



Section 206AA of the Income-tax Act cannot override the beneficial provisions of a tax treaty

Background

Recently, the Ahmedabad Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Quick Flight Ltd¹ (the taxpayer) held that where tax has been deducted on the basis of the beneficial provisions of tax treaties, the provisions of Section 206AA of the Income-tax Act, 1961 (the Act) cannot be invoked. The Assessing Officer (AO) cannot insist on deduction of tax at the rate of 20 per cent, having regard to the overriding nature of the provisions of Section 90(2) of the Act.

Facts of the case

- The taxpayer is a company engaged in the business of chartering, hiring and leasing aircrafts. During the year, payment was made to a non-resident.
- Tax was deducted at source at the rate of 10 per cent plus surcharge and education cess on the said payment of Fees for Technical Services (FTS) as per provisions of Section 115A of the Act.
- The AO alleged that the tax was required to be deducted at the rate of 20 per cent in view of the provisions of Section 206AA of the Act as the deductee did not have a Permanent Account Number (PAN) and accordingly raised a demand of INR30,250 towards short deduction and INR5750 towards interest on short deduction.

Tribunal's ruling

- Section 206AA of the Act has been included in Part B of Chapter XVII dealing with Collection and Recovery of Tax. Section 206AA of the Act deals with the requirement of furnishing a PAN by any person, entitled to receive any sum or income on which tax is deductible under Chapter XVII-B, to the person responsible for deducting such tax.
- It would suffice to note that Section 206AA of the Act prescribes that where a PAN is not furnished to the person responsible for deducting tax at source then the tax deductor would be required to deduct tax at the higher of the prescribed rates, namely, at the rate prescribed in the relevant provisions of this Act; or at the rate/rates in force; or at the rate of 20 per cent.
- Section 90(2) of the Act provides that the provisions of the tax treaties would override the provisions of the domestic Act in cases where the provisions of tax treaties are more beneficial to the taxpayer.
- There cannot be any doubt to the proposition that 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 between India and the relevant country, whichever is more beneficial to the taxpayer, having regard to the provisions of Section 90(2) of the Act.

¹ Quick Flight Ltd. v. ITO (ITA No. 1204/Ahd/2014) – www.taxindiainternational.com

- The Supreme Court in the case of Azadi Bachao Andolan² upheld the proposition that the provisions made in the tax treaties will prevail over the general provisions contained in the Act to the extent they are beneficial to the taxpayer.
- Tax treaties entered into between India and the other relevant countries in the present context 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 the tax at source having regard to the provisions of the respective tax treaties which provided for a beneficial rate of taxation.
- Even the charging Section 4 as well as 5 of the Act which deals with the principle of ascertainment of total income under the Act are 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, as 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.
- However, the case of the tax department was that the tax deduction at source was required to be made at 20 per cent under Section 206AA of the Act in the absence of a PAN of recipient non-residents.
- It would be quite incorrect to say that though the charging Section 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.
- Notably, Section 206AA of the Act which is the centre of controversy before us is not a charging section but is a part of a 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. In fact, in the context of Section 195 of the Act also, the Supreme Court in the case of Eli Lily & Co³ observed that the provisions of tax withholding 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 the Sections 4, 5, 9, 90 & 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 be understood to override the charging Sections 4 and 5 of the Act. Thus, where 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 which, in turn, override the Section 206AA 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 the rate of 20 per cent, having regard to the overriding nature on the provisions of Section 90(2) of the Act.
- Following the decision in the case of Alembic Ltd.⁵ and analysing the facts of the case, the Tribunal held that the payment was made towards FTS to a non-resident not having a PAN through a banking channel as approved by the RBI and the payment was well covered under the provisions of Section 115A(1)(b) of the Act and therefore, special rate of tax i.e. 11.33 per cent was applicable and was rightly deducted and deposited by the taxpayer and the provisions of Section 206AA of the Act cannot be made applicable to this payment.

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

³CIT v. Eli Lily & Co. [2009] 312 ITR 225 (SC)

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

⁵Alembic Ltd. v. ITO (ITA No.1202/Ahd/2014)

Our comments

The issue with respect to deduction of tax at source under Section 206AA of the Act where the tax treaty benefit is available has been a matter of litigation. While the Tribunal⁶ in some of the cases has held that a beneficial tax treaty rate should apply as a tax treaty overrides the provisions of Section 206AA of the Act. On the other hand, the Tribunal⁷ has held that the 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 Ahmedabad Tribunal in the instant case observed that Section 206AA of the Act cannot be understood to override the charging Sections 4 and 5 of the Act. Section 90(2) of the Act provides that tax treaties override the Act 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 which, in turn, override the Section 206AA of the Act.

The provisions of Section 206AA have been amended by the Finance Act, 2016. The CBDT vide Notification⁸ introduced Rule 37BC 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.



⁶ 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)

⁷ Bosch Ltd v. ITO [2012] 141 ITD 38 (Bang)

⁸ CBDT Notification No. 53 /2016, F.No.370 142/16/2016-TPL, dated 24 June 2016

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, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh

SCO 22-23 (1st Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai

No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi

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

Hyderabad

8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

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 44034000
Fax: +91 33 44034199

Mumbai

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

Noida

6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune

703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2017 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.