

## FOREIGN COLLABORATION

### Some key points

- (a) The tax liability of a foreign collaborator and the Indian counter part is dependent on their residential status and the applicable provisions of DTAA, if any.
- (b) The residential status and the tax incidence are closely related. Also, the scope of income chargeable to tax hinges on their residential status.
- (c) Place where the income is received also has some bearing on the taxability of such receipt. An income received outside India when remitted to India it will not attract any tax in India for the simple reason that the same income cannot be received more than once (*Banaras State Bank Ltd v. CIT (1970) 75 ITR 167 (SC)*).
- (d) Receipt of capital sums in India is not chargeable to tax. Where the receipt of income is in some other form other than cash, the market value of the items received should be determined and such amount is assessable to tax. [*CIT v. Central India Industries Ltd 82 ITR 555 (SC)*].
- (e) Choice of the method of accounting and form of organization also has some influence in taxation of international transactions.

### Question 1

"X", while making payment to a non-resident for providing technical services on a world bank aided project "Net of Tax", had deducted tax as per rates prescribed but says that the payee is not entitled for the TDS certificate since the tax was not to be borne by the payee as per agreement. Examine.

### Answer

Section 195A provides that where under an agreement, the tax chargeable on any income is to be borne by the person by whom the income is payable, then, for the purpose of deduction of tax at source, such income shall be increased to such amount as would, after deduction of tax thereon, be equal to the net amount payable under the agreement. The CBDT has, vide Circular No.785 dated 24.11.99, clarified that even in those cases where the tax has been borne by the payer of income under an agreement, the payer is under a legal obligation to furnish a TDS Certificate as per the provisions of section 203 of the Income-tax Act, 1961. Therefore, the contention of Mr. X that the payee is not entitled for the TDS certificate is incorrect.

## Direct Tax Laws

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### Question 2

*The net result of the business carried on by a branch of foreign company in India for the year ended 31.03.2011 was a loss of Rs.100 lacs after charge of head office expenses of Rs.200 lacs allocated to the branch. Explain with reasons the income to be declared by the branch in its return for the assessment year 2011-12.*

### Answer

Section 44C restricts the allowability of the head office expenses to the extent of lower of an amount equal to 5% of the adjusted total income or the amount actually incurred as is attributable to the business of the assessee in India.

For the purpose of computing the adjusted total income, the head office expenses of Rs.200 lakh charged to the profit and loss account have to be added back.

The amount of income to be declared by the assessee for A.Y. 2011-12 will be as under:

| Particulars                                                                        | Rs.             |
|------------------------------------------------------------------------------------|-----------------|
| Net loss for the year ended on 31.03.2011                                          | (100 lacs)      |
| Add: Amount of head office expenses to be considered separately as per section 44C | <u>200 lacs</u> |
| Adjusted total income                                                              | 100 lacs        |
| Less: Head Office expenses allowable under section 44C is the lower of             |                 |
| (i) Rs.5 lacs, being 5% of Rs.100 lacs and                                         |                 |
| (ii) Rs.200 lacs.                                                                  | <u>5 lacs</u>   |
| Income to be declared in return                                                    | <u>95 lacs</u>  |

### Question 3

*A foreign company, ST, has entered into an agreement with an Indian Company KN for supply of know-how and the agreement is within the Industrial Policy conditions laid down by the Central Government. In the year 2010-11, Rs.50 lakhs was paid, under the agreement, to ST by KN.*

*ST claims to have spent Rs.14 lakhs as expenses in India to be recognized as a deduction.*

*In the following situations, what will be your decision on the tax liability of the parties:*

- The agreement having been entered into before 1<sup>st</sup> June, 2002 and approved by the Government, KN pays to the Indian income-tax authorities the tax payable by ST;*
- There is no agreement as to KN bearing the tax liability; the royalty payable is decided to be Rs.59 lakhs (net of taxes).*

**Answer**

- (i) As per section 10(6A), in the case of a foreign company deriving income by way of royalty or fees for technical services from the Government or an Indian concern under the terms of an agreement entered into before 1.6.2002 relating to a matter included in the industrial policy of the Central Government, the tax paid by the Government or an Indian concern on such income would not be included in the total income of the foreign company. Hence, such tax paid would be exempt in the hands of the foreign company.

Therefore, in the present case, the tax paid by KN will be exempt from tax in the hands of ST. In this case, section 195A is not applicable and consequently, the royalty of Rs.50 lakhs should not be grossed up. As per section 44D, where a foreign company receives income by way of royalty from an Indian concern in pursuance of an agreement made on or after 1<sup>st</sup> April, 1976 but before 1<sup>st</sup> April, 2003, no deduction is allowable in respect of any expense or allowance under sections 28 to 44C in computing such income.

