

# Section 195 – An Introduction & Recent Developments



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# Scheme of Collection and Recovery of tax

- ❖ The Income tax law provides for two methodologies for payment of tax:-



# Objective of section 195

- ◆ Section 195 is contained in Chapter XVII-B of the Income-tax Act, 1961 (the Act), which deals with deduction of tax at source
- ◆ This chapter defines the methodology of payment of tax by way of tax deducted at source (TDS)
- ◆ The objective of section 195 is to ensure, as far as possible, that the tax liability on the income element of the amount paid is deducted at source itself



# Overview of Section 195



# Section 195 (1)

**Who  
Should  
Deduct?**

- Any person;
- Who is responsible for making payments to a non resident; or a foreign company

**Nature of  
Payment**

- Any interest, not including interest u/s 194LB, 194LC, 194LD;
- Any other sum chargeable under the Act
- Does not include salary; or dividend under section 115-O

**Time of  
Deduction**

- At the time of credit or payment whichever is earlier

**Rate of  
Deduction**

- At the rates in force

# Any Person

- ◆ Any Person – includes all persons, resident or non-resident whether or not the non-resident person has –
- ◆ (i) a residence or place of business or business connection in India; or
- (ii) any other presence in any manner whatsoever in India.

[inserted by the Finance Act,2012 (23 of 2012),  
w.r.e.f 1-4-1962]



# Any Person

- The Hon'ble Supreme Court (SC) in the case of Vodafone International Holdings BV v. Union of India, (2012) 6 SCC 613, held that, section 195 would apply only if payments were made from a resident to a non-resident and not between two non-residents situated outside India. The SC concluded that :

“The expression “any person”, in our view, looking at the context in which Section 195 has been placed, would mean any person who is a resident in India.”

- In order to overcome this limitation, Section 195 (1) was then amended to clarify that “Any person” will also include non-residents





# Any Sum Chargeable to tax

- Any Sum chargeable to tax in India should be understood and read along with



# Any sum chargeable to tax

- ◆ GE India Technology Centre Pvt. Ltd (327 ITR 456) SC

The Hon'ble SC, in this case, held that:

- ◆ The obligation to deduct tax at source arises only when there is a sum chargeable under the Act, and not merely because there is a remittance to a non-resident
- ◆ Section 195 casts an obligation on the payer to deduct tax at source on payments made to non-residents which are chargeable to tax
- ◆ Therefore, where payment, made by resident to non-resident, was an amount not chargeable to tax in India, no tax is deductible at source even though assessee has not made an application before the Assessing Officer(AO)



# Rates of deduction

- At the rates in force:- Section 2(37A)(iii) defines 'rates in force' as :
  - Rates as specified in the Finance Act of the relevant year; or
  - Rates specified by the government in the Treaty under section 90 or 90A whichever is applicable

The tax shall be deducted at the rates specified in the finance act or at the rate provided in the Treaty whichever is beneficial



# Section 206AA- Issues and amendments

- Section 206AA requires the payer to deduct TDS at the higher of:

If the payee fails to furnish details of PAN

- This led to a controversy whether section 206AA would prevail over section 90(2) in respect of payments to non-residents



# Section 206AA- Issues and amendments...

**contd** The Pune Bench of Income-tax Appellate Tribunal (ITAT) held the in the case of Serum Institute of India Ltd that:

Section 90(2) provides that the provisions of the DTAA's would override the provisions of the domestic Act in cases where the provisions of DTAA's are more beneficial to the assessee

- On the other hand, the Bangalore ITAT, in the case of Bosch Ltd. V. ITO[2012] 141 ITD 38 (Bang) held that the higher tax rate specified under section 206AA should be applied even if tax treaty benefit is available
- Subsequently, section 206AA was amended to clarify that such requirement of PAN would not be applicable to non-residents in respect of certain payments like interest on long term bonds, royalty, FTS, etc.
- Rule 37BC was also inserted to reduce the compliance burden. The Rule requires the furnishing of certain information instead of



# Section 195 (2)

- ◆ If a person responsible for paying any such sum chargeable under this Act (other than salary) to a non-resident, considers that the whole of such sum would not be income chargeable in the case of the recipient,
- ◆ he may make an **application to the Assessing Officer to determine, by general or special order**, the appropriate proportion of such sum so chargeable, and upon such determination, tax shall be deducted under sub-section (1) only on that proportion of the sum which is so chargeable
- ◆ This sub-section is proposed to be amended by the **Finance Bill 2019 (No. 2)** to prescribe the form and manner of application to the AO

# Proposed amendments in

## 195(2)/195(7)

- At present, the procedure for making application to an Assessing Officer in order to obtain a certificate/order for lower or nil withholding-tax is a manual process with no prescribed format
- In order to streamline this process, this sub-section is proposed to be amended by prescribing the form and manner of such application along with the manner of determining the appropriate proportion of such sum chargeable by the AO.
- This application can now be filed electronically
- Similar amendments have also been made in section 195(7)



