TAX FLASH NEWS

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When the foreign recipient is eligible for the benefit of the tax treaty, there is no scope for deduction of tax at source at the rate of 20 per cent under Section 206AA of the Income-tax Act

Background

Recently, the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Wipro Ltd.[1] (the taxpayer) held that Tax Deduction at Source (TDS) provisions of the Income-tax Act, 1961 (the Act) have to be read along with the tax treaty for computing the tax liability on a particular sum. When the recipient is eligible for the benefit of the tax treaty, there is no scope for deduction of tax at source at the rate of 20 per cent under the provisions of Section 206AA of the Act.

On the issue of jurisdiction, the Tribunal held that the question of computing the rate of 20 per cent under Section 206AA of the Act is a debatable issue when the recipient is eligible for the benefit of provisions of the tax treaty. Therefore, the Assessing Officer (AO) cannot proceed to make the adjustment while issuing the intimation under Section 200A of the Act.

Facts of the case

- The taxpayer filed its quarterly E-TDS returns in Form No.27Q in respect of the payment to non-residents.
- The AO issued an intimation giving the summary of short deduction and interest payable for delayed deposit of tax. The AO along with an intimation under Section 200A the Act also issued a demand notice under Section 156 of the Act.
- The taxpayer contended before the CIT (Appeals) [CIT(A)] that the AO issued the demand without giving effect to the provisions of the tax treaty. The taxpayer has deducted tax in accordance with the provisions of the respective tax treaty and therefore, there was no shortfall in the deduction of tax at source in respect of the payments made to non-residents.
- The CIT(A) confirmed the action of the AO.

The Tribunal's ruling

- In this case, the AO made the adjustment under Section 200A of the Act, on account of short deduction of tax at source by the taxpayer in respect of payment to non-residents on the ground that the taxpayer has not furnished a PAN of the non-resident recipients. Accordingly, the taxpayer was required to deduct tax at the rate of 20 per cent in view of the provisions of Section 206AA of the Act.

[1] Wipro Ltd. v. ITO (2016-TII-27-ITAT-BANG-INTL)[IT (IT) A. Nos.1544 to 1547/Bang/2013, (AY 2011-12)

- The Tribunal observed that an identical issue has been considered and decided by the co-ordinate bench of this Tribunal[2], wherein it was held as under:

  - The taxpayer made payment to the non-resident on account of royalty and Fee for Technical Services (FTS). The taxpayer deducted tax at source at the rate of 10 per cent in some cases and the rate of 10.56 per cent in some other cases, as per the provisions of Section 115A(1)(b) of the Act.

  - The AO while issuing the intimation under Section 200A computed the tax liability at the rate of 20 per cent, as provided under Section 206AA of the Act.

  - The Tribunal held that the benefit of the tax treaty was available to the recipients of the payments, and therefore, the tax liability of the recipients could not be more than the rate prescribed by the tax treaty or the Act, whichever is lower.

- In the case of Serum Institute of India Ltd.[3], an identical issue has been considered by the Pune Tribunal, inter alia, as under:

  - Section 206AA of the Act prescribes that if the PAN is not furnished to the person responsible for deducting tax at source, the tax deductor would be required to deduct tax at the higher of the following rates, (a) at the rate prescribed in the relevant provisions of this Act, (b) at the rate/rates in force, or (c) at the rate of 20 per cent.

  - In the present case, the taxpayer was responsible for deducting tax on payments made to non-residents on account of royalty and/or FTS.

  - The Supreme Court in the case of Azadi Bachao Andolan[4] has upheld the proposition that the provisions made in the tax treaty will prevail over the general provisions contained in the Act to the extent they are beneficial to the taxpayer.

  - In this context, the tax treaty entered into between India and the other relevant countries in the present context provide for the scope of taxation and/or a rate of taxation, which was different from the scope/rate prescribed under the Act. Accordingly, the taxpayer deducted tax at source having regard to the provisions of the respective tax treaty, which provided for a beneficial rate of taxation.

  - Even the charging Section 4 as well as Section 5 of the Act, which deals with the principle of ascertainment of total income under the Act, are also subordinate to the principle enshrined in Section 90(2) as held by the Supreme Court in the case of Azadi Bachao Andolan and others.

  - Thus, in so far as the applicability of the scope/rate of taxation with respect to the impugned payments made to the non-residents is concerned, no fault can be found with the rate of taxation invoked by the taxpayer based on the tax treaty, which prescribes for a beneficial rate of taxation.

  - Section 206AA of the Act is not a charging section but is a part of the procedural provisions dealing with collection and deduction of tax at source. The provisions of Section 195 of the Act, which casts a duty on the taxpayer to deduct tax at source on payments to a non-resident, cannot be looked upon as a charging provision.

  - Where the tax has been deducted on the strength of the beneficial provisions of section tax treaty, the provisions of Section 206AA of the Act cannot be invoked by the AO to insist on the tax deduction at the rate of 20 per cent, having regard to the overriding nature of the provisions of Section 90(2) of the Act.

