABC carries on business in India and also in 3 foreign countries (A1, A2, A3) (hereinafter collectively referred to as 'Foreign countries'), with whom India does not have tax treaties.
- For financial year 2014-15, the amount of net income earned from all businesses and tax paid in accordance with the respective tax conventions in each of the foreign countries is as follows.

(Amount in INR)

Particulars	A1	A2	A3	India	Total
Net Income from business/ 'Total Income'	2000	2000	(1800)	800	3000
Tax Paid in foreign jurisdictions (in accordance with the respective tax conventions)	400[1]	700[2]	-	-	-
Gross Income tax liability in India (before FTC)[3]	-	-	-	-	900[3]

[1]Assumed Tax rate of 20% in A1
[2]Assumed Tax rate of 35% in A2
[3]Assumed Tax rate of 30% in India

The relief under Section 91 for the doubly taxed income is granted by way of a deduction against the Indian income tax payable. This relief can be worked out only when it is calculated country wise and not in aggregation of all foreign income earned. If that is done, it would not be possible to compare the rate of tax in the foreign country with the Income Tax rate as held in the case of *CIT vs. Bombay Bermuda Trading corporation ltd. [2003] 126 Taxman 403 (Bom).*

Thus in the above example, the relief under section 91 would be

- In respect to the tax paid in A1, a credit of 400 would be available,
- In respect of A2, a credit of only 600 would be available, as the relief under section 91 is lower of the Indian income tax rate or the tax paid in the foreign country;

However as the tax liability in India is only 900, relief under section 91 would be available only to the extent of 900. For the balance amount 100 (i.e., 1000 – 900), neither a relief nor a refund would be available in India or in any of the foreign countries.

Whether foreign tax credit can be claimed against Minimum Alternate Tax (MAT) paid in India?

Section 91 provides relief by way of deduction from Income-tax payable. Hence if the company is liable pay taxes in India as per Section 115JB, then such MAT rate shall be considered as the Indian tax rate and relief would be accordingly provided.

If Section 91 provides unilateral relief, then what is the objective of India entering into agreement / Treaty with other countries?

There are many reasons why a country enters into treaty with another country, each treaty negotiation is unique and a combination of the model convention. When treaties are negotiated between the countries various criteria are examined including, the trade and commerce balance, the defence implications, exchange of information, socio-political and economic relations between the countries etc., The benefit and exemption in taxation may not be the only criteria based on which the treaties are negotiated, through relief from double taxation is what the treaties provide for.

However the objective of Indian Income-tax Act, 1961 with respect to treaty-negotiation is:

- To grant relief in respect of Income on which income taxes are paid by the assessee both in India as per the provisions of Income-tax Act, 1961 as well as Income taxes in the other country or specified territory.
- To avoid double taxation of income in both the countries
- To exchange information for prevention of evasion or avoidance of income-tax under the provision of Income-tax Act, 1961 or under the corresponding law in force of the other country or specified territory.
- To recover income-tax under Income-tax Act, 1961 or under the corresponding law in force of the other country or specified territory.

Whether State Taxes paid in USA is eligible for claiming tax credit in India?

There are contrary views for claiming state taxes paid is USA as tax credit:

1. ***DCIT vs. M/s. Tata Consultancy Services***

   Mumbai ITAT held in the case of DCIT vs. M/s. Tata Consultancy Services that, as both the sections, i.e., section 80HHE and section 10A entitle the benefit, also, there is no attempt by the assessee to extend the period of the tax holiday by exercising option to claim deduction under section 10A instead of under section 80HHE, the assessee is eligible to get credit of Federal taxes paid in USA and Canada. However, State taxes paid in the USA and Canada are ineligible for relief under section 90,

2. ***Karnataka HC rules on availability of foreign tax credit relief where the income is exempt from Indian taxes under income linked incentive scheme***

   *The Karnataka High Court ("**HC**" or "**High Court**') recently held that Wipro is eligible to claim tax credit on foreign taxes paid in*

*relation to exempt income under section 10A of Income-tax Act, 1961 ("**ITA**"), which provides tax exemptions to income arising to newly established free trade zones on export of software etc.*

The Karnataka High Court held the following:

- *Foreign tax credit is available to the taxpayers even on a portion of exempt income.*
- *Exempt income (under Section 10A) is chargeable to tax under Section 4 and 5 of the Income-tax Act, 1961 although no tax may actually be payable.*
- *Actual payment of tax is not necessary for claiming tax credits.*
- *State level foreign taxes paid are also eligible for claiming credit under Section 91 of the Income-tax Act, 1961.*
- *The High Court has interpreted the provisions of Section 91 to mean that if the tax payer has paid income tax in a foreign country at state level, the income tax paid at state level, is also eligible for credit being given to the taxpayer in India (this is because Section 91 covers tax credits in cases where no agreement has been entered by India).*

We stopped our discussion for the day and left to our respective home. Since, it was late that day Mohanambika's dad had come to pick up her. We both took one book each on International Taxation to study at home, so that, we can discuss the same next day.

Next day morning both of us were in office by 9:30 AM. We continued with our analysis on international taxation and discussed on whatever we learnt from that book, that night. We expected that Mr. Gopal Rao will be coming to office, but he did not come as he was busy with some other work.

However we continued our discussion and analysis…

We started making note of other points in our discussion, which was actually asked by Mr. Gopal Rao in yesterday's discussion.

Whether it is mandatory for an assessee to consider Treaty provisions, when the provisions of Income-tax Act, 1961 is beneficial?

No, as per Section 90(2) of the Income-tax Act, 1961 for relief of tax, or avoidance of double taxation in relation to the assess to whom such Treaty applies, the provisions of Income-tax Act, 1961 or the relevant provisions of the Treaty, the provisions of Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assess (i.e., whichever is more beneficial to that assessee shall apply).

Whether Section 90 or any of the Income Tax Rules prescribes the manner of computing Tax Credit?

No, the tax credit needs to be computed based on the terms of the Treaty with other country or specified territory.

Is TRC mandatory for Resident to get Tax Credit paid outside India?

No, the requirement of TRC is applicable only to those assessee who are not being a resident of India.

Is tax Treaty mandatory to claim Tax Credit?

No, many countries provide unilateral relief for doubly taxed income to mitigate the adverse impact of double taxation to a limited extent. Unilateral relief in a country's domestic law provide relief to its residents for the foreign sourced income which may be double taxed.

In India, Section 91 of the Income-tax Act, 1961 grants unilateral relief to its residents for the foreign sourced income which may be doubly taxed.

What procedures do you follow for claiming Tax Credit?

The steps to be followed for claiming Tax Credit are:

Step 1	Determine the Residential status of the Assessee	This is very important, as Tax credit under Section 90 / 91 is given only to a Resident Assessee.

Step 2	Determine the income for which the income is doubly taxed during the relevant year under consideration.	Only the relevant year during which such income is doubly taxed is eligible for tax credit
Step 3	Collate the documentary evidences to identify the income which are doubly taxed.	Documentary evidences are must to be eligible for claiming tax credit.
Step 4	Identify / compute the tax rate at which the income is taxed in foreign country	
Step 5	Refer the relevant Article of the Treaty (between India and the foreign country) to identify the permissible method / manner of computingtax credit. In cases where there is no Treaty with the foreign country, refer Section 91 of the Income-tax Act, 1961 for computing the amount of tax credit.	
Step 6	Fill the relevant details in Income Tax Return (ITR) – **Refer Tax Credit Annexure 1 & Tax Credit Annexure 2**	
Step 7	Fill relevant details of Foreign Assets and Income from any source outside India in **Schedule FA** of the ITR – **Refer Tax Credit Annexure 3**_(only for details of Foreign Bank Accounts) other Foreign Assets details can be referred in ITR tab "TR_FA"	

What documents and details are required to claim tax credit / relief?

There are no list of standard documents which are required to be submitted to Indian Tax Authorities to claim Tax Credit, however the relevant documents required to claim tax credit are given below:

- Copy of Passport for determining the Residential Status of the Assessee
- Tax Returns filed in foreign country for the relevant year
- Taxpayer Identification number
- Foreign Income Tax computation (suggested)
- Tax Deduction Certificate obtained from the tax authorities of foreign country
- Computation statement showing the manner/method considered for claiming relief under Section 90 / 91

There is a With Holding of Taxes made by Indian Company for obtaining software license from company in USA, Whether the US Company can claim tax credit / relief in USA?

Generally, in USA granting of software license is not considered as Royalty as per Article 12 of the Treaty between India – USA. In many instances the US Tax Authorities (i.e., IRS) have not given Tax Credit / Relief for such withholding of taxes in India.

In case if a Non-Resident having income in the nature of Fees for Technical Services which is liable to tax at the rate of 15% or 10% as per the treaty, however such Non-Resident did not have PAN in India, hence it was subjected to higher rate of With Holding of taxes in India at the rate of 20% as per Section 206AA of the Income-tax Act, 1961.If such Non-Resident obtains PAN in India latter, can he claim refund of excess taxes deducted in India?

Yes, the Non-Resident can claim refund, subject to other procedural aspects and limitations.

...days went on and our analysis on Foreign Tax Credit was over and we had covered almost all topics as illustrated above:

Our firm started handling International taxation matters and filing Return of Income of the assessee's having international transaction.

After three months Mr. Gopal Rao, came to our office with his cousin brother son, Mr. Ashwin.Mr. Gopal Rao had got a new client to our firm to file a Return of income.Mr Gopal Rao had become my friend by that time.

Mr. Ashwin had a problem in his taxation, that is,conflict between Calendar year and previous year.

CALENDAR YEAR AND PREVIOUS YEAR RECONCILIATION FOR TAX CREDIT COMPUTATION:

Mr. Gopal Rao cousin brother son went to USA for employment on 30th November 2014 for 2 years, during the F.Y 2014-15 he was Resident in India and the salary income earned by him in USA was taxed in USA as well as in India.

