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Analysis of two recent tax rulings in 2015

Case I: Withholding to be made at the lower rate of tax under DTAA even if Permanent Account Number ("PAN") is not furnished by the recipient

Background

The assessee, Serum Institute of India Ltd **("assessee")** a company incorporated in India (engaged in the business of manufacture and sale of vaccines) made certain payments in the nature of interest, royalty, and fees for technical services to non residents in various countries. The payments being subject to withholding under section 195 of the Income Tax Act, 1961 **("IT Act")**

The provisions of section 90(2) of the IT Act, allows an assessee to apply the provisions of the IT Act or the provisions of the double taxation avoidance agreement **("DTAA")** whichever is more beneficial to him. Thus, the tax rate so provided in the respective DTAA's being lower than the rate prescribed under the IT Act, the assessee withheld tax at the lower rates provided in the respective DTAA's in terms of provisions of section 90(2) of the IT Act.

Some of the non residents, who received the payment from the assessee, did not furnish their PAN to the assessee. The Assessing Officer **("AO")** treated such payments, as cases of 'short deduction' of tax in terms of the provisions of section 206AA of the Act. Section 206AA of the IT Act provides that if the recipient of any sum or income on which tax is deductible under the provisions of the IT Act, does not furnish his PAN, tax shall be deducted at the higher of the rates in force, or rates prescribed under the IT Act or at the rate of 20 per cent.

Contentions raised

The assessee contended that provisions of section 206AA would not apply to non residents, as rule 114 of the Income Tax Rules, 1962 prescribes that non residents are not required to apply for PAN. Thus, the assessee contended that where a non resident are not obligated to obtain a PAN, the requirement to furnish its PAN under section 206AA would not arise.

The assessee further contended that the tax rate in terms of section 206AA cannot prevail over the rates prescribed under relevant DTAA's, the latter being more beneficial to an assessee. The assessee filed an appeal against the assessment order passed by the AO, before the CIT (Appeals).

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The CIT (A) rejected the first argument of the assessee that a non-resident was not required to obtain PAN in India, however the CIT (A) concurred with assessee in respect of its second argument and observed that where the provisions of DTAA provide for a lower rate of tax than the rate prescribed in the IT Act, the provisions of DTAA would prevail.

Before the Income Tax Appellate Tribunal **("ITAT")**, the Revenue contended that provisions of section 206AA would override section 90(2) of the IT Act, and thus where PAN is not furnished by the non-resident tax would be withheld at higher rate of 20 per cent in terms of section 206AA of the IT Act.

Decision

The ITAT (Pune) on upheld the order of the CIT(A) and observed that section 206AA would not override provisions of section 90(2) of the IT Act, consequently, the assessee has rightly deducted tax at the beneficial rates provided under the respective DTAA's even if the non resident has not furnished PAN.

The ITAT relied on the judgment of the Supreme Court in the case of *Azadi Bachao Andolan v Union of India* [(2003) 263 ITR 706 (SC)] wherein it was observed that even the provisions contained in the charging sections of the IT Act, dealing with the ascertainment of total income are subordinate to the principles enshrined in section 90(2) of the IT Act. The ITAT further, observed that section 206AA being procedural in nature, cannot override the provisions of section 90(2) of the IT Act.

Conclusion

The decision of the ITAT brings respite to non-residents who have not obtained a PAN in India failing to furnish PAN while receiving any sum chargeable to tax in India. It is worth noting, however that high courts in India have not had the opportunity to adjudicate on the application of 206AA vis-a-vis section 90(2) of the IT Act. Thus, it would be interesting to see the approach taken by the High Courts once the issue reaches before them.

Case II: Cyprus continues to be a notified jurisdictional area under section 94A of the Income Tax Act, 1961

The High Court of Uttarakhand **("High Court")** has in a recent case of *Expro Gulf Ltd v Union of India* [(2015) 53 taxmann.com 413 (Uttarakhand)] upheld the validity of notification 86/2013 ("notification") issued by the Central Board of Direct Taxes **("CBDT")** which had declared Cyprus as a notified jurisdictional area **("NJA")** under section 94A of the IT Act with the effect that all payments made to a resident of Cyprus are subject to withholding tax at the highest rate as explained below.

Background

Expro Gulf Limited **("Taxpayer")** a company incorporated in Cyprus filed an application for obtaining a lower withholding tax rate certificate **("WHT certificate")** in India as per the treaty provisions. Pursuant to the application, the tax authorities issued a lower WHT certificate to the Taxpayer.

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Subsequently, the CBDT vide the notification declared Cyprus as a NJA. A NJA is a country which is so notified under the provisions of section 94A of the IT Act, when it does not provide information requested by India in accordance with the provision for exchange of information under the relevant DTAA or tax information exchange agreement. Under the provisions of section 94A of the IT Act, the effect of the said notification was that; any sum payable to any person located in Cyprus, on which tax is deductible under the provisions of the IT Act, will be subject to withholding tax at the higher of the rate specified in the India-Cyprus DTAA, or rates prescribed under the IT Act or at the rate of 30 per cent.

The case report does not provide details on the actual facts but it appears from reports that the tax authorities placing reliance on the notification apparently revised the WHT certificate *suo moto* to provide for withholding to be made at the higher rate of 30 per cent from the initial lower rate of 10 per cent that was applied as per the DTAA. The Taxpayer filed a writ petition before the High Court assailing the notification and *suo moto* revision of the WHT certificate by the income tax authorities.

Contentions raised

The petitioner challenged the notification on the grounds that Cyprus ought not to have been declared as a NJA in the light of the fact that the Cyprus authorities never refused to provide information to the Indian tax authorities. Hence, the assessee contended that the very basis of issuing the impugned notification was wrong. The assessee relied on the press release made by the Cyprus authorities that they are willing and ready to supply information.

Decision

The HC declined to invoke its jurisdiction to quash the Notification and, observed that while exercising writ jurisdiction, the court should not proceed to look into as to whether information sought by Indian authorities were ever declined by Cyprus authorities. Moreover there seems to be no valid reason to disbelieve the satisfaction recorded by the CBDT that the Cypriot authorities declined to provide information to the Indian tax authorities.

The HC held that the tax authorities were within their authority to revise the WHT certificate to increase the withholding tax rate and, dismissed the appeal as the Taxpayer had "alternate remedy of statutory appeal" to assail the revision of the WHT certificate.

The Court further upheld the power of the tax authorities under the IT Act to revise earlier orders passed, even *suo moto*, if any illegality or irregularity is observed therein at the subsequent stage.

Conclusion

In the light of the judgment of the Court, notification continues to be valid, and thus, Cyprus continues to be regarded as a "notified jurisdictional area" and withholding at the higher rate of 30 per cent continues to apply. Thus, transactions with a person located in Cyprus would continue to attract ramifications under provisions of section 94A of the IT Act. Section 94A of the IT *inter alia* provides for:

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- disallowing deduction on payments made to any financial institution located in a NJA, unless the assessee furnishes an authorization allowing Indian tax authorities to seek relevant information from the said financial institution

- disallowing any other expenditure or allowance (including depreciation) arising from the transaction with a person located in Cyprus unless the assessee maintains such other documents and furnishes prescribed information.

- additional reporting compliances under transfer pricing regulations.

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