KPMG

TAX FLASH NEWS

23 February 2018

# In case of conflict between the tax rate prescribed in Section 206AA of the Income-tax Act and in a tax treaty, the tax treaty rate would apply

## Background

Recently, the Delhi High Court in the case of Danisco India Private Limited[1] (the taxpayer) held that the provision in Section 206AA of the Income-tax Act, 1961 (the Act) has to be read down to mean that where the non-resident deductee conducts its operation from outside the territory of India whose government has entered into a tax treaty with India, the rate of taxation would be governed by the provisions of the tax treaty. Further, the amendment[2] in Section 206AA of the Act is mitigating to a large extent, the rigors of the pre-existing laws[3].

## Facts of the case

- The taxpayer remitted payments to a Singapore based company (non-resident). A non-resident company is not a taxpayer in India. The services rendered by a non-resident company are in the nature of Fees for Technical Services (FTS). The India-Singapore tax treaty (tax treaty) provides a cap of 10 per cent tax rate for FTS.
- The taxpayer contended that on the application of the principle enunciated by the Supreme Court in the decision of Azadi Bachao Andolan[4], even if the tax rate for the activity which would form part of the expression FTS is higher, not more than 10 per cent could be recovered by the tax authorities. The taxpayer contended that Section 206AA of the Act has the effect of undoing the provisions of the tax treaty. The levy of 20 per cent rate is unconstitutional. The taxpayer relied on the recommendations of Justice Easwar Committee report of 2016.
- Acting upon the Easwar committee recommendations, the central government moved an amendment, which the Parliament effected through the Finance Act of 2016, that, in effect, neutralised the existing provision by substituting Section 206AA(7) of the Act.
- The taxpayer contended that Section 206AA of the Act cannot be sustained having regard to the facts of the present case.
- The taxpayer filed a writ petition before the Delhi High Court.

---

[1] Danisco India Private Limited v. UOI (W.P. (C) 5908/2015) – Taxsutra.com

[2] The Finance Act 2016 (with effect from 1 June 2016) amended Section 206AA of the Act to provide that the higher rate of tax shall not apply to a non-resident in specified cases

[3] Section 206AA of the Act provides that any person who is entitled to receive any amount on which tax is deductible at source shall mandatorily furnish his PAN to the deductor failing which higher withholding tax rate will be applicable

[4] Azadi Bachao Andolan v. Union of India [2003] 263 ITR 706 (SC)

## High Court decision

- The issue with respect to Section 206AA of the Act has been rendered largely academic on account of the amendment which substituted pre-existing Section 206AA(7)[5] with the present Section 206AA(7) of the Act.
- The amendment is mitigating to a large extent, the rigors of the pre-existing laws. The law, as it existed, went beyond the provisions of the tax treaty which in most cases mandates a 10 per cent cap on the rate of tax applicable to the contracting parties.
- Section 206AA (prior to its amendment) resulted in a situation, where, over and above the mandated 10 per cent, a recovery of an additional 10 per cent, in the event, the non-resident payee, did not possess a Permanent Account Number (PAN).
- The Pune Tribunal in the case of Serum Institute of India Ltd[6] has discussed this very issue and held that
  - Section 206AA of the Act which is not a charging section but is a part of 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.
  - 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 and the same also overrides the charging Sections 4 and 5 of the Act.
  - Where the tax has been deducted on the strength of the beneficial provisions of 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.
- Having regard to the position of law explained in Azadi Bachao Andolan and various other decisions, a tax treaty acquires primacy in such cases, where reciprocating states mutually agree upon acceptable principles for tax treatment. The provision in Section 206AA (as it existed) has to be read down to mean that where the non-resident deductee conducts its operation from outside the territory of India whose government has entered into a tax treaty with India, the rate of taxation would be as dictated by the provisions of the tax treaty.

## 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 when the tax treaty benefit is available has been a matter of litigation before the Tribunal/Courts

Special Bench of the Tribunal as well as some other Benches of the Tribunal[7] in some of the cases have held that a beneficial tax treaty rate should apply as a tax treaty overrides the provisions of Section 206AA of the Act. The Bangalore Tribunal in the case of Bosch Ltd[8] held that higher tax rate specified under Section 206AA of the Act should be applied even if the beneficial rate under the tax treaty is available.

The Delhi High Court in this case held that provision in Section 206AA has to be read down to mean that where the non-resident deductee conducts its operation from outside the territory of India whose government has entered into a tax treaty with India, the rate of taxation would be as per the provisions of the tax treaty.

The Finance Act 2016 amended Section 206AA of the Act to provide that the higher rate of tax shall not apply to a non-resident, in specified cases. The CBDT vide Notification[9] introduced Rule 37BC of the Income-tax Rules, 1962 to provide that if a non-resident taxpayer does not have a PAN, but furnishes the specified details and the documents to the deductor, the provisions of Section 206AA shall not apply.

---

[5] Pre-existing Section 206AA provides that the provisions of Section 206AA shall not apply in respect of payment of interest on long-term bonds as referred to in Section 194LC, to a non-resident, not being a company, or to a foreign company

[6] DCIT v. Serum Institute of India Ltd. [2015] 56 taxmann.com 1 (Pune)

[7] Nagarjuna Fertilizers & Chemicals Ltd v. ACIT [2017] 78 taxmann.com 264 (Hyd) (SB), DCIT v. Pricol Ltd [2014] 223 Taxman 187 (Mad)(Mag), Wipro Ltd. v. ITO (2016-TII-27-ITAT-BANG-INTL) [ IT (IT) A. Nos.1544 to 1547/Bang/2013], DCIT v. Serum Institute of India Ltd. [2015] 56 taxmann.com 1 (Pune)

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

[9] CBDT Notification No. 53 /2016, F.No.370 142/16/2016-TPL, dated 24 June 2016

## www.kpmg.com/in


Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh – 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
KRM Tower, Ground Floor,
No 1, Harrington Road
Chetpet, Chennai – 600 031
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Gurugram
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurugram, Haryana – 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
Salarpuria Knowledge City,
ORWELL, 6th Floor, Unit 3, Phase
III, Sy No. 83/1, Plot No 2,
Serilingampally Mandal, Raidurg
Ranga Reddy District,
Hyderabad, Telangana – 500081
Tel: +91 40 6111 6000
Fax: +91 40 6111 6799

Jaipur
Regus Radiant Centres Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road
Jaipur, Rajasthan, 302018.
Tel: +91 141 - 7103224

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091
Tel: +91 33 4403 4000
Fax: +91 33 4403 4199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai – 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park
Tower-B, Plot# 7, Sector 142,
Expressway Noida, Gautam Budh Nagar,
Noida – 201305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex, Mundhwa Road,
Ghorpadi, Pune – 411001
Tel: +91 20 6747 7000
Fax: +91 20 6747 7100

Vadodara
iPlex India Private Limited,
1st floor office space, No. 1004,
Vadodara Hyper, Dr. V S Marg
Alkapuri, Vadodara – 390 007
Tel: +91 0265 235 1085/232 2607/232 2672