# Section 195 (3)

- ◆ Any person entitled to receive any interest or other sum on which income-tax has to be deducted under sub-section (1) may make an application in the prescribed form to the Assessing Officer
- ◆ For the grant of a certificate authorising him to receive such interest or other sum without deduction of tax
- ◆ And where any such certificate is granted, every person responsible for paying such interest or other sum to the person to whom such certificate is granted shall, so long as the certificate is in force, make payment of such interest or other sum without deducting tax thereon under sub-section (1)





195(4)

195(5)

195(6)

195(7)



# Furnishing of information under section 195 (6)

- Procedure prescribed in Rule 37BB of the Income-tax Rules, 1962
- Information on remittance of amount to be furnished by the payer in Form 15CA
- Certificate from Chartered Accountant may be obtained in Form 15CB



# Section 201 and section 40

- Section 201 specifies that the deductor shall not be deemed to be an assessee in default if he fails to deduct tax on a payment made to a resident, if such resident has furnished his return of income under section 139 and has paid the tax due on such income declared by him
- Benefit of Section 201(1) has now been extended in case of failure to deduct tax at source from sum paid also to **non-residents.**
- Therefore, a deductor shall not be deemed to be an assessee in default even if he fails to deduct tax from sum paid to a non-resident, if such non-resident discloses such income in his return of income and pays tax due on such income and a certificate from a Chartered Accountant is furnished to this effect.



# TRC and beneficial ownership

- ◆ Section 195 requires the payer to deduct tax at source before making payment to the payee
- ◆ The tax has to be deducted only on the income element embedded in the transaction
- ◆ Income from the transaction has to be determined after analyzing the taxability under the Act as well as the relevant Double Taxation Avoidance Agreements (DTAA)
- ◆ Section 90(4) of the Act requires a Tax Residency Certificate (TRC) to be furnished by the non-resident to avail the benefits of [the DTAA](#)



# TRC and beneficial ownership

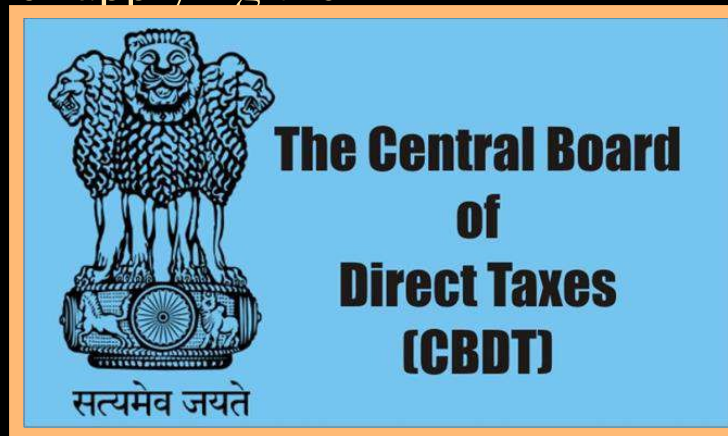
- ◆ The Ahmedabad ITAT in a recent decision of Skaps Industries \* held that non-furnishing of the TRC cannot be the sole ground for rejecting DTAA benefits. However, the ITAT in its final directions, asked the assessee to furnish TRC along with other evidences.

\*Skaps Industries India (P.) Ltd. [2018] 94 taxmann.com 448  
(Ahmedabad - Trib.)



# TRC and beneficial ownership

- ◆ Some DTAA's also provide for a Limitation of Benefits (LOB) clause which stipulates that the non-resident should also be the beneficial owner of the income earned from the other contracting state so as to be eligible for the DTAA benefits
- ◆ However, the CBDT circular 789 of 2000 dated 13-04-2000 clarifies that, furnishing of the TRC is sufficient proof for accepting the status of residence as well as of beneficial ownership for applying the DTAA



# TRC and beneficial ownership

- ◆ The said circular has been recently relied upon by the Hon'ble Bombay High Court (HC) in Indostar Capital\*:
  - ◆ **The AO contended that the assessee was not the beneficial owner of the shares as, he was not engaged in commercial activities and there were no employees in Mauritius and accordingly passed an order under section 197 r.w.s. 195 which denied DTAA benefits to the assessee**
  - ◆ **On Writ Petition before the HC, the said order of the AO was struck down, relying on the above Circular**

\*Indostar Capital [2019] 105 taxmann.com 96 (Bombay)



# TRC and beneficial ownership

- ◆ **The HC further observed that even if a certificate under section 197 is issued, the AO can always in normal assessment proceedings bring the said income to tax, if otherwise permissible in law**
- ◆ **The HC thus held that the AO is entitled to conduct a detailed enquiry later during final assessment proceedings**





# Equalisation Levy and withholding of tax



# Equalisation Levy

- The Indian Budget introduced, through the Finance Act, 2016:
  - **an Equalisation Levy of 6% on the services availed**
  - **by an Indian resident or non-resident having a Permanent Establishment in India**
  - **for specified services**
    - Online advertisements
    - Provision for digital advertising space
    - Any other facility or service for the purpose of online advertisement
    - Any other service as notified
  - **to a non-resident (NR)**



