Income-tax PAN S. 206AA
TDS from Payments to Non-Residents

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What is the legal position on S.206AA! In this article, arguments on both sides – Tax Payer & Tax Commissioner (CIT) are presented as if a chartered accountant (CA) & the tax commissioner are arguing the case. Difficulties of the Tax Payer, legal issues and probable responses by the Tax Commissioner (CIT) are given. Author's observations are also given.

1. **Provision:** The section 206AA provides (in simple words) that when an Indian resident makes any payment to any Non-Resident of India (NR) the NR should provide his Permanent Account Number (PAN). If the NR does not have a PAN, the Indian payer should deduct tax at the rate of 20% or the appropriate rate – whichever is higher.

2. **Tax Payer difficulties:** Generally, the NR service provider insists that the Indian tax has to be borne by the Indian payer. The NR is not concerned about Indian law. We have no jurisdiction over an NR. In any case, NR wants to avoid doing anything with Indian Income-tax department. How can we ask him to obtain PAN! If he does not obtain PAN, we have to suffer this tax @ 20%. This may be well beyond our profits in the business. We cannot afford to pay this tax.

3. **CIT's probable response:** Well, if an Indian resident were to do business with a U.S., U.K. or German Company, can the he say that he does not want to do anything with the other country's income-tax department! If some one wants to do business with India, he has to abide by the Indian law.

4. **CA:** It is all fine theoretically. If the NR refuses to comply with the provision and throws the burden at the Indian payer, what can the Indian do! He has no legal authority to force the NR. Ultimately the Indian will have to suffer the tax.

5. **CIT:** Those Indians who accept **grossing up of TDS** do not have confidence in themselves. Why should they accept it! If an Indian software engineer provides technical services to a foreign company, can the Indian service provider insist that he will not bear the foreign tax! Can he ask his client to bear the tax! Why should Indian buyer of services accept to bear the tax payable by the NR?

   Today, most economies in the world are in recession. China, India and a few countries have growth. Most important suppliers want to supply goods & services to India. This is the right time when Indian buyers must exercise their **purchasing power** and set the matters right.

Gross injustice lies in Indian residents accepting the grossing up. It is for them to refuse to succumb to the injustice.

6. **CIT:** Section 90(2) provides that where ever the provisions of the Act are more beneficial as compared to the Treaty, the provisions of the Act will override the Treaty. S.206AA is a **Non-Obstante clause**. "Not withstanding anything contained in any other provisions of this Act … the payer shall deduct tax @ 20% if ….." Hence S. 206AA will override section 90(2).

CA: However, the principle that Treaty Overrides the domestic Act is not derived from S.90(2). It is a principle accepted by Indian Courts even before this provision was made into the law. [Section 90(2) was introduced by Finance (No. 2) Act, 1991. A.P. High Court had upheld the principle in CIT V. Vishakhapatnam Port Trust case -144 ITR 146 in the year 1983.] Even the HC decision was acceptance of international law on the subject. In short, the principle of law that wherever the provisions of the treaty and the domestic law – are different; **whichever provision is more beneficial to** the assessee shall apply is an established principle of international law. Section 206AA being a Non-Obstante clause can override S. 90(2), not the international law.

S.206AA is a part of the domestic law. It provides for 20% tax rate. If treaty provides for a lower rate, that rate shall apply. Hence wherever Double Tax Avoidance Treaty applies, assessees can take benefit of the lower rate!

7. **CIT:** For **normal** provisions, it is a settled principle of law in India that Treaty overrides the domestic law.

However, S.206AA is an **Anti-Avoidance provision**. Not normal provision. The UN & OECD commentaries specifically state that anti-avoidance provisions in the law will override the Treaty provisions. S.206AA being an anti-avoidance provision, shall override the Treaty.

Even a cursory look at the Commentaries will make the above statement clear. However, for ready reference, some extracts form the OECD commentary are given in the annexure.

8. **CA:** In Chettiar's case, **Honourable Supreme Court** has held that **OECD Commentary is not binding in India.** If OECD & UN commentaries are contrary to Indian settled law, they will be ignored by the Courts.

CIT: OECD & UN commentaries are of course not binding in India. However, they have tremendous **intellectual value**. They explain & clarify the interpretation of several clauses.

For example, Commentaries by Late Mr. N. A. Palkhiwala & Late Professor Klaus Vogel are not binding on any Court of law. However, both the commentaries have tremendous intellectual value. If someone does not accept any particular view contained in any of the four commentaries, he has to give valid arguments and logic for ignoring the commentaries.

