THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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Pune Branch of WIRC of ICAI

N E W S L E T T E R

November 2023

ISSUE NO. 11

CHAIRMAN'S MESSAGE

CA Rajesh Agrawal

Chairman

Pune Branch of WIRC of ICAI

Dear Members & Students,

Greetings of the Season!

Wish you all the very Happy Diwali!

Month of November always sets in a happy mood since almost all the audit work, income tax work is almost over exception being the Transfer pricing specialists and few others. This is a month where we can plan new things, learn latest issues, update ourselves about newer techniques etc. With this in mind, your branch also has planned various activities, courses and sessions. Despite the GST deadline still looming overhead I'm sure the members are keen to take a break from the routine.

We conducted "GST Pathshala" where we covered Supply including Mixed & Composite Supply, Schedule I, II & III and Recent Trends in Litigation with respect to Input Tax Credit, Valuation & Place of Supply Registration & Composition Scheme, Provisions related to Documentation, E-way Bill & E-invoice, Provisions & Recent Trends in Reverse Charge Mechanism and Time of Supply & Classification with the motive to make concept of GST strong.

It is very evident that how global organizations and professionals have embraced and implemented generative artificial intelligence over the past year, providing an in-depth look into the impact of emerging technical skills in the workplace.

Considering the same, we have arranged Seminar on Artificial Intelligence & ChatGPT as well as Full Day Workshop on Technology jointly with Pune WICASA and received great response.

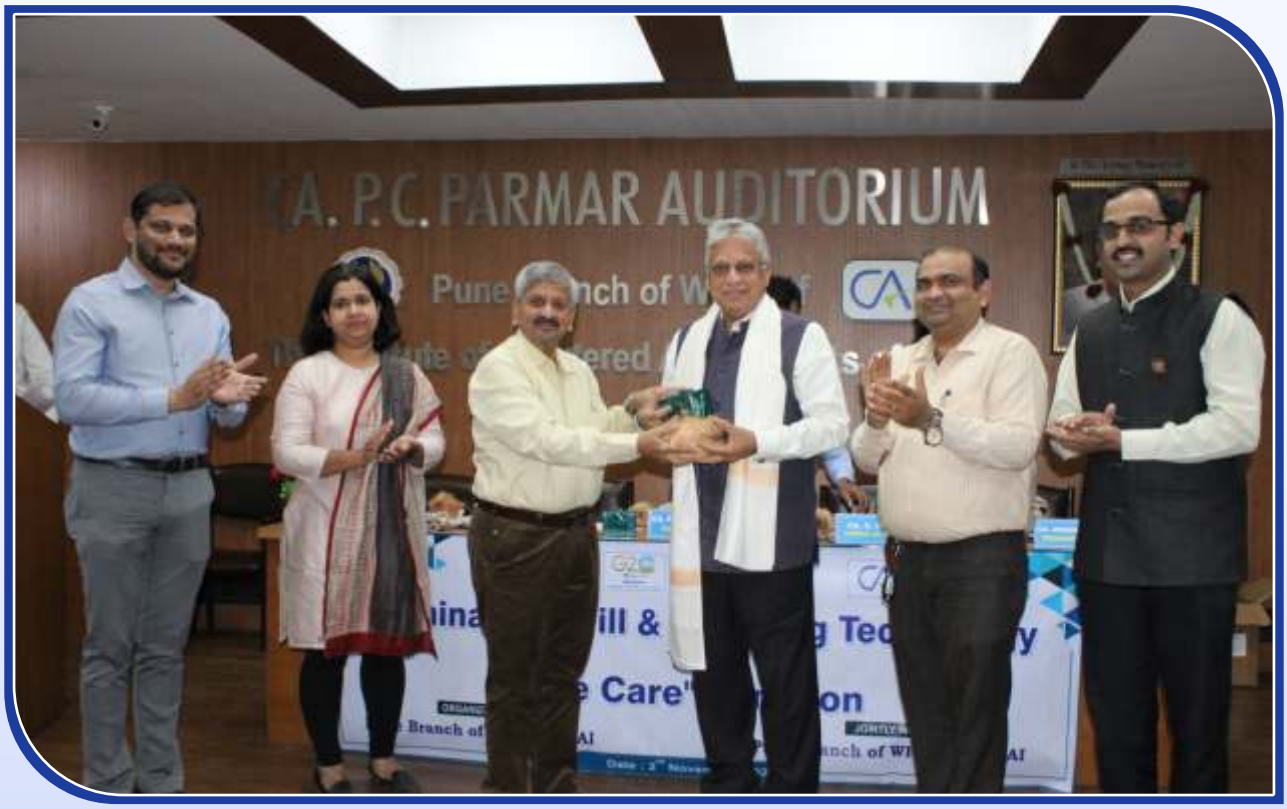
As we know, Diwali is one of the biggest festival of our country and it symbolizes the spiritual "victory of light over darkness, good over evil, and knowledge over ignorance" and to celebrate the same, we have arranged ICAI Family Week - Celebrating Togetherness (Diwali Celebrations) and same was attended by more than 350 participants.