He witnessed a problem in the period of claiming credit

- In USA the taxable year is calendar year (i.e., 2014)
- In India his salary income is taxable for the period April 2014 to March 2015
- For salary income earned during the period January – 2015 to March – 2015, he was subjected to tax in India for the A.Y 2015-16 and taxes were also deducted at source in USA as well. But there were no sufficient documents available with him as on 31stAugust 2016(the due date for filing return of income for the A.Y 2015-16)[4] to claim the tax credit for the period Jan'2016 to Mar'2016.

4 Note the due to filing the Income Tax returns is 31st July, however for the A.Y 2015-16 CBDT has extended the due date of filing return of income from 31st July 2015 to 31st August 2015 (vide Notification No. O.M.F.No.225/154/2015/TA.II, dated 10.6.2015) which was further extended upto 7th September 2015.

Solutions for his problem are as follows:

- He has to pay tax on the entire salary income earned during the period Apr'14 to Mar'15.
- As he is resident in India during the previous year 2014-15, his entire global income is subject to tax in India.
- He has to compute the Tax Credit as per Section 90 and claim the tax credit for the taxes paid in USA for the period Nov'14 & Dec'14.
- For the taxes paid in USA during for the period Jan'15 to Mar'15 – claim the tax credit after filing the return of Income in USA for the calendar year 2015.
- Determine the amount of taxes paid in USA for the month Jan, Feb & Mar'2015
- Revise the return of Income for the previous year 2014-15 (A.Y 2015-16) by claiming the Tax Credit in India as per Section 90 of the Income-tax Act, 1961 read with Treaty between India and USA.

COMPUTATION MANNER UNDER SECTION 90 & 91

When I explained my newly appointed Articled clerk Ms. Pragathi to take up the case of Mr. Ashwin, she was excited to take up the job (as she was handling the first client where there is tax credit computation), but she had following questions in her mind!!

How to calculate tax credit?

What is the computation format?

When I asked her what you arethinking? She expressed her challenges to start the work…

I told to her to refer the recent tax return filing of one our client Karthik B M a software engineer, however some of the facts are different... Pragathi was very happy!! As she has reference work paper which had all answers to her questions.

<u>Information from client:</u>

Mr. Karthik B M is a Software Engineer who has Taxable Income from Salary from Indian Company (as per Form 16) amounting to

Rs. 12,50,000, the taxes deducted at source on Salary Income is Rs. 159,650 (as per Form 16).

Also the assessee is receiving Training Fees from outside India for conducting training sessions on software testing. He did not incur any travelling and lodging expenses, as all such expenses were directly borne by the client.

Gross amount of fees for training services from an US Company (Resident of USA) Rs.100,000/- on such income taxes were deducted by US Company at the rate of 15% (As per Article 12 of the India – USA Tax Treaty).

Gross amount of fees for training services from a Hong Kong Company (Resident of Hong Kong) Rs.100,000/- on such income taxes were deducted by Hong Kong Company at the rate of 40%.

Computation of Total Income & Tax Liability			
Name :	Karthik B M	AY :	2015-16
PAN :	ABCDE1234F	PY :	2014-15
Status :	Individual	DOB :	08-12-95
		Due Date:	31-Aug-15

Income from Salary		1,250,000	
Income from House Property		-	
Profits or Gains from Business or Profession		200,000	
Income from Capital Gains		-	
Income from Other Sources		-	
Gross Total Income			**1,450,000**
Less: Deductions Under Chapter VI A	**Gross Amount**	**Eligible Amount**	
Sec : 80C/80CCC	150,000	150,000	
Aggregate Deduction under Chapter VI A			**150,000**
Total Taxable Income (Rounded Off)			**1,300,000**

TAX ON TOTAL INCOME			
	Income	**Tax**	
Total Income	1,300,000	215,000	
Income Tax		215,000	
Add: Education Cess @ 3%		6,450	
Total Tax Payable			**221,450**
Less: Prepaid Taxes			
TDS as per Form 16	159,650		
Total Tax relief available in respect of country where DTAA is applicable (section 90/90A)	15,000		
Total Tax relief available in respect of country where DTAA is applicable (section 91)	30,900	**205,550**	
Total Tax Payable (Before Interest under Section 234)			**15,900**

Tax Credit computation abstract from Income Tax Return (ITR)

Sl No	Country Code (Note : If no entry is made in this column, then other columns will not be considered for that row)	Taxpayer Identification number	Head of Income (a)	Income from outside India (included in PART B-TI) (b)	Tax paid outside India (c)	Tax payable on such income under normal provisions in India (d)	Tax relief available in India (e=lower of c and d) (e)	Relevant article of DTAA if relief claimed u/s 90 or 90A (f)
1	UNITED STATES OF AMERICA:2	123456789	**Other Sources**	100000	15000	30900	15000	ARTICLE 12
				100000	15000	30900	15000	
2	OTHERS:9999	987654321	**Other Sources**	100000	40000	30900	30900	NA
				100000	15000	30900	30900	

ONCE RETURN OF INCOME IS FILED, WHAT IS NEXT?

Generally for cases where Income Tax Return is e-filed claiming tax credit the following are practically noticed:

- Income Tax Central Processing Centre (CPC) will send communication to the Assessee that his/her case has been transferred to the Jurisdictional Assessing for processing of e-return filed by the assessee.
- There are chances that the Income Tax Return filed by the assessee may get selected by CASS (Computer Aided Selection Scrutiny) for scrutiny assessment and the Jurisdictional Assessing Officer (AO) will send notice to the Assessee and subsequent procedure of assessment will follow.

ASSESSMENT PROCEDURE FOR TAX CREDIT

It was a tiring day, after successfully completing all my tasks for the day for which I had already planned yesterday night, I went out on a walk to Krishna Rao park which happens to be near my place and surprisingly, met my school mate Kamesh, as we started the conversation he told me that he has recently settled in USA and keeps visiting India at regular intervals for meeting his clients, investors and to handle his Income Tax Scrutiny Assessment. I being a Chartered Accountant asked him….

How, the assessment was going on??

Are there any issues?

He started explaining the following scenario:

My friend was resident of both USA and India for the current financial year (due to his number of days of stay in India) and was filing return of Income in both the Countries as a resident.

While explaining his grief's and his experience with the department he told me that his income has been taxed in both the countries and he has claimed tax credit on the income which is doubly taxed in India and the Assessing Officer is not allowing him to claim the same.

I asked him…Why is the Assessing Officer not allowing the tax credit?

What all did he ask you?

The very first question AO asked me, was about my **Residential status**, he also asked me to produce a Copy of my passport!!

I was ready with both the copy of my passport and the Residential status workings (i.e. the calculation of number of days of stay in India) which I thought would be enough to support that I m a resident in USA as well.

But little did I know, the copy of my passport was abrupt; name, address & seals on it were not clear and the very first document I submitted to him was rejected.

To this; As I knew how, department works I explained him, that whenever a person is a resident in two contracting states it is very important for the AO to confirm the same, by checking some basic documents like

1. Passport copy
2. Flight tickets or any proof substantiating stay in India.
3. Residential status workings containing the details of number of days of my stay in India

My friend continued… Oh!! Is it? In US the method and the procedure followed is completely different. He wasn't happy with the view of carrying all documents in paper and not having a common platform to submit documents online to the AO.

I told my friend India is becoming digitalized, soon you will miss, the picture of Typical Indian government offices with files piled up everywhere in the department, as shortlyeverything in India will be digitalized.

I continued asking what happened next. What else was asked by AO?

He answered, that he was bulleted with a series of questions like:

a. Whether Tax Returns were filed in the foreign country or not?

b. Period considered in foreign tax return i.e. whether financial year (April-March) or Calendar year (Jan-Dec).

c. Reconciliation of income between foreign return and return filed in India.

Kamesh was completely fine till the Assessing officer asked him the above questions as he could totally understand the importance of above documents.

But he lost his cool when the Assessing officer asked him to produce all the bank statements of his US based accounts.

He couldn't understand the very reason of AO asking him to produce Income Tax Returns of his other half and his bank account statements.

I explained him that when one says that he has already been taxed in one country i.e. he has already paid taxes in other contracting state then it is duty of the AO to check the same by asking appropriate proof for the same like Challan and bank statements since he was a resident in two countries.

When I explained him the above and now he could totally understand the insight of what the AO was asking him.

Because of my friend's temperament and behaviour the AO didn't allow him to claim the Tax credit on the Income which is doubly taxed in India.

I could now totally understand why the AO disallowed him the Tax credit!! As there was no understanding of what the AO was asking him and moreover he was not aware of the procedural aspects of claiming tax credit in India.

Then I narrated him my involvement with a similar issue of foreign tax credit and how successfully I was able to claim the Tax credit for my client Mr Punith. He was also issued the same notice and was asked to produce the same documents which my friend was asked.

I told him that I had collated all the necessary documents from my client like:

a. Passport copy

b. Residential status working as per Section 6 of the Income-tax Act, 1961

c. Returns filed in the foreign country

d. Reconciliation statement between Income considered in Foreign and Indian return.

e. Further I collated and submitted the Income Tax returns for both previous & current assessment year to the AO, as the period considered in the foreign return is other than financial year.

f. Bank statements

Along with satisfactory documentation, I also supported myself with enough explanatory Sections of the Income-tax Act, 1961 and Articles of the Double Taxation Avoidance Agreement relevant to the assessment to answer queries of AO.

After doing a substantial homework, I met the AO officer and could effectively answer him all the questions by sighting all the relevant Sections, Articles and supporting documents.

I explained to Assessing Officer the relevance of Section 90 and 90A of the Income-tax Act, 1961, Article 4 (Residence) and Article 25 – Relieffrom Double Taxation of India – USAtreaty to support the Tax credit claimed in India.

