

ARTICLE

TDS on Payments Made to Non-Residents: A Comprehensive Guide

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With the rapid globalization of businesses and the increased mobility of individuals across borders, transactions with non-residents have become a routine part of corporate and financial dealings. In India, payments made to non-residents are subject to Tax Deducted at Source (TDS) under the Income Tax Act, 1961. Understanding the TDS implications on such payments is crucial for businesses, as non-compliance can result in significant penalties and interest. This article aims to provide a clear understanding of TDS on payments to non-residents, along with the relevance of Double Taxation Avoidance Agreements (DTAAs).

1. Understanding the Basics: Section 195 of the Income Tax Act

Under Section 195 of the Income Tax Act, any person (resident or non-resident) making a payment to a non-resident, which is chargeable to tax in India, must deduct TDS at the applicable rate (The rates of income tax specified in the Finance Act of the relevant previous year, or DTAA (Double Taxation Avoidance Agreement)). This provision is aimed at ensuring that taxes are collected at the source of income generation, even when the income is paid to a non-resident.

Payments that attract TDS under Section 195 include:

- Interest
- Royalty
- Fees for technical services
- Capital gains
- Dividends
- Salary (in certain cases)
- Business Income (In case of PE in India)

It is crucial to note that TDS applies only if the income is **chargeable to tax in India**. Payments not chargeable to tax in India do not attract TDS under Section 195.

Let's Understand Chargeability?

As per the provisions of Section 5(2)(b) of the Act, the total income of a non-resident also includes all income which accrues or arises or is deemed to accrue or arise in India to the non-resident.

To check whether the income of the non-resident is deemed to accrue or arise in India—we have to refer Section 9. If the income is deemed to accrue or arise in India, then the payer is liable to withhold taxes in India.

Further, TDS u/s. 195 is also required to be withheld at the time of making provision on accrual basis the payee is identified, and amount is ascertainable. "Any person who is responsible for paying any sum being royalty or fees for technical services to a non-resident / foreign company carrying on business through a Permanent Establishment (PE) in India shall deduct tax u/s. 195 of the Act at the rate of tax at applicable rates."

In the case of GE India Technology Centre (P) Ltd. (supra) in the context of s. 195(1), interpretation of the word "chargeable" under the provisions of IT Act has been made by which it is clarified that a person paying interest or any other sum to a non-resident is not liable to deduct tax if such sum is not chargeable to tax under the IT Act. Further, the Court clarified where there is no obligation on the part of the payer and no right to receive the sum by the recipient and that the payment does not arise out of any contract or obligation between the payer and the recipient but is made voluntarily, such payments cannot be regarded as income under the IT Act.

2. Applicability of TDS and Thresholds

Unlike payments to residents, where TDS may be applicable only after certain thresholds are exceeded, there is no threshold limit under Section 195. This means that even if a small payment is made to a non-resident, TDS must be deducted, provided the payment is chargeable to tax in India.

3. Role of Double Taxation Avoidance Agreement (DTAA)

India has signed DTAAs with more than 90 countries to avoid double taxation of the same income. Under the DTAA, non-residents can benefit from a lower TDS rate, provided they meet the required conditions.

The payer (the person making the payment) must check the DTAA between India and the non-resident's country of residence to determine the applicable rate. Non-residents must submit a Tax Residency Certificate (TRC) to the payer, confirming their tax residency in a particular country, No PE certificate and Form 10F to claim DTAA benefits. If the DTAA offers a lower TDS rate than the Income Tax Act, the payer can deduct TDS at the lower rate.

For instance, the TDS rate on royalty payments under the Income Tax Act may be 10%, but if the DTAA with the non-resident's country prescribes a rate of 5%, TDS can be deducted at the lower rate.

4. Common Payments to Non-Residents and TDS Rates

The TDS rates vary depending on the type of payment and whether a DTAA is applicable. Here are some of the common payments made to non-residents along with the TDS rates as per the Income Tax Act and relevant DTAA's:

SL No.	Type of Payment	TDS Rate under Income Tax Act	DTAA Rates (example)
A	Dividend	20%	5%-15%
B	Interest	20%	10%
C	Royalty	20%*	10%-15%
D	Long Term Capital Gains as per 115E	10%	Varies
E	Long-term capital gain from listed shares and securities referred to in Section 112A	10%	Varies
F	Any other long-term capital gain	20%	Varies

* The Finance Act 2023 was introduced last year. One of the amendments is to increase the tax rate on royalty and FTS from 10 per cent to 20 per cent (plus surcharge and cess tax) with effect from 1 April 2023. As per provisions of the Act, a non-resident can opt to be taxed as per the domestic tax provisions or tax treaty entered between India and the country of residence of the taxpayer or the Act, whichever is more beneficial.