The rate of tax is 20% as per section 115A(1)(b)(A), if the royalty is received in pursuance of an agreement made after 31.5.1997 but before 1.6.2005.

- (ii) Since there is no agreement as to KN bearing the tax liability, the benefit under section 10(6A) is not available. However, KN has to deduct tax at source on royalty payment to ST, a foreign company, as per section 195. Since in this case, KN has to pay the royalty of Rs.59 lakhs 'net of taxes' to ST, therefore, the royalty has to be grossed up.

*The tax liability of ST has to be computed as under:*

|                                              |           |
|----------------------------------------------|-----------|
| Net royalty income                           | 59,00,000 |
| Gross royalty income (59,00,000 x 100/79.40) | 74,30,730 |
| Tax on royalty of 74,30,730 @ 20.60 %        | 15,30,730 |

KN has to deduct this tax of Rs.15,30,730 at source under section 195.

**Question 4**

*XY Pvt. Ltd., a company having registered head office in Singapore, for the first time had carried out operations during the year 2010-11 of purchase of goods in India on four occasions. Immediately after purchase, the company exported the same to China. The total value of such exports was Rs.100 lakhs, on which it earned profits of Rs.20 lakhs, before the expenses of Rs.12 lakhs, which were directly paid by H.O. The company seeks your advice regarding its tax liability in India:*

*How much of income for the A.Y. 2011-12 shall be subjected to tax?*

**Answer**

Section 2(26) defines an "Indian Company". The proviso to section 2(26) states that for a company to be an Indian company, the registered or principal office should be in India. In this case, since the registered office is in Singapore, XY Pvt. Ltd. is not an Indian company.

## Direct Tax Laws

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A company, other than an Indian company, would be considered as resident in India only if the control and management is wholly in India. In this case, the control and management is not wholly in India and therefore, XY Pvt. Ltd. is a non-resident / not a domestic company.

XY Pvt. Ltd. is a non-resident assessee during the previous year relevant to assessment year 2011-12. As per Explanation (b) of section 9(1)(i), no income shall be deemed to accrue or arise in India to a non-resident through or from operations which are confined to purchase of goods in India for the purpose of export. XY Pvt. Ltd. had purchased the goods in India and thereafter exported the same in total to China and accordingly no income of the non-resident company shall be subject to tax for assessment year 2011-12.

### Question 5

*M/s. Kangaru Australia, a non-resident foreign company, had entered into a collaboration agreement on 21.02.2002 with an Indian company and was in receipt of the following payments during the previous year ended on 31.03.11. How do you deal with them for computation, in the case of M/s. Kangaru Australia?*

- (i) Interest on 8% debentures for Rs.50 lakhs issued by Indian company on 01.07.2010 in consideration of providing of technical know-how, manufacturing process and designs.
- (ii) Service charges @ 2½% of the value of Plant & Machinery for Rs.500 lakhs leased out to Indian company payable each year before 31<sup>st</sup> March.

### Answer

The foreign non-resident company had entered into a collaboration agreement with the Indian company and was in receipt of interest on debentures and service charges during the year. These incomes shall be subject to tax as under:-

- (i) The interest on debentures of Rs.3 lakhs, being 8% of Rs.50 lakhs, for the period from 1<sup>st</sup> July to 31<sup>st</sup> March (9 months) shall be chargeable as "Income from other sources".
- (ii) The service charges of Rs.12.50 lakhs for the year, being 2½% of the value of the plant & machinery of Rs.500 lakhs, will be a payment by the collaborator in the nature of royalty as per Explanation 2(iva) to section 9(1)(vi) and accordingly, will be subject to tax under section 115A(1)(b).

### Question 6

*Human Life Insurance Co. of U.K. conducted business in India during 2010-11. It seeks your advice for the computation of its income from Life Insurance business in India, in accordance with the provisions of Income-tax Act, 1961.*

### Answer

The income of Human Life Insurance Corporation of U.K. in respect of the business conducted in India shall be worked out in accordance with Rule-6 of First Schedule read with section 44 of the Act. The income chargeable to tax will be computed as under:

- (a) That proportion of the world income which corresponds to the proportion which its premium income derived from India bears to its total premium income.
- (b) The world income shall be computed in the manner as laid down in the Act for computing the profits and gains of life insurance business carried on in India.

