WITHHOLDING TAX IMPLICATIONS ON PAYMENT OF ROYALTY

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Taxation is one of the most fundamental aspect of cross border transactions and generally attracts a lot of attention while negotiating and closing international deals. Varied opinions, narrow interpretations by tax assessing officers (often favouring treasury) and conflicting judicial precedents on the same issues sometimes shake investor confidence.

In this article, we will be addressing one of the most common issues faced vis-à-vis a withholding tax implications on payments made to foreign collaborators for provision of license of trade mark/brand name etc.

As per Section 9(1)(vi) of the Income Tax Act, 1961 ("**IT Act**"), income by way of '***royalty'*** payable by a person who is a resident of India is deemed to accrue or arise in India (except when the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India). Consideration for transfer of rights (including granting of a licence) in respect of a trade mark or similar property or for use of a trademark or transfer of rights (including granting of a licence) in respect of any copyright, literary, artistic or scientific work, falls under the definition of 'Royalty' under the IT Act.

Therefore, the license fees/royalties payable to the foreign collaborator by the Indian entity for the license/right to use the brand name/trademark of the foreign collaborator, can be classified as income by way of '*royalty'* under the IT Act in the hands of such foreign collaborator, thereby requiring the Indian payer to deduct tax at source ("**TDS**") under the IT Act.

Recommended by:

Royalty payments (taxable under the IT Act) are ordinarily subject to TDS @ 10% (plus surcharge and cess, as applicable) under the IT Act. However, where royalty payments are received by a non-resident who is entitled to the benefits of the double taxation avoidance agreement ("**DTAA**"), the non-resident is entitled to claim the benefit of the more beneficial provisions and rates between the IT Act and the DTAA between India and the country of residence of such non-resident.

For instance, let's consider the India-UK DTAA. As per Article 13(3) of the India-UK DTAA, the term "royalties" is defined to mean:

(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work, including cinematography films or work on films, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; and

(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial or scientific equipment, other than income derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic.

In terms of Article 13(2) of the India-UK DTAA, '*royalties'* arising in India and paid to a UK resident can be taxed in India according to the laws of India, provided the tax charged does not exceed 15% (or 10% where payments is for use of industrial, commercial or scientific equipment) of the gross amount of such royalties.

Therefore, the license fees received by the foreign collaborator which can be considered as payment for grant of license (i.e. right to use) of the brand (i.e. trademark) is likely to qualify as 'royalty' payments as defined under Article 13(3)(a) of the Indian-UK DTAA, and therefore can be taxed as per Indian laws, subject to the tax not exceeding 15% of the gross amount of royalties.

Therefore, (assuming that foreign collaborator would not have any business connection or permanent establishment in India, as in such case other provisions of the India UK DTAA may come into play) royalty payments made to the foreign collaborator would be subject to TDS @ 10% (plus surcharge and cess, as may be applicable) under the IT Act (being the more beneficial rate than the prescribed maximum rate of 15% under the India-UK DTAA[1]).

Endnotes

[1] Ordinarily in terms of Section 206AA of the IT Act, if a person entitled to receive any income on which withholding tax is deductible does not furnish a Permanent Account Number ("**PAN**") to the person responsible for deducting such tax, in such case the tax is deducted at a higher tax rate of 20%. However, by virtue of Rule 37BC of the Income Tax Rules, 1962 the provisions of Section 206AA are not applicable to a non-resident, not having a PAN where payments received are in the nature of royalty or fees for technical services**.** The non-resident is however required to furnish the prescribed details and documents, including the name, email id, contact number, address in the country where such person is a resident, its tax identification number in the country of residence or such other unique identification number by which it is identified by the Government of its resident country (where the tax identification number is not available).

Feedback

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