AO officer was satisfied with all the documents and details provided by us and he agreed to PASS the order in favour of my client for him to claim Tax credit on Income which is doubly taxed in India,

After handling Tax Credit cases for a while… to my surprise my other batch mates helped me adding some more clients to my list…. Mr. Deepak

Information of the Client:

Mr. Deepak resident Indian filing IT returns both in India and USA. In USA he has filed his return of income. As per US return being a non-resident alien (Green Card Holder) he has claimed tax credit for the

taxes paid in India on Indian Income. Now he has to file returns in India.

The sources of income are like this:

In USA

Long term Capital Gains and Interest income

In India

Long term Capital Gains, Rental income and Interest income.What is the mechanism of tax credit for the taxes paid in USA?

The assessee is Resident in India and hence, Global income is taxable in India. However, the taxes paid in USA are eligible for claiming tax credit in India as per Tax treaty between India and USA:

SOLUTION

Article 25 of the treaty between India - USA

Where a resident of India derives income which, in accordance with the provisions of the treaty, may be taxed in the United States, ***India shall allow as a deduction from the tax on the income of that resident an amount equal to the income-tax paid in the United States****, whether directly or by deduction.* ***Such deduction shall not, however, exceed that part of the income-tax (as computed before the deduction is given) which is attributable to the income which may be taxed in the United States.***

Method of Tax credit –**Ordinary Tax Credit**

Step 1	Compute the Taxable Income of Mr. Deepak
Step 2	Compute the Tax amount on the total income of Mr. Deepak
Step 3	Compute the Tax credit amount for the tax paid in USA on Foreign income by applying the applicable rate (lower of India tax rate and USA tax rate)
Step 4	Give the credit of amount as computed in step 3.

The computation for the same is as follows:

Particulars		**Amount in INR**	**Tax rate in India**	**Tax rate in USA**	**Tax rate to be considered** (Lower of India & USA)
Income in India					
-House property income	A	52,000	30%	35%[5]	
-Income from capital gains	B	480,000	20%	35%	
-Income from other source (Interest)	C	230,000	30%	35%	
Total Indian Income		**762,000**			
Income in USA					
-Income from capital gains	D	5,600,000	20%	15%	15%
-Income from other income (Interest)	E	890,000	30%	35%	30%
Total USA Income	F	**6,490,000**			
Total Global income		**7,252,000**			

Taxation in India

Particulars		Amount in INR
-House property income	A	52,000
-Income from capital gains	G = B+D	6,080,000
-Income from other source income (Interest)	H = C+E	1,120,000
Total income taxable in India		**7,252,000**
Tax amount	Refer Working Note 2	**1,392,600**
Add: Surcharge		139,260
Add: Educational and secondary & higher educational Cess		45,955
Tax payable (at Normal Slab rate)		**1,577,815**
Foreign tax credit in India		
Total foreign income		6,490,000
Credit on Income from capital gains	Refer Working Note 1	840,000
Credit on Income from other sources(Interest)	Refer Working Note 1	267,000
Total Tax Credit	J	**1,107,000**
Final tax payable in India	K	**470,815**

Working Note 1 - Computation of Relief as per Section 90

Details of Income from outside India and tax relief									
Details of Income included in Total Income in Part-B-TI above									
Sr No	**Country Code** (Note : If no entry is made in this column, then other columns will not be considered for that row)	**Taxpayer Identification number**	**Sr No**	**Head of Income** (a)	**Income from outside India (included in PART B-TI)** (b)	**Tax paid outside India** (c)	**Tax payable on such income under normal provisions in India** (d)	**Tax relief available in India (e=lower of c and d)** (e)	**Relevant article of DTAA if relief claimed u/s 90 or 90A** (f)
1	UNITED STATES OF AMERICA:2	123456	**iv**	**Capital Gains**	5600000	840000	1120000	840000	Article 13
			v	**Other Sources**	890000	311500	267000	267000	Article 23
			Total		6490000	1151500	1387000	1107000	

Schedule TR	Summary of tax relief claimed for taxes paid outside India					
1	Details of Tax relief claimed					
		Country Code (a)	Tax Identification number (b)	Total taxes paid outside India (total of (c) of Sch FSI in respect of each country) (c)	Total tax relief available (total of (e) of Schedule FSI in respect of each country) (d)	Section under which relief claimed (90, 90A or 91) (e)
		UNITED STATES OF AMERICA:2	123456	1151500	1107000	90
				1151500	1107000	

Working Note 2 - Computation of Tax

Particulars	Amount in INR
Capital gains	6,080,000
Tax at 20%	**1,216,000**
Other income	1,172,000
Tax as per slab rate	
Upto 2,50,000	-
From 2,50,000 to 5,00,000	25,000
From 500,000 to 10,00,000	100,000
Beyond 10,00,000	51,600
Total	**176,600**
Total tax amount	**1,392,600**

Wow!! What a start! the queries of Mr. Gopal Rao have enriched our knowledge on International Taxation and Foreign Tax Credit claim in India…

* * *

Tax Credit Annexure 1

Abstract from ITR showing the manner of computing tax relief

FSI

Details of Income from outside India and tax relief									
Details of Income included in Total Income in Part-B-TI above									
Sr No	**Country Code** (Note : If no entry is made in this column, then other columns will not be considered for that row)	**Taxpayer Identification number**	**Sr No**	**Head of Income** (a)	**Income from outside India (included in PART B-TI)** (b)	**Tax paid outside India** (c)	**Tax payable on such income under normal provisions in India** (d)	**Tax relief available in India (e=lower of c and d)** (e)	**Relevant article of DTAA if relief claimed u/s 90 or 90A** (f)
1	(Select)		**i**	**Salary**				0	
			ii	**House Property**				0	
			iii	**Business Income**				0	
			iv	**Capital Gains**				0	
			v	**Other Sources**				0	
			Total		0	0	0	0	

Source:
Excel utility of Income Tax Return 4 (ITR4) tab **"FSI"**

Tax Credit Annexure 2

Abstract from ITR showing Tax relief eligible for the Assessee to claim

Schedule TR

Summary of tax relief claimed for taxes paid outside India					
Details of Tax relief claimed					
	Country Code **(a)**	**Tax Identification number** **(b)**	**Total taxes paid outside India (total of (c) of Sch FSI in respect of each country)** **(c)**	**Total tax relief available (total of (e) of Schedule FSI in respect of each country)** **(d)**	**Section under which relief claimed (90, 90A or 91)** **(e)**
	AFGHANISTAN:93		0	0	(Select)
	ALBANIA:355		0	0	(Select)
	ALGERIA:213		0	0	(Select)
	ANDORRA:376		0	0	(Select)

Source:

Excel utility of Income Tax Return 4 (ITR4) tab **"TR_FA"**

Tax Credit Annexure 3

Abstract from ITR - Schedule FA (only for details of Foreign Bank Accounts)

Schedule FA

Details of Foreign Assets and Income from any source outside India

NOTE : This Schedule is not Applicable for NRI \(Non Resident Indians) as per Residential Status

Details of Foreign Bank Accounts held (including any beneficial interest) at any time during the previous year

Sr No	Country Name & Code	Name of the Bank	Address of the Bank	Account Holder Name	Status-Owner/ Beneficial owner/ Beneficiary	Account Number	Account opening date	Peak Balance during the year (in Rupees)	Interest accrued in the account	Interest taxable and offered in this return		
										Amount	Schedule where offered	Item number of schedule
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
1												

Source:
Excel utility of Income Tax Return 4 (ITR4) tab **"TR_FA"**

Note:
For other Foreign Assets details kindly be refer tab **"TR_FA"** in Income Tax Return (ITR)

CHAPTER – 10

Taxation of Cross – Border Partnerships

- CA Rani N R

On Wednesday, Mr Gopal Rao called and informed us that he wanted to discuss some more issues. We thought that maybe the basics of international taxation we had informed him on Monday were not comprehensive enough and that he had some more complexities to discuss.

When he met us, he informed us that Kiran is now planning to return to India as the project in which he is working is now establishing an office in India. Considering the ambiguity on taxation of companies in India (the ghost of Vodafone and retrospective taxation still exists), the company intends to set up a partnership firm in India. Kiran had sent a list of questions with Mr Gopal Rao on the taxation of partnership firms. His questions and our answers are reproduced below.

1. Does the definition of 'person' as per Article 3 in India's treaties with other countries includes 'Partnership firm' ?

   No, Partnership not specifically included in the definition of person as per Article 3 of every tax treaty that India has entered into. This is treaty-specific and varies from one Treaty to another. In some of the Treaties, Partnership is included in the definition of person as per Article 3 while in others, it is not.

   For example:

   i. In India – US Treaty, the definition of person includes a partnership.

   ii. In India-Germany Treaty there is no specific mention of Partnership in the definition of person but the definition includes any other entity which is treated as a taxable unit under taxation laws in force in the respective contracting

states. So if a partnership is recognized as a taxable entity as per the domestic tax law of the contacting state then it is considered as person for the purpose of the Treaty.

iii. In India – UK Treaty - A partnership which is treated as a taxable unit under the Income-tax Act, 1961 (43 of 1961) of India shall be treated as a person for the purposes of this Convention.

2. What are the basic issues in cross border taxation of Partnerships ?

Domestic tax laws of countries provide rules on taxation of partnerships- some countries tax income earned by the Partnership at the entity level while others choose to tax income of the partnership firm in the hands of the partners. This difference in the treatment of income of partnership by the counties is one of the key issues to be addressed in the taxation of cross border partnerships. The difference in the treatment of the same entity in the country of source and country of residence creates confusion and complexity in giving the benefits of tax treaties to the partnership and the partners.

For example:

Situation 1

Let us assume Mr Gopal Rao's son, Kiran is resident in UK and his friends Shravan and Arun, both residents in India enters into a partnership firm KSA Associates. The control and management of the affairs of the firm is wholly situated in India, so the firm is resident in India.

As per Income Tax Act in India, the profit of the firm is taxable in the hands of the firm and share of profits from firm is exempt in the hands of the partners.

As per the domestic tax laws of UK, partnership firms are pass-through entities and not taxable per se.