**Question 7**

*M/s. Global Airlines incorporated as a company in USA operated its flights to India and vice versa during the year 2010-11 (April, 2010 to March, 2011) and collected charges of Rs.125 lakhs for carriage of passengers and cargo out of which Rs.65 lakhs were received in U.S Dollars for the passenger fare booked from New York to Mumbai. The total expenses for the year on operation of such flights were Rs.195 lakhs. Income chargeable to tax of the foreign airlines may please be computed.*

**Answer**

The income of Global Airlines is to be calculated and computed with reference to the provisions contained in section 44BBA on presumptive basis at the rate of 5 per cent of the total amount of passenger fares received and charges for handling of cargo, whether received in India or outside India. Therefore, the airlines is to be assessed on Rs.6.25 lakhs for the relevant assessment year, which is 5% of total collection of Rs.125 lakhs from flights to India and vice versa. The expenses incurred on operation of such flights are to be ignored.

**Question 8**

*A foreign company has entered into an agreement with an Indian company on 1<sup>st</sup> February 2002 under which industrial equipment belonging to the firms has been leased to the latter on an annual lumpsum payment of \$ 50,000. How will the lease rent be taxed in the hands of the foreign company in respect of assessment year 2011-12?*

**Answer**

Under clause (iva) of Explanation 2 to section 9(1) inserted w.e.f 01.4.2002, the expression "royalty" would include any lump sum consideration for the use of or the right to use of any industrial, commercial or scientific equipment. Under section 44D, no deduction will be allowed in respect of any expenditure or allowance in computing the income by way of royalty.

Under section 115A, income-tax payable on such royalty under an agreement entered into after 31<sup>st</sup> May, 1997 but before 1<sup>st</sup> day of June, 2005 will be 20%. This will be subject to the provisions of the Double Taxation Avoidance Agreement between India and the country in which the foreign company is assessed.

**Question 9**

*Write short notes on*

*Global depository receipts and their impact on non-residents*

### Answer

Under section 115AC, in the case of non-resident, the income by way of dividends, other than dividends referred to in section 115-O, on GDR's is subjected to concessional rate of tax.

Global Depository Receipts means any instrument in the form of depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares or foreign currency convertible bonds of issuing company.

The tax payable on both the dividend income and long-term capital gains, arising out of the transfer of GDR's will be 10%. No deduction under section 28 to 44C or section 57 will be allowed against such income. The deduction under chapter VI-A will be allowed only after reducing such income from the gross total income of the assessee. The benefits of indexation are also not available in computing capital gains arising on transfer of GDR's.

### Question 10

*Nadal, a tennis professional and a non-Indian citizen participated in India in a Tennis Tournament and won the prize money of Rs.15 lacs. He contributed articles on the tournament in a local newspaper for which he was paid Rs.1 lakh. He was also paid Rs.5,00,000 by a Soft Drink company for appearance in a T.V. advertisement. Although his expenses in India were met by the sponsors, he had to incur Rs.3,00,000 towards his travel costs to India. He was a non-resident for tax purposes in India.*

*What would be his tax liability in India for assessment year 2011-12? Is he required to file his return of income under section 139(1)?*

### Answer

Under section 115BBA, all the three items of receipts in India are chargeable to tax. No expenditure is allowable against such receipts. The rate of tax chargeable is 10 per cent, plus education cess @2% and secondary and higher education cess @1%. The total tax liability works out to Rs. 2,16,300 being 10.3% of Rs.21 lakhs.

Thus, Nadal will be liable to tax on the income earned in India. He is not required to file his return of income if (a) his total income during the previous year consists only of income arising under section 115BBA and (b) the tax deductible at source under the provisions of Chapter XVIII-B has been deducted from such income.

### Question 11

*A foreign company has the following two options before it for negotiation with an Indian company. It seeks your advice as to the incidence to tax, under the provisions of Income-tax Act, 1961, to exercise the better option.*

- (i) *Receiving royalty for the use of rights of manufacturing process*
- (ii) *Outright sale of manufacturing process.*

**Answer**

The use of a manufacturing process yields a return by way of royalty and the tax thereon is leviable at 20% under section 115A (1) clause (b) if the agreement made before 1<sup>st</sup> June 2005. Where the agreement is made after 1<sup>st</sup> June 2005, the rate of tax shall be 10%.

The agreement governing the payment of royalty should be approved by the Central Government or where it relates to a matter included in the industrial policy, it should be in accordance with that policy.

The sale of manufacturing process would yield capital gain which is also chargeable to tax at 20% under section 112(1) clause (c). Therefore, under either option, the incidence of tax is the same if the agreement is made before 01-06-2005. If the agreement is made after 01-06-2005 then it would be beneficial to offer the income as per section 115 A instead of section 112 (1)(c) as the tax rate applicable would be @ 10%.