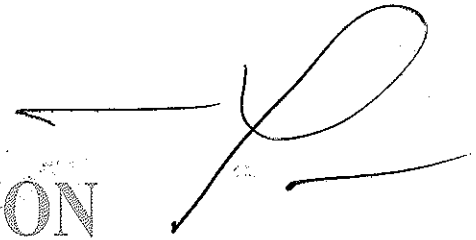


  
**IVCA**  
**IVC ASSOCIATION**  
THE INDIAN PRIVATE EQUITY & VENTURE CAPITAL ASSOCIATION

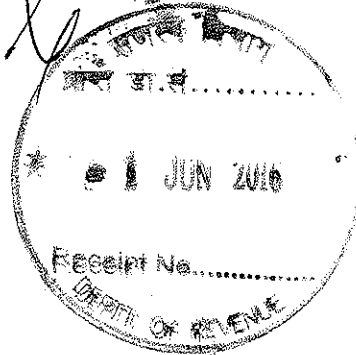


To,

31st May, 2016

Ms. Pragya Saxena  
Joint Secretary (~~FF and TR~~) - 1  
Central Board of Direct Taxes  
Ministry of Finance  
Hudco Vishala Building  
Bhikaji Cama Place, New Delhi

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Dear Madam,

**Subject: Clarifications on operational aspects of section 94A of the Income-tax Act, 1961 ('Act') on payments made to Cyprus residents**

IVCA understands and appreciates the reforms undertaken by Government of India towards a clear and more stable tax regime. A transparent tax regime provides comfort to investors while investing in India and enhances confidence.

In view of the notification and press release issued by the Government of India and Ministry of Finance in relation to payments made to Cyprus residents, there have been hardships faced by investors. It would be greatly appreciated if you could clarify certain aspects of the tax deduction provisions. This would help further promote a stable tax regime.

Kindly refer to **Enclosure 1 for the clarifications sought.**

We request you to consider the above request. Our members would be happy to meet with you in person to explain the issues in greater detail and clarifications sought.

Thanking you for your kind consideration.

Enclosures: As above.

## Enclosure 1

### A. Section 94A of the Act

Section 94A was introduced in the Act, through the Finance Act, 2011 in respect of transactions with residents of Notified Jurisdictional Area ('NJA') as an anti-avoidance measure. This section provides an enabling power to Central Government to notify any country or territory outside India, having regard to the lack of effective exchange of information with India, as a NJA.

Section 94A of the Act lays out specific mechanism to deal with transactions undertaken with persons located in such country or area. *Inter alia*, sub-section 5 of section 94A of the Act provides as follows (emphasis supplied)

*"(5) Notwithstanding anything contained in any other provisions of this Act, where any person located in a notified jurisdictional area is entitled to receive any sum or income or amount **on which tax is deductible under chapter XVII-B**, the tax shall be deducted at the highest of the following rates, namely:*

- (a) at the rate or rates in force;*
- (b) at the rate specified in the relevant provisions of this Act;*
- (c) at the rate of thirty per cent."*

As is evident from the above, section 94A (5) of the Act prescribes **only the rate at which tax needs to be deducted** on sum payable to resident of NJA. This sub-section only provides for a rate override in cases where tax needs to be deducted at a prescribed rate under Chapter XVII-B of the Act.

### B. Cyprus notified as 'NJA'

The Central Government vide **Notification No. 86/2013** dated 1 November 2013 ('Notification') notified Cyprus as the first NJA for the purpose of section 94A of the Act (Refer **Annexure 1** for copy of the Notification). By virtue of the Notification, any transaction entered into with a Cyprus resident, shall be governed by the provisions of Section 94A of the Act.

Subsequent to notification of Cyprus as NJA, Ministry of Finance published a Press Release ('Press Release') for public information explaining the premise of the aforesaid Notification (Refer **Annexure 2** for a copy of the Press Release). It was explained that Cyprus has not been forthcoming

in providing the information requested by the Indian tax authorities under the exchange of information provisions of the Double Taxation Avoidance Agreement between Indian and Cyprus<sup>1</sup> ('Cyprus Tax Treaty').

Referring to section 94A of the Act, the Press Release also brought out the implications of the Notification. One of such implication provided was that **any payment** made to a person located in Cyprus shall be liable for withholding tax at the rate of 30 percent or a rate prescribed in the Act, whichever is higher. The language of Press Release is not consistent with that of section 94A (5) of the Act, thus, creates a confusion in the correct interpretation of the section.

#### **C. Taxability under section 94A(5) of the Act:**

From a plain reading of section 94A(5) of the Act, it is clear that deduction of tax at source at higher rate set out therein is applicable in respect of any sum, income or amount on **which tax is deductible at source under Chapter XVII-B** of the Act. It is not as if section 94A(5) of the Act mandates that all payments to Cyprus residents have to be subject to higher deduction of tax at source.

As of date, Government of India has not released any notification suspending or terminating the Cyprus Tax Treaty. Thus, the taxability of any sum payable to Cyprus residents will have to be determined on the basis of relevant articles of the Cyprus Tax Treaty read with the provisions of the Act.

