



## Surcharge and education cess cannot be levied on the tax deducted at source based on Section 206AA of the Act

### Background

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Computer Sciences Corporation India (P.) Ltd.<sup>1</sup> (the taxpayer) observed that Section 206AA of the Income-tax Act, 1961 (the Act) does not mention charging any surcharge or education cess on the prescribed rate. Thus, while making payments, in absence of the Permanent Account Number (PAN) of the payee, surcharge and education cess cannot be levied on the amount of tax deducted at source under Section 206AA(1)(iii) of the Act.

The Tribunal further observed that only the deductee is entitled to the credit of the tax deducted by the deductor on his behalf for which a certificate is issued to him. Therefore, the taxpayer cannot claim the refund of tax deducted at source on payments made to its non-resident parent company.

### Facts of the case

- The taxpayer, a public limited company in India, is engaged in providing software development services, and is also availing management services from its parent company, namely, Computer Sciences Inc., USA (CSC USA).
- In lieu of the management services obtained, the taxpayer paid to CSC USA, after deducting tax at source at the rate of 20 per cent on the premise that the payment made to the parent company was in the nature of 'Royalty' and

'Fees for technical services', and hence liable for deduction of tax at source as per the Act as well as India-USA tax treaty (the tax treaty).

- As the non-resident parent company did not have any PAN, the Assessing Officer (AO) held that the tax ought to have been deducted at source at a higher rate in terms of the provisions of Section 206AA of the Act. The AO held that the taxpayer should have deducted tax at the rate of 25 per cent plus surcharge and education cess on such payments. The taxpayer was treated as an 'assessee-in-default' under Section 201(1) and also made liable to pay interest under Section 201(1A) of the Act.
- The Commissioner of Income-tax (Appeals) [CIT(A)] held that the taxpayer should deduct tax at source at the rate of 20 per cent, and surcharge and education cess should have also been levied.

### The Tribunal's decision

#### ***Decision in the case of Serum Institute of India Ltd. is not applicable***

- Before the Tribunal, the taxpayer contended that the rate of 15 per cent should have been considered for the overall Section 206AA(1) instead of the rate of 20 per cent as per clause (iii), being the rate at which the taxpayer deducted tax at source. In support of this contention, the taxpayer relied on the Pune Tribunal decision in the case of Serum Institute of India Ltd.<sup>2</sup>

<sup>1</sup> Computer Sciences Corporation India (P.) Ltd. v. ITO [2017] 77 taxmann.com 306 (Del). The Tribunal desisted from considering as to what should rightly have been the correct rate of tax as per clause (i) of Section 206AA(1) or the overall rate as applicable under Section 206AA, as such issues were not before it.

<sup>2</sup> DDIT (IT) v. Serum Institute of India Ltd. [2015] 56 taxmann.com 1 (Pune)

- Based on this decision, the taxpayer in the present case, urged before the Tribunal that deduction of tax at source should have been made by it at 15 per cent and the excess deduction to the extent of 5 per cent should be refunded to it.
- In the present case, the Tribunal held that the facts in the case of Serum Institute lie in a different compartment. In that case, the question was whether the taxpayer's deduction of tax at source at the rate of 15 per cent was right or some higher deduction of tax should have been made so as to make the 'assessee-in-default' to the extent of such short deduction under Section 201(1). On the other hand, in the present case, the taxpayer is not in default in terms of Section 201(1) as it deducted tax at source at the rate of 20 per cent as has been approved by the CIT(A).
- Thus, the decision of the Pune Tribunal in the case of Serum Institute (supra) does not advance the case of the taxpayer any further, and is not applicable to the facts of the instant case.

***Refund of excess tax deducted can be claimed only by the deductee***

- The taxpayer has deducted tax at source at the rate of 20 per cent and the CIT(A) also upheld the taxpayer's stand. Before the Tribunal, the taxpayer resiled from its suo motu rate of deduction of tax at source made at 20 per cent by claiming that the tax ought to have been rightly deducted at source at the rate of 15 per cent.
- A conjoint reading of the provisions<sup>3</sup> boils down that the person responsible for paying to the non-resident is required to deduct tax at source (Section 195); issue certificate for tax deducted to the deductee (Section 203); and the credit for tax deducted at source is given to the deductee by treating it as a payment of tax by the deductor on behalf of the deductee (Section 199).
- Once a deduction of tax at source has been made on behalf of the deductee (payee), the deductor (payer) becomes *functus officio* and, cannot, under any circumstance, claim refund of the tax deducted at source. The deduction of tax at source is always a payment of tax by the deductor on behalf of the deductee, and only the deductee is entitled to the credit of the tax deducted by the deductor on his behalf for which a certificate is issued to him.
- If the taxpayer's contention is accepted that the tax should have been deducted at lower rate of 15 per cent instead of voluntary deduction made at 20 per cent for which it also issued TDS certificate to the deductee, then not only the deductee parent company will avail credit for TDS at the rate of 20 per cent, but the taxpayer will also get refund of 5 per cent, being the excess amount suo motu paid by it.
- No statutory provision permits the deductor to claim refund of the excess tax deducted at source.
- The deduction of tax at source is simply a mode of collection of tax. It does not in any manner affect the chargeability of the income in the hands of the payee.
- Article 265 of the Constitution does not come into play in this case, since the rightful amount of tax due on the income of the payee is not determined in the present case.
- Section 190 dealing with 'Deduction at source and advance payment', stipulates through sub-Section (2) that deduction of tax at source shall not 'prejudice the charge of tax on such income under the provisions of sub-Section (1) of Section 4.' The instant proceedings are in the hands of the deductor-payer and are not in any manner going to affect the tax liability of the payee as has been specifically provided for under Section 190(2) of the Act, such that deduction of tax at source does not prejudice the charge of tax on such income.

