

TAX FLASH NEWS

Section 206AA of the Income-tax Act does not override the beneficial provisions of the tax treaty

Background

Recently, the Pune Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Serum Institute of India Limited¹ (the taxpayer) held that where tax has been deducted on the basis of the beneficial provisions of the tax treaties, Section 206AA of the Income-tax Act, 1961 (the Act) cannot be invoked by the Assessing Officer (AO) to insist on deduction of tax at 20 per cent, having regard to the overriding nature of the provisions of Section 90(2) of the Act. Section 90(2) of the Act provides that tax treaties override domestic law in cases where the provisions of tax treaties are more beneficial to the taxpayer.

Facts of the case

- The taxpayer is engaged in the business of manufacture and sale of vaccines, and it is a major exporter of vaccines. During the financial year 2010-11, the taxpayer made payments to non-residents on account of interest, royalty and fee for technical services. These payments were subject to withholding of tax under Section 195 of the Act.
- The tax rate provided in the tax treaties was lower than the rate prescribed under the Act, and therefore in terms of the provisions of Section 90(2) of the Act, the tax was deducted at source by applying the beneficial rate prescribed under the relevant tax treaties.

¹ DDIT v. Serum Institute of India Limited (ITA No.792/PN/2013) – Taxsutra.com

- The tax department noted that on account of payment of royalty and fee for technical services in case of some of the non-residents, the recipients did not have Permanent Account Number (PAN). Relying on Section 206AA of the Act, the tax department treated payments to those non-residents who did not furnish the PAN as cases of 'short deduction'. Accordingly, demands were raised on the taxpayer for the short deduction of tax and also for interest under Section 201(1A) of the Act.
- The Commissioner of Income-tax (Appeals) [CIT(A)] held that Section 206AA of the Act would override the other provisions of the Act but not the provisions of Section 90(2) of the Act. Therefore, where the tax treaties provide for a tax rate lower than that prescribed in 206AA of the Act, the provisions of the tax treaties shall prevail and the provisions of Section 206AA of the Act would not be applicable. Accordingly, the CIT(A) deleted the tax demand raised by the tax department.

Tribunal's ruling

- In case of non-residents, tax liability in India is liable to be determined in accordance with the provisions of the Act or the tax treaty, whichever is more beneficial to the taxpayer, having regard to the provisions of Section 90(2) of the Act.
- The Supreme Court in the case of Azadi Bachao Andolan and Others² held that the tax treaties will prevail over the general provisions contained in the Act to the extent they are beneficial to the taxpayer.

² Azadi Bachao Andolan and Others v. UOI, [2003] 263 ITR 706 (SC)

- The tax treaties provide for scope of taxation and/or a rate of taxation which was different from the scope/rate prescribed under the Act. For the said reason, the taxpayer deducted tax at source having regard to the provisions of the respective tax treaties where a beneficial rate of taxation is provided.
- 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 is also subordinate to the principle enshrined in Section 90(2) of the Act 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 treaties which prescribed for a beneficial rate of taxation.
- It would be incorrect to say that though charging Sections 4 and 5 of the Act (dealing with ascertainment of total income) are subordinate to the principle enshrined in Section 90(2) of the Act, but the provisions of Chapter XVII-B, governing tax deduction at source are not subordinate to Section 90(2) of the Act.
- 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.
- The Supreme Court in the case of Eli Lilly & Co.³ observed that the provisions of withholding of tax i.e. Section 195 of the Act would apply only to sums which are otherwise chargeable to tax under the Act.
- The Supreme Court in the case of GE India Technology Centre Pvt. Ltd.⁴ held that the provisions of tax treaties along with Sections 4, 5, 9, 90 and 91 of the Act are relevant while applying the provisions of tax deduction at source. Therefore, in view of the aforesaid schematic interpretation of the Act, Section 206AA of the Act cannot override the charging Sections 4 and 5 of the Act.
- Section 90(2) of the Act provides that tax treaties override domestic law in cases where the provisions of tax treaties are more beneficial to the taxpayer. Therefore, where the tax has been deducted on the basis of the beneficial provisions of the tax treaties, the provisions of Section 206AA of the Act cannot be invoked by the AO to insist on the tax deduction at 20 per cent, having regard to the overriding nature of the provisions of Section 90(2) of the Act.
- The Commissioner of Income-tax (Appeals) [CIT(A)] has correctly inferred that Section 206AA of the Act does not override the provisions of Section 90(2) of the Act. While making payments to non-residents, the taxpayer correctly applied the rate of tax prescribed under the tax treaties and not as per Section 206AA of the Act because the provisions of the tax treaties are more beneficial. Accordingly, the Tribunal affirmed the CIT(A)'s ruling.

Our comments

This is a welcome decision of the Pune Tribunal where it has been held that where tax has been deducted based on the beneficial provisions of tax treaties, the provisions of Section 206AA of the Act cannot be invoked by the tax authorities to insist on deduction of tax at the rate of 20 per cent.

The Bangalore Tribunal in the case of Bosch Ltd.⁵ had held that the provisions of Section 206AA of the Act override the other provisions of the Act. Therefore, a non-resident whose income is chargeable to tax in India has to obtain PAN and provide the same to the tax deductor. The only exemption given is that the non-residents whose income is not chargeable to tax in India are not required to apply and obtain PAN.

In the present case, the tax department had relied on the decision in the case of Bosch Ltd. However, the Tribunal has not dealt with this decision while delivering its judgement. If this matter reaches the higher courts, it would be interesting to observe how the courts deal with this issue.

³ CIT v. Eli Lilly & Co. (India) (P.) Ltd. [2009] 312 ITR 225 (SC)

⁴ GE India Technology Centre Pvt. Ltd. v. CIT [2010] 327 ITR 456 (SC)

⁵ Bosch Ltd v. ITO [2012] 141 ITD 38 (Bang)

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