
Withholding Tax in Source Country v/s. Subsequent Credit in Home Country

**A case study between India (source) and Germany (home)
with inputs from other countries.**

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Tax deducted at source (TDS) for services

Practical example – basic case:



Freiburg

Renders services
Marketing Research

Mumbai



Services
GmbH

India Ltd.

remuneration
100.000 €



Tax deducted at source for services

Overview withholding tax in Indian DTA

Withholding Tax 10%

Austria, Belgium, China, Croatia, Czech Republic, Finland, France, Germany, Hungary, Ireland, Israel, Japan, Netherlands, Norway, Portuguese Republic, Romania, Russian Federation, Slovenia, South Africa, Sweden, Switzerland

**Withholding Tax 10% -
20%**

Australia, Canada, Cyprus, United Kingdom, United States

Withholding Tax 15%

Brazil, Korea, Poland, Turkey

Withholding Tax 20%

Bulgaria, Denmark, Italy, Spain



Tax deducted at source for services

Tax deducted at source in India - principles

- Principle: certain services are liable for withholding taxes (called TDS) as per Indian Tax laws.
- Examples:
 - remuneration for technical services, royalties, interest
 - rent of machines, rent and sale of real assets
- TDS not only for cross border cases but also for purely domestic cases
- India Ltd. has to deduct the tax from the payment to be made and deposit the tax to the revenue authorities directly. The rate of TDS is specified in the Indian tax law.
- If the contract is for full payment, India Ltd. is liable to gross up the TDS and bear the additional cost of the TDS



Tax deducted at source for services

Tax deducted at source in India - principles

- So what happens to the treaty between India and Germany ?
- India Ltd. is also responsible to check if Service GmbH is eligible to claim the benefits of the treaty.
- Hence Services GmbH has to submit its Tax Residency Certificate and a 'No Permanent Establishment in India' certificate to India Ltd. to prove that it is eligible to claim the treaty benefit.
- If Services GmbH does not produce these documents, India Ltd. is responsible to deduct TDS at an enhanced rate.
- Hence there are three scenarios that are possible :
 - India Ltd. deducts tax at the rate mentioned in the Act or
 - India Ltd. deducts tax at the rate mentioned in the Treaty or
 - India Ltd. deducts tax at the enhanced rate



Tax deducted at source for services

Tax deducted at source in India - principles

	As per Act	As per DTAA	Enhanced
Remuneration	100,000	100,000	100,000
Less : TDS (assumed)	15,000	10,000	20,000
Net Payment	85,000	90,000	80,000

In case, the TDS is borne by India Ltd., should Services GmbH even try to claim the credit in Germany?



Tax deducted at source for services

Tax deducted at source in India - principles

- India Ltd. will provide a certificate to Services GmbH to prove that the TDS has been deposited to the Indian tax Authorities. This document is called the Form 16A, which describes details of:
 - i. the payer
 - ii. the payee
 - iii. the nature of payment
 - iv. the amount of payment
 - v. the amount of tax deducted at source
 - vi. the date of payment / credit
 - vii. signed digitally by the payer's authorised representative

This form is downloaded directly from the website of the tax department and hence it is an authentic document for all purposes.



Tax deducted at source for services

Tax credit in Germany for Indian TDS:

- Tax credit for Indian TDS on German corporate income tax as far as German income tax results from income of services for Indian client
- Tax credit is limited on TDS-rate of 10 % in DTA India
 - ➔ **even in case of withholding TDS of 20 % by Indian client (without PAN/certificate of residence)!**
- **No (additional) tax credit on German trade tax!**
- Full tax credit of 10% requires at least 10 % German corporate income tax on income generated by service order with Indian client
- ➔ Tax credit has no effect if directly related expenses regarding the service order are higher than directly related profits.



Tax deducted at source for services

Determination of foreign income § 34c Abs. 1 S. 2 EStG:

foreign service revenue

./. therefore economically related expenses

= foreign income

Principle of deduction operating expenses:

- Economic connection isn't defined by law
- Must be interpreted strictly to avoid inclusion of indirect costs related to the service
- In practice estimation and allocation of the related expenses in each individual case



Tax deducted at source for services

Tax credit in Germany for Indian TDS – Examples

Example 1

remuneration market research (before TDS)	EUR	100.000
<u>./. related expenses</u>	EUR	<u>25.000</u>
= foreign income acc. § 34c EStG	EUR	75.000
thereon charged German KSt (15%)	EUR	11.250
<u>Credit of Indian TDS (10 %)</u>	EUR	<u>10.000</u>
= remaining tax burden in Germany	EUR	1.250

Complete tax credit Indian TDS is achieved.



Tax deducted at source for services

Tax credit in Germany for Indian TDS - Examples

Example 2

remuneration for market research (before TDS)	EUR	100.000
<u>./. related expenses</u>	EUR	<u>50.000</u>
= foreign income acc. § 34c EStG	EUR	50.000
thereon charged German KSt (15%)	EUR	7.500
<u>Credit of Indian TDS (10 %)</u>	EUR	<u>7.500</u>
= remaining corporate income tax burden in Germany	EUR	0

Tax credit for Indian TDS in amount of 2.500 EUR can't be used.



Tax deducted at source for services

Tax credit in Germany for Indian TDS - Examples

Example 3

remuneration for market research (before TDS)	EUR	100.000
<u>./. related expenses</u>	EUR	<u>100.000</u>
= foreign income acc.. § 34c EStG	EUR	0
Credit of Indian TDS	EUR	0
German income tax burden	EUR	0
Remaining tax burden Indian TDS	EUR	10.000

Tax credit for Indian TDS remains completely unused.

Is it possible to claim a refund of the India portion of the tax?

- In the case of Fees for Technical Services and Royalty, it is not possible to claim the India portion of the tax, as these are liable to tax in India.
- For other types of income, there are options available to reduce the India portion of the tax before a payment is made and in very few cases, even after the end of the year by filing a tax return.
- Refund of the India portion of tax may take 2-3 years and may involve scrutiny of the tax return and the transaction before the refund is processed.

Hence when you have an income from a source country, it is important to find out the withholding tax rates, but it is equally important to find out the methodology to be able to claim the credit in the home country and the documents required to claim the tax credit.