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Dear Sir / Madam,

**Sub: Payment to a non-resident - TDS obligation  
Karnataka High Court - Samsung Electronics**

Recently, the Karnataka High Court has pronounced a decision on tax deduction at the time of making payment to a non-resident. We have explained the implications below:

**Executive summary:**

Payment to a non-resident by an Indian resident involves the examination of the issue - "Whether withholding tax (TDS) has to be deducted at source before remitting the funds?"

This issue has become controversial for the past few years. Recently the Karnataka High Court has pronounced its decision which is adverse to the tax payer. It states that for every payment to a non-resident, tax has to be deducted at source. If the payer considers that no tax is deductible, or tax to be deducted is less than what is prescribed, then he has to approach the Income-tax department for a certificate. On his own, he cannot take a decision.

This can have far reaching implications. Further details are discussed in the detailed note attached.

If you require any further clarification, kindly let us know.

Yours sincerely,

Rashmin Sanghvi and Associates

## **Payment to a non-resident - TDS obligation Karnataka High Court - Samsung Electronics**

### **1. The case in brief:**

1.1 Several Indian residents are importing shrink-wrapped software for their use in India, or distribution in India. The department holds a view that payment for import of software is payment of royalty. Tax has to be deducted at source. The tax payers hold a view that import of software is akin to **import of goods**. Normally on import of goods, there is no tax to be deducted (unless the non-resident payee has a presence in India and import is connected with the presence).

There are several decisions on this subject - mostly at the Tribunal level. Several decisions were in favour of the tax payer. The decisions held that import of software is not royalty. It is normal business income. Without a Permanent Establishment in India, it does not give rise to taxable income. Therefore no tax has to be deducted at source.

Against these decisions, the Income-tax department had gone in appeal to the Karnataka High Court.

1.2 The Karnataka High Court has clubbed several appeals together and decided the matter with one order.

1.3 The decision states that:

i) Deduction of tax is a first level of tax payment process. It is a provisional tax and not the final tax.

ii) The taxability of income has to be decided at the time of assessment - i.e. when the non-resident files a return.

iii) At the time of payment, the only issue to be decided is whether to deduct tax or not. If there is slightest doubt about the taxability, or tax to be deducted at rates less than the prescribed rates, the payer has to approach the Income-tax department for a certificate. The tax has to be deducted only as per the directions given by the Income-tax department.

iv) When the payer approaches the Income-tax department, at that time also, the Income-tax department cannot consider the taxability. Only if there are past directions, orders, etc. that no tax / less tax has to be deducted, he can issue the certificate to that effect. He cannot consider the taxability at the time of payment to a non-resident.

v) Even the Tribunal was in error on deciding on the “taxability” of software payments. It had no jurisdiction to do so.

## 2. **Our Observations and Implications:**

2.1 While the decision is with reference to payment for software, **it has implications for all kinds of payments to non-residents.**

2.2 It appears that the decision has gone contrary to the existing Supreme Court decisions.

2.3 Under section 195, tax has to be deducted from payment to a non-resident:

- **if it is taxable in India**, and
- at the rates in force.

**Thus without examining the “taxability of income”, one cannot decide whether to deduct tax at source or not. The “taxability” and “tax deduction at source” are linked. They are not independent issues.**

However the Honourable High Court has said that at the time of making payment, the **“taxability” of payment should not be considered.**

2.4 If the payer can not consider the taxability, it may mean that for every payment, tax has to be deducted. Or the Income-tax department has to be approached for a certificate.

Take the case of imports. India imports goods in excess of US\$ 250 bn. Normally the foreign exporters are not taxable in India. Now will the importer have to approach the Income-tax department for NIL deduction of tax?

## 3. **Payment based on Chartered Accountants’ certificate:**

Under the rules, an option is available to the payer that he may make a payment based on the certificate of a Chartered Accountant. The Chartered Accountant will certify the amount of tax to be paid.

It is not clear whether this process is now available. The High Court has neither considered nor ruled on this aspect.

The procedure of remitting the funds based on the certificate of a Chartered Accountant was based on the circular of the tax department itself. The Income-tax department can always provide for procedures which are beneficial to the tax payers. The procedure of making

remittances based on the CA certificate was to save the trouble of approaching the Income-tax department. As the High Court has not decided on this aspect, in our view the process of making payments based on a Chartered Accountant's certificate should still be available.

4. **Summary:**

So far the position was that if the payment is not taxable in India, the payer can make the payment without deducting any tax at source. If there are doubts about the taxability, the payer should approach the Income-tax department.

However with this decision, the position has become stricter. **The decision states that the taxability cannot even be considered at the time of payment.**

5. **Consequences of not deducting tax at source:**

If the resident payer does not deduct tax from foreign remittances and the Income-tax department considers that tax should be deducted at source, interest and penalty can be levied. Further, the expense can be disallowed in the hands of the resident businessman. The appellate process is of course available to the payer. However it is time consuming and expensive. Hence it is advisable to be conservative.

6. **Alternatives for the payer:**

6.1 If the payment is clearly not taxable in India, then the payment can be made without deducting tax at source. A Chartered Accountant's certificate will be required for making the payment.

6.2 If the matter is controversial, then the payer or receiver should approach the Income-tax department and obtain a certificate for deduction of tax at source. If the matter involves computation of profit (e.g. business payments), a certificate from the Income-tax department should be obtained.

It is not advisable to make remittance based on the certificate of a Chartered Accountant.

7. Some illustrations where payment can be made without a CA certificate are as under:

Capital payments: e.g. (i) a non-resident had given a loan and the loan is now being repaid.

(ii) Indian resident makes a Capital investment abroad.

Exempted payments: e.g.	Dividends declared by Indian companies are exempted from tax u/s. 10(34).
Settled position in law:	Certain payments are accepted by CBDT as not liable to tax. E.g. Indian Oil Corpn. Imports crude oil worth US\$ 50 bn. every year.
Treaty override:	It is also accepted by the Income-tax department that: "In case of differences in the provisions of the Income-tax Act (ITA) and Double Tax Avoidance Agreement; the provisions more beneficial to the assessee shall prevail". Agreement may provide for a rate of TDS lower than the ITA.

All the above matters can be determined by the assessee; and based on a certificate by a Chartered Accountant; these remittances can be made abroad without going to Income-tax department.

In our view, even after this decision; these amounts can be remitted abroad based on a CA certificate.

Thus in situations where there is a **clear knowledge** that the income is not taxable, payments can be made.

In situations where the Income-tax department can have a **discretion**, payment should not be made without obtaining a certificate from the Income-tax department.

Rashmin Sanghvi and Associates