Considering tax treaties with major countries (e.g. United Kingdom, Canada and the United States of America) provide for a tax rate of 15 per cent, many non-residents receiving royalty and FTS were opting for the tax rate under section 115A of the Act. Furthermore, even in the case of the majority of the tax treaties (e.g. Belgium, Netherlands, Singapore) signed by India which provide for the tax rate of 10 per cent, the recipient non-residents were opting for section 115A due to specific exclusion of filing of tax return which is available to non-resident recipients if (i) such non-resident only had income from royalty/FTS from India and (ii) tax has been withheld from such income at a rate which is not lower than the rate provided under section 115A, which was formerly 10%.

However, pursuant to the amendment, the tax rate for royalty and FTS is doubled, and for the taxpayer a way forward to avoid the increased tax rate is to make use of the treaty benefit which would result in certain compliances which may include obtaining tax registrations, filing return of income in India, providing tax residency certificates, etc. detailed below.

5. Procedure to Deduct TDS on Payments to Non-Residents

Step 1: Determine the Non-Resident Status

The first step is to ascertain whether the payee is a non-resident as per Section 6 of the Income Tax Act. Residency is determined based on the number of days the individual or entity has stayed in India during the financial year.

Step 2: Identify the Nature of Payment

It is essential to correctly categorize the payment, whether it's for interest, royalty, technical services, or other forms of income. The nature of payment influences the applicable TDS rate.

Step 3: Check DTAA Applicability

Once the nature of the payment is determined, check if India has a DTAA with the non-resident's country of residence. If so, compare the TDS rates under the Income Tax Act and the DTAA, and apply the lower of the two rates.

- To claim benefit under the tax treaty, the non-resident needs to maintain specific documents and the resident payers are required to obtain the following documents:
 1. Tax residency certificate issued by the tax authorities of their country of residence
 2. No permanent establishment declaration is a certificate given by a non-resident, who is deriving any income from India (which could be interest, Fee for Technical Services, Business Income, etc.,)
 3. Electronically filed Form 10F on the Income Tax portal. Non residents not having a Permanent Account number (PAN) can also file this Form by registering themselves as "Non residents not holding and not required to have PAN" on the Income Tax Portal. A screenshot of the same is as under:

The screenshot shows the e-Filing portal interface. At the top, there is a header with the e-Filing logo and the text "e-Filing Anywhere Anytime" and "Income Tax Department, Government of India". Below the header, the main heading is "Let's Get Started". Under this heading, there is a section "Register as" with two buttons: "Taxpayer" and "Others". Below this, there is a section "Category *" with a dropdown menu. The dropdown menu is open, showing the following options: "Tax Deductor and Collector", "External Agency", "TIN 2.0 Stakeholders", "Chartered Accountant", "e-return Intermediary", and "Non-Residents not holding and not required to have PAN".

Step 4: Deduct and Deposit TDS

Once the applicable rate is determined, TDS should be deducted at the time of credit or payment, whichever is earlier. The deducted TDS must be deposited with the government within the stipulated timeline using Challan ITNS 281.

Step 5: File Form 15CA and Form 15CB

In cases of foreign remittances, the payer must furnish Form 15CA, and in certain cases, a Chartered Accountant's certificate in Form 15CB. Form 15CB certifies that the payment complies with tax laws and that appropriate TDS has been deducted.

Step 6: File TDS Return

The payer must file a quarterly TDS return using Form 27Q for payments made to non-residents. Additionally, a TDS certificate (Form 16A) must be provided to the non-resident payee.

6. Penalties for Non-Compliance

Non-compliance with the provisions of Section 195 can lead to severe penalties, including:

- Interest for failure to deduct TDS (1% per month for delay in deduction and 1.5% per month for delay in deposit).
- Penalty under Section 271C for failure to deduct TDS or deposit TDS.
- Disallowance of expenses under Section 40(a)(i), where the entire payment may be disallowed as a deduction while computing taxable income.

7. Conclusion

TDS on payments made to non-residents is a complex and critical aspect of international transactions. Businesses and individuals must ensure compliance with Section 195 of the Income Tax Act, consider the benefits of DTAA, and follow the correct procedures to avoid penalties.

By staying compliant with TDS provisions and leveraging the advantages of DTAA's, taxpayers can ensure smooth cross-border transactions without the risk of double taxation or tax disputes.

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Important Announcement

Hosting of Multipurpose Empanelment Form (MEF) - 2024-25

Professional Development Committee (PDC) is pleased to host the Multipurpose Empanelment Form (MEF) for the year 2024-25, which is available at <https://meficai.org/>. Before filling the Multipurpose Empanelment Form (MEF) for the year 2024-25, Members are advised to go through the Advisory. Information provided through MEF is shared by ICAI with RBI, NABARD and other authorities for the purpose of empanelment for professional work.:

Registration/ Login Credentials:

Applicant already registered for MEF in previous year/(s), may login using the credentials directly of previous year for MEF 2024-25. If one has forgotten the password, please go to "Forgot Password" button to retrieve the password.

Applicant applying for the first time, the applicant must first register for MEF 2024-25 at <https://app.meficai.org/register>.

Last date for submission of online Form is 7th October, 2024.

Professional Development Committee, ICAI