

Tax Hotline

July 26, 2006

WITHHOLDING TAX ON PAYMENTS MADE TO NON-RESIDENTS FOR SERVICES RENDERED ABROAD

The Authority for Advance Rulings ("AAR") in a recent ruling (AAR/671/2005) has held that there will be a withholding tax requirement on payments made to a non-resident agent, even if such payments are made outside India and the services are performed outside India, if the agent's entitlement to the income has arisen in India.

As per section 5 of the Income Tax Act, 1961 ("ITA") the income of a non-resident is taxable in India if it accrues or arises in India or if it is received in India. Income is said to have accrued or arisen in India if it arises directly or indirectly from or through any source of income in India. As per section 9 (1) ITA. The question in the instant case was whether the income earned by a non-resident for services performed outside India, could be considered to have been sourced in India.

In this case, an Indian resident involved in the organization of an exhibition in India, appointed a non-resident agent for the purpose of business promotion and solicitation abroad. Payments were to be made to the agent only when those foreign participants which the agent had solicited, attended the exhibition in India. These payments were made outside India. The AAR held that the non-resident agents would be taxable in India because their right to receive commission arose in India, when the exhibitors participated in the Indian exhibition.

Prior to this ruling the Central Board of Direct Taxes ("CBDT") had issued circulars on the issue of taxation of income payable to non-residents. As per CBDT Circular No. 23 of 1969 payments to a non-resident, who acted as the agent of an Indian exporter, for services rendered outside India, are not liable to tax in India. Circular No. 786 of 2000 reiterated this position. However, the AAR, distinguished the two circulars and certain cases such as *In re Ind Telesoft Pvt Ltd* [267 ITR 725 (AAR)] and *Airports Authority of India* (140 Taxmann 147) from the present situation. It held that, as per the circulars and precedents cited, the payment made outside India to a non-resident were not related to activities taking place in India. In the instant case, the entitlement of the non-resident was dependant on an activity that was to take place in India i.e. the exhibition, on the cancellation of which the non-resident agent would not be entitled to his income. Therefore, the AAR held that the payments made to a non-resident would be taxable in India if the non-resident's entitlement to income arises out of an event that takes place in India.

As per this ruling, places other than those where the service is rendered, may be the source of income. Services could therefore be rendered abroad and income from those services still be considered to have accrued or arisen in India if they are dependant on certain events which take place in India.

- Shreya Rao & Annapoorna Jayaseelan

Source: AAR/671/2005.

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