So in this case, share of profits received by Kiran from partnership firm in India may be subjected to tax in UK. But whether he will

get credit for the taxes paid by the firm in India for his share of profits from the firm against the UK taxes is to be ascertained.

Situation 2

In the above case assume that the partnership firm is registered in UK. Hence, it is a foreign partnership. However the control and management of affairs is partly carried out by Shravan and Arun in India. The foreign partnership firm becomes resident of India as per Section 6 of the Income Tax Act. Since this firm is resident in India the worldwide income of the firm becomes taxable in India.

Since the firm is registered in UK, it is resident of UK. However as per domestic tax laws of UK, a partnership firm is considered a pass through entity. Since the firm is not 'liable to tax' in UK, it may not be treated as 'resident of UK' for the purpose of the Treaty.

Income of the firm is taxed in the hands of the partners. So there is double taxation of income but in the hands of different persons in different countries.

Situation 3

Assume in the above case where firm is registered in UK, Kiran is in UK, Shravan is resident of Country X, Arun resident Country Y. In this case the issue gets complicated due to difference in the tax treatment of partnership and income of partners under the domestic tax laws of each country.

To summarise, the following are some of the basic issues in the case of taxation of cross border partnerships:

i. Income of the partnership firm whether taxed as firm's income or as income in the hands of the partners. ie; whether the partnership is treated as 'transparent' or 'opaque' as per the domestic tax laws of a source country as well as resident country.

ii. Possibility of double taxation or double non taxation of income on account of difference in the treatment of income of the partnership and also income from the firm in the hands of the partners.

iii. Residential status of a partnership - as per domestic tax laws of the source country as well as resident country

iv. Residential status of a partnership as per the Tax Treaty.

v. If Partnership is not expressly included in the definition of persons as per article 3 of the Treaty, whether Treaty benefits can be given to the firm or can it be given to the partners if income gets taxed in the hands of the partners.

vi. Who can avail the benefit of the Treaty – whether the partnership or the partners – when there is a difference in the taxation of partnership between the country of resident and country of source.

3. How have these issues have been addressed ?

To address the above issues OECD (Organisation for Economic Co-operation and Development) released a report known as 'The Application of the OECD model convention to Partnerships'

Some of the suggestion included in the report are :

i. Person definition as per Article 3 of a Treaty must include Partnership

ii. Partnership must be considered a 'resident of the contracting state' as per Article 4 of the Treaty

iii. If the jurisdiction where the partnership is treated as fiscally transparent (pass through) entity, the partnership cannot be entitled to the benefits of the Treaty

iv. Whenever a fiscally transparent partnership is not entitled to avail Treaty benefits, the individual partners would be eligible to claim Treaty benefits in respect of their respective share of partnership income that is liable to tax in their hands. The nature and source of the income in the hands of partners will be the same as in the hands of the partnership for tax purposes.

v. Transparency for tax purposes is to be decided by the country of residence and the source country must adhere to such

determination. This means, the source country should accept the decision of the resident country to treat the Partnership as transparent or opaque entity for tax purposes.

4. India's approach and Judicial decisions:

   i. India being not a member of the OECD has not endorsed the approach of OECD with respect to the Taxation of Partnerships

   ii. In the case of Linklaters LLP vs ITO, [2010] 6 Taxman 38, the Tribunal held that the assessee was indeed eligible to the benefits of India –UK Tax Treaty, as long as the profit of the partnership firm is taxed in UK, irrespective of whether it is taxed in the hands of the partnership firm or in the hands of the partners. This decision is not in consonance with the suggestions in the OECD report.

   iii. In the case of Schellenberg Wittner, AAR concluded that the partnership is not termed as person as per India-Switzerland Treaty and hence not entitled to Treaty benefits. As per the AAR, the partners are not the recipients of income hence partners are not entitled to Treaty benefits. AAR declined to grant Treaty benefits to partnership or its partners.

* * *

CHAPTER – 11

Provisions of Tax Deduction at Source

(Sec 195, 115A, 206AA, Form 15CA, 15CB and Form 27Q)

- CA Cotha S Srinivas

A Day in Office..

On Monday morning, when I CA. Cotha S. Srinivas entered the office, everyone in office wished me Good Morning Sir and I reciprocated with Good Morning Everyone.

Settling in my chair invited all my juniors to the cabin. Well, I hope everyone had a wonderful weekend enjoyed Saturday and Sunday. Yes Sir, was the unanimous answer. In the midst of discussion, I informed the team that, we have got an international tax assignment and we need to learn more about international taxation. Team was excited!! to hear this and were eager to learn and work on International Taxation. Team wanted to know more on International Taxation.

CA. Cotha S. Srinivas is Vice Chairman of SIRC and also a member of ICWAI. Practicing as partner of SSB & Associates, Bengaluru.

CA. Cotha S. Srinivas has been active in all forums of ICAI at Bangalore Branch of ICAI and SIRC. He has been instrumental in new initiatives in ICAI at Branch and Regional level and has a wide exposure to administrative functions.

Bangalore Branch has received Best Branch Award in his tenure as Chairman.

He has conducted various Conferences, Workshops and Student related activities which are well recognized as innovative and appreciated for quality. He has been a speaker at various forums of ICAI.

Presented papers at various study circles meetings, workshops, seminars & conferences on topics covering Direct Tax & International Taxation; and a Visiting Faculty at ICAI Bangalore;

Authored a Book named "CA Refrencer for Chartered Accountants" which was released by Bangalore Branch of ICAI as Study Circle Series Booklet;

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Team decided to have a meeting and every one of us moved to Conference Hall for further discussion.

Let me take you through aspects of International Taxation and more so wrt Section 195. We all have a reasonable knowledge on Basics of International Taxation, which I am not going to deal with. Let me make this more of a interactive session in the form of Q&A. I will be asking question to each one of you and even you can pose the questions.

Lets Begin with Keerthi

Cotha Keerthi what is the charging section under Income Tax

Keerthi It is Section 4 Sir.

Cotha Do you know what are the means and ways of collecting the tax

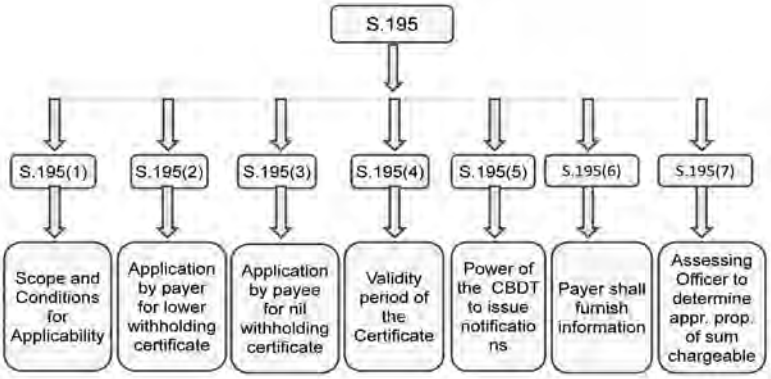
Keerthi Yes, it is through Advance Tax and Tax Deduction at Source.

Cotha Good, Can anyone tell me the provisions dealing with collection and recovery of tax under Income Tax Act.

Divya Sir, Chapter XVII deals with these provisions.

Cotha Correct, Chapter XVII covering Section 190 to 234E deals with these provisions. Let me explain a bit about these provisions

Chapter XVII deals with Deduction, Collection, Advance Tax and Interest Provisions. Today let us focus on TDS provisions more specifically with respect to non-residents. Section 195 deals with Other Sums containing provisions for TDS for Non-residents. Section 195 has 7 sub sections and let us try to understand these provisions –



Section 195 (1) - Any person responsible for paying to a non-resident, not being a company, or to a foreign company,

Naveen When was Section 195 introduced?

Cotha It was introduced from 01.04.1961 w.e.f A.Y. 1962-63.

Naveen Who is person responsible for paying, Whether it is defined?

Cotha Section 204 defines person responsible for paying to include the payer himself, In case of a company, the company including the principal officer. It also includes authorized person.

Akshay Sir, Any person means who all will be included?

Cotha Good Question and let me explain with a Table

Payer	Payee	Applicability of Sec.195
Resident	Resident	Not Applicable
Resident	Non Resident	Applicable
Non Resident	Resident	Not Applicable
Non Resident	Non Resident	Applicable

Cotha How to determine the status of Non-resident, everyone knows as per sec. 6, Now there is an amendment wrt to foreign companies having POEM (Place of Effective Management) in India. There may be a case where because of POEM in India, a foreign company can become a resident company in India. Then, there may be a case where foreign company is a resident and still sec. 195 may apply?

Naveen When to determine the Residential Status ?

Cotha Usually, residential status is determined at the end of the previous year. But when it comes to payment to non-resident, we have to determine the status on the date of deduction of tax.

There may be a situation wherein at the time of deduction a person may be non-resident but subsequently by the year end he may become resident.

Keerthi What is the difference between TDS under other sections and WHT u/s. 195 -

Cotha Again let me take the help of a table to explain the differences

Particulars	Section 195	Other TDS provisions
Nature	Income Chargeable under Income Tax Act	Specific Payments, Whether Income or not.
Sum	Any Sum (No Basic Exemption)	Above threshold limits
Applicability	Any persons	Specified persons in the sections
Rate of Tax	We should refer the Finance Act and also see Sec. 115A	Specified in respective sections
Certification for remittance	Mandatory except where it is specifically exempted.	Not required

OK, moving further to the provisions of Section 195, what needs to be paid is 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" and Dividends referred to in Section 115-O)

If we analyze the above provisions, it covers interest payment and other sums chargeable under the provisions of this act to be subject to TDS u/s. 195. In case of interest, it excludes few types of interest payments which is specifically dealt with under section 194LB, 194LC and 194LD.

Akshay What are those interests ?

Cotha Today our focus is on 195 any way I will introduce the sections, we can discuss some other day.

