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TAX FLASH NEWS

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Even in the absence of a PAN, lower tax rate prescribed under the tax treaty will apply

Background

Recently, the Special Bench of the Hyderabad Income-tax Appellate Tribunal (the Tribunal) in the case of Nagarjuna Fertilizers and Chemicals Ltd.[1] (the taxpayer) held that the provisions of Section 206AA[2] of the Income-tax Act, 1961 (the Act) will not have an overriding effect on the provisions of the tax treaty to the extent they are beneficial to the taxpayer by virtue of Section 90(2)[3] of the Act.

Facts of the case

- The taxpayer is a Public Limited Company. During both the years under consideration[4], the taxpayer made certain payments in the nature of Fees for Technical Services (FTS) to non-residents. Some of such non-residents were the residents of countries' with whom India did not have a tax treaty and in their cases, tax at the higher rate of 20 per cent was required to be deducted by the taxpayer, where the payees failed to furnish a valid Permanent Account Number (PAN) as per the provisions of Section 206AA of the Act. In case of other non-residents, who were the residents of those countries, with whom India had entered into tax treaties, tax at the lower rate as prescribed in the relevant Articles of the tax treaties was deducted by the taxpayer even in case of payees, who did not furnish a valid PAN.

- While processing the Tax Deducted at Source (TDS) returns filed by the taxpayer for both the years under consideration, the taxpayer was held to be liable to deduct tax at source at a higher rate of 20 per cent in such cases for want of PAN of the concerned non-resident payees as per the provisions of Section 206AA of the Act.

- The Commissioner of Income-tax (Appeals) [CIT(A] rejected the taxpayer's case and observed that Section 206AA inserted in the Act with effect from 1 April 2010 was an overriding provision and there was no escape for the taxpayer except to quote the deductee's PAN or to deduct tax at source at 20 per cent. It was held that a PAN was required to be quoted for making declaration under Section 197A of the Act for claiming exemption from TDS to be valid. It was also held that Section 206AA starting with non-obstante clause overrides all other sections including Section 90(2), Section 115A and Section 139A of the Act.

- Reliance was placed by the CIT(A) in this regard on the decision of the Bangalore Tribunal in the case of Bosch Limited[5], wherein it was held that

[1] Nagarjuna Fertlizers and Chemicals Limited v. ACIT (ITA No. 1187/H/2014 AY:2011-2012) Hyderabad– Taxsutra.com
[2] Dealing with higher rate of deduction of tax at source in case of payments made to non-residents and where there is a failure to furnish a PAN
[3] Where India has entered into any tax treaty with any other country or specified territory outside India for granting of relief or avoidance of double taxation, the provisions of the Act shall apply to the extent they are more beneficial to the taxpayer
[4] AY 2011-12 and 2012-13.

[5] BOSCH Ltd. v ITO [2013] 115 TTJ 354 (Bang)

non-residents having an income exceeding the taxable limit were bound to obtain and furnish a PAN and if there was a failure to do so, the taxpayer was liable to withhold tax at higher of the rates prescribed under Section 206AA of the Act, i.e. 20 per cent.

- Keeping in view the conflicting decisions of the Bangalore Tribunal in the case of Bosch Limited and the Pune Tribunal in the case of Serum Institute of India Limited[6], a reference was made to constitute a Special Bench to decide the issue and resolve the controversy.

Tribunal's decision

- Any person responsible for paying to a non-resident, not being a company, or to a foreign company, inter alia, any other sum chargeable under the provisions of the Act (not being income chargeable under the head 'salaries') shall deduct income-tax thereon at the 'rates in force'[7].

- The term 'rates in force' used in Section 195(1) is defined in Section 2(37A) of the Act which, inter alia, means the rate or rates of income-tax specified in this behalf in the Finance Act of the relevant year or the rate or rates of income-tax specified in the tax treaties, whichever is applicable by virtue of the relevant provisions of the Act, as the case may be.

- Thus, the deduction of tax under Section 195 of the Act from the payments made to the non-residents in the nature of FTS was made by the taxpayer at the rate or rates of income tax specified in the relevant tax treaties which were adopted as rates in force for the purpose of deduction of tax under Section 195 of the Act in view of the specific provisions contained in Section 2(37A) of the Act.

- With regard to the issue of whether the rate of tax as provided in the relevant tax treaty and adopted for the purpose of tax deduction at source being rate in force by virtue of Section 2(37A) of the Act would be applicable or the higher rate as provided in Section 206AA of the Act by virtue of the overriding effect given to the said provision, reference was made to the decision of the Andhra Pradesh High Court in the case of Sanofi Pasteur Holding SA[8], where the High Court made reference to the decision of the Supreme Court in the case of Azadi Bachao Andolan[9] and P.V.A.L. Kulandagan Chettiar[10]. It was held in the case of Azadi Bachao Andolan that when the tax treaty becomes operational and is notified by the Central Government for implementation of its terms under Section 90 of the Act, provisions of the tax treaty, with respect to cases to which they would apply, would operate even if inconsistent with provisions of the Act. Further, in the case of P.V.A.L. Kulandagan Chettiar, it was held that the taxation polity is within the power of the government and Section 90 of the Act enables the government to formulate its policies through treaties entered into by it and such treaties determine the fiscal domicile in one state or the other and this determination in the treaty prevails over the other provisions of the Act.

