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cutting through complexity

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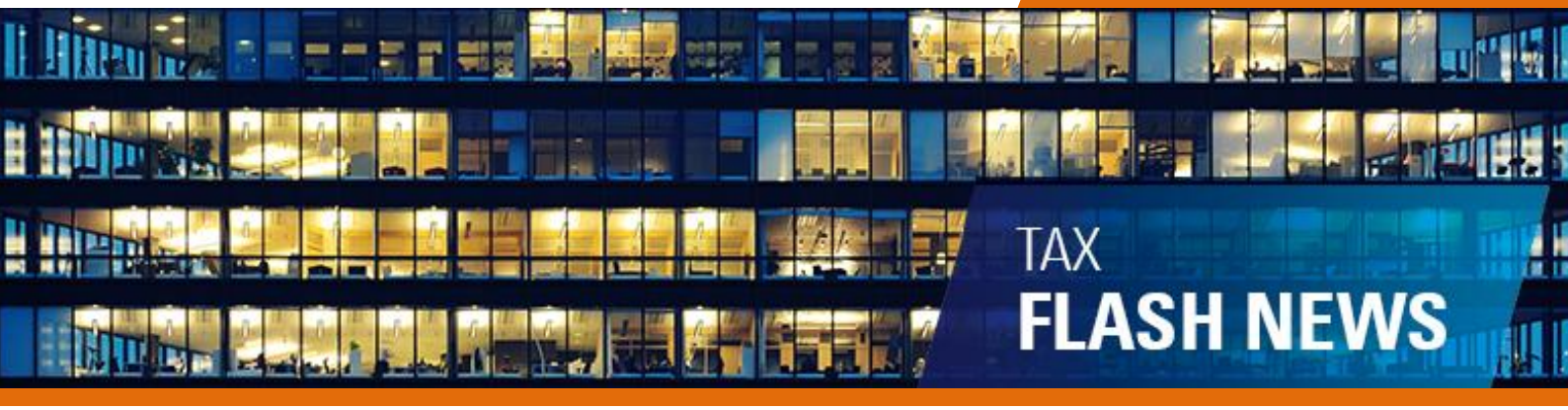


Tax is not to be deducted at a higher rate of 20 per cent under Section 206AA of the Income-tax Act when the benefit of tax treaty is available

Background

Recently, the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) held that there is no scope for the tax deduction at source (TDS) at a higher rate of 20 per cent as per the provisions of Section 206AA of the Income Tax Act, 1961 (the Act) when the benefit of tax treaty is available to a non-resident.

Facts of the case

- The taxpayer is engaged in the business of Business Process Outsourcing (BPO). The taxpayer made certain payments to a non-resident on account of royalty and/or Fees for Technical Services (FTS). As the benefit of a tax treaty was available to the non-resident, tax was deducted by applying the beneficial rate prescribed under the tax treaty in terms of the provision of Section 90(2) of the Act.
- The taxpayer filed statements of deduction of tax at source for various quarters of the relevant financial year in respect of payments made to non-resident during the period.
- The Assessing Officer (AO) after processing TDS statement issued intimation under Section 200A of the Act. The AO raised a tax demand on account of the short deduction of tax and interest was also charged on the same. The tax demand was raised on the ground that the taxpayer has not furnished the PAN of the non-resident deductee/recipient. The AO held that if the taxpayer did not furnish PAN, as per the provisions of Section 206AA of the Act, the TDS should have been deducted at the rate of 20 per cent
- The Commissioner of Income-tax Act, 1961 [CIT(A)] rejected the objection of the taxpayer regarding the scope of Section 200A for making the adjustment and consequential demand. However, the CIT(A) decided the matter in favour of the taxpayer and held that payment made to the non-resident recipient was eligible for the tax treaty benefit and by applying the beneficial provisions, the rate of tax to be withheld cannot be more than the tax liability provided in the tax treaty.

Tribunal's ruling

Applicability of higher TDS under Section 206AA of the Act

- The Tribunal held that there was no dispute that the benefit of the tax treaty was available to the non-resident recipient. Therefore, the tax liability of the recipient could not be more than the rate prescribed by the tax treaty or the Act, whichever is lower.
- Reliance was placed on the Pune Tribunal's decision in the case of Serum Institute of India Limited[1] wherein the Tribunal observed that Section 206AA of the Act does not override the provisions of Section 90(2) of the Act. The taxpayer had rightly applied the rate of tax as per the tax treaty and not as per Section 206AA of the Act since the provision of the tax treaty was more beneficial.
- The Tribunal observed that the similar view has been taken by the co-ordinate bench in the case of Bosch Ltd[2].

