

INSIGHT: India—Nonresidents Exempt from Filing Income Tax Return

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The requirement to file a tax return in India is provided under Section 139(1) of the Indian Income-tax Act, 1961 (the Act), whereby all companies are required to furnish an income tax return irrespective whether the income earned by them (which has territorial nexus with India) is chargeable to tax in India or not (see Castleton Investment Ltd and XYZ/ABC Equity Fund for such obligation on foreign companies).

Section 115A(5) of the Act provides relief to nonresident taxpayers who derive dividend and/or interest income from the requirement to furnish a tax return in India, subject to the condition that the tax has been withheld by the Indian payer in terms of the provisions of the Act.

At present, no such exemption is available to nonresidents deriving income by way of “royalty” or “fees for technical services” (FTS), subject to tax in India under clause (b) of sub-section (1) of Section 115A of the Act.

In the Finance Bill, 2020, which was tabled in the Lower House of the Parliament on February 1, 2020, provisions of Section 115A of the Act are proposed to be amended to extend the exemption from the requirement to furnish tax returns in India to nonresidents deriving income by way of royalty or FTS, where tax has been withheld at source.

The amended provisions, however, require that the above exemption of not filing the return of income would apply only where the rate at which tax is with-

held by the Indian payer is not lower than the tax rates prescribed under Section 115A(1) of the Act.

In other words, the previous option to not file a tax return in India would be available to nonresidents only if they were to let go the benefit of the nil or lower rate of taxation of such incomes as per the double taxation avoidance treaty (the Treaty) which India has entered into with their country of residence.

Therefore, a nonresident taxpayer will not be required to file a tax return in India if the following conditions are cumulatively satisfied:

- the total income consists of dividend or interest income as referred to in clause (a), or royalty or FTS income of the nature specified in Section 115A(1)(b) of the Act; and

- tax on such income has been withheld at source under the provisions of Chapter XVII-B, at the rates which are not lower than the prescribed rates under Section 115A(1) of the Act.

These amended provisions are proposed to be applicable with effect from assessment year 2021–22 (i.e. financial year 2020–21).

**Reduced Compliance Burden. . .Only in
Selected Cases**

The proposed amendment, aimed at reducing the compliance burden of nonresident taxpayers in India, will promote the government’s “Ease of Doing Business” initiative.

Under the amended provisions of Section 115A of the Act, a nonresident taxpayer will still be required to file an income tax return in order to avail the benefit of provisions of the Treaty, inter alia, for:

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- a lower tax rate provided in the Treaty;
- non-application of surcharge and/or education cess, which is otherwise leviable under the Act;
- the benefit of “make available” clause or performance rule provided in the Treaty;
- the benefit of Article 7 (Business Profits) where the Treaty does not contain the FTS clause and such company does not have permanent establishment in India.

The proposed amendment will bring relief to nonresidents based in Australia, Belarus, Brazil, Bulgaria, Canada, Denmark, Jordan, Kyrgyz Republic, Mauritius, Mongolia, Nepal, Oman, Philippines, Poland, Turkey, U.K. and U.S. where the tax rate in case of “royalty” prescribed in the respective tax treaties is higher than the rate prescribed in the Act.

In the case of nonresidents based in Belarus, Bulgaria, Denmark, Jordan, Kyrgyz Republic, Mongolia, Oman, Poland, Spain, Turkey, U.K. and U.S., the amendment would be beneficial if they derive income in the nature of FTS since the tax rate prescribed in the respective tax treaties is higher than the rate provided in the Act.

The proposed amendment would also be beneficial to residents of Australia, Canada, U.K. and U.S. in case the benefit of the “make available” clause available in the respective tax treaties is not to be availed in respect of income earned by way of FTS.

In cases where the Indian payer has withheld tax at source at a higher rate, for instance, where the nonresident has not obtained a Permanent Account Number (PAN) in India, the person will be required to file an income tax return in case the excess tax withheld is sought to be claimed as refund.