194LB – Income by way of interest from Infrastructure Debt Fund;

194LC – Interest by way of interest from India company ;

194LD – Interest by way of interest on certain bonds and Government securities.

Anusha What is the relevance of any other sum

Cotha Basically, section 195 is a residual section, to mean wherever specific section is not available for payment to non-residents it is covered under this section. As I explained just now, we have various type of interests covered under specific sections, remaining will be coming under the purview of section 195.

Keerthi Sir, Can you throw more light on sum chargeable under the provisions of this act

Cotha Yeah, First we need to ascertain that, payments made to non-residents are subject to tax under the Income Tax Act, 1961. To determine this we have to refer Section 5, 6, 9 and other relevant provisions of the Act.

Only, when the sum payable to non-resident is chargeable to tax in India, then only section 195 will become operative.

So suppose any payment which is not subject to tax in India will not be liable for TDS u/s. 195

To explain in simple terms -

- Amount paid should bear the character of income subject to tax.
- TDS has to be done on Gross Amount
- Since, the section says sum and not income so we need to consider gross amount.

Similarly, as per the section Salary and Dividends referred to U/s. 115O is not covered u/s. 195

Divya Sir, you mean to say salary and dividend paid to non-resident will not attract TDS ?

Cotha Not like that, Salary paid to non-resident is covered u/s. 192 itself and Dividend u/s. 115O is exempted.

Divya What are the various incomes for which Sec 195 apply to ?

Cotha

1) Business or Professional income
2) Dividend other than those covered u/s. 115-O
3) Interest
4) Royalties
5) FTS (Fees for Technical Service)
6) Capital Gains
7) Income from Immovable Property
8) Any other sums not specifically covered under any section and is subject to tax in India under the Income Tax Act, 1961.

To continue Sec. 195 discussion –

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 issue of a cheque or by any other mode,

Whichever is earlier,

Anusha What does time of credit mean ?

Cotha Time of Credit means when an Invoice raised is accounted in the books of account.

Divya In the above it only specifies regarding payment through cash or cheque what about payment made through Electronic Transfer, Demand Drafts , payment made in kind etc.

Cotha In the provision it is mentioned as payments made through other modes so all the payments other than Cash or by way of cheque will be included in other modes

Akshay Whether "payment in kind" attracts withholding of taxes?

Cotha Payment shall include all payments in kind as has been confirmed in a decided case. [Kanchenjunga Sea Foods Ltd v CIT & ITO [2010] 325 ITR 540 (SC)]

Keerthi Whether taxes need to be deducted even when there is no remittance due to adjustment of dues?

Cotha As per section 195(1), deduction of taxes is at the point of payment or credit, whichever is earlier.

The Tribunal in Raymond Ltd v DCIT [2003] 86 ITD 791 (Mum) held that an adjustment of the amount payable to the non-resident or deduction thereof by the nonresident from the amounts due to the resident-payer would be considered under "any other mode". Such adjustment or deduction also was stated to be equivalent to actual payment.

Thus the payment is held to be constructive payment.

Naveen Whether an agent is required to withhold taxes on payment to nonresident?

Cotha An agent is a person who is himself liable to pay taxes on the payments to be made to the nonresident. It was held in the case of Premier Tyres that he cannot be additionally burdened with the responsibility to withhold taxes on the payments made

Keerthi Can taxes be deducted when the payee is not known?

Cotha In the case of IDBI Ltd v ITO [2007] 293 ITR 267 (Mum), interest provision was required to be made in the books of accounts, however the same had not been crystallized and the payee was not known. The Tribunal held that if the payee was not known, then taxes need not be withheld.

Divya Is there any exemption to Interest paid by Government or a public sector bank or a public financial institution?

Cotha As per the Proviso to Sec 195 (1) TDS shall be deducted only at the time of payment in cash or by issue of cheque or by any other mode & not on the credit of income to the account of the payee in case of Government or a public sector bank within the meaning of clause 23D of Sec 10 or a public financial institution including Co-operative Banks.

The last limb of Sec. 195 is -

Deduct Income Tax thereon at the rate in Force

Shweth Which Section defines Rates in Force?

Cotha As per Sec.2(37A)(iii) Rates in Force means :

- Rate or Rates of Income Tax specified in this behalf in the finance act of the relevant year, or
- Rates of Income Tax specified in a DTAA entered into by the Central Government under Section 90.

  Whichever is beneficial by virtue of the provisions of Section 90(2)

Shweth What are the various requirements to determine the Tax Rates ?

Cotha The various requirements are :

- PAN
- TRC
- PE in India

Rashmi Which section specifies that we should have a PAN to claim a lower rate of TDS ?

Cotha Sec 206AA specifies that we need to have a PAN, without PAN tax shall be deducted

- At the rate specified in the relevant provision of this Act; or
- At the rate or rates in force; or
- At the rate of 20%

  Whichever is higher.

Rashmi While deducting TDS, what rate should be considered ?

Cotha
- rates specified in DTAA
- rates specified in finance act of the relevant year whichever is beneficial

Well, now let me discuss few common questions u/s. 195 -

Cotha What is the tax rates to be considered in various scenarios ? Considering DTAA Rate as 10%, Income Tax Rate 10.82%.

Scenarios	PAN Obtained	TRC Obtained	PE in India	Tax Rates
1	Yes	Yes	No	10.00%
2	Yes	Yes	Yes	43.26%
3	Yes	No	No	10.82%
4	Yes	No	Yes	43.26%
5	No	Yes	No	20.00%
6	No	Yes	Yes	43.26%
7	No	No	No	20.00%
8	No	No	Yes	43.26%

Q1 Should we consider surcharge and cess when we are deducting at DTAA rate ?

A Sur-charge and Cess should not be added for DTAA rate, Only for Income Tax Rate we should increase by surcharge and cess.

Q2 For 206AA rate of 20%, whether we should add surcharge and cess?

A No for 206AA, surcharge and cess is not to be considered as it is a penal provision rate. Also when we go through the finance act it specifies certain sections which needs to be increased by surcharge and cess. But, 206AA section is not specified in the finance act. Hence, 206AA rate need not be increased by surcharge and cess.

Q3 When can we avail the DTAA benefit, can we claim the benefit for all the payments or only specified kind of payments ?

A DTAA benefit can be claimed only when the non-resident is having TRC.

Q4 What is TRC ?

A TRC is a Tax Residency Certificate. It determines the non-residents resident country. TRC is usually issued by the tax authorities of that country where non-resident is filing his tax returns as a resident.

Q5 Is section 195 applicable to payees who are “resident but not ordinarily resident”?

A As per section 2(30) "non-resident" means a person who is not a "resident", and for the purposes of sections 92, 93 and 168, includes a person who is not ordinarily resident within the meaning of clause (6) of section 6. Section 2(30) does not cover section 195. Thus section 195 is not applicable to payees who are “resident but not ordinarily resident”.

Q6 Does payment by an Indian branch of a foreign company to its overseas head office trigger withholding of taxes?

A It has been held clearly in the case of ABN Amro Bank [2005] 280 ITR 117 (Kol) that since payer and payee are distinct with separate identities, section 195 shall be applicable and withholding of taxes triggered.

Q7 Does payment by a resident to an Indian branch of a foreign bank attract withholding of taxes?

A Withholding is apparent as payment is made to a non resident.

A word of caution being that at the time of payment to such banks, a copy of the certificate u/s 195(3) may be insisted as there is a possibility of the foreign bank not having a valid certificate.

Q8 Does payment made to a offshore branch of an Indian bank by a branch of an Indian company located offshore attract withholding of taxes?

A Since both are Indian entities, section 195 shall not apply. However the same will be covered u/s194A.

Q9 Does payment made to a resident agent of a non resident shipping company attract withholding of taxes?

A Since such payments are covered u/s 172, section 195 shall not apply, being special provision overriding general provision.

Q10 Whether payment of advance attract withholding at the time of its payment?

A Though there are contradictory decisions, till the time the service is received or rendered, the amount retains the character of an advance and would not have transformed to income and also considering accrual system, the balance tilts in favour of no withholding of taxes.

Q11 What are the various Categories of Payments?

A There can be three categories of payments to non residents

- ❑ Payments not liable to tax
- ■ Income tax Act
- ■ DTAA
- ❑ Payments taxable on Gross Basis – Interest, Royalty and fees for technical services
- ❑ Payments taxable on Net Basis – Business Income. (Net Income – How to determine?)

Q12 What are the various types of payment ?

A The various types of payments are :

- A1 Payments
- A2 Payments

Q13 Should the assessee have to deduct taxes on the entire payment or on income alone?

A Any sum given in section 195 relates to sum which is subject to tax.

However in the case of Transmission Corporation of AP Ltd v CIT [1999] 239 ITR 587 (SC) & Associated Cement Co. Ltd. Vs. CIT [1993] 201 ITR 435, it was a composite contract of supply and services.

In the given case it was held that tax has to be deducted on the whole amount before making payment.

In case of Associated Cement Co. Ltd, the Honorable Supreme Court

In the context of payer's responsibility to deduct tax at source u/s 194C held that "it was neither possible nor permissible for the payer to determine what part of the sum paid to the contractor constituted the income of the latter".

In such case the assessee has to approach the Assessing Office for order u/s 195(2).

Q14 Who should apply for the approval from the Assessing Officer ?

A The Payer U/s 195(2) and Payee U/s. 195(3)/197 can apply for the Approval from the Assessing Officer.

Q15 Is there any prescribed form to apply to the Assessing Officer ?

A There is no prescribed Form

Q16 Is it possible to make a payment without deducting TDS or Lower deduction of TDS ?

A Yes it is possible, only when an approval is taken from the Assessing Officer U/s 195 (2) or 195(3)/197.

Q17 Is there any prescribed form to apply to the Assessing Officer U/s 195(3)?

A It should be applied in Form No 15C/15D

Q18 What is the difference between the approval obtained under sec 195(3) & sec 197 ?