[1] DDIT v. Serum Institute of India Ltd. (ITA No. 792(Pune)2013) (Pune)
[2] Bosch Ltd v. ITO [2012] 141 ITD 38 (Bang)

- The Tribunal relied on the decision of Karnataka High Court in the case of Bharti Airtel Ltd.[3] where it was held that the Act is to be read as an integral code. To deduct tax while making payment to a non-resident, the amount paid must be ascertainable as income chargeable to tax in the hands of the non-resident. TDS is a vicarious liability, and it presupposes the existence of primary liability and hence the TDS provisions need to be read in conformity with the charging provisions i.e. Section 4, 5 and 9 of the Act.
- The Tribunal held that provisions of TDS had to be read along with the machinery provisions of computing the tax liability on the sum in questions.
- Following the aforesaid decisions, the Tribunal held that there was no error in the CIT(A)'s order where it was held that there is no scope for deduction of tax at the rate of 20 per cent as provided under the provisions of Section 206AA of the Act when the benefit of tax treaty is available.

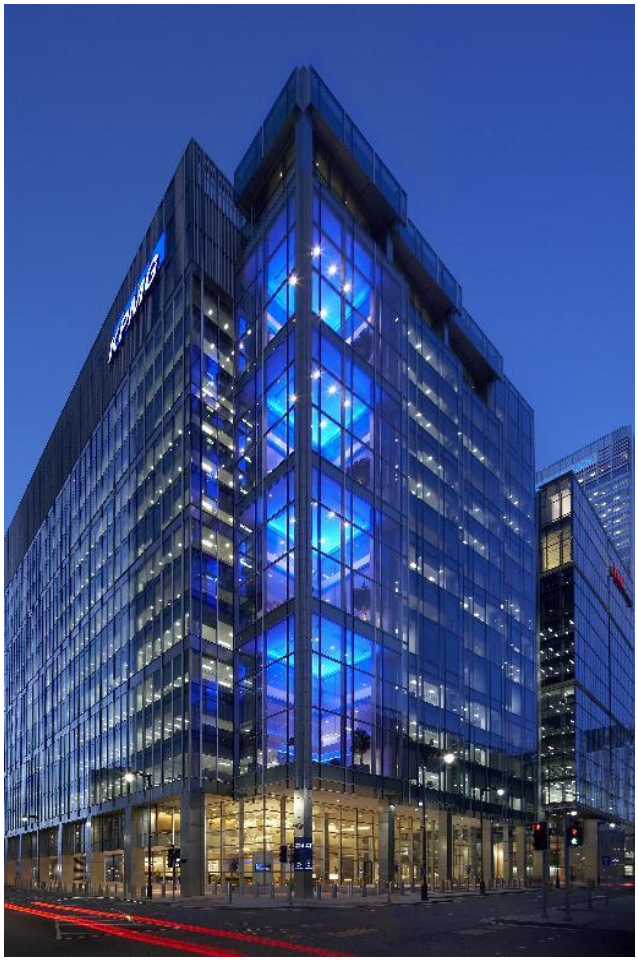
Adjustment under Section 200A of the Act

- While making the adjustment under Section 200A of the Act the AO had ignored the provisions of the tax treaty.
- The payment in question was made to the non-resident, and the provisions of tax treaty were applicable. Thus, the issue of applying the rate of tax at 20 per cent and ignoring the provisions of tax treaty is a debatable issue and does not fall into the category of any arithmetical error or incorrect claim apparent from any information in the statement, as per the provisions of Section 200A(1) of the Act.
- On reference to Explanation to Section 200A(1) of the Act it is clear that in respect of deduction of tax at source where such rate is not in accordance with provisions of the Act, it can be considered as an incorrect claim apparent from the statement. However, in the present case it was not a simple case of deduction of tax at source by applying the rate only as per the provisions of the Act, when the benefit of tax treaty was available to the recipient of the amount.
- Therefore, the question of applying the rate of 20 per cent as provided under Section 206AA of the Act is an issue which requires a long drawn reasoning and finding. Hence, it was held that applying the rate of 20 per cent without considering the provisions of the tax treaty and consequent adjustment while framing the intimation under Section 200A is beyond the scope of the said provision.
- Thus, the AO had travelled beyond the jurisdiction of making the adjustment as per the provisions of Section 200A of the Act. Accordingly, the issue was decided in favour of the taxpayer.

Our comments

This is a welcome decision of the Bangalore Tribunal where it has been held that there is no scope for deduction of tax at source at a higher rate of 20 per cent by invoking provisions of Section 206AA of the Act when the benefit of tax treaty is available to a non-resident.

The Tribunal also held that the question of applying the rate of 20 per cent under Section 206AA of the Act is an issue that requires a long drawn reasoning and finding. Therefore, applying the rate of 20 per cent without considering the provisions of the tax treaty and consequent adjustment while framing the intimation under Section 200A is beyond the scope of the said provision.



[3] Bharti Airtel Ltd. v. DCIT (ITA Nos. 158 to 163) (Kar)

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, Bangalore 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
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

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