In several cases, considering the onerous consequences of non-withholding of tax at source, the Indian payer, in respect of issues that are controversial, may have withheld tax even when there was no obligation to do so to avoid litigation. For example, in case of reimbursement of expenditure, payment for purchase of standardized software, recharge of expatriates’ salary, etc. In such cases too, the nonresident person shall be required to file an income tax return in order to claim a refund of tax withheld at source.

The foreign tax authorities may require the nonresident to furnish a copy of the income tax return filed in India for allowing claim of foreign tax credit qua taxes withheld in India, in some cases. This may be required to ensure that such a person has not claimed a refund of tax withheld in India.

The amended provisions of Section 115A have increased the compliance burden for a nonresident who earns income in the nature of “interest” and/or “dividend” and wish to avail the benefit of a treaty.

For instance, as per the existing provisions, a U.K. company deriving interest income on monies lent to an Indian company under Section 115A(1)(a)(ii) will be exempt from filing a tax return as per the existing provi-

sions if the Indian payer has withheld tax at source at the tax rate of 15% prescribed under the India-U.K. Treaty (as opposed to the tax rate of 20% plus applicable surcharge and cess prescribed under the Act).

However, as per the amended provisions, the U.K. company would now be required to file a tax return in India since the withholding tax rate as per the India-U.K. Treaty is lower than the rate prescribed under the Act.

Nonresidents Deriving Dividend Income from India

As per the existing provisions of the Act (Section 115-O) an obligation is imposed on every Indian company to pay dividend distribution tax (DDT) on profits distributed by way of dividend and the sum received by the shareholder (resident/nonresident) is exempt from tax.

The Finance Bill, 2020 has proposed to abolish the DDT and revert to the traditional system of taxing dividends in the hands of respective shareholders. Section 115A provides a tax rate of 20% in case of dividend income opposed to a rate of 5%/10%/15% in various treaties.

Going forward, in order to claim the benefit of a lower tax rate available in the Treaty, the foreign company will be required to file a tax return in India. Further, it will be mandatory to file a tax return in cases where the tax is withheld by the Indian company at the beneficial rate prescribed in the Treaty—a requirement that did not exist previously.

Further, the Indian company paying dividends will be required to withhold tax at source under Section 195 at the rate of 20% (for nonresident Indian)/30% (in case of other nonresidents and LLP)/40% (in case of foreign companies) increased by an applicable surcharge and cess.

However, such nonresidents are liable to pay tax on dividend income at the rate of 20% under Section 115A of the Act. Therefore, nonresident taxpayers, in order to claim refund of excess withholding taxes, will be required to file a tax return in India even in cases where tax is withheld at source at the rates in the Act.

Transfer Pricing Compliance

Under the proposed regime, no relaxation has been provided in respect of transfer pricing compliance. Accordingly, the foreign company is still required to file a transfer pricing certificate in Form 3CEB, and prepare and maintain transfer pricing documentation prescribed under Section 92D.

The due date of filing Form 3CEB has changed to October 31 (from November 30) each year.

In cases where the foreign company is not required to file an income tax return in India, it is advisable that sufficient documentation, namely invoices, withholding tax certificates, underlying agreements, etc. is main-

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tained each year. This will help the companies to respond effectively respond to any queries raised by the Indian tax authorities.

The exclusion of cases to which the proposed amendment is sought to be made inapplicable, i.e. where the nonresident claim relief under a treaty is in line with the principal purpose test introduced in Article 7 of the Multilateral Instrument. The government intends to maintain a record of such cases in order to scrutinize them, if needed.

Way Forward

By way of the proposed amendment, the government seeks to reduce the compliance burden of nonresident taxpayers deriving income by way of royalty or FTS from India subject to the condition that such nonresident does not avail benefit of a Treaty.

However, due to the abolition of DDT, nonresidents deriving dividend income from India will now have to mandatorily file a tax return in India, particularly to claim refund of excess taxes withheld at source.

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