Do not forget to share your ideas, views and thoughts on any and every matter related to the branch. Assuring you that we shall definitely consider and response to each and every email, message and verbal communication.

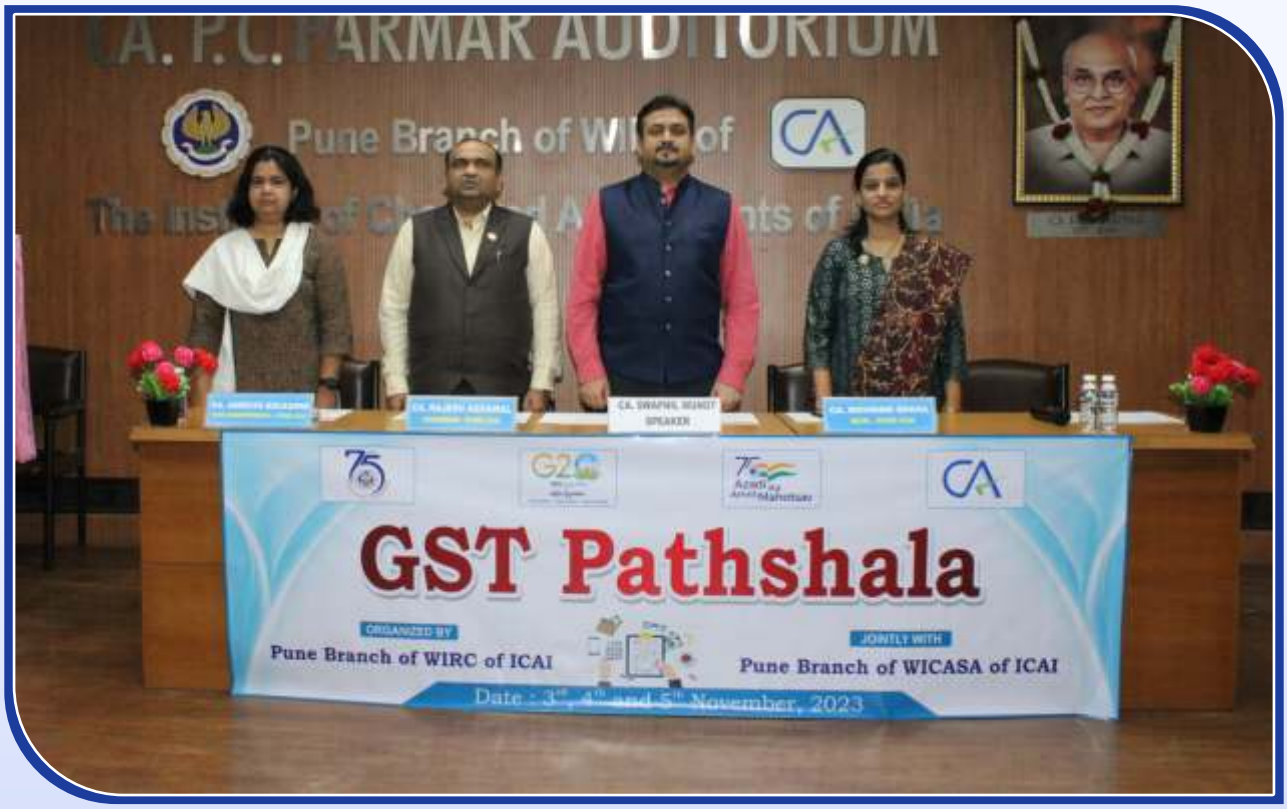
Once again Wishing you a peaceful and joyous Diwali! May the diyas and candles of Diwali dispel the darkness from your life and fill it with radiance and positivity. This Diwali filled with laughter, delicious feasts, and cherished moments with family and friends.