- Thus, the ratio laid down by the Supreme Court in the cases of Azadi Bachao Andolan and P.V.A.L. Kulandagan Chettiar as further explained and clarified by the Andhra Pradesh High Court in the case of Sanofi Pasteur Holding SA makes it abundantly clear that whenever there is a conflict between the provisions of the tax treaty and the provisions of the domestic law, the provisions of the tax treaty will prevail and override even the charging provisions of the domestic law.

- The ratio of the two decisions of the Supreme Court in the case of Ili Lilly And Co. (India) P. Limited[11] and G.E. Technology Centre (P) Limited[12] clearly shows that the charging provisions control and override the machinery provisions dealing with tax deduction at source. Similarly, the provisions

[6] DDIT v. Serum Institute of India Limited [2015] 68 SOT 254 (Pune)
[7] Section 195(1) of the Act

[8] Sanofi Pasteur Holding SA - v. Department of Revenue and Others [2013] 354 ITR 316 (AP)
[9] UOI v. Azadi Bachao Andolan [2003] 263 ITR 706 (SC)
[10] CIT v. P.V.A.L. Kulandagan Chettiar [2004] 267 ITR 654 (SC)
[11] CIT v. Eli Lilly And Co. (India) P. Limited [2009] 312 ITR 225 (SC)
[12] G E India Technology Centre (P) Limited v. CIT [2010] 327 ITR 456 (SC)

of tax treaties by virtue of Section 90(2) of the Act to the extent more beneficial to the taxpayer override the provisions of domestic law as held, inter alia, by the Supreme Court in the case of Azadi Bachao Andolan & Another and P.V.A.L. Kulandagan Chettiar. Since Section 206AA of the Act falls in Chapter XVII –B dealing with tax deduction at source, it follows that the treaty provisions which override even the charging provision of the domestic law by virtue of Section 90(2) of the Act would also override the machinery provisions of Section 206AA of the Act irrespective of non-obstante clause contained therein and the same is required to be restricted to that extent and read down to give effect to the relevant provisions of tax treaties, which are overriding being beneficial to the taxpayer.

- With respect to Chapter-XA of the Act containing the provisions relating to General Anti-Avoidance Rule (GAAR) that has been inserted in the statute by the Finance Act, 2013 with effect from 1 April 2016 and although the provisions contained in the said chapter are given overriding effect by virtue of non-obstante clause contained in Section 95, a separate provision has been inserted simultaneously in the form of Section 90(2A) of the Act providing specifically that notwithstanding anything contained in sub-section (2), the provisions of Chapter-XA (GAAR) of the Act shall apply to the taxpayer even if such provisions are not beneficial to him. The Tribunal agreed with the point raised by the taxpayer that no such provision, however, is made separately and specifically in Section 90 of the Act to give overriding effect to Section 206AA over Section 90(2) of the Act, which clearly shows that the intention of the legislature is not to give overriding effect to Section 206AA over the provisions of the relevant tax treaty which are beneficial to the taxpayer.

- Thus, the provisions of Section 206AA of the Act will not have an overriding effect on all other provisions of the Act and the provisions of the tax treaty to the extent they are beneficial to the taxpayer will override Section 206AA of the Act by virtue of Section 90(2) of the Act.

Our comments

The issue with respect to applicability of Section 206AA of the Act over the provisions of the tax treaty has been a subject matter of litigation before the courts/Tribunal[13]. Since there were conflicting decisions in this regard, a Special Bench was constituted to decide the issue.

The Special Bench observed that to apply the non-obstante provisions under Section 206AA of the Act, Section 90 of the Act should have specifically provided to give an overriding effect of Section 206AA of the Act over Section 90(2) of the Act, which clearly shows the intention of the Legislature is not to give overriding effect of Section 206AA of the Act over the provisions of the relevant tax treaty. Further, it was also observed that the Finance Act, 2013 introduced Section 90(2A) to have an overriding effect of Section 95 (GAAR) even if these provisions are not beneficial to the taxpayer.

The Special Bench has provided a relief in case of applicability of a higher withholding tax rate to the aforesaid payments. This decision would have a binding effect on the other benches of the Tribunal.

Provisions of Section 206AA have been amended by the Finance Act, 2016. The CBDT vide Notification[14] 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.

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[13] Quick Flight Ltd. v. ITO (ITA No. 1204/Ahd/2014) www.taxindiainternational.com; 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]

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

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