# Equalisation Levy

- Equalisation Levy is applicable irrespective of whether any income arising from the transaction is chargeable to tax in India or not. It does not fall within the scope of 'income tax' or 'tax on income' or 'any identical or substantially similar taxes' which are included in the scope of 'Taxes Covered' in the DTAA
- Section 10(50) of the Act states that once income is chargeable to EQL under Chapter VIII of Finance Act, it is exempted from income-tax
- Since the payment of the nature referred to in EQL has been specifically exempted, provisions of section 195 would not be applicable and no TDS would be required to be deducted



# Google India Pvt. Ltd. (Bang. ITAT)

- Facts of the case:
  - **Google India Pvt. Ltd. (GIPL) made payment to Irish company-Google Ireland Ltd. (GIL ) for purchase of advertisement spaces under Google-USA's Ad words programme**
  - **The same was then resold to advertisers in India. Thus GIPL was a distributor for Ad Word programme in India**
  - **GIPL made payment to GIL without deducting tax under section**

The Google logo is displayed in its characteristic multi-colored font (blue, red, yellow, green, red) with a trademark symbol. It is enclosed in a white rectangular box with an orange border. The logo is positioned in the lower right quadrant of the slide, partially overlapping the text of the third bullet point.

Google™



# Google India Pvt. Ltd. (Bang. ITAT)

- Facts of the case:
  - **The contentions raised by GIPL was that:**
    - since equalisation levy was applicable on the payments made to GIL in the subsequent years
    - the nature of the payment in the current year was also business income and
    - in the absence of a PE in India, there was no income taxable in India
    - Thus, section 195 is not applicable



# Google India Pvt. Ltd. (Bang. ITAT)

Observations, Analysis and Decision of the ITAT in respect of the above contention:

- The ITAT held that the scope of the equalization levy was only on specified services as defined under Finance Act, 2016
- In the present case, under Ad word distribution and service agreement, the taxpayer has acquired license to use IPRs , copyright and other intangibles to provide better services either to GIL or to advertisers
- Therefore, the introduction of equalization levy would not convert the nature of payment made by GIPL to GIL



# Effect of Multilateral Instrument (MLI) on Section 195



# Overview of BEPS Action 15 - MLI

- Objective is to facilitate countries interested in implementing tax treaty-related BEPS measures
- A multilateral instrument (MLI) – over 100 countries – ‘modify’ bilateral tax treaties between them
- Minimum standard provisions – have to be applied; others – optional, reservations possible
- Treaty between two countries modified only if **both** countries accept the provisions (without reservations)
- Notification – countries need to notify existing treaties containing provisions referred to
- Interpretation – using existing treaty – otherwise explanatory statement
- Not an amending protocol – operates alongside existing treaties





# Proposed India Positions on MLI -

- The minimum standards which MLI asks for implementation are as under:
  - **Article 6 – The Article deals with prevention of treaty abuse, it lays down the Principal Purpose Test (PPT). India has opted for this Article along with a simplified Limitation of Benefits (LOB) option which would grant treaty benefits to only qualified persons.**
  - **Article 16 – The Article deals with introduction of Mutual Agreement Procedure (MAP) clause in DTAA**
  - **These Articles, on entry into force, would impact the withholding of tax which would be applicable on the**



# Proposed India Positions on MLI -

- One of the other important MLI positions are in respect of fiscally transparent entities. Article 3 of the MLI provides entities resident in the contracting state would be allowed treaty benefits only to the extent that the income is taxed in the other state
- This would have wide implications with regards to which DTAA would be applicable as also the TDS rate that would be applicable on the same



# Illustration

**ABC Ltd.,**  
Incorporated in State A

**Considered as a opaque entity  
and subject to tax in State A**

Payment of  
interest

Withholding of  
taxes

**State A**

**State B**

Interest taxed in  
State B in the  
hands of P

**Member P –**  
Resident of State  
B

**State C**

Interest taxed in  
State C in the  
hands of Q

**X LLC**  
Incorporated in State B

**Member Q –**  
Resident of  
State C

**Considered as a transparent entity  
and members are liable to tax in  
State B**



# Impact after MLI

- Which treaty to be applied by ABC Ltd. for withholding of tax on interest payment?
- How the MLI will affect the grant of credit by the respective states, where the interest is taxed?



# Comparative Analysis of section 195

and 197

	<b>SECTION 195 (2)</b>	<b>SECTION 195 (3)</b>	<b>SECTION 197</b>
<b>OBJECTIVES</b>	Provides for an application for lower/nil rate of withholding if the payer considers whole of sum is not income chargeable	Provides for an application for lower/nil rate of withholding if the payee considers whole of sum is not income chargeable	Provides for a Certificate to be given by the AO for deduction at a lower rate on an application made
<b>WHO CAN APPLY ?</b>	<b>Payer</b>	<b>Payee</b>	<b>Payee</b>
<b>APPLICATION FORM</b>	No prescribed form (Amended)	Form 15C or 15D	Form no 13
<b>WHETHER APPEALABLE?</b>	Appealable under section 248	Order not appealable	Order not appealable



Thank You

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