"The aim of education is to manifest in our lives the perfection, which is the very nature of our inner self."
- Swami Vivekananda

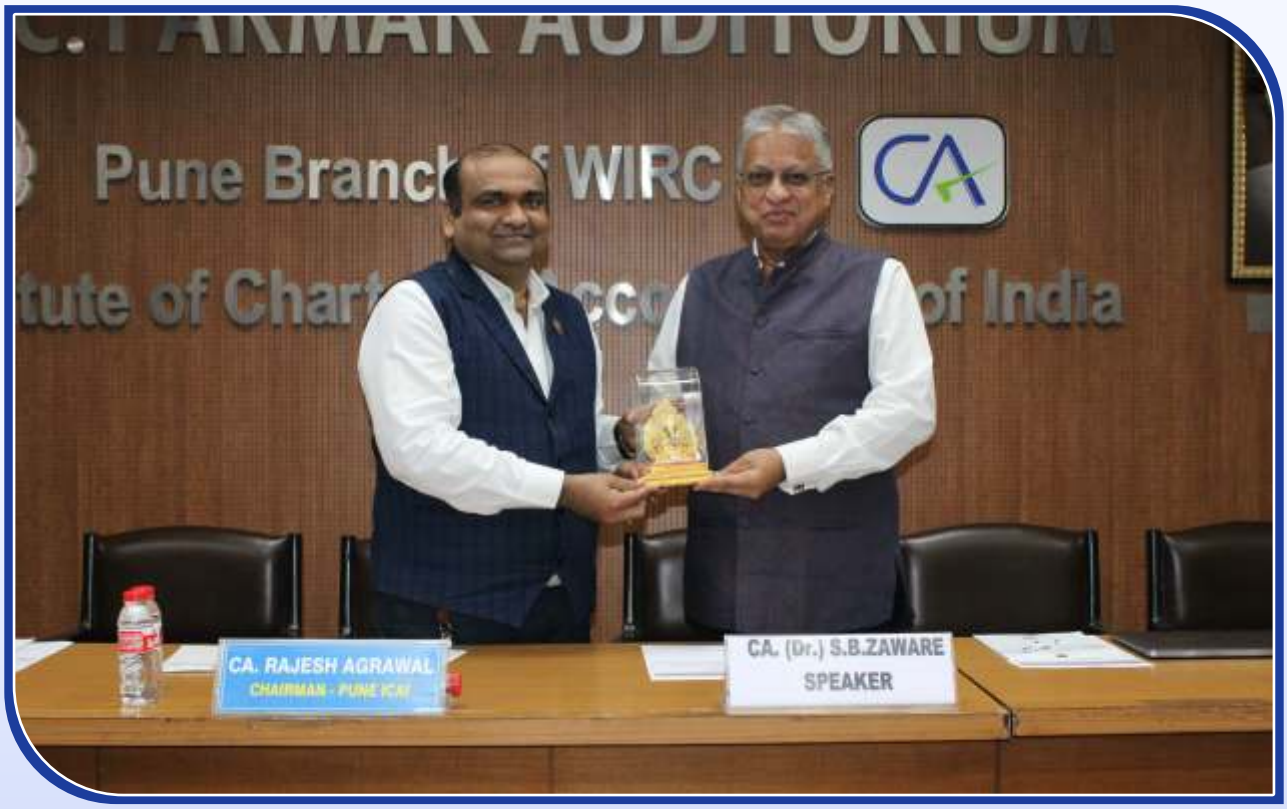
SEMINAR ON WILL & ADOPTING TECHNOLOGY & "WE CARE" FUNCTION : 2ND NOVEMBER 2023



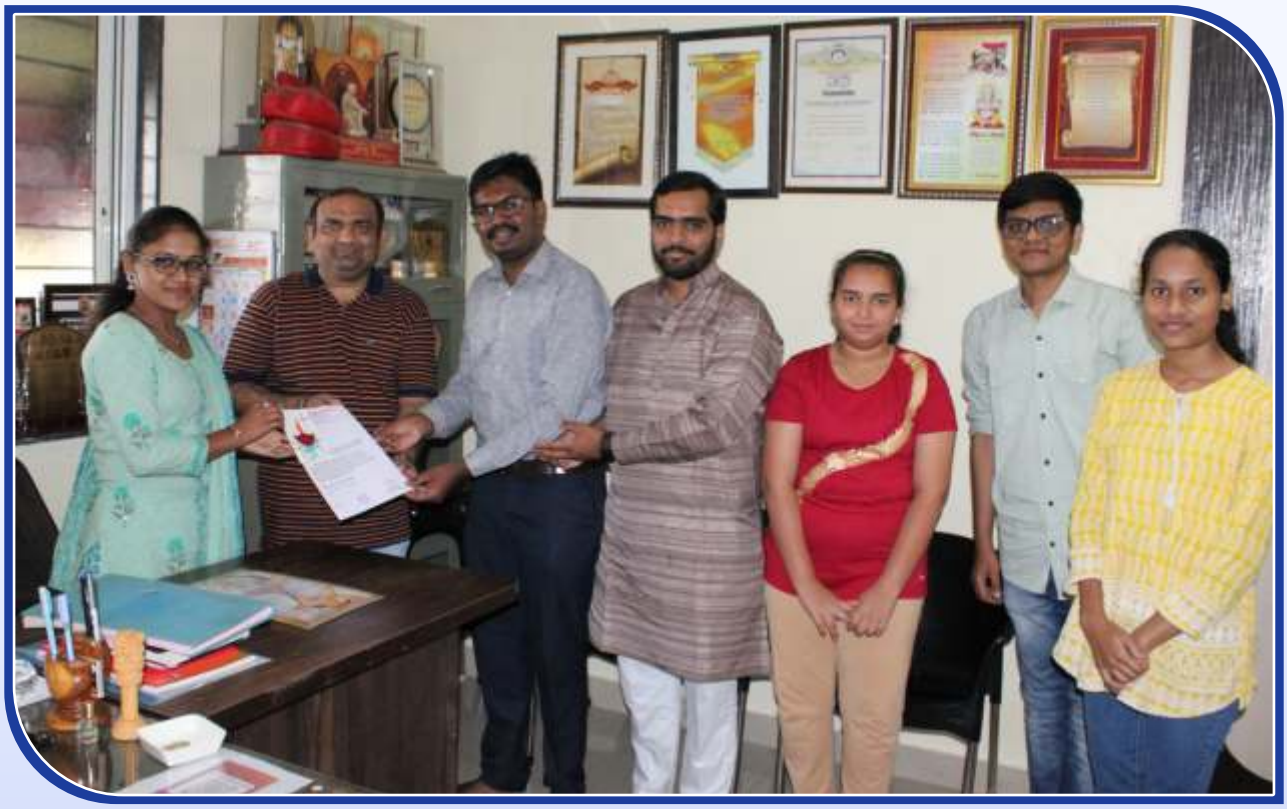
GST PATHSHALA : 3RD TO 5RD NOVEMBER 2023



