Tax rate of 20 per cent under Section 206AA of the Income-tax Act shall not apply to salary payments for default in providing PAN

Background

Recently, the Visakhapatnam Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Rashtriya Ispat Nigam Ltd.¹ (the taxpayer) held that deduction of tax at a flat rate of 20 per cent under Section 206AA of the Income-tax Act, 1961 (the Act) shall not be applied on salary payments for default in providing the Permanent Account Number (PAN). The Tribunal observed that the tax on salary shall be deducted in the manner specified under Section 192 of the Act, after allowing a basic exemption limit and deductions towards investments in savings schemes, etc.

Facts of the case

- The taxpayer is a public sector undertaking engaged in the business of manufacture and sale of iron and steel products. During the year under consideration, the taxpayer had filed its Electronic Tax Deducted at Source (e-TDS) returns.

- The CPC-TDS processed the e-TDS return and issued an intimation under Section 200A of the Act to the taxpayer with a demand of tax and interest. The demand was raised on account of levy of a normal rate of tax for furnishing an invalid PAN, non-furnishing of PAN, wrong classification of the category of employee’s and also for rounding off tax and interest to the nearest ten rupees. The Assessing Officer (AO) applied the flat rate of 20 per cent as per Section 206AA of the Act.

Tribunal’s ruling

- Section 206AA of the Act provides for deduction of tax at higher rates, in case the deductee fails to furnish the correct PAN to the person responsible for deducting tax at source. In the event, the deductee fails to furnish PAN, then the deductor shall deduct tax at the rates which are higher of (i) the rates specified in the relevant provisions of the Act, or (ii) the rate or rates in force, or (iii) the rate of 20 per cent.

- On perusal of the provisions of Section 206AA of the Act, it indicates that a flat rate of 20 per cent shall not be applied automatically wherever a PAN is not furnished. The deductor shall compute the tax in the manner specified under Section 206AA of the Act, by applying the rate specified under the relevant provision of the Act, or at the rate or rates in force and then, compared to the flat rate of 20 per cent to decide whichever is higher.

¹ Rashtriya Ispat Nigam Ltd. v. ACIT [2016] 65 taxmann.com 292 (Visakhapatnam)
In the instant case, the taxpayer deducted tax at source on salary payments to employees under Section 192 of the Act. Section 192 of the Act provides for computation of tax under normal rates in force for the financial year in which payment is made, on the estimated income of the taxpayer.

The taxpayer contended that it had deducted tax at source as per the applicable rates in force in the manner specified under Section 192 of the Act after allowing a basic exemption limit. The Tribunal agreed with the arguments of the taxpayer, for the reason that the payment covered under dispute is salary to employees.

Tax at source on salary shall be deducted in the manner specified under Section 192 of the Act, after allowing basic exemption limit and deductions towards investments in savings schemes, etc. Unlike other provisions of TDS, tax at source on salary cannot be deducted by applying a flat rate of tax on gross payment.

It is not necessary that all payments fall under the 20 per cent flat rate. In some cases, the rate of tax may be 10 per cent while in others it may be 30 per cent. Unless this was done, the AO cannot apply a flat rate of 20 per cent and compute the short deduction of tax. Thus, it is clear that the onus is on the Revenue to demonstrate that correct tax has not been recovered from the person who had the primary liability to pay tax. Without doing so, the AO cannot simply compute the short deduction by applying a flat rate of 20 per cent tax on gross payment.

In the present case, the taxpayer being a public sector undertaking had deducted tax at source at the rates prescribed under the Act and filed the necessary e-TDS returns. The CPC–TDS, processed the return and computed the short deduction of tax by applying the 20 per cent flat rate specified under Section 206AA of the Act, merely based on the statements filed by the taxpayer, without applying the higher of the three rates prescribed under Section 206AA of the Act.

It is a settled position of law that a short deduction of tax at source, by itself does not result in a legally sustainable demand under Section 201(1) and 201(1A) of the Act. Taxes cannot be recovered once again from the taxpayer in a situation where the recipient of income has already paid the due taxes on such income.

Unless, the AO by himself verified that the recipient of income has not paid the tax on such income and also demonstrate that the rate applied by him/her was in accordance with the provisions of Section 206AA of the Act, the taxpayer cannot be held as an 'assessee in default' under Section 201(1) and 201(1A) of the Act. Therefore, the AO/TDS officer was not correct in computing the short deduction of tax and interest, by applying a flat rate of 20 per cent.

The Commissioner of Income Tax (Appeals) [CIT(A)], without appreciating the facts, simply upheld the action of the AO/TDS officer. Therefore, the issue is remitted back to the file of the AO/TDS officer, and the AO has been directed to examine the issue in light of the discussions above, after affording an opportunity of hearing to the taxpayer.

Our comments

The Tribunal in the instant case held that unlike other provisions of TDS, tax at source on salary cannot be deducted by applying a flat rate of tax on gross payment. Therefore, deduction of tax at a rate of 20 per cent on salary payment for default of providing a PAN is not appropriate. Tax at source on salary shall be deducted in the manner specified under Section 192 of the Act, after allowing a basic exemption limit and deductions towards investments in savings schemes, etc.

This decision may provide relief to employers who have deducted tax on salary payment in the manner specified under Section 192 of the Act, in cases where employees have defaulted in providing a PAN.
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