FOREIGN COMPANIES RECEIVING MONEYS FROM INDIAN PAYERS MAY NOT NEED A PERMANENT ACCOUNT NUMBER (PAN)

Background

The provisions of section 90(2) of the Income-tax Act, 1961 (the "**Act**") permit a non-resident to avail either the provisions of the Act or the Double Taxation Avoidance Agreement (the "**DTAA**"), whichever are more beneficial. There are various judicial precedents propounding the principle that beneficial DTAA provisions override the provisions of the Act.

However, with effect from April 1, 2010, a new section 206AA was introduced in the Act, which mandated that every recipient (including a non-resident) whose receipts were subject to tax withholding in India should provide a Permanent Account Number ("**PAN**") to the payer responsible in India for withholding taxes, failing which the payer should withhold tax at the rate of 20%. A PAN is a tax identification number allotted to taxpayers by the Indian tax authorities, and it is compulsory to quote the PAN on all tax returns and documents pertaining to financial transactions.

Section 206AA of the Act begins with the verbiage, "Notwithstanding anything contained in any other provisions of this Act…", and has been interpreted to override the entire Act, including the provisions of section 90(2) of the Act. Thus, in cases where a PAN is not made available, Indian tax payers deduct tax at the fixed rate of 20%, notwithstanding that the DTAA provides a reduced rate of say 10% or 15%.

<u>Recently, in the case of Infosys BPO Limited (the "**Taxpayer**"), the Bangalore Bench of the Income-tax Appellate Tribunal (the "**Tribunal**") has held that section 206AA of the Act cannot override the provisions of the DTAA, especially if the provisions of the DTAA are more beneficial to the Taxpayer</u>.

Brief Facts

The Taxpayer, engaged in business process outsourcing, made payments to various non-residents on account of interest, royalty and fees for technical services during the financial year and deducted withholding taxes as per the rates prescribed in the relevant DTAAs. The DTAA rates were used even when no PAN was provided by the non- resident recipient. During the course of tax assessment proceedings, the income tax officer (the "**ITO**") 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 the DTAA and the 20% rate under section 206AA of the Act).

Aggrieved, the Taxpayer filed an appeal before the Commissioner of Income-tax, (Appeals) (the "**CIT(A)**"). The CIT(A) agreed with the Taxpayer's stand. Aggrieved with the CIT(A)'s decision, the ITO preferred an appeal before the Tribunal.

Issue before the Tribunal

The question before the Tribunal was whether section 206AA of the Act overrides the provisions of a DTAA when a non-resident does not furnish a PAN, necessitating a withholding tax rate of 20% irrespective of the rate provided in the DTAA?

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The Tribunal's Ruling

The Tribunal held that the tax liability of a non-resident cannot be more than the rate prescribed under the DTAA if the DTAA rate is lower than that in the Act. The Tribunal relied on the decisions of: (i) the Pune Income-tax Appellate Tribunal in *Serum Institute of India Ltd.* (TS-158-ITAT-2015(Pune)); and (ii) India's Supreme Court ("**SC**") in *UOI v. Azadi Bachao Andolan and Others* (2003) 263 ITR 706 (SC)), wherein it was held that the provisions of DTAAs prevail over the general provisions of the Act to the extent they are more beneficial to the taxpayer.

The Tribunal also observed that DTAAs entered into between India and various countries provide for a scope or rate of taxation that is different from the scope or rate prescribed under the Act. The charging sections of the Act (i.e., sections 4 and 5 of the Act), which deal 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 SC in the *Azadi Bachao* case.

Reliance was also placed by the Tribunal on: (i) *CIT v. Eli Lilly & Co.* (2009) 312 ITR 225 (SC), wherein it was held that section 195 of the Act (which deals with withholding tax on payments made by Indian residents to non-residents) applies only to sums which are chargeable to tax under the Act; and (ii) *GE India Technology Centre Pvt Ltd v. CIT* (2010) 327 ITR 456 (SC)) wherein it was held that the provisions of the DTAAs, along with the sections 4, 5, 9, and 90 of the Act, are relevant while applying the provisions of withholding tax at source.

Based on the foregoing judicial rulings, the Tribunal upheld the CIT(A)'s order and stated that where the tax had been withheld on the strength of the beneficial provisions of the DTAA, the provisions of section 206AA of the Act could not be invoked by the ITO to insist on a tax withholding of 20%. The Tribunal held that section 206AA of the Act was not a charging section, but only a procedural provision dealing with collection and deduction of tax at source. Therefore, it could not override the charging sections, viz. sections 4 and 5 of the Act, let alone section 90(2) of the Act. The Tribunal's ruling went against the *Bosch* case (*IT Appeal Nos. 552 to 558 (Bang.) of 2011*), which had upheld the applicability of section 206AA of the Act. In the circumstances, the tax demand relatable to the difference between 20% and the actual tax rate on which tax was withheld by the taxpayer in terms of the relevant DTAA was deleted.

Majmudar's Comments

The implementation of section 206AA has resulted in undue hardship for non- residents, especially those who have had one-off transactions with Indian companies. On the other hand, Indian payers are also wary of the consequences of not withholding tax. For example, if tax is not withheld on payments as per the relevant provisions, including section 206AA, such payments will be treated as a non-tax deductible expense for the payers. In addition, a payer can also be declared as an "assessee in default" and be required to pay tax, interest and penalty thereon. Therefore, all Indian resident payers have taken a conservative view and have withheld tax at the higher rate in the absence of a PAN. This has left the income recipient with no alternative but to claim a refund from the Indian tax authorities.

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In our view, this is welcome ruling. Nevertheless, the Tribunal's decision is appealable to the High Court, and until there is a High Court ruling in this matter, tax authorities will continue to insist on a PAN. However, the principle that beneficial DTAA provisions override the Act has been upheld.

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