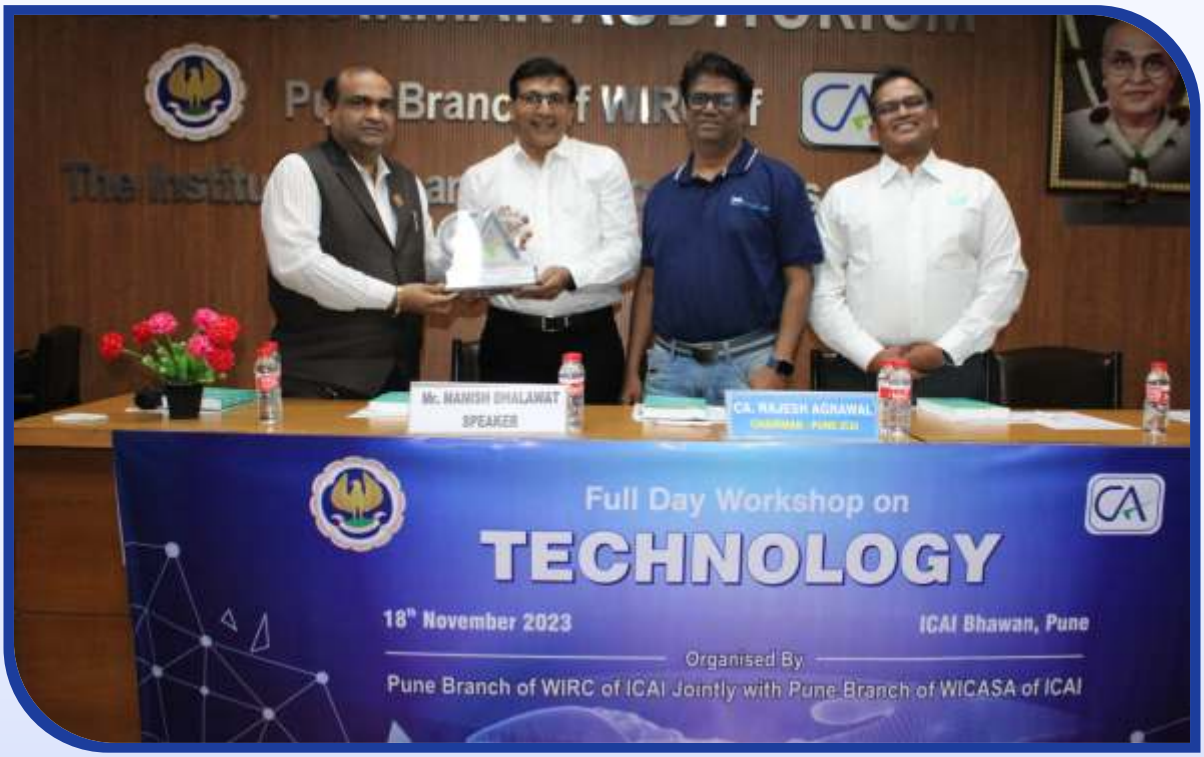
SEMINAR ON ACCOUNTING STANDARDS FOR MSME : 8TH NOVEMBER 2023



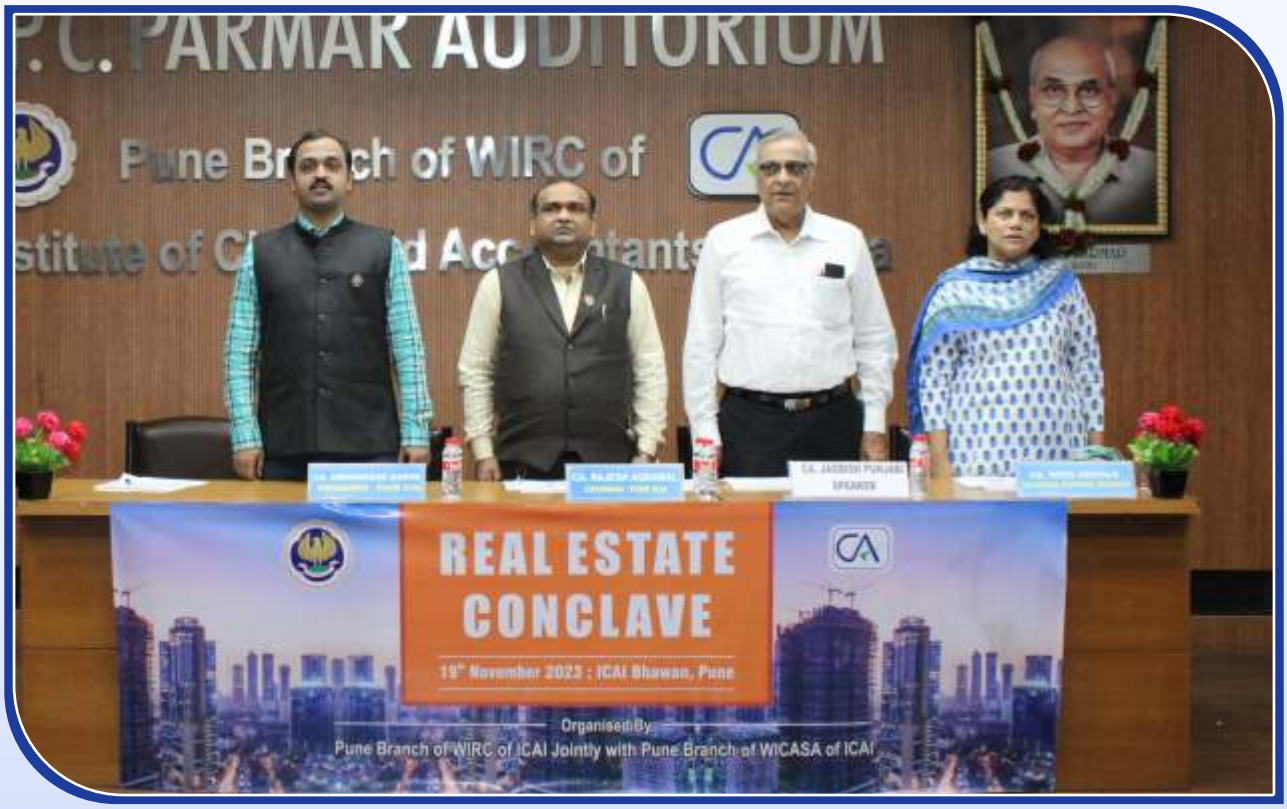
CSR ACTIVITY : 11TH NOVEMBER 2023



FULL DAY WORKSHOP ON TECHNOLOGY : 18TH NOVEMBER 2023



REAL ESTATE CONCLAVE : 19TH NOVEMBER 2023



CFO MEET : 30TH NOVEMBER 2023

Ambiguous Income-tax provisions governing tax deduction at source make sale of Indian assets a taxing affair for NRI's settled abroad.

General context

Recent times have seen an interesting new trend in the whole NRI property debacle - NRIs from North America and Europe coming back to India to sell their purchased or inherited assets after they obtain citizenship in these countries. This is not a trend that has been extensively examined, but it makes perfect sense. Holding on to real estate is not always feasible if one is unable to manage them.