For determining taxability in the hands of the Cyprus resident, there is no suggestion or indication within section 94A(5) of the Act, that Cyprus Tax Treaty provisions which are otherwise available, are sought to be denied. The liability to deduct tax at source, post notification of Cyprus as NJA under section 94A of the Act, has to be determined (as it was determined prior to notification) on the basis that whether on such sum tax would be deductible under section 195 of the Act.

#### **D. Deduction of tax at source under section 195 of the Act:**

Section 195(1) of the Act provides as follows (emphasis supplied):

*"Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest [(not being interest referred to in section 194LB or section 194LC)] or [section*

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<sup>1</sup>Notified vide No. GSR 805(E), dated 26-12-1995

*194LD] or any other sum chargeable under the provisions of this Act (not being income chargeable under the head "salaries")....."*

Accordingly, any person while making payment to a non-resident is required to deduct taxes where such payment is chargeable to tax under the Act. In the context of section 195 of the Act, it is a well settled position<sup>2</sup> that there is no requirement to deduct tax at source if the income payable to a non-resident or a foreign company is not chargeable to tax in India either as per the provisions of the Act or as per the provisions of the relevant Double Tax Avoidance Agreement ('DTAA').

An emphasis has been placed by the Hon'ble Supreme Court that the most important expression in section 195 of the Act consists of the words '**sum chargeable under the provisions of this Act**'. A person paying any sum to any non-resident is not liable to deduct tax if such sum is not taxable as income under the Act or relevant DTAA. The phrase 'sum chargeable' under the provision of the Act would refer to such amount, which has an element of income in them as required under the Act or relevant provision.

#### **E. Ramification of Press Release**

As discussed in above paragraphs, Section 94A(5) of the Act is applicable only in circumstances wherein taxes are deductible according to section 195(1) of the Act under Chapter XVII-B of the Act. On the contrary, the Press Release specifies that the deduction of tax is on any payment which is made to a Cyprus resident. The Press Release erroneously seems to suggest a requirement to deduct taxes on any sum or income or amount which are not subject to tax in India under the provisions of the Act read with section 90(2) of the Act and the Cyprus Tax Treaty. A plain reading of the Press Release seems to propose that there is a requirement even to withhold tax on investment being made in a Cypriot entity or payment to Cypriot resident for sale of goods.

#### **F. Conclusion**

Accordingly, it follows that where a particular sum, income or amount payable to Cyprus is not subject to deduction of tax at source [either on account of there being no income or where the income is not chargeable to tax in India as per the provisions of the Act read with section 90(2) of the Act and DTAA], the same shall not be subject to any deduction of tax at source under section 195(1) of the Act.

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<sup>2</sup>GE Technology Centre Pvt Ltd vs CIT (327 ITR 456) (SC)

## **G. Clarifications sought on the following aspects**

In order to make the Indian tax regime transparent, stable and predictable, we wish to obtain confirmation on our understanding of the abovementioned provisions of the Act and implications thereunder.

Accordingly, we request your office to kindly issue confirmation on following aspects-

### **1. Cyprus Tax Treaty remains valid**

The Cyprus Tax Treaty notified vide No. GSR 805 (E), dated 26-12-1995 continues to remain in force and has **not been suspended / terminated**. Hence, the taxation of income earned by Cyprus resident from India would still be governed by the provisions of the Cyprus Tax Treaty.

### **2. Tax liability under section 94A(5) of the Act**

As prescribed under section 94A(5) of the Act, the liability to deduct tax at higher rates is **only in respect of payment of sum on which tax is deductible** under chapter XVII-B of the Act. Therefore, the obligation casted on a payer to deduct tax at source at a higher rate prescribed under section 94A (5) of the Act would only arise on making payments which are chargeable to tax.

### **3. Excess tax deducted at source would be provisional**

The higher tax deducted at source on payments described in paragraph 2 under section 94A(5) of the Act, if any, should be provisional in nature and rates prescribed in Cyprus Tax Treaty would continue to prevail to determine final tax liability. Hence, upon completion of assessment, excess tax deducted would be refundable to the payee.

### **4. No obligation to deduct taxes on income not liable to tax in India**

Any payment, on which no tax is payable by the Cyprus resident (either under the Act or Cyprus Tax Treaty) **should not be subjected to any deduction of tax at source**. Please clarify that no tax should be deductible on payment made towards sale of any securities (including equity, preference shares and mandatorily or fully or compulsorily convertible debentures of private limited company) by a Cypriot resident given that income in the nature of capital gains is exempt under Cyprus Tax Treaty.

5. **No obligation to deduct taxes on capital payments / loan repayment**

Any payment towards Capital or repayment of loan or any transactions resulting in a loss to Cyprus resident does not result in any income taxable in India and correspondingly **should not be subjected to any deduction of tax at source.**

6. **Assessee in default**

The payer of any sum (referred to in point 4 & 5 above), to a Cyprus resident should not be considered as an 'Assessee in default' under section 201(1) of the Act for not deducting tax at source.

We would be grateful if this representation be considered and above mentioned confirmations are provided. We shall be pleased to discuss the same with your office for any clarification required.

Thanking you

Respectfully,



**Arvind Mathur  
President, IVCA  
09818934615  
011 4173 0003**

**cc: Yogesh Arora  
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