

TAX FLASH NEWS

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CBDT amends rules to exempt dividend payment to non-residents from higher deduction of tax in the absence of PAN

Background

Rule 37BC¹ of the Income-tax Rules, 1962 provides certain relaxations from deduction of tax at source at a higher rate under Section 206AA of the Income-tax Act, 1961 (the Act) to a non-resident not having a Permanent Account Number (PAN). It provides that a non-resident deductee without a PAN, shall not be subject to higher deduction of tax under Section 206AA, in respect of payments in the nature of interest, royalty, fees for technical services (FTS) and payments on transfer of any capital asset, if the non-resident deductee furnishes the Tax Residency Certificate (TRC) and other specified details and documents to the deductor.

Recently, the Central Board of Direct Taxes (CBDT) has issued a Notification² amending Rule 37BC to include dividend payment within its ambit. This is pursuant to the amendment made by the Finance Act, 2020 in the dividend taxation in the hands of shareholder with effect from 1 April 2020. The Notification comes into force from 24 July 2020, being the date of publication in the Official Gazette.

Higher rate of tax in the absence of PAN

Section 206AA provide that any person who is entitled to receive any amount on which tax is deductible at source, shall furnish his PAN to the deductor, failing which the payer is liable to deduct tax on such sum at a rate which is higher of:

- The rate specified in the Act
- The rate or rates in force or
- 20 per cent.

The above provision applies to non-resident payees also, which imposed a burden on them to obtain PAN in India to avoid the trigger of higher deduction of tax. On one hand, the aforesaid provision does not exempt non-residents who are eligible for lower tax rate as per the tax treaty. However, on the other hand, the Courts/Tribunal in some of the decisions³ have held that non-residents who are entitled to tax treaty benefit will not be subject to higher tax deduction rate of 20 per cent in absence of PAN.

To improve the ease of doing business in India and to remove undue hardships faced by non-residents, certain exceptions were provided. When payment is made to a non-resident, in respect of –

- Payment of interest on long-term bonds which qualify for concessional tax rate of 5 per cent as referred to in Section 194LC. No documents or information is required to be furnished by non-resident payee for this purpose.
- Payments specified in the Rule 37BC subject to certain specified conditions. The Rule prescribes following payments to which higher deduction of tax will not apply but subject to payee furnishing TRC, Tax identification number (TIN) and other relevant information as prescribed therein:
 - Interest
 - Royalty
 - FTS
 - Payment on transfer of any capital asset.

¹ Relaxation from deduction of tax at a higher rate under Section 206AA

² CBDT Notification No. 54/2020, dated 24 July 2020

³ Danisco India (P) Ltd v. UOI [2018] 404 ITR 539 (Del), Nagarjuna Fertilizers & Chemicals Ltd. v. ACIT [2017] 78 taxmann.com 264 (Hyd) (SB)

Dividend payment was not covered in the above Rule for the reason that till 31 March 2020, the Act provided for dividend distribution tax (DDT) regime where tax on dividends paid to shareholders was payable by the company and dividend income was exempt in the hands of shareholders. Hence, no tax was deductible on dividend payment by domestic companies.

Amendments by the Finance Act 2020 to dividend taxation

The Finance Act, 2020 amended the dividend taxation system to tax dividend in the hands of shareholders with effect from 1 April 2020. Consequently, dividend income in the hands of non-resident shareholders is taxable at a general rate of 20 per cent (plus applicable surcharge and cess) on gross basis under Section 115A. Therefore, the domestic company is required to deduct tax at 'rates in force' on dividend payment which, as per the definition, is the rate specified in the annual Finance Act or in the tax treaty, whichever is more beneficial.

However, final tax rates (and corresponding TDS rates) for certain classes of non-resident shareholders i.e. Foreign Portfolio investors (FPIs) are provided separately. For instance, final tax rate and TDS rate at 20 per cent (plus applicable surcharge and cess) applies for FPIs under a separate provision.

Amendments by the Finance Act 2020 to the gross basis of taxation under Section 115A

The Finance Act 2020 also amended Section 115A which provides for gross basis of taxation for certain incomes like interest, royalty, FTS, etc. which now includes dividend also.

Prior to amendment, Section 115A provided for exemption from furnishing of return of income for those non-resident taxpayers whose total income included interest income and/or dividend (not covered by DDT regime) and tax deductible at source as per the Act has been deducted from such income. There was no such similar exemption for non-resident taxpayers whose total income included only royalty or FTS income. Hence, such taxpayers were required to furnish return of income even if tax payable on such income was already paid in the form of TDS by the payer.

The Finance Act 2020 amended Section 115A, inter alia, to extend the exemption from return filing compliance to royalty and FTS as well. However, the condition for exemption was modified to provide that exemption shall be applicable only in cases where the tax deductible at source under the provisions of the Act has been deducted from such income and the rate of deduction is not less than the rates of tax specified in Section 115A. This implies that if the TDS rate is as per lower rate provided in a tax treaty, the exemption from return filing compliance will not apply.

PAN is a pre-condition for return filing compliance. Hence, even if higher deduction of tax in the absence of PAN is avoided by a non-resident payee by furnishing TRC and other information to the payer, the non-resident payee is still required to obtain PAN for the purposes of filing return of income.

CBDT Notification

Rule 37BC is amended to provide dividend payment in the list of payments prescribed for which higher deduction of tax at 20 per cent will not apply in absence of PAN on furnishing of TRC and other specified information.

As per the amended Rule if a non-resident shareholder does not hold PAN but furnishes TRC and other specified information to the company, the company can deduct tax at the 'rates in force' (which includes lower tax treaty rate, if applicable).

If tax is to be deducted at 20 per cent (plus applicable surcharge and cess) as provided in Section 115A and a non-resident shareholder does not have any other taxable income in India (other than incomes covered by section 115A which meet similar condition), then the non-resident shareholder is not required to furnish return of income.

However, if the tax is deducted on dividend at a lower tax treaty rate, then the non-resident shareholder will be required to furnish return of income.

Our comments

The amendment with respect to non-applicability of higher rate of tax under Section 206AA in the case of a non-resident not having PAN with respect to the payments of 'dividend' is a welcome move. It provides relief to non-resident shareholders who do not possess PAN. Such shareholders can furnish TRC and other specified information to the company for claiming lower tax treaty rate on dividend income. However, the relief is only for the limited purposes of deduction of tax at source. If tax is to be deducted at a lower tax treaty rate, the non-resident shareholder will be required to obtain PAN in order to furnish return of income. If the non-resident shareholder does not wish to claim tax treaty benefit, then the Notification has no impact since the company will be required to deduct tax at 20 per cent as per Section 115A.

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