Particulars	195(2)	195(3)	197
Application by -	Payer	Payee	Payee
Circumstances -	Part of the income is chargeable to tax	No Income is chargeable to tax	No deduction / deduction at lower rate
Appealable -	Yes; section 248	No	No

Q19 When does the Approval U/s 195(3) Expire ?

A As per Sec 195 (4) a certificate granted under sub-section (3) shall remain in force till the expiry of the period specified therein or, if it is cancelled by the Assessing Officer before the expiry of such period, till such cancellation.

Q20 Conditions to be fulfilled by payee for application for Nil withholding Certificate

A The various conditions to be fulfilled as per sec. 195(5) are :

- Regularly assessed to tax in India
- Filed all Returns within due date
- No defaults of Tax / Interest / Penalty / Fine
- Not subject to penalty of concealment of Income
- Value of Fixed Assets exceeds Rs.50 Lakh
- Carrying on Business for a period of 5 years

Q21 Should TDS U/s 195 deducted on the Net or Gross Payment ?

A It should be deducted on Gross Payment

Q22 What should be done if the taxes are already borne by the Payer, On what sum should TDS be deducted ?

A TDS shall be deducted & paid at the appropriate rate on the aggregate of:

- the amount paid plus
- the tax thereon.

Q23 How is grossing up of amount and taxes to be withheld calculated?

A This could be explained with an example.

A entered into an agreement with B for payment of Rs.90,000 as royalty, net of taxes. Suppose royalties are subject to withholding of 10%. A can remit the amount subject to grossing the amount and remitting the taxes.

Grossed up amount is

$$= \frac{\text{Rs.90,000}}{90} * 100 = \text{Rs.1,00,000}$$

Taxes to be withheld being 10% of Rs.1,00,000 = Rs.10,000

Amount to be remitted = Rs.1,00,000-Rs.10,000 = Rs.90,000

Q24 Can the Payee claim a credit of these taxes paid by the payer ?

A Yes as per Sec 195 A we can claim a credit of these taxes in the Home Country.

Q25 What is Sec 195(6) all about?

A Section 195(6) specifies that we should Furnish Information of payments in Form 15CA & 15CB

Q26 How does the Assessing Officer determine the appropriate proportion of sum chargeable ?

A As per Section 195(7), (a) The Board may, by notification in the official Gazette, specify a class of persons or cases, where the person responsible for paying to a non-resident, not being a company, or to a foreign company,

(b) any sum, whether or not chargeable under the provisions of this act, shall make an application to the assessing officer to determine, by general or special order, the appropriate proportion of sum chargeable,

(c) and upon such determination, tax shall be deducted under sub section (1) on that proportion of the sum which is so chargeable

Q27 Under which rule does it specify that we should issue Form 15CA & 15CB ?

A Rule 37BB mentions that the information to be furnished under sub-section (6) of section 195 shall be in Form No. 15CA and shall be verified in the manner indicated therein and the certificate from an accountant referred to in sub-rule (1) shall be obtained in Form No. 15CB

Q28 Should a Form 15CA & 15CB issued for every payment made or is there any specified limit for the same ?

A
- Amount of Payment doesn't exceed 50,000 rupees and the aggregate of such payments made during the financial year doesn't exceed 2,50,000 rupees;
- Now amended as per Notification dt.17th December 2015 as payments made during the financial year doesn't exceed 5,00,000 rupees w.e.f 01.04.2016

Q29 Any other Payments which do not require the Issuance of Form 15CB & Form 15CA ?

A
- Indian Investment abroad – in equity capital, in debt securities, in real estate
- Loan extended to Non-resident
- Travel for medical treatment
- Remittance towards payment or refund of taxes
- List of payments mentioned in the Specified List
- Import of goods and advance for import of goods
- Payment under LRS upto USD 2,50,000/- p.a.

Q30 What is the purpose of Issuing Form 15CB ?

A The Purpose of Issuing Form 15CB is to

- Determine the Nature of Service
- Determine the rate of Tax

Q31 Will the Chartered Accountant be held liable for the mistakes in Form 15CB?

A Form 15CB is an opinion of a Chartered Accountant, Final responsibility and liability is on the assessee.

Q32 Is there any Obligation to submit Form 15CA & Form 15CB in case no TDS has been deducted ?

A There is no Obligation to submit Form 15CA & Form 15CB in case no TDS has been deducted. However w.e.f 01.04.2016, Part D of Form 15CA is to be issued.

Q33 What is Form 15CA?

A Form 15CA – Information to be uploaded by payer on incometaxindiaefiling.gov.in website

Part A – General Information about the Non resident

Part B – Information to be captured from Form 15CB

Q34 What is From 15CB ?

A It is a Certificate of an accountant

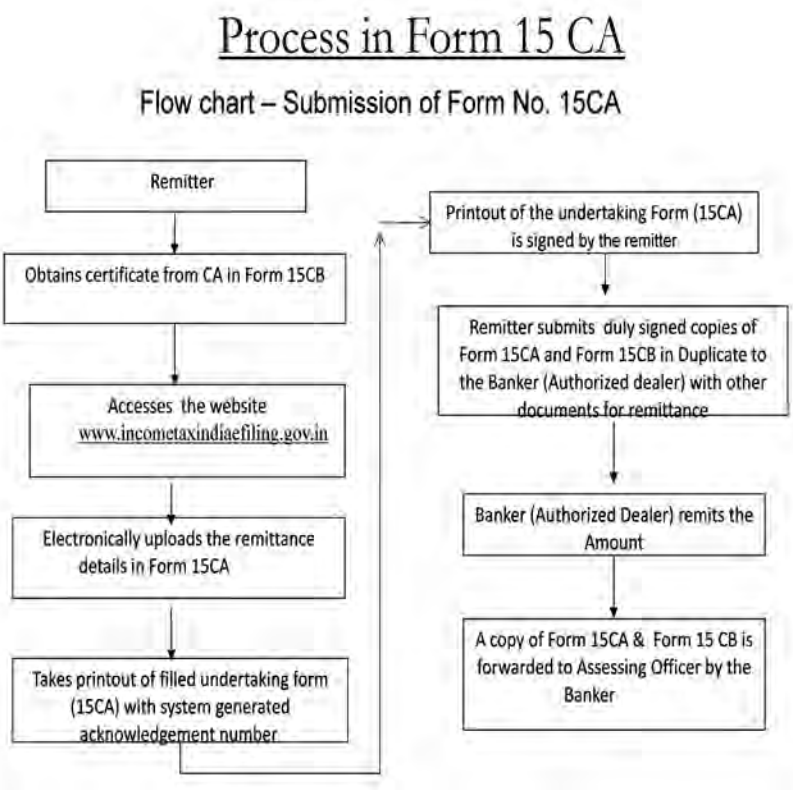
Q35 What are the contents of Form 15CB ?

A
- Name and Address of the Remitter and Beneficiary
- Country to which remittance is made and the Currency
- Amount involved (Gross, TDS and Net) in Foreign Currency & in INR
- Particulars of Bank through which the remittance will be made
- Proposed date of remittance
- Rate of TDS both as per IT Act and as per DTAA
- Date of TDS and the Nature of Remittance
- Whether the remittance is net of taxes
- Whether the remittance is for Royalties, Fee for Technical Services, Interest, Dividend etc.,
- Business Income

- Capital Gains
- In case of any other remittance, reason for non deduction of tax

Q36 What is the process carried out in Form 15CA

A Explained in the form of a Flow Chart.



Q37 Which exchange rate needs to be considered for deduction of taxes?

A Telegraphic transfer (T.T.) buying rate of the State Bank of India as on the date on which the tax is deducted, needs to be applied.

Q38 Can an assessee enter into an agreement with a non resident payee for making payments without deduction of taxes?

A An assessee can enter into an agreement with a non resident payee for making payments without deducting taxes. However statutory dues cannot be circumvented by an agreement. It shall be understood that the assessee undertook to bear the taxes due on the payment. The assessee shall gross up the amount paid and remit the taxes due thereron.

Questions Related to Form 27Q

Q1 In which Form we need to file the TDS return related to section 195?

A We need to file the return in Form 27Q

Q2 What are the details required for filling return?

A We need the below details for filing return.

- TAN of Deductor
- PAN of Deductor
- Name of Deductor
- Address of Deductor
- Email of the Deductor
- Status of Deductor
- Name of the Person responsible for deduction
- PAN of Responsible person
- Designation of the Person Responsible for Deduction
- Address of Responsible Person
- Mobile number of the Person responsible for deduction

Q3 What details are required in Form 27Q?

