

Increase in Tax Rate for Royalty & FTS for Non-Residents

CURRENT PROVISIONS UPTO 31ST MARCH, 2023

With increased inter dependence among global economies, the borders between the countries are diminishing at a rapid pace with service transactions happening at a blink of an eye.

Income earned by way of Royalty & FTS (Fees for Technical Services) by a non-resident not having a Permanent Establishment (PE) in India has been taxable under the domestic tax provisions @ 10% plus applicable surcharge and cess on gross basis. Further relaxation is provided from filing tax return in India to such non-resident whose income comprises only of dividend, royalty & FTS if the withholding is done as per the domestic provisions instead of tax treaty to non-residents though there is a lack of clarity on applicability of Transfer Pricing provisions in such cases.

AMENDMENT BY FINANCE ACT, 2023

The domestic tax rate for Royalty and FTS has been increased from 10% to 20% w.e.f. 1st April, 2023 in case of non-resident not having PE vide Finance Act, 2023. This amendment was not part of original finance bill presented but has been part of Finance Bill, 2023 passed by the Lok Sabha. **Thus, Royalty/FTS shall be taxable @ 20% plus surcharge and cess under domestic tax provisions.** The amended provision and its implications are simplified in the Flowchart section of this Note.

IMPACT OF AMENDMENT

Particulars	Pre Amendment	Post Amendment
Income as Royalty/FTS	1,00,00,000	1,00,00,000
Rate as per India-Germany Tax Treaty	10.00%	10.00%
Tax withheld as per tax treaty	10,00,000	10,00,000
Domestic Tax rate (including surcharge & cess)	10.40%	20.80%
Tax withheld as per domestic tax rate	10,40,000	20,80,000
Difference in tax withhold amount	-40,000	-10,80,000

(amounts in above table are in INR)

Although the tax rate on Royalty and FTS for Non-Residents as per the domestic act has increased from 10% to 20%, the rate of tax in majority of Tax Treaties is lower than 20%. Few tax treaties have benefit of reduced scope of taxation in the form of narrower definition, make available clause etc. for e.g. in Indian tax treaties with US, Singapore, UK, Netherlands, etc.

Non-resident intending to opt for beneficial treatment as per Tax Treaties should be eligible to avail tax treaty benefit and need to provide the documents as illustrated below -

1. Tax Residency Certificate (TRC)
2. PAN (Indian tax identification number)
3. Online filling of Form 10F (for this registration on Indian Income tax portal is required and digital signature certificate ("DSC") should be obtained by the non-resident). There is relaxation to certain non-resident taxpayers not required to obtain PAN from online filing of Form 10F until 30th September, 2023
4. Declaration as referred to in Key Actionables below
5. If withholding is done as per Tax Treaty then there is no relaxation to non-resident for filing Income tax return. Hence obtaining PAN becomes necessary for filing form 10F and tax return. Non filling of income tax return might expose the non-resident to assessment risk apart from other consequences

KEY ACTIONABLES

As a deductor of taxes for Royalty and FTS payments made to non-resident, one needs to ensure robust mechanism is in place based on the following action points:

- List down the countries of all the non-resident parties/vendors to whom Royalty/FTS payment are made
- Review of existing agreements/contracts to examine the nature of services as per the definition of Royalty and FTS of the relevant tax treaty. Evaluate scope of definition under the Act & tax treaty
- Cost – benefit analysis when selecting tax treaty rates and domestic tax rate
- Tax Residency Certificate (TRC) to be obtained from the non-resident

- Online filing of Form 10F, if applicable¹
- Declaration for eligibility to avail tax treaty benefit including confirmations on-
 - Eligibility to be governed by the tax treaty
 - No Permanent Establishment or fixed base in India
 - Principal purpose not of obtaining tax benefits
 - Limitation of Benefit clause
 - Beneficial owner of income
- Obtaining PAN and tax filing requirement for the foreign group entity if tax treaty benefit availed
- Evaluating gross-up situations and engaging in dialogue with non-resident to provide documents to claim tax treaty benefits to avoid additional tax cost

CONCLUSION

The delta between domestic tax rate and tax treaty rate has increased significantly requiring businesses to relook their strategy on withholding taxes on payment to non-residents.