9. **Author:** A simple, sweeping rejection of entire OECD commentary would be incorrect. In my humble submission, with full respect, Honourable Supreme Court's observation in Chettiar's case on OECD commentary is improper.

10. **CA:** Assume that a treaty provides for TDS @ 10%. U/s. 206AA, Indian Payer deducts tax @ 20%. The NR claims full 20% credit in the Country of his Residence (COR). Income-tax officer of **COR may refuse to give credit** for anything in excess of 10% - the treaty rate. What is the way out!

CIT: This is possible. The NR may have to suffer the cost of additional tax. The way out is – apply for PAN.

11. **CA:** Can the Indian Payer deduct tax at treaty rate and then argue out his position on the grounds that "Treaty overrides domestic Tax Act"!

CIT: Well, he can certainly do so. **Consequences** will be –

The CIT may not agree with him. In that case,

(i) CIT will recover the tax short deducted.
(ii) CIT will disallow the expenditure pertaining to the particular transaction.
(iii) CIT may impose penalty & collect interest.

Altogether the consequences can be harsh. Assessee can of course go in appeal – after payment of taxes. The litigation will continue. One can avoid litigation by obtaining PAN.

12. **CA:** Can the Indian Payer **apply for PAN on behalf of NR?** U/s. 160 the Indian Payer may become an agent of the NR. U/s. 161 he will step in the shoes of the NR.

Author: One may think before filing an application on behalf of a NR. The Indian payer may be concerned with only his payment to the NR. However, the NR may have tax exposure for several different payments from several other Indians. Will the Indian Payer be ready to take up responsibility for all the payments!

In any case, there should be a clear understanding between the Indian Payer & the NR before the Payer wants to file any paper on behalf of the NR.

13. **CA:** Can the **CA** give a **certificate** that tax should be deducted at the treaty rate!

CIT: CA has to give certificate in accordance with the law. If his interpretation is that tax is not deductible, he may give such a certificate.

It should be remembered that CA cannot form an opinion on the grounds of client's difficulties. He has to proceed as per the law. At times, the law may be incorrect. Such a law can be held to be invalid by a Court of Law. In his **"opinion"** the CA can say that the law is incorrect. However, while giving a **certificate**, the CA may not give a certificate contrary to the law.

14. **CA:** An Indian resident is **importing goods** into India. Very clearly article 7 of the treaty applies. NR does not have a permanent establishment (PE) in India. Hence he is not liable to tax in India – under The Income-tax Act as well as under the Treaty. Is it necessary for the NR to obtain PAN?

Author: All TDS provisions are **machinery** provisions for collection of tax. They cannot operate unless there is a **taxable income**. This has been decided by Honourable SC in **Transmission Corporation** of A.P. Ltd. V. CIT 239 ITR 587.

Hence wherever the Indian Payer is confident that the NR does not get an Income liable to tax in India; he need not deduct tax at all.

India imports goods worth approximately $ 200 billions every year. Most of the foreign exporters – who do not have PE in India, are not liable to tax in India. Hence the Indian importers need not apply S.206AA.

Before giving a certificate, it is necessary for the CA to satisfy himself that (i) the person claiming DTA relief is actually a resident of the specific country; and that (ii) he has no PE in India.

15. **CA:** If for import of goods, one can take support of the SC decision (and not deduct tax @20% even in the absence of PAN), why not take the same support for other matters! A payment is a payment. In this case (import of goods) also, it is the Indian importer who decides that no tax is deductible. In the same manner, in the case of import of technology etc. also it is for the Indian importer of technology to decide whether tax is deductible or not & if deductible, what is the tax rate.

Author: Section 206AA is an anti-avoidance provision. Like deeming provisions, these have to be interpreted strictly. The purpose of the section is to curb tax avoidance. In case of import of goods, under the treaty as well as under the Income-tax Act, the foreign supplier is not liable to tax in India. Hence Indian payer is not liable to deduct tax in India. If no tax is payable, there cannot be any tax evasion. Where no tax is payable, anti-avoidance provisions have no role to play. In my view, section 206AA cannot be applied while making payments for import of goods.

16. **Conclusion:** S.206AA is a valid legal provision with a valid purpose. Concerned parties would better abide by the law & obtain PAN, or face consequences.

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