A Form 27Q consists of Three sheets

Sheet 1 – Deductor details

- TAN of Deductor
- PAN of Deductor
- Name of Deductor
- Address of Deductor
- Email of the Deductor
- Status of Deductor
- Name of the Person responsible for deduction
- PAN of Responsible person
- Designation of the Person Responsible for Deduction
- Address of Responsible Person
- Mobile number of the Person responsible for deduction

Sheet 2 – Challan details

Codes	Particulars	Explanations
701	Challan Serial No	Sl. No. 1,2,3,4……so on
702	Income Tax	Basic tax amount
703	Surcharge	Surcharge amount
704	Education Cess	Education Cess amount
704	Secondary Education Cess	SEC amount
705	Interest	Interest amount
706	Fees	Fees amount
707	Penalty	Penalty amount
708	Total Tax Deposited / Book adjustment	Total tax amount (702 to 707)
709	Whether deposited by book entry	Need to select. 1. Yes 2. No

Codes	Particulars	Explanations
710	BSR code	7 digit BSR code (Basic Stastical Return) need to mention.
712	Date on which tax deposited	Date of Challan paid.
711	Challan Serial No	5 digit challan number.
710	Receipt No of Form 24G	If any
713	Minor head	Which head we paid the challan. 1. 200 2. 400
	Cheque No	If any
	Section Code	Which section we made a payment

3 – Deductor Details

Codes	Particulars	Explanations
	Challan Serial Number	We need to write the challan serial number for the Deductee
	Section Code	Which Section we are deducting tax.
	Deductee Identification Number	If assessee allotted any identification number to deductee, we need to write here.
716	Deductee Code	Need to select 1. Company 2. Other than a company

Codes	Particulars	Explanations
717	Permanent Account Number	10 Digit number allotted by NSDL
715	Deductee Reference Number	In case of invalid PAN, we need to write 10 digits reference number
718	Name of Deductee	To whom we are paying amount.
727	Date on which tax deducted	Tax Deducted Date
720	Date on which amount paid/credited	On which date we are making a payment.
721	Amount of payment	Gross paid amount
728	Rate at which tax deducted	Rate of TDS
	Surcharge rate	Rate of Surcharge
	Education Cess rate	Rate of Education cess
	Secondary Edu Cess rate	Rate of Secondary Education Cess
722	Amount of Tax deducted	Basic Tax amount
723	Surcharge amount	Surcharge amount
724	Education Cess amount	Education Cess amount
724	Secondary Edu Cess amount	Secondary Education cess amount
726	Total Tax deposited	Total tax deposited (722 to 724)
729	Reason for Non deduction or Lower deduction	We may have various reasons for this so we need to select from the drop down list

Codes	Particulars	Explanations
		A – if lower deduction u/s 197 B – 197A H – Higher deduction S – software acquired from FY2012-13 D – Grossing up
730	Number of certificate u/s 197	In case of lower deduction we need to write the certificate number
731	Whether rate of TDS is as per IT act or DTAA	We can deduct the TDS as per IT act or DTAA so we need to mention that A – IT act B - DTAA
732	Nature of Remittance	Nature of remittance we need to select from dropdown list like Royalty, Fees for Technical service, etc
733	Unique acknowledgement number of Form 15CA	If it is available we can write
734	Country to which remittance is made	To which country we made payment, we need to select from the dropdown list
	Grossing up Indicator	If the payment is made as grossing up tax, we need to mention Yes or No.
	Deductee Flat Number	Deductee Address
	Deductee Building Name	Deductee Address
	Deductee Street Name	Deductee Address
	Deductee Area	Deductee Address
	Deductee City	Deductee Address
	Deductee Pin	Deductee Address
	Deductee State	Deductee Address

Q4 What is Form 27A?

A Form No. 27A is a control chart of quarterly e-TDS statements to be filed in paper form by deductors along with quarterly statements. It is a summary of e-TDS returns which contains control totals of 'amount paid' and 'income tax deducted at source'. And also contains the verification, needs to be signed by Responsible Person.

Q5 Is PAN mandatory?

A No PAN is not mandatory, we can go with higher deduction u/s 206AA

Q6 What is Form 16A?

A It is the certificate of deduction of tax at source by any person in accordance with Chapter XVII-B of IT Act.

Form 16 is issued on deduction of tax by the employer on behalf of the employee under section 192 of IT Act, 1961.

Form 16A is issued if the deduction of tax is under any other provision of Chapter XVII-B of IT Act.

These certificates provide details of TDS for various transactions between deductor and deductee. It is mandatory to issue these certificates to Tax Payers u/s 203 of IT Act, 1961.

Q7 Is there any format for these certificates?

A Form 16 / 16A are issued as per the provisions of Rule 31(1).

Q8 What is the due date for the issue of Form 16A certificates?

A Within fifteen days from the due date for furnishing the statement of tax deducted at source under rule 31A.

Q9 Tax has been deducted at the rate of 20% due to non-availability of PAN. How can I issue Form 16A?

A PAN is mandatory to issue Tax deduction certificates.

Q10 What is the due date for filling TDS statement?

A The due dates is given below
Quarter 1 – 15th July
Quarter 2 – 15th October
Quarter 3 – 15th January
Quarter 4 – 15th May

Q11 What will be the consequences if I do not file TDS statement within due date?

A There will be a levy of Rs. 200.00 per day under section 234E of the IT Act, 1961 from the due date till the date when statement is filed.

Q12 Which are the major defaults in TDS statement?

A Major defaults are given below

Particulars	Explanations
Short payments	In case of deductee total, exceeds challan amount.
Short deduction	
Interest on payments defaults u/s 201(1A)	Interest on Short payment or late payment has been calculated u/s 201(1A) @ 1.5% for every month or part of the month.
Interest on short payment	
Interest on late payment	
Interest on deductions defaults u/s 201(1A)	Interest on Short deduction or late deduction has been calculated u/s 201(1A) @ 1% for every month or part of the month.
Interest on short deduction	
Interest on late deduction	
Short payment on account of late filing	Interest on late filling calculated u/s 234E

Q13 How to resolve the defaults?

A We need to analyse the defaults, for analysing we may download Justification report. And need to download the conso file for filing correction statement.

Q14 What is Conso file?

A - It is the consolidated data of the statements processed (regular & correction) for the relevant Financial Year, Quarter and Form Type

Q15 Why is Conso file?

A While filing correction for a particular Financial Year, Quarter and Form Type, conso file provides details about all the previous corrections made in the relevant statement. This conso file can be uploaded to the RPU to enable correction. This file gets updated each time a correction is filed for the particular Financial Year, Quarter and Form Type. Hence, each time a correction statement is to be filed for the given combination, a fresh conso file is required.

Q16 From which year Conso file is available on traces?

A Conso file is available on TRACES from FY 2007-08.

Q17 What is a justification report?

A It is a document which serves as an annexure to the intimation to be sent to the deductor. Intimation will be sent to the deductor through mail / post but a justification report will have to be downloaded from the portal.

Q18 How many times we can file the revise return?

A Any number of times we can revise the return.

Q19 How can we file the revise Return?

A We can file Two types of Correction return?

1 – Physical return

2 – Online correction

Q20 What is Online Correction?

A TRACES has provided the functionality of "Online Correction" where deductor can perform correction of TDS/TCS statements

online. Following are the various facilities available through online correction:

- View default summary
- Rectifying challan mismatch cases
- Addition of new challan to the statement
- Pay 220/interest/levy
- Add or Delete Salary Detail
- Rectifying statement challan information
- PAN Correction
- Correction in Personal Information
- Add/Modify deductee detail
- Movement of deductee rows

Q21 If TDS payments made for some other section, whether we can utilize the same challans for Form 27Q?

A Yes we can.

Q22 TDS payment done for different AY, whether we can utilize the same?

A Yes we can. For eg: challan relating to FY 2014-15 can be adjusted with FY 2013-14 and/or FY 2015-16.

NOTE ON CHANGES IN RULE 37BB AFTER AMENDMENT VIDE NOTIFICATION NO. 93/2015

CBDT amends Rule 37BB inserts Income-tax (21st Amendment) Rule, 2015 vide Notification no. 93/2015 following amendment shall be substituted for rule 37BB <u>with effect from 1st April 2016</u>.

(1) <u>Every Person responsible for paying to a non-resident not being a company or to a foreign company any sum chargeable under the provisions of the Act, shall furnish</u>:

(i) If the payment or aggregate payments does not exceeds 5 lakh rupees during the financial year, shall furnish Information in Part- A of Form 15CA only

(ii) If the payment or aggregate payments does not exceeds 5 lakh rupees during the financial year but obtained lower deduction certificate u/s 197 or an order of assessing officer u/s 195(2) or 195(3), then every person shall furnish,

(a) Information in Part-B of Form 15CA after obtaining a certificate from the assessing officer u/s 197 or an order from an assessing officer u/s 195(2) or 195(3).

If the payment or aggregate payments exceeds 5 lakh, then every person shall furnish

(b) Information in Part-C of Form 15CA after obtaining a certificate in Form 15CB from a Chartered Accountant.

So Form 15CB is compulsory only when the payment or payments during the financial year exceeds 5 lakh rupees.

(2) Every Person responsible for paying to a non-resident not being a company or to a foreign company any sum which is not chargeable under the provisions of the Act, shall furnish:

If the payment or payments made during the financial year which is not chargeable to tax as per the Income tax Act, 1961 then every person shall furnish Information in Part-D of Form 15CA only.

It is seen however in practice that the remitter does not provide the above information in respect of non-taxable remittances. Therefore, it is felt that obtaining of information only in respect of remittances which the remitter declared as taxable, defeats one of the main principles of obtaining information in respect of foreign remittances i.e., to identify the taxable remittances on which tax was deductible but was not deducted. In view of this, the above amendment is made in Section 195(6). Therefore through this amendment Part-D of Form 15CA is introduced

(3) However in the sub rule (2), no information is required to be submitted if

(i) Remittance made by an individual & does not require prior approval of RBI as per the provisions of section 5 of FEMA

Act, 1999 read with schedule III to the foreign exchange where remittance under Liberalised Remittance Scheme (LRS) limited to USD 250,000 p.a.

(ii) If the remittance is of the nature specified in below 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

Sl. No.	Purpose code as per RBI	Nature of payment
15	S0301	Remittance towards business travel.
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 Indian 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

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.

SUMMARY OF THE ABOVE ARE CAPTURED IN THE BELOW TABLE

Parts in Form 15CA	Remittance Type	Limit	Additional Requirement
Part-A	Chargeable to Tax	Remittance or aggregate remittance during the Financial Year (FY) is below Rs.5,00,000	No need of Form 15CB
Part-B	Chargeable to Tax	Remittance or aggregate remittance during the FY is below Rs.5,00,000	(i) If lower deduction certificate u/s 197 or an order of assessing officer u/s 195(2) or 195(3) is obtained (ii) No certification is required in Form 15CB from a Chartered Accountant

Parts in Form 15CA	Remittance Type	Limit	Additional Requirement
Part-C	Chargeable to Tax	Remittance or aggregate remittance during the FY exceeds Rs.5,00,000	Certification is required in Form 15CB from a Chartered Accountant
Part-D	Not Chargeable to Tax	Limit is Not Applicable	No need of Form 15CB

(4) The information in form 15CA shall be furnished,

(i) Electronically under digital signature in accordance with the procedures, formats and standards specified by the Principal Director General of Income-tax (Systems) under sub-rule (8) and thereafter printout of the said form shall be submitted to the authorized dealer, prior to remitting the payment; or

(ii) Electronically in accordance with the procedures, formats and standards specified b the Principal Director General of Income-tax (Systems) under sub-rule (8) and thereafter signed printout of the said form shall be submitted to the authorized dealer, prior to remitting the payment.

