

# INDIA LEGAL UPDATE

2 May 2023

## Taxation of Income from Royalty and Fee for Technical Services (FTS)

<b>Notification Date</b>
28 March 2023
<b>Effective Date</b>
1 April 2023
<b>Legal Framework</b>
<ul style="list-style-type: none"><li>• The Finance Act, 2023;</li><li>• The Income-tax Act, 1961;</li><li>• The Income-tax Rules, 1962</li></ul>
<b>Government Authority</b>
<ul style="list-style-type: none"><li>• Central Board of Direct Taxes (CBDT)</li></ul>
<b>Source Weblink</b>
<a href="#">CBDT Notification Dated 28 March 2023;</a> <a href="#">12 December 2022;</a> and <a href="#">16 July 2022</a>

### Background:

- The Indian government *vide* amendment to the Finance Budget 2023 proposed to increase the withholding tax rate on Royalty income and FTS earned by a foreign company or a non-resident from the existing 10% to 20% plus surcharge and cess, as applicable.
- This amendment has been made effective from 1 April 2023.

### KEY CLIENT QUESTION

#### What are the implications of this change of tax rule in India?

- The income earned by foreign companies / non-residents from India requires withholding tax deduction from Indian company.
- Withholding tax rates are provided in the Indian income tax law as well as double tax avoidance treaties entered by the Indian Government with various other countries including Japan.
- Due to the increase in withholding tax rate, there is a difference in the applicable rate of tax as per the Indian tax laws vis-a-vis the double tax avoidance treaties.
- Accordingly, foreign companies / non-residents must avail the benefits of lower withholding tax rates under the tax treaties to reduce their tax costs in India.

## How to claim the benefit of lower withholding tax rate under the tax treaty?

- Foreign companies / non-residents are required to furnish the following documents to the person responsible for paying the royalty or fee income:
  - Form 10F, and
  - Tax Residency Certificate (TRC)
- **Form 10F contains the following particulars:**
  - Status (Individual, Company, Firm, etc) of the assessee (foreign companies / non-residents)
  - Permanent Account Number (PAN) of the assessee (foreign companies / non-residents)
  - Nationality (in case of an individual) or Country or specified territory of incorporation or registration (in the case of others)
  - Tax Identification Number of the assessee, in the country of Residence or Unique Tax Identification Number
  - Period for which residential status is applicable
- **Process of furnishing Form 10F:**
  - **Physical / Offline:** Earlier, Form 10F which is in the nature of a self-declaration by the foreign companies / non-residents, had to be prepared in a physical (offline) manner and furnished to the tax deductor making foreign remittance from India.
  - **Electronically / Online:** With effect from 16 July 2022, it has been prescribed to furnish it online via Income Tax Department's e-Filing Portal.
  - TRC is the mandatory certificate to be attached while filing Form 10F electronically.
  - Digital Signature Certificate (DSC) or electronic verification code is required to sign Form 10F electronically.
- **Extension in time-line for online filing of Form 10F:**
  - Government has extended the time-line for online filing of Form 10F for foreign companies / non-residents without having PAN in India:
    - Earlier till 31 March 2023; and
    - Further Revised till 30 September 2023
  - Hence, foreign companies / non-residents who do not have PAN in India may continue to furnish Form 10F till 30 September 2023 in physical form to avail relevant tax treaty benefits.
- **Consequences of non-compliances:**
  - In case of any failure with respect to:
    - withhold such taxes, or
    - depositing the taxes with the tax authorities, or
    - withholding or payment of taxes at lower rate;there may be interest and penal implications in the hands of Indian/resident payer.

## KEY CLIENT QUESTION

### Is there any compliance requirements connected with this change of tax rule in India?

- Foreign companies / non-residents who are willing to reduce their tax costs in India by availing the benefits provided in the tax treaty are required to comply with the following compliances:
  - Apply PAN in India
  - Apply DSC in India
  - File Corporate Income Tax Return in India
  - Comply with Transfer Pricing Rules in India
- The government *vide* the Finance Act, 2020, had granted an exemption from filing of return of income to foreign companies / non-residents whose only source of income from India is in the nature of royalty and FTS provided the tax has been withheld on such income at a rate not lower than that specified under Section 115A (rates provided in the Indian tax laws pertaining to tax on dividends, royalty and technical service fees in case of foreign companies).
- Hence, foreign companies / non-residents are having an option and may avoid aforementioned compliances and choose to go with higher withholding tax rate of 20%.

## CLOSING REMARKS

With this amendment, the government aims to further improve its control over Indian sources of income of foreign companies / non-residents and ensure tax compliances.

### Queries?

If you have any queries about this article, please reach out to our experts:



**Mayank Srivastava (マヤンク スリバスタバ)**  
Director | Tax Practice

Mobile: +91-93-3536-3533  
Email: [Mayank@HLS-Global.in](mailto:Mayank@HLS-Global.in)



**Ejima Naoto (江嶋直人)**  
General Manager | Japan Desk

Mobile: +91-91-0803-0825  
Email: [nejima@HLS-Global.in](mailto:nejima@HLS-Global.in)

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# HLS Global in India

## New Delhi (Corporate Office)

Vegas Mall, Office Block-B, 8th Floor, Unit No.883, Sector-14, Dwarka, New Delhi 110075 | India  
Tel.: +91-11-6134-0450  
Email: Info@HLS-Global.in  
JapanDesk@HLS-Global.in

## Gurugram

Level 1, Building No. 10A, DLF Cyber City, Gurugram  
Tel.: +91-79-8266-6136  
Email: Info@HLS-Global.in

## Japanese Zone - Neemrana

Office No. 206, Regent Square Mall, CP-4, Japanese Zone, Neemrana, Rajasthan - 301705  
Tel.: +91-73-5732-0237  
Email: JapanDesk@HLS-Global.in

## Lucknow

Office No. 22/181, Indira Nagar, Lucknow, Uttar Pradesh - 226016  
Tel.: +91-93-3536-3533  
Email: Info@HLS-Global.in

## Mumbai

Plot C-20, G Block Near MCA, Bandra Kurla Complex, Bandra(East), Mumbai City MH 400051  
Tel.: +91-93-3536-3533  
Email: Info@HLS-Global.in

## Ahmedabad

A - 413, Titanium Business Park, Beside Railway underpass, Makarba, Ahmedabad-380051  
Tel.: +91-79-8266-6136  
Email: Info@HLS-Global.in

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[www.HLS-Global.in](http://www.HLS-Global.in)

## Noida

304, 3rd Floor, Tradex Tower-1, Alpha Commercial Belt, Alpha-1, Greater Noida, Uttar Pradesh-201310  
Tel.: +91-79-8266-6136  
Email: Info@HLS-Global.in

## Bangalore

Old Data Center, West Wing, North Tower, Level 6, ITC Green Centre, Dodda Banaswadi Main Rd, Bengaluru, Karnataka 560005  
Tel.: +91-79-8266-6136  
Email: Info@HLS-Global.in

# HLS Global Worldwide

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