This is especially true if the NRIs in question do not visit India frequently and are not open to renting out their properties. They prefer not to burden relatives and friends with the task of paying property tax, maintenance and society dues and see more sense in encashing the capital value of their inherited properties.

Selling such real estate is usually not the biggest challenge. What has created confusion in the minds of NRI sellers is the quantum of sales proceeds which would be available for immediate repatriation to the country of residence post deduction of Indian taxes. Main culprit for this confusion reigning in the minds of NRI sellers and taxmen around the country is the ambivalent interpretations arising out of relevant provisions of the Income Tax Act,1961 (hereinafter referred to as 'Act') and diverse interpretations arrived thereof by various judicial authorities.

What are the relevant provisions of Act?

In a transaction involving sale of Indian assets by a Non-resident seller, one would need to take into consideration following provisions of the Act to arrive at the quantum of taxes required to be deducted at source before making payment to a Non-resident seller–

? S. 5 of the Act provides for the scope of income taxable in India in case of non-residents. S. 5(2) of the Act provides that income which is received; accrues or arises; or is deemed to accrue or arise to a non-resident in India is taxable under the Act.

? S.9(1)(I) of the Act states that any income accruing or arising on transfer of an asset situated in India shall be deemed to have been accrued to the assessee or earned by the assessee in India and shall be chargeable to Indian Income-tax in accordance with other provisions of the Act.

? S. 45 of the Act provides that any profits or gains arising from the transfer of a capital asset effected in the previous year shall be chargeable to tax under the head "Capital gains" and shall be deemed to be income of the previous year in which the transfer took place.

? As per S. 48 of the Act, for computing capital gains, full value of consideration received on transfer is to be reduced by the expenditure on transfer and the cost of acquisition or improvement. However, this computation is subject to certain adjustments as required by the second proviso to S.48, widely known as "Indexation" provision. Taking into consideration the indexation provision, seller arrives at amount of capital gain / loss chargeable to tax in India.

? As per S.112(1)© of the Act, long term capital gains earned by a non-resident seller is chargeable to tax at a rate of 20% (exclusive of surcharge and education cess).

? As per S. 195(1) of the Act, any person responsible for paying to a non-resident, or to a foreign company, any interest or any other sum chargeable under the provisions of this Act shall, at the time of credit of such income to the account of the payee or at the time of payment thereof by any mode, whichever is earlier, deduct income-tax thereon at the rates in force.

A cumulative reading of the above provisions results in taxability of capital gains arising in the hands of a non-resident, in India if the capital assets is situated in India.Therefore, the buyer of such capital asset is expected to deduct Tax at source(Popularly known as TDS) at the rate prescribed by the Act while remitting such capital gain to the nonresident seller.

Bone of contentions on the amount of tax deduction to be made before making payment to NRI sellers

Given the ambiguous wording of aforesaid S.195 of the Act, one could arrive at two possible tax interpretations which have been stated below:

? View 1: Income-tax is required to be deducted on entire sale consideration payable to the non-resident seller.

? View 2: Income-tax is required to be deducted only on amount of capital gain computed in accordance with provisions of the Act.

Aforesaid issue has come up time and again for adjudication before various judicial authorities wherein following issues were primarily raised by various parties to the law suits:

? Whether the buyer is liable to deduct income-tax on the sum paid to non-resident seller, where the seller is not deriving any capital gain on such transaction.?

? If sum paid to non-resident does not wholly represent income for seller, whether taxes are required to be deducted on total consideration payable or only on the capital component in the said sum? and

? Can the payer himself determine the amount of tax to be deducted at source by making appropriate capital gain computation or does he have to compulsorily obtain a lower withholding certificate from assessing officer?

Detailed analysis of diverse interpretations and supporting arguments:

View 1: Income-tax is required to be deducted on entire sale consideration payable to the nonresident seller.

? Per provisions of S.5 read with S.9 read with S.45 of the Act, capital gain/loss earned on sale of a specified capital asset is chargeable to Indian Income-tax. Further, Supreme Court in case of Harprasad & Co (P) Ltd Vs CIT (99 ITR 118) held that loss is a negative income chargeable to tax. Given that S.195 mandates payer to deduct taxes while making payment of any sum chargeable to tax as per the Act, sale proceeds payable to non-resident seller would attract tax deduction even if seller has incurred capital loss on sale transaction.

? Legislative authorities have introduced a specific provision S.195(2) of the Act whereby only an assessing officer is authorized to compute amount of income component involved in a gross payment made to non-resident payee. Given the restricted scope of the specific provision, one could argue that legislative authorities did not intend to allow a payer to compute amount of income component involved in a gross payment made to a non-resident payee.