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<sup>3</sup> Section 195, 199, 203 of the Act

- Thus, the taxpayer's claim for refund of tax deducted at source at the rate of 5 per cent on payments made to its parent company is rejected.

### **Levy of surcharge and education cess**

- Section 206AA provides in unequivocal terms that the tax should be deducted 'at the rate of twenty per cent'. This is the prescribed final rate of tax and there is no mention of charging any further surcharge or education cess on the same. The legislature cannot be understood as oblivious of the levy of surcharge etc. in certain cases in addition to the specific rates prescribed in the Act itself.
- The term 'maximum marginal rate' has been defined in Section 2(29C) to mean 'the rate of income-tax (including surcharge on income-tax, if any) applicable in relation to the highest slab of income in the case of an individual, association of persons, etc.
- Under Section 115JB, which is a special provision for payment of tax by certain companies, Explanation 1 provides that the amount of income-tax shall include surcharge, education cess on income-tax and secondary and higher education cess on income-tax, as levied by the Central Acts from time-to-time.
- Thus, wherever the legislature intended to levy surcharge, education cess, etc. on a particular prescribed rate of tax in a provision, it expressly provided the same. In the absence of a specific mention for the levy of surcharge on the rate of 20 per cent as prescribed in Section 206AA(1)(iii), the same cannot be read into it.
- The Supreme Court in the case of Vatika Township Pvt. Ltd.<sup>4</sup> has rejected that the levy of surcharge on the tax was always intended to be there, and hence this proviso being clarificatory, is retrospective in nature. It was held that such levy is prospective because such surcharge was inserted only with effect from 1 June 2002.

- Section 206AA(1)(iii) simply provides for deduction of tax 'at the rate of twenty percent.' Unlike Section 113 and other provisions as discussed above, there is no mention for the levy of any surcharge, education cess, etc. on such rate of 20 per cent.
- A perusal of a part of the Central Board of Direct Taxes (CBDT) Circular<sup>5</sup> in the context of compulsory requirement to furnish PAN of employees under Section 206AA indicates that the CBDT has provided that education cess at the rate of 2 per cent, and secondary and higher education cess at the rate of 1 per cent is not to be deducted, in case the tax is deducted at 20 per cent under Section 206AA of the Act. Though, this part of the Circular is not relevant for the purposes of deduction of tax at source in terms of Section 195. Yet it throws some guidance on the non-levy of education cess, surcharge, etc. in case the tax is deducted in terms of Section 206AA on the payments made to non-residents.
- No contrary provision mandating the levy of surcharge and education cess on the rate of 20 per cent under Section 206AA(1)(iii) was brought to the notice of the Tribunal.
- Accordingly, the surcharge and education cess cannot be levied on the amount of tax deducted at source under Section 206AA(1)(iii) of the Act.

### **Our comments**

In the instant case, the Tribunal observed that if the legislature intended to levy surcharge and education cess on a particular prescribed rate of tax, it would have expressly provided the same. In absence of a specific mention for the levy of surcharge and cess on the rate of 20 per cent as prescribed in Section 206AA(1)(iii), the same cannot be levied while making payments to persons not having a PAN.

<sup>4</sup> CIT v. Vatika Township Pvt. Ltd. [2014] 367 ITR 466 (SC)

<sup>5</sup> CBDT Circular No.17/2014 dated 10 December 2014

In this relation, CBDT vide Notification<sup>6</sup> introduced Rule 37BC in the Income-tax Rules, 1962 clarifying that in the case of a non-resident not being a company, or a foreign company and not having a PAN, the provisions of higher rate of tax under Section 206AA of the Act shall not apply in respect of payments in the nature of interest, royalty, fees for technical services and payments on transfer of any capital asset, if the deductee furnishes the details and the specified documents to the deductor.



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<sup>6</sup> CBDT Notification No. 53/2016, dated 24 June 2016

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