Section 206AA cannot override section 90(2) of the Act

April 2, 2015

In brief

Recently, the Pune Bench of the Income-tax Appellate Tribunal (Tribunal), in the case of Serum Institute of India Limited (Serum or Taxpayer), held that section 206AA of the Income-tax Act, 1961 (the Act) would not override provisions of a Double Taxation Avoidance Agreement (DTAA) to the extent that the latter is more beneficial to a taxpayer.

In detail

Facts

The taxpayer[1] was a company engaged in the business of manufacture, sale and export of vaccines. The taxpayer made payments to various non-resident taxpayers on account of interest, royalty and fee for technical services during the financial year under consideration and deducted withholding taxes per the rates prescribed in the relevant DTAAs. The DTAA rates were used even when no Permanent Account Number (PAN) was provided by the recipient, and provisions of section 206AA were not invoked.

During the course of assessment, the Tax Officer (TO) held the taxpayer to be in default to the extent of short deduction of tax, being the difference between the tax rate applied as per DTAA, and the 20% rate under section 206AA of the Act.

Aggrieved, the taxpayer filed an appeal before Commissioner of Income-tax (Appeal) [CIT (A)]. The CIT(A) concurred with the taxpayer, and held that section 206AA of the Act would override other provisions of the Act, but not the provisions of section 90(2) of the Act, which allow a taxpayer to avail the provisions of DTAAs to the extent they are more favourable than provisions of the Act.

Aggrieved with the CIT(A)'s decision, the Revenue filed an appeal before the Tribunal.

Issue before Tribunal

Whether section 206AA would override the provisions of DTAA in a situation where non-resident taxpayer did not furnish PAN, thereby necessitating a minimum withholding tax rate of 20% irrespective of the rate provided in the DTAA?

Taxpayer's Contentions

- The taxpayer contended that provisions of section 206AA were not applicable to payments made to non-resident taxpayers.

  As per provisions of section 139A(8) of the Act read with rule 114C(1) of the Income-tax Rules, 1962, non-resident taxpayers were not required to apply for PAN. Since there was no obligation to obtain PAN, section 206AA of the Act would not be applicable, as it prescribed that the taxpayer shall furnish PAN, and this would be possible only where the taxpayer was required to obtain PAN in the first place.

- As per section 90(2) of the Act, provisions of the Act are applicable to the extent that they are more beneficial to the taxpayer. Since section 206AA of the Act prescribed the higher rate of withholding tax, it would not be beneficial to the taxpayer *vis-à-vis* the rates prescribed in the DTAAs.

[1] Dy.DIT *v.* Serum Institute of India Limited [TS-158-ITAT-2015(PUN)]

Revenue's Contentions

- Section 206AA of the Act overrode section 90(2) of the Act, and thus, tax was liable to be deducted @ 20% in case PAN was not provided by the recipient non-resident taxpayers.

- The Revenue pointed out that the CIT(A) had himself concluded that section 206AA of the Act required even non-resident taxpayers to obtain and furnish PAN to the tax deductor. Thus, section 206AA of the Act was applicable to non-resident taxpayers also.

Tribunal's Ruling

- The Tribunal upheld the CIT(A)'s reliance on the Supreme Court (SC) ruling in the case of Azadi Bachao Andolan and Others,[2] where it had been held that provisions made in the DTAAs would prevail over the general provisions contained in the Act, to the extent they were more beneficial to the taxpayer.

- The Tribunal also observed that DTAAs entered into between India and the other relevant countries in the present context provided for scope of taxation and/ or a rate of taxation, which was different from the scope/ rate prescribed under the Act.

  Charging section 4, as well as section 5 of the Act, which deals with the principle of ascertainment of total income under the Act, were also subordinate to the principle enshrined in section 90(2) as held by the SC in the case of Azadi Bachao Andolan[2]. Section 206AA of the Act was not a charging section, but was a part of the procedural provisions dealing with collection and deduction of tax at source, and it could not override the charging sections, viz. sections 4 and 5 of the Act.

- Reliance was placed on case of Eli Lilly & Co[3] wherein it had been held that section 195 of the Act would apply only to sums which were otherwise chargeable to tax under the Act. Reliance was also placed on case of GE India Technology Centre Pvt Ltd[4] wherein it had been held that the provisions of the DTAAs, along with the sections 4, 5, 9, 90 & 91 of the Act, were relevant while applying the provisions of tax deduction at source (TDS).

- Thus, upholding the CIT(A)'s order, the Tribunal held that where the tax had been deducted on the strength of the beneficial provisions of DTAAs, the provisions of section 206AA of the Act could not be invoked by the TO to insist on tax deduction @ 20%, having regard to the overriding nature section 90(2) of the Act. The tax demand relatable to the difference between 20% and the actual tax rate on which tax was deducted by the taxpayer in terms of the relevant DTAAs, was therefore deleted.

The takeaways

- Provisions of section 206AA of the Act would not be applicable to non-resident taxpayers, i.e., TDS rate of 20% should not be applicable where the rate prescribed under DTAAs is lower.

- Section 206AA of the Act is not the charging section, and cannot override section 90(2) of the Act.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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

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

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

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