? Circulars issued by tax department have been recognized as substantive evidence by Indian judicial authorities to comprehend intention behind the introduction of particular provision in the Act. Circular No. 528 dated 16th December 1988 specifically states that S.195(2) has been introduced to enable an assessing officer to determine the income component of the payment made to non-residents through a general or special order in any case which may arise rather than giving general powers to an assessee to determine income in a prescribed manner.

? Departmental circular No. 1/2009 further clarifies that intention behind introduction of S.195 and restricting the authorization to compute income component to tax officers is to ensure that taxes are collected at the stage when remittance is made as it may not be possible to recover taxes from a non-resident payee at a later stage. Given that the intention is to prevent future tax leakage, provisions of S.195 need to be given a strict interpretation.

? It is a well-settled judicial position that a set of inter-connected tax provisions should be interpreted in a holistic manner to arrive at the intention and mechanism of said provisions. In thepresent context, scheme of tax deduction at source for payments made to non-residents should be interpreted considering the provisions of S.195 and S.197 of the Act. A holistic interpretation of said provisions makes it clear that the expression "any other sum chargeable under the provisions of this Act" would mean any sum which is chargeable to tax either in its entirety or a part thereof. In other words, the scheme of tax deduction at source applies not only to the amount paid which wholly bears the character of income chargeable to tax, but also to the gross payments, the whole of which may not be income chargeable to tax in hands of the recipient.

? Issue at hand has been adjudicated by Supreme Court in Transmission Corporation of AP Ltd. (239 ITR 587) wherein it held that TDS was liable to be deducted by the payer on the gross amount if such payment included in it an amount which was eligible to tax in India. It was held that if the payer wanted to deduct TDS not on the gross amount but on the lesser amount, on the footing that only a portion of the payment made represented “income chargeable to tax in India”, then it was necessary for him to make an application under S. 195(2) of the Act to the ITO(TDS) and obtain his permission for deducting TDS at lesser amount

? Aforesaid interpretation of S.195 by Supreme court has been relied upon by Bangalore ITAT in following judgements wherein buyer has been penalized for failing to deduct taxes on entire sale consideration paid to Non-resident seller:

? Syed Aslam Hashmi (ITA 1076 & 1313/ Bangalore ITAT/2012):

In the case under consideration, buyer did not deduct tax on gross payment made to non-resident seller. Further, non-resident seller did not file Indian Income-tax return or pay tax on capital gains earned through sale transaction. ITAT ruled that taxes should have been deducted on gross sale consideration payable to non-resident seller and accordingly, directed taxpayer to deposit shortfall in taxes along interest thereupon.

? Shri R. Prakash Vs ITO (ITA 1097/Bangalore ITAT/2012):

In the case under consideration, one of the sellers was a non-resident for Income-tax purposes. Buyer did not deduct tax on gross payment made to the other owner which included the consideration payable to non-resident seller. Further, non-resident seller did not file Indian Income-tax return or pay tax on capital gains made through sale transaction. ITAT ruled that taxes should have been deducted on part of gross sale consideration payable to non-resident seller and accordingly, directed taxpayer to deposit shortfall in tax deducted along interest thereupon.

View 2: Income-tax is required to be deducted only on amount of capital gain computed in accordance with the provisions of the Act.

? Departmental circular No. 45 dated 2nd September 1970 specifically states that if provisions of S.195 are interpreted literally, it would require deduction of taxes on income component embedded in payments made for large number of goods and services provided by Non-resident. In view of the above, one could argue that the concerned provision requires payer to deduct taxes only on the income component in the amount payable to non-resident seller pursuant to sale transaction.

? Supreme Court in GE India Technology Cen. (P.) Ltd. (327 ITR 0456) (2010) has discussed the aforesaid judicial ruling in Transmission Corporation of AP Ltd and clarified that the most important expression in Section 195(1) consists of the words "chargeable under the provisions of the Act". A person paying interest or any other sum to a non-resident is not liable to deduct tax if such sum is not chargeable to tax under the IT Act.It was also held that, “Section 195 contemplates not merely amounts, the whole of which are pure income payments, it also covers composite payments which has an element of income embedded or incorporated in them. Thus, where an amount is payable to a non-resident, the payer is under an obligation to deduct tax at source in respect of such composite payments.