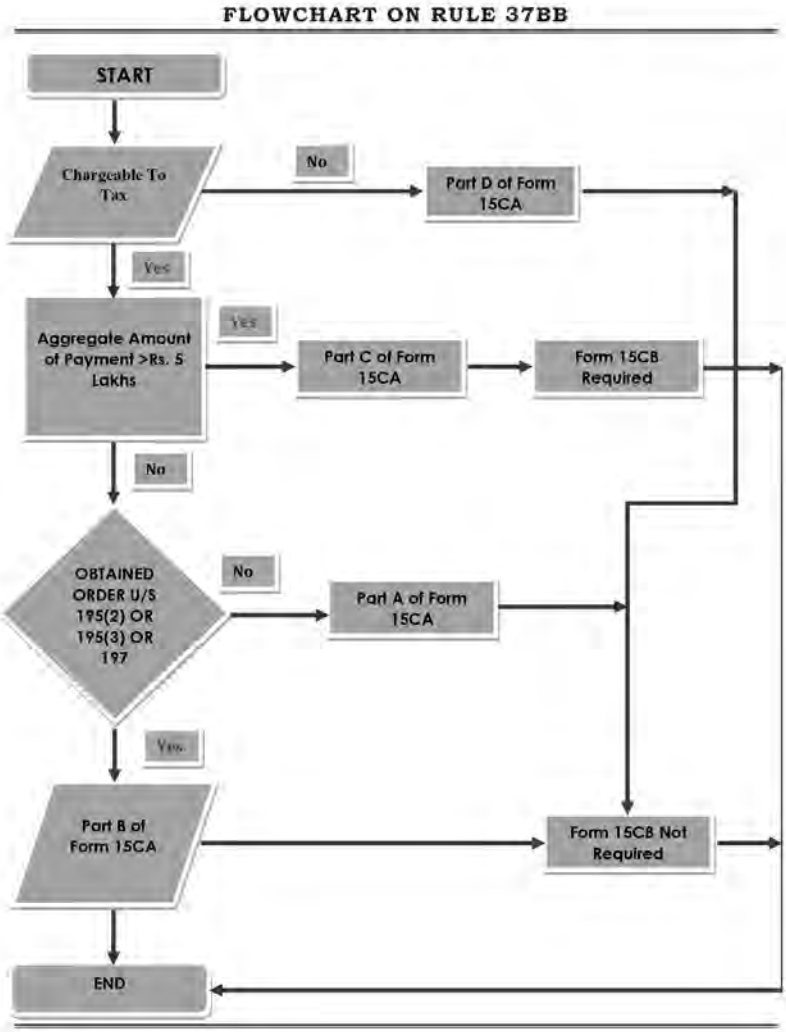
(5) The authorized dealer is under obligation to furnish the signed printout of Form 15CA referred to in clause (ii) of sub-rule (4) if required by the Income Tax authority for the purpose of IT Proceedings.

(6) The certificate in Form 15CB shall be furnished and verified and verified electronically in accordance with the procedures, formats & standards specified by the Principal Director General of Income Tax (systems) under sub rule (8).

It is proposed to make the certification by Chartered Accountant is in Form 15CB electronically.

(7) As per the amendment the Authorised Dealer shall furnish the quarterly statement for each quarter of the financial year in Form No. 15CC to the Principal General of Income Tax (Systems) or to the person authorized by the Principal General of Income Tax (Systems) electronically under Digital Signature within 15 days from the end of the each quarter of the financial year to which such statement relates in accordance with the procedures formats and standards specified by the Principal Director General of Income-tax (Systems) under sub-rule (8).

(8) The Principal Director General of Income-tax (Systems) shall specify the procedures, formats and standards for the purposes of furnishing and verification of Form 15CA, Form 15CB and Form 15CC and shall be responsible for the day-to-day administration in relation to the furnishing and verification of information, certificate and quarterly statement in accordance with the provision of sub-rules (4), (6) and (7).


FLOWCHART ON RULE 37BB
START
Chargeable To Tax
No
Part D of Form 15CA
Yes
Aggregate Amount of Payment >Rs. 5 Lakhs
Yes
Part C of Form 15CA
Form 15CB Required
No
OBTAINED ORDER U/S 195(2) OR 195(3) OR 197
No
Part A of Form 15CA
Yes
Part B of Form 15CA
Form 15CB Not Required
END

COMPARISON

Particulars	As per earlier rule 37BB of IT Act, 1961(Effective till 31.03.2016)	As per amended rule 37BB of IT Act, 1961(Effective from 01.04.2016)
Limit for Form 15CB	For certification in Form 15CB (i.e., accountant's certificate) needs to be furnished only in case of remittances exceeding Rs.2,50,000/-	For certification in Form 15CB (i.e., accountant's certificate)needs to be furnished only in case of remittances exceeding Rs. 5,00,000/-
Signature of 15CB	Certification done on printed Form15CB (Manually)	Certification done on Form 15CB through Electronically using Digital Signature.
Details to be Furnished by Authorised Dealer(Banker) to DGIT	Not Applicable	An authorised dealer shall furnish the Digitally signed quarterly statement in Form 15CC to the Principal Director General of Income Tax (Systems).
Requirement of Form 15CB for remittances not chargeable to tax	Provisions are not clear whether certification in Form 15CB is required or not for remittances which are not chargeable to tax.	Provisions are clear, that certification in Form 15CB is not required if remittances are not chargeable to tax. However furnishing of information for such transaction is compulsory in Part-D of Form 15CA

Particulars	As per earlier rule 37BB of IT Act, 1961(Effective till 31.03.2016)	As per amended rule 37BB of IT Act, 1961(Effective from 01.04.2016)
Parts of 15CA	Form 15CA is divided into 2 parts Part-A & Part-B. Part-A: Information under Part-A is required to be furnished always if any remittance to non-resident during the financial year. Part-B: Information under Part-B is required to be furnished only when the remittance or aggregate remittance exceeds 2,50,000 during the financial year (in other words it is compulsory only when Form 15CB is compulsory)	Form 15CA is divided into 4 Parts, Part-A: Information under Part-A is required to be furnished if any remittance or aggregate remittance to non-resident which is chargeable to tax during the financial year does not exceeds 5,00,000/-. Part-B: Information under Part-B is required to be furnished if the remittance or aggregate remittance to a non-resident which is chargeable to tax during the financial year does not exceeds Rs. 5,00,000 during the financial year

Particulars	As per earlier rule 37BB of IT Act, 1961(Effective till 31.03.2016)	As per amended rule 37BB of IT Act, 1961(Effective from 01.04.2016)
		AND Obtained Lower deduction certificate from the assessing officer u/s 197 or an order from the assessing officer u/s 195(2) or 195(3). Part-C: Information under Part-C is required to be furnished if the remittance or aggregate remittance to a non-resident which is chargeable to tax during the financial year exceeds 5,00,000 AND Obtained certificate from a chartered accountant in Form 15CB. Part-D: Information under Part-D is required to be furnished if the remittance is not chargeable to tax in India as per the provisions of the Income Tax Act, 1961.

Particulars	As per earlier rule 37BB of IT Act, 1961(Effective till 31.03.2016)	As per amended rule 37BB of IT Act, 1961(Effective from 01.04.2016)
Exception for Form 15CA	Not Applicable	No information is required to be furnished if the remittance falls under the specified list of 33 items under Rule37BB(3)
Requirement for disclosure of Residential Status	Not Applicable	Disclosure of Residential status of remitter has been made a necessary requirement
Requirement for disclosure of Relevant Purpose code as per RBI	Not Applicable	Disclosure of Relevant Purpose code as per RBI has been made a necessary requirement
In case where the remitter is an Individual	Not Applicable	No information is required to be furnished under Rule 37BB, if the remittance is made by an individual and further it does not require prior approval of Reserve Bank of India as per the provisions of section 5 of the Foreign Exchange Management Act, 1999 (42 of 1999) read with Schedule III to the Foreign Exchange (Current Account Transaction) Rules, 2000.

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CHAPTER – 12

Glossary of International Tax Terms

A. Associated Enterprise

B. Business Profits, Beneficial owner; Bilateral Treaties

C. Controlled Foreign Corporation

D. Dependent Personal Services; Dividends

E. Economic Double Taxation; Exemption method

F. Force of attraction; Fees for Technical services

G. GAAR; Global Tax system

H. Hybrid entity; Hybrid instruments

I. Independent Personal Services; Interest

J. Juridical Double Taxation

K. Know-how

L. Limitation of Benefit ; Limitation of Relief

M. Make Available; Multilateral Treaties; Mutal Agreement Procedure, Most Favoured Nation

N. Non-Discrimination

O. OECD (Organisation for Economic Co-operation and Development); Ordinary Credit Method

P. Permanent Establishment ; Protocol ; Participation exemption; Preferential Tax Regime; Place of Effective management

Q. Quarantining

R. Royalty ; Residence ; Repatriation

S. Source Jurisdiction ; Safe Harbour

T. Tie- breaker Rule ; Transfer Pricing ; Tax Credit ; Tax sparing ; Tax Residency Certificate

U. Underlying Tax Credit ; Unilateral Relief ; UN Model Convention

V. Vienna Convention

W. Withholding Tax ; Worldwide Income

X. X- tra Territorial Jurisdiction

Y. Year of earning income, Year of Assessment of Income

Z. Zero Coupon Bond ; Zero rate

* * *

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5. Insights into the Basics of International Taxation.
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