

INDIA



Withholding tax obligations of Indian resident payers – practically uncertain



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Under Indian tax laws, a person making payments to a non-resident must withhold applicable taxes or face penal consequences.

In a recent decision of the Karnataka High Court involving Samsung Electronics (2009-TIOL-629-HC-KAR-IT), it was held that an Indian resident must withhold tax from a payment to a non-resident which is “income” in the hands of the non-resident. Until this ruling, the generally accepted view was that tax had to be withheld by a resident payer only if the payment was “liable to tax” in India. As a result of the Court’s decision, every payer would now need a nil withholding tax certificate from the Tax authorities if he feels that the payment to be made to a non-resident is not taxable in India.

In this case, Samsung-India (SI) imported software from its parent Samsung-Korea (SK). SI did not withhold tax on payments made to SK since it believed that such payments were not “royalties”, and hence not taxable. The Tax authorities disagreed.

On appeal, the Court held that a resident payer’s liability to withhold tax takes effect the moment payment is to be made to a non-resident which is prima-facie in the nature of “income”. The Court observed that withholding tax provisions under Indian tax laws were subject to final determination of the tax liability of the concerned non-resident by the Tax authorities.

The judgment leads to some critical practical issues, although unintended. Practically, the characterisation of income is a necessary pre-requisite to determine the tax rates and, consequently, is a must to determine the taxability of payments to non-residents. Pursuant to this judgment, it may be possible for a “royalty” payment that is taxable at a lower rate of 10 percent (compared to “business income” which is taxable at 40 percent), to be liable to withholding

tax at the higher rate of 40 percent. In addition, the judgment also seems to suggest that in a withholding tax certificate application, the Tax authorities can only determine the taxable ‘proportion’ of the income and not the taxability of the non-resident recipient.

Furthermore, the attention of the Court was not directed to the fact that a resident payer is also permitted by the Government to remit payment to non-residents by obtaining a Chartered Accountant’s certificate, certifying that the concerned payment is either not taxable in India or is taxable at a particular rate.

This decision is now before the Supreme Court, which has granted a stay on the recovery of tax demand until further

order. The verdict of the Supreme Court on the merits of the case will come in due course. Until the final outcome of that Court’s judgment, the Tax authorities, based on this decision of the High Court, may take a view that tax-payers would need to approach Tax authorities to obtain a nil or lower withholding certificate (instead of remitting payments based on a Chartered Accountant’s certificate) for every payment to be made to non-residents. However, legally speaking, the judgment of the High Court would not be binding on tax-payers based in jurisdictions other than Karnataka.

All in all, for the time being, the modalities of withholding tax obligations remain unclear. It is hoped that the Supreme Court judgment will provide clarity on such critical issues arising out of the Samsung judgment.

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