The obligation to deduct tax at source is, however, limited to the appropriate proportion of income chargeable under the Act forming part of the gross sum of money payable to the non- resident. This obligation being limited to the appropriate portion of income flows from the words used in S.195, namely, 'chargeable under the provisions of the Act'"

non-resident is in no doubt that tax is payable in respect of some part of the amount to be remitted to a non-resident but is not sure about the portion of gross payment which is taxable in India or is not sure as to the amount of tax to be deducted while making said payment. Only in such a situation, payer is required to make an application to assessing officer for determination of amount of taxes to be deducted at source. It is only when these conditions are satisfied, the question of making an application for an order under s. 195(2) would arise.

? The payer needs to determine the amount of capital gains earned by the payee and deduct appropriate tax at source. Determination of tax liability can be difficult in certain cases of composite payments, however working out the capital gains earned on a transaction can be computed with almost certainty. Therefore, the payer can, if proper details are available, compute the gain and deduct the taxes on his own. Approaching the tax officer for an order u/s. 195(2) is not required in every case.

The Supreme Court in GE India Technology Cen. (P.) Ltd. (Supra) also held that "…. where a person responsible for deduction is fairly certain then he can make his own determination as to whether the tax was deductible at source and, if so, what should be the amount thereof."

? Further, tax department appears to have accepted view 2 vide departmental instruction 2/2014 whereby assessing officers have been directed to determine the appropriate proportion of the sum chargeable to tax as per the facts and circumstances of the case involved and determine tax liability on such chargeable sum for purposes of S.195 read with S.201 of the Act.

? Failure to deduct taxes or short deduction of taxes results into a consequential disallowance under S.40(a)(I) of the Act. In this regard, CBDT vide circular No. 3/2015 has clarified that assessing officer shall determine the sum chargeable to tax to ascertain tax liability in respect which payer shall be regarded as assessee-in-default and such sum as computed for purposes of S.195 shall be consequently disallowable under S.40(a). Given the above, one could argue that tax authorities have reiterated position stated in aforesaid instruction 2/2014 through clear instructions to

ascertain the tax liability on income chargeable to tax and not on entire amount of composite payment made to non-residents.

? S. 119 of the Act empowers CBDT to issue circulars, instructions or directions to tax authorities for effective administration of provisions of the Act. It is a well settled judicial position that any departmental circular, instruction or direction issued by CBDT is binding on the tax authorities. It is not open to tax authorities to contest the validity of circular or instruction in the court of law. Given that aforementioned circulars issued by tax department seem to adopt view 2, one could argue that tax authorities cannot adopt a tax position which is in contradiction to the tax position emanated from the aforementioned CBDT circulars.

? S. 195(1) uses the word 'payer' and not the word "assessee". The payer is not an assessee. The payer becomes an assessee-in-default only when he fails to fulfill the statutory obligation u/s 195(1). If tax officer is of a view that payer has failed to deduct taxes or there is short deduction of requisite taxes, he is bound to determine the portion of income chargeable to tax in India and tax liability thereupon in accordance with instructions laid down in Circular 2/2014. This would effectively result in the computation of requisite taxes required to be deducted at source on income portion of gross payments and not on the entire amount. In such a scenario, payer who has deducted taxes in accordance with tax position expressed in view 2 would not be declared as assessee-in-default for income-tax purposes and no further punitive action can be initiated against said payer by the tax officer.

? It further appears from Circular No. 45 that a certificate from tax officer u/s 195(2) is primarily required to be obtained when remittance is for purchase of goods and services wherein income component embedded therein cannot be determined with requisite certainty by the payer which is not a case with sale transaction resulting in capital gain/loss in hands of seller.

? ITAT case laws mentioned in view 1 above can be distinguished given that they have been rendered in a peculiar fact pattern before SC decision in GE India Technology Centre (P) Ltd and income-tax directions thereafter. Supreme Court being the Apex judicial authority, issue at hand would be adjudicated by judicial authorities in accordance with the principles laid down by Supreme Court in GE Technology Center (supra).

? This position also appears to be acceptable to the Income Tax department, which has in the FAQs released on date 26 December 2012, for QFIs mentioned in the answer to Question Number 22 that the payer need not approach the tax department in every case of deduction of tax under Section 195.

? In case, view 1 is accepted to be correct, it would lead to abnormal situation wherein tax deducted by buyer could exceed the capital gain earned by non-resident seller from sale transaction. This would result in an avoidable inconvenience to the non-resident sellers which would not have been the intention of legislative authorities.

Conclusion

In view of the aforesaid arguments, it prima-facie appears that both the aforementioned views are backed by strong arguments and judicial decisions. However, decisions mentioned in View 1 has not considered decision of GE India Technology Cen. (P.) Ltd (supra) and CBDT instruction 2 of 2014 and therefore, author is of the opinion that position mentioned in view 2 should meet test of scrutiny by the tax authorities.

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