

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 (*Benares State Bank Ltd v. CIT (1970) 75 ITR 167 (SC)*).
- (d) 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.

Question 2

The net result of the business carried on by a branch of foreign company in India for the year ended 31.03.2014 was a loss of ₹100 lacs after charge of head office expenses of ₹200 lacs allocated to the branch. Explain with reasons the income to be declared by the branch in its return for the assessment year 2014-15.

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 ₹ 200 Lacs 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. 2014-15 will be as under:

Particulars	₹
Net loss for the year ended on 31.03.2013	(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) ₹ 5 lacs, being 5% of ₹ 100 lacs and	
(ii) ₹ 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 2013-14, ₹ 50 Lacs was paid, under the agreement, to ST by KN.

ST claims to have spent ₹ 14 Lacs 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 1st June, 2002 and approved by the Government, KN pays to the Indian income-tax authorities the tax payable by ST;
- There is no term in the agreement that KN has to bear the tax liability; the royalty payable is decided to be ₹ 59 Lacs (net of taxes) instead of ₹ 50 Lacs.

Answer

- 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 ₹ 50 Lacs 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 1st April, 1976 but before 1st 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 25% as per section 115A(1)(b)(A), if the royalty is received in pursuance of an agreement made after 31.3.1976.

- (ii) Since there is no term in the agreement that KN has to bear 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 ₹ 59 lacs '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 ($₹ 59,00,000 \times 100/74.25$)	79,46,128
Tax on royalty of ₹ 79,46,128 @ 25.75 %	20,46,128

KN has to deduct this tax of ₹ 20,46,128 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 2013-14 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 ₹ 100 Lacs, on which it earned profits of ₹ 20 Lacs, before the expenses of ₹ 12 Lacs, 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. 2014-15 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.

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 2014-15. As per *Explanation 1(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 2014-15.

Question 5

M/s. Global Airlines incorporated as a company in USA operated its flights to India and vice versa during the year 2013-14 (April, 2013 to March, 2014) and collected charges of ₹ 125 lacs for carriage of passengers and cargo out of which ₹ 65 lacs 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 ₹ 195 lacs. Compute the income chargeable to tax of the foreign airlines.

Answer

Under section 44BBA, a sum equal to 5% of the aggregate of the following amount is deemed to be the profits and gains chargeable to tax under the head "Profits and gains of business or profession" in respect of a non-resident, engaged in the business of operation of aircraft -

- the amount paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and
- the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

In the present case, the income chargeable to tax of M/s Global Airlines is as follows

Particulars	Fare booked from India to outside India whether received in India or not (₹)	Fare booked from New York to Mumbai	
		If received in India (₹)	If not received in India (₹)
Fare	60,00,000 (1,25,00,000 – 65,00,000)	65,00,000	65,00,000
Deemed income @5% under section 44BBA	3,00,000 (60,00,000 × 5%)	3,25,000 (65,00,000 × 5%)	Nil

Question 6

A foreign company has entered into an agreement with an Indian company on 1st 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 2014-15?

Answer

Under clause (iva) of *Explanation 2* to section 9(1)(vi), 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 31st March, 1976 will be 25%. 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.

Self-examination Questions

1. Discuss the taxability of the following income in the hands of a non-resident -
(a) Interest income; (b) Royalty; (c) Fees for technical services.
2. Who are representative assesseees? Discuss the rights and liabilities of a representative assessee.
3. Discuss the different forms in which foreign collaboration may be made and the tax implications involved therein.