  - Section 206AA of the Act does not override the provisions of Section 90(2) of the Act and that in the impugned cases of payments made to non-residents, the taxpayer correctly applied the rate of tax prescribed under by tax treaty and not as per Section 206AA of the Act because the provisions of the tax treaty were more beneficial.

[2] [2015-TII-138-ITAT-BANG-INTL]
[3] DDIT v. Serum Institute of India Ltd. (ITA Nos. 792/2013) (Pune)
[4] Azadi Bachao Andolan and Others v. UOI [2003] 263 ITR 706 (SC)

- Thus, the tax demand relatable to the difference between 20 per cent and the actual tax rate on which tax was deducted by the taxpayer in terms of the relevant tax treaty was deleted.

- The Bangalore High Court in the case of Bharti Airtel Ltd., inter alia, observed as under:

  - The TDS provisions and the charging provisions of the Act, from one single integral, inseparable Code. Consequently, the provisions relating to TDS apply only to those sums, which are 'chargeable to tax' under the Income-tax Act.

  - While interpreting the provisions of the Act, one cannot read the charging sections of that Act *dehors*, the machinery sections. The Act is to be read as an integral Code.

  - In order to deduct tax at source, the amount being paid out must necessarily be ascertainable as income chargeable to tax in the hands of the payee.

  - TDS is a vicarious liability, and it presupposes the existence of primary liability.

  - Therefore, the TDS provisions have to be read in conformity with the charging provisions i.e. Sections 4, 5 and 9 of the Act.

  - Based on the Explanation below subsection (1) of Section 200A of the Act, which clarifies that in respect of deduction of tax at source, where such rate is not in accordance with provisions of this Act, it can be considered as an incorrect claim apparent from the statement.

  - However, in the case in hand, it is not a simple case of deduction of tax at source by applying the rate only as per the provisions of the Act, when the benefit of the tax treaty is available to the recipient of the amount.

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  - Hence, applying the rate of 20 per cent without considering the provisions of the tax treaty, and consequent adjustment while framing the intimation under Section 200A is beyond the scope of the said provision.

- No contrary decision has been brought to the notice of the Tribunal in the present case.

- Consequently, in view of the decision of the coordinate bench as well as the other decisions as followed by the coordinate bench, the issue is decided in favour of the taxpayer on both grounds. The provisions of TDS has to be read along with the tax treaty for computing the tax liability on the sum in question. Therefore, when the recipient is eligible for the benefit of tax treaty, then there is no scope for deduction of tax at source at the rate of 20 per cent as provided under the provisions of Section 206AA of the Act.

- Similarly, on the issue of jurisdiction, the question of computing the rate of 20 per cent under Section 206AA of the Act is a debatable issue when the recipient is eligible for the benefit of provisions of tax treaty, and therefore, the AO cannot proceed to make the adjustment while issuing the intimation under Section 200A of the Act.

Our comments

The issue with respect to deduction of tax at source at the rate of 20 per cent under Section 206AA of the Act where the tax treaty benefit is available has been a matter of debate before the courts. Some of the courts[5] held that the provisions of the Act cannot override the tax treaty and, therefore, the tax deduction shall be made as per the beneficial tax rate specified in the tax treaty. However, a few courts[6] held that in the case of non-availability of PAN, tax shall be deducted at the rate of 20 per cent irrespective of tax treaty benefit.

[5]DDIT v. Serum Institute of India Ltd. (ITA No. 792/2013) (Pune), [2015-TII-138-ITAT-BANG-INTL]
[6] Bosch Ltd v. ITO [2012] 141 ITD 38 (Bang)

In the present case, the Bangalore Tribunal held that Section 206AA of the Act could not be applied when the benefit of the tax treaty is available. The Tribunal approves the taxpayer's action of deducting tax at source as per the rate specified under the tax treaty while making payment to the non-resident company.

The Easwar Committee in its report on 'simplification of tax provisions' has recommended that for compliance under Section 206AA of the Act it should suffice if a non-resident furnishes to the deductor, in lieu of PAN, his/her Tax Identification Number (TIN) in the country or the specified territory of residence; and in case there is no such number, then, a unique number on the basis of which the person is identified by the government of the country or the specified territory of which such a person claims to be a resident. Accordingly, the Committee recommended that an appropriate amendment to Section 206AA of the Act shall be made.

The Finance Bill, 2016 (the Bill) has proposed to amend provisions of Section 206AA of the Act. The Bill provides that Section 206AA of the Act shall not apply to a non-resident, not being a company, or to a foreign company, in respect of any payment[7], subject to such conditions as may be prescribed. The Finance Minister while introducing the Bill in the Lok Sabha stated that non-residents without a PAN are currently subjected to a higher rate of TDS. Therefore, it is proposed that on furnishing of alternative documents, the higher rate will not apply under the relevant provisions of the Act.

[7] Any other payment, other than interest on bonds

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