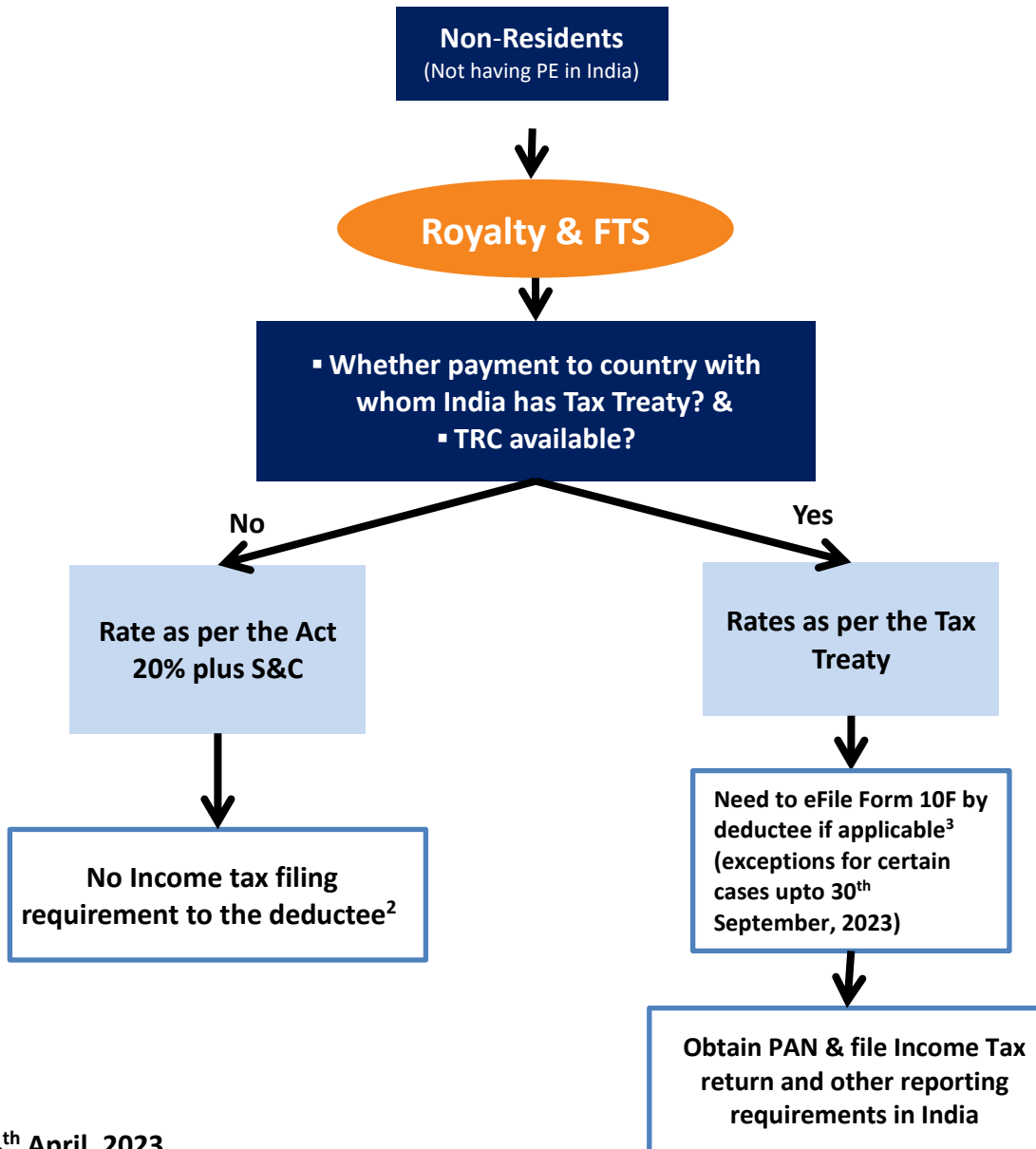
Business will have to do a thorough cost-benefit analysis to decide on the way forward considering higher tax rate, increased documentation and tax filing requirements.

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¹ Form 10F is required only if TRC does not contain specified details

FLOWCHART

The amendment and its application have been simplified and provided in a flowchart below :



Date: 4th April, 2023

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² If the income of non-resident comprises of Dividend, Royalty or FTS and the tax withholding is done on such income as per the domestic tax provisions

³ Form 10F is required only if TRC does not contain specified details