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A dissection of Section 195 of the Income Tax Act

TDS is required to be deducted where any person pays to a non-resident a sum which is chargeable under the provision of Income Tax.

The income which accrues or arises or is deemed to accrue or arises in India is taxable in India.

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Section 195 of the Income Tax deals with the deduction of TDS in case where the payment is made to a Non-Resident. The tax rate is 30% in case where the payment is to a person who is not a company and 40% where the payee is a Company. The tax rates being pretty high it makes sense to thoroughly examine if the tax could be saved within the given framework of the Act. Let us examine the provisions of the Section 195 of the Income Tax Act to understand the conditions where it is obligatory upon the payer to deduct Tax at source. The Section specifies that where any person is responsible for paying to a non-resident any interest or any other sum chargeable under the provisions of this Act shall, at the time of credit or payment deduct income-tax thereon at the rates in force. Here the most important requirement is that the payment being made should be chargeable to tax under the provisions of the Income Tax Act.

Now the question arises as how to determine if a transaction between a person based in India and a person sitting outside India will attract Indian Income Tax or not.

Let us therefore understand what is the scheme of taxation in India about a Non-Resident.

Section 5(2) specifies that the income of a non-resident will include all income from whatever source which is received or deemed to be received in India or Income which accrues or arises or is deemed to accrue or arises in India.

The term Accrue' connotes growth or accumulation with a tangible shape so as to be receivable. Arising' means 'coming into existence or notice or presenting itself. In a secondary sense, the two words together mean 'to become a present and enforceable right' and 'to become a present right of demand'.

The terms deemed to accrue or arisen has been explained in Section 9 which inter alia reads as under:

- The following incomes shall be deemed to accrue or arise in India--

(i) All income accruing or arising, whether directly or indirectly, through or from any **business connection** in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

Let us try to understand meaning of the term **"business connection"**. The term "business connection" has been interpreted by the Supreme Court to mean something more than mere business and is not equivalent to carrying on business, but a relationship between the business carried on by a non-resident, which yields profits and gains and some activities in India, which contributes directly or indirectly to the earning of those profits or gains. It predicates an element of continuity between the business of the non-resident and the activity in India [CIT Vs. R.D. Aggarwal and Company (1965) 56 ITR 20 (SC), Carborandum & Co. Vs. CIT (1977) 2 SCC 862 and Ishikawajma-Harima Heavy Industries ltd. Vs. Director of income Tax, Mumbai (2007) 3 SCC 481]. (Delhi High Court in **The Commissioner Of Income Tax ... vs Eon Technology P. Limited)**

The Circular No.786 dated 07.02.2000 states where the non-resident agent operates outside the country, no part of his income arises in India, and since the payment is usually remitted directly abroad, it cannot be held to have been received by or on behalf of agent in India. Such payments were therefore, held to be not taxable in India.

SC TURNS DOWN I-T DEPARTMENT'S APPEAL IN SAMSUNG HEAVY ENGINEERING'S CASE

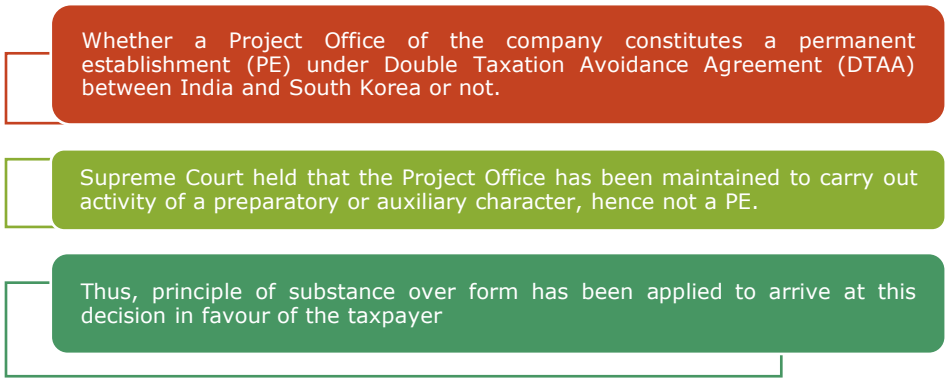

Figure 1: Summary of the case

The Supreme Court has rejected the Income-Tax Department's appeal in a case of Samsung Heavy Engineering on the question of whether a project office of the company constitutes a permanent establishment (PE) under Double Taxation Avoidance Agreement (DTAA) between India and South Korea or not.

The case here talks about awarding a turnkey contract in 2006 to a consortium comprising Korea-based Samsung Heavy Industries and Larsen & Toubro Limited. This contract was for carrying out the work of surveys, design, engineering, procurement, fabrication, installation and modification at existing facilities, and start-up and commissioning of entire facilities covered under the 'Vasai East Development Project'.

In order to set up a communication channel, Samsung set up a project office in Mumbai. Some activities under the contract took place abroad and then assembled here to be used in the project.

Following the tax law here for its project office, Korean company filed Income Tax Return for Assessment Year 2007-08 showing NIL profit and loss allegedly been incurred in relation to the activities carried out by it in India.

Dissatisfied with the return, the IT Department issued show cause notice. The matter moved from the Dispute Resolution Panel (DRP) to the Income Tax Appellate Tribunal to the High Court which ruled in the favour of company. Aggrieved by the high court order, the Income-Tax Department appealed in the Supreme Court. After nearly five years, the apex court finally disposed the matter.

According to apex court, the appeal by the I-T Department revisits the question as to the taxability of income attributable to a PE set up in a fixed place in India, arising from the 'Agreement for avoidance of double taxation of income and the prevention of fiscal evasion' with the Republic of Korea (DTAA)

Initially, income tax was charged on deemed/assumed profit of 25 per cent by tax officer, upheld by the DRP, which was sent back for reconsideration by ITAT, partially allowing the taxpayer's appeal. On appeal to the high court also, the Uttarakhand High Court allowed taxpayer foreign company's appeal only on the point that arbitrary profit rate of 25 per cent applied by tax authorities without examining whether the same is attributable to activities of the PE in India (i.e. Project Office) could not be sustained.

The apex court has not gone by nomenclatures and after perusal of all the relevant factual documents, has even rejected factual findings of ITAT (which is generally considered as final fact-finding authority under income-tax provisions).

"The Supreme Court has reinforced an important principle that instead of general perceptions and sweeping assumptions (that a project office would generally execute a project), tax liability can be imposed based on actual activities carried out by a taxpayer. Thus, principle of substance over form has been applied to arrive at this